

# **WATER INDUSTRY (SCOTLAND) BILL**

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## **POLICY MEMORANDUM**

### **INTRODUCTION**

1. This document relates to the Water Industry (Scotland) Bill introduced in the Scottish Parliament on 26 September 2001. It has been prepared by the Scottish Executive to satisfy Rule 9.3.3(c) of the Parliament's Standing Orders. The contents are entirely the responsibility of the Scottish Executive and have not been endorsed by the Parliament. Explanatory Notes and other accompanying documents are published separately as SP Bill 35-EN.

### **POLICY OBJECTIVES OF THE BILL**

2. The Bill deals with issues related to the Scottish Executive's responsibilities for the provision of water and sewerage services on the public networks, and for ensuring that standards on drinking water quality are met. It has three principal objectives:

- creating Scottish Water as a single all-Scotland public water authority that will improve services to its customers, realise substantial efficiency savings and act in a more commercial manner within a framework of accountability to the Scottish Ministers and the Parliament
- ensuring that the views of customers are properly represented by establishing Water Customer Consultation Panels under an independent Convener
- safeguarding public health by creating the post of Drinking Water Quality Regulator.

### **Scottish Water**

3. The last restructuring of the water industry took place in 1996 when, under Part II of the Local Government etc. (Scotland) Act 1994, water and sewerage services, which had previously been under local authority control, became the responsibility of three newly formed public water and sewerage authorities. The three authorities, North of Scotland Water, East of Scotland Water and West of Scotland Water became responsible for the public water and sewerage infrastructure and networks and are currently responsible for supplying water and sewerage services to all customers – domestic and commercial – on the public networks.

4. It is now proposed to alter the structure of the industry and establish a single all-Scotland water authority. This proposal has been developed as a response to the challenges that the water industry faces.

5. Pressure for change has come from the need to increase investment in the water and sewerage infrastructure, while ensuring that charges remain affordable. Achieving these aims will require the industry to improve the efficiency with which it runs all its activities.

6. Though there is a general consensus that the water industry needs to implement a very substantial programme of investment, the scale of the investment required is not always fully appreciated. European and national legislation requires higher standards in drinking water quality and in the treatment of wastewater. These alone require substantial new investment in infrastructure. In addition to this, decades of under-investment and a backlog of maintenance need to be tackled. The combined effect of these requirements is an investment requirement likely to be around £2 billion over the next four years.

7. The common key to the public industry responding to the challenges it faces is achieving improved efficiency across the whole range of its activities. This is necessary if it is to deliver its investment programme while ensuring that charges remain affordable for the two million domestic customers and 200,000 non-domestic customers that it serves. It is also necessary as part of a larger commercial strategy geared to retaining current business and winning new customers by matching the performance, charge and service levels of its competitors.

8. The authorities mounted a major study last year to identify the scope for them to achieve efficiency savings through collaboration with each other. They concluded that by 2005-06 they could achieve annual savings of between £100 million and £168 million through collaboration in areas such as asset management. Savings on this scale would have a major, positive impact on future charge levels and on competitiveness.

9. Realising in full these efficiency savings requires a level of collaboration that in practice is only likely to be achieved within the single unified management structure of a single authority.

10. It is also the case that having a single authority makes possible the harmonisation of domestic charges across Scotland. The scale of the efficiency savings available to Scottish Water means that over a number of years this will greatly ease pressure on charge levels in the north of Scotland, without placing additional burdens on customers elsewhere.

11. Finally, a single authority will be stronger and better placed to compete than three separate authorities, particularly in the growing market for single contracts to service a customer's sites across Scotland and further afield. Its ability to respond to the challenges posed by a more competitive environment will be enhanced by provisions in the Bill to allow for changes to the corporate governance of Scottish Water – most notably by allowing for a number of executive board members – and through an increase in the commercial powers that Scottish Water, subject to appropriate Ministerial control, will have at its disposal.

## **Water Customer Consultation Panels**

12. Part II of the Water Industry Act 1999 established the Water Industry Commissioner with the general function of promoting the interests of the water authorities' customers and with duties to act as the authorities' economic and customer service regulator. It also provided for the

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Commissioner to be advised by three Water Industry Consultative Committees – one to each authority. The Commissioner appoints the members of these committees and chairs their meetings.

13. Establishing the Commissioner as the water authorities' economic regulator has been a major factor in identifying the scope that exists for the authorities to improve their efficiency. The Executive recognises however that the current arrangements with the Consultative Committees are open to criticism on the grounds that they do not give a sufficiently distinct voice to customers. In circumstances where there will be a single water authority, the Executive wishes to ensure that the range and variety of customers' views are fully represented. Therefore the Bill provides for the Committees to be replaced by a number of Water Customer Consultation Panels to represent the views and interests of customers at a local level. It gives Ministers flexibility as to the number of panels to be established, and the expectation is that there will be more panels than there are committees at present.

14. In a further departure from present arrangements, the panels will be chaired and appointed by a Convener, rather than by the Commissioner, and Ministers will appoint the Convener. The panels will be able to make recommendations to the Commissioner on aspects of customer service and to publish reports based on their consultations with customers.

15. The Executive believes that these arrangements will give proper weight to the customers' voice within the regulatory system.

### **The Drinking Water Quality Regulator**

16. The Scottish Executive is currently responsible for regulating drinking water quality under administrative arrangements that have developed over a number of years. The Executive believes that these responsibilities and the manner in which they are discharged, which are vital in safeguarding public health, should have a proper statutory basis. The Bill will provide for this by establishing the post of Drinking Water Quality Regulator to ensure compliance with drinking water quality regulations and conferring on the post powers to monitor drinking water quality, investigate possible breaches of the regulations and enforce compliance where necessary.

## **ALTERNATIVE APPROACHES**

### **Scottish Water**

17. Besides the proposal to create a single publicly owned water authority, two other options exist.

18. The first is to remain with the existing structure of the industry, leaving the three water authorities as they are and allowing them to deliver their own individual efficiencies. The Executive believes that this would not be an effective or reliable way of achieving the efficiencies that are required to allow investment in the water industry infra-structure whilst ensuring that charges remain affordable for domestic customers.

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19. The other option would be to change the ownership structure of the water industry, for example by adopting a mutual model of ownership or through creation of a public limited company. The Scottish Ministers ruled out the privatisation model as being clearly incompatible with Ministers' commitment to retaining Scottish Water as a publicly owned water and sewerage authority. While Ministers recognise the validity of the mutual model in a range of sectors, they rejected it as being inappropriate to the water industry. Their reasoning was that mutualisation works most effectively when the mutual owners have a strong, direct interest in the outcome of the mutual organisation, for example as is increasingly the case in housing. Such a clear interest is not present in the case of a large capital intensive industry that has to meet demanding standards on environmental protection as well as the expectations of customers.

### **Water Customer Consultation Panels**

20. Given the assessment that the current arrangements for taking account of customers' interests needed to be strengthened, the option to remain with the existing approach was effectively ruled out. The alternatives, therefore, were the approach adopted in the Bill, or separate institutional status for the Panels through the creation of a new free-standing public body. The Executive concluded that creating an effective voice for customers did not require the creation of a separate body and could not be justified in terms of the bureaucracy and extra cost that it would place on customers who, through a levy on Scottish Water, will pay for the Panels. Therefore, the Bill gives the Commissioner's office the duty of providing the Convener and the Panels with adequate administrative support.

### **Drinking Water Quality Regulator**

21. As with the Customer Panels, the option for retaining the existing arrangements for regulating drinking water quality was effectively ruled out by the assessment that the arrangements needed to be strengthened. Thus the alternatives were the approach taken in the Bill and the creation of a separate body. The Executive concluded that the public health objectives behind the decision to establish the Regulator did not require the creation of a new body. Instead it decided to locate the Regulator's office within the Scottish Administration reflecting the position of its equivalent the Drinking Water Inspectorate within the Department of Environment, Food and Rural Affairs in England.

## **CONSULTATION**

22. The Scottish Executive carried out an initial consultation in June 2000, when the Minister for the Environment Sarah Boyack issued the consultation paper *Managing Change in the Water Industry*. This first consultation paper represented the Executive's response to increasing competition in the industry generally and to the prospect of competition on the public networks. At that time Ministers felt that there was no strong case for restructuring the water authorities and as a result no firm proposals were made on this issue, though it was recognised that the future structure of the industry was one that should be kept under review.

23. Subsequently, for the reasons outlined at paragraphs 3 to 11 above, Ministers concluded that the arguments in favour of a single water authority had become significantly more persuasive. The second consultation paper, *The Water Services Bill – The Executive's*

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*Proposals*, issued on 23 March 2001, therefore included proposals for establishing Scottish Water. It also proposed the creation of the Drinking Water Quality Regulator and invited comments on whether the role of the Water Industry Consultative Committees need to be revised.

24. Proposals for updating the regulatory framework to deal with the prospect of competition on the public networks – including the creation of a regime to license new entrants to the water market – were also contained in the paper. However, the Executive announced on 5 September 2001 that these will now be part of the Water Environment and Water Services (Scotland) Bill that the Executive plans to introduce to the Scottish Parliament next spring, rather than included in this Bill.

25. The document was made available on the Executive website, in the Stationery Office Bookshops and in a number of libraries. In addition, approximately 400 copies of the consultation paper were distributed to individuals and organisations including:

- MPs representing Scottish constituencies at Westminster
- MSPs
- local authorities
- the Convention of Scottish Local Authorities
- the Water Industry Commissioner
- Water Industry Consultative Committees
- water authorities
- voluntary organisations and charities
- academic and policy institutes
- private sector firms and business organisations
- the Scottish Trade Union Congress
- individual trade unions

26. In total there were 65 responses to the second consultation paper. The proposal to establish a single water authority was supported by a substantial majority of those who commented on the issue.

27. Reasons given for supporting the move from three to one included the increased efficiencies that would be achieved. In addition it was recognised that the move to one authority should result in a more co-ordinated all-Scotland approach from the water authority, which would be of benefit to non-domestic customers in particular who would be able to organise their water and sewerage provision on an all-Scotland basis. It was also felt that a single Scottish water authority would be better placed to compete in the more competitive water market that is developing. The proposal was also welcomed because it will lead to a gradual harmonisation of charges across Scotland.

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28. Amongst all respondents – both those in favour and those opposed to the move to a single authority – there was concern that centralisation of the authority might lead to a loss of local accountability and responsiveness. And many respondents called for consumer representative arrangements that would be effective in representing local interests. There was broad general support for the proposal to establish the Drinking Water Quality Regulator.

29. A copy of the responses to the consultation (other than those given in confidence) has been placed in the library of the Scottish Executive, and a further copy in the Scottish Parliament Information Centre. The Scottish Executive has also prepared a paper summarising the responses, which will also be placed in the library of the Scottish Executive, and the Scottish Parliament Information Centre.

## **EFFECTS ON EQUAL OPPORTUNITIES, HUMAN RIGHTS, ISLAND COMMUNITIES, LOCAL GOVERNMENT, SUSTAINABLE DEVELOPMENT, ETC.**

### **Equal opportunities**

30. The provisions in this Bill have no implications for equal opportunities. They do not inherently provide for discriminatory effects on the basis of gender, race, disability, marital status, religion or sexual orientation.

### **Human rights**

31. The provisions of the Bill are not expected to have any particular effects on human rights.

### **Island communities**

32. The establishment of a single water and sewerage authority and the move to harmonised charges across Scotland will have a positive impact on charges for island communities in the North of Scotland Water area.

### **Local government**

33. Currently local authorities on behalf of the water authorities carry out the billing and collection of water and sewerage charges. The establishment of Scottish Water will not affect this duty, which the local authorities will continue carry out, albeit on behalf of Scottish Water.

### **Sustainable development**

34. The Bill places on Scottish Water a duty to have regard to the best way of contributing to the achievement of sustainable development.



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