



OFFICIAL REPORT
AITHISG OIFIGEIL

Net Zero, Energy and Transport Committee

Tuesday 22 November 2022

Session 6



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CONTENTS

| | Col. |
|--|-------------|
| DECISION ON TAKING BUSINESS IN PRIVATE | 1 |
| SCOTTISH WATER | |
| (ANNUAL REPORT AND ACCOUNTS 2021-22) | 2 |
| SUBORDINATE LEGISLATION..... | 37 |
| Electricity (Applications for Consent and Variation of Consent) (Fees) (Scotland) Amendment Regulations 2022 (SSI 2022/310) | 37 |

NET ZERO, ENERGY AND TRANSPORT COMMITTEE
31st Meeting 2022, Session 6

CONVENER

*Edward Mountain (Highlands and Islands) (Con)

DEPUTY CONVENER

*Fiona Hyslop (Linlithgow) (SNP)

COMMITTEE MEMBERS

*Jackie Dunbar (Aberdeen Donside) (SNP)

*Liam Kerr (North East Scotland) (Con)

*Monica Lennon (Central Scotland) (Lab)

*Ash Regan (Edinburgh Eastern) (SNP)

*Mark Ruskell (Mid Scotland and Fife) (Green)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Jackie Baillie (Dumbarton) (Lab)

Johanna Dow (Business Stream)

Peter Farrer (Scottish Water)

Douglas Millican (Scottish Water)

Dame Susan Rice (Scottish Water)

Alan Sutherland (Water Industry Commission for Scotland)

CLERK TO THE COMMITTEE

Peter McGrath

LOCATION

The Mary Fairfax Somerville Room (CR2)

Scottish Parliament
Net Zero, Energy and Transport
Committee

Tuesday 22 November 2022

[The Convener opened the meeting at 09:30]

Decision on Taking Business in
Private

The Convener (Edward Mountain): Good morning, and welcome to the 31st meeting in 2022 of the Net Zero, Energy and Transport Committee.

Agenda item 1 is a decision on whether to take items 4 and 5 in private. Item 4 is consideration of evidence that we will hear today under agenda item 2. Item 5 is consideration of our approach to a committee report on our inquiry into the role of local government in delivering net zero targets. Are we all happy to take those items in private?

Members *indicated agreement.*

Scottish Water
(Annual Report and Accounts
2021-22)

09:31

The Convener: Agenda item 2 is an evidence session on Scottish Water's annual report and accounts for 2021-22. I refer members to papers on the item by the clerk and the Scottish Parliament information centre.

On 31 May 2022, Scottish Water published its annual report and accounts for 2021-22, setting out its financial and operational performance for the previous year. Earlier this year, the committee agreed to hold a one-off evidence session with Scottish Water to consider its annual report. It agreed to include at this session representatives from Business Stream and the Water Industry Commission for Scotland to explore broader questions on water and sewerage in Scotland.

I welcome the panellists who join us today: Dame Susan Rice, chair of Scottish Water; Douglas Millican, chief executive of Scottish Water; Peter Farrer, chief operating officer of Scottish Water; Alan Sutherland, chief executive of the Water Industry Commission for Scotland; and Johanna Dow, chief executive of Business Stream.

We thank you all for accepting our invitation. We move straight to questions, which the deputy convener, Fiona Hyslop, will start off.

Fiona Hyslop (Linlithgow) (SNP): Good morning, and thank you for joining us. I will initially focus on net zero, directing my questions first to Douglas Millican and then to Johanna Dow, if she thinks that she can come in as well.

I have a fairly open question. What progress has been made on Scottish Water's route map to net zero? What are the key challenges ahead? Witnesses might wish to break those down into short-term, medium-term and long-term challenges. Are you happy to answer that, Douglas?

Douglas Millican (Scottish Water): Very much so—thank you for the question. We have had a long-term commitment to decarbonising our activities. If we look at our operational emissions, we can see that our operational carbon footprint is now about half—

The Convener: I always like to admit when I am wrong—which does not, I am glad to say, happen very often. However, I am wrong in this case, because I promised some opening statements, which is why Dame Susan Rice looked at me as if I was on a different planet. Susan, I was, indeed,

on a different planet this morning. I apologise profusely. I will come back to Fiona Hyslop's question, if I may.

Fiona Hyslop: Are you apologising to me or to the panel? [*Laughter.*]

The Convener: Only this morning.

Susan, would you like to give an opening statement?

Dame Susan Rice (Scottish Water): Convener, I thought that I never gave anything away with my expressions.

I thank you and the committee for having us. If we look back at the key highlights of the latest annual report for 2021-22, which you mentioned, we can all see that the past year was really quite extraordinary. As we all know, we faced extreme weather, intensifying climate change and a challenging economy with steep and quick cost rises. Like most organisations, Scottish Water has had to respond and adapt with speed and agility.

Despite those challenges, Scottish Water and Business Steam each had a successful year while keeping focused on delivering for our customers, which is always at the centre.

Our dedicated teams had to work hard to keep customers in water. Some of our reservoirs fell to previously unknown levels in 2021. At the other extreme, our teams also had to manage the effects of storms Arwen, Corrie and Malik, which caused significant disruption to power supplies in the north-east of Scotland for a prolonged period.

With inflation and the cost crisis continuing to show little sign of calming down and a growing need to manage significant climate challenges, as well as the challenge of ageing assets, we will need to continue to be innovative and resilient. Above all, we have to keep moving forward.

We are under no illusion about how difficult that will be if income and future charge increases are not fully achievable due to wider considerations. We will need to continue to work with all industry stakeholders to ensure that we continue to focus investment on key priorities and meet our net zero emissions ambition. That leads right back to the deputy convener's question.

The Convener: Well, not quite, because another person was offered the opportunity to make an opening statement. Alan Sutherland, do you want to do so?

Alan Sutherland (Water Industry Commission for Scotland): It is probably best to simply let the questions come.

The Convener: Okay. All that I can say is that I am not going to play cards with you, because you

kept a very straight face when I obviously made an error.

I will go back to the deputy convener, who perhaps would like to ask her question again.

Fiona Hyslop: Clearly, net zero is the most important ambition for us all if we are going to make a difference to our planet. We have just come through the 27th United Nations climate change conference of the parties—COP27—and Scottish Water has key responsibilities in that area. My question is about your route map to net zero and what progress has been made. Further, what are the key challenges in the short, medium and long term? I will go to Douglas Millican first.

Douglas Millican: Decarbonising our activities has been a long-term commitment and priority of Scottish Water. In relation to our emissions footprint, we have now halved the level of carbon that is consumed in our operations.

Given the significance of the issue, when we were setting our strategic plan looking towards the middle of the century, we settled on three core ambitions that Scottish Water should be focusing on. One of those ambitions is about getting to net zero emissions and then beyond that. There are a number of different dimensions to that.

Let me start with the operational side. We have a really good story so far about halving the operational emissions footprint. Clearly, we want to get that down towards zero. We can make a lot more progress by driving energy efficiency into our operations and further increasing the extent of renewable energy generation in relation to the energy that we generate in our own assets or the generation that is hosted on our land.

One of the trickiest issues in trying to decarbonise our operational emissions are the emissions that are, in effect, a by-product of the waste water treatment process—things such as methane, for example. About a quarter of our operational emissions relate to those areas. There is no existing technology to decarbonise those fugitive emissions. We, and the wider water industry around the globe, are engaged on that issue and are trying to see what the art of the possible could be in relation to decarbonising those emissions. We are trialling different things. Part of it is about measuring where the emissions occur across our waste water treatment plants.

The next big area of our emissions is to do with our capital investment programme. We are a major investor; we invest about £3 million every day in replacement and upgraded infrastructure. That investment consumes significant elements of carbon in terms of extracting raw materials from the ground and then transporting, processing and assembling them.

For probably around three or four years now, we have been doing a lot of work upstream with supply chain partners to consider what can be done in that space.

First of all, it is a hearts and minds challenge. It is about ensuring that everybody shares the imperative that we all share about decarbonising. The human side is a really big part of it. We have engineers with careers of 20 or 30 years who have a tried and tested way of building new assets and know what works, and unlearning what works and learning new ways of doing things is a massive challenge to those people professionally. That also plays into the commercial side because it has impacts on risk models.

I can simplify the extensive work that we are doing into three key priorities. First, how can we have lower-carbon designs that avoid pumping, use gravity, build above ground and minimise digging? Secondly, what could low-carbon materials look like? For example, we are now using low-carbon concrete in certain situations. Thirdly, how do we develop low-carbon approaches to construction, such as reusing existing materials and using lower-emission plant and equipment?

I will pause there, but we are engaged in a huge amount of work year-on-year as we try to reach that goal.

Fiona Hyslop: Thank you—that was very informative.

Johanna Dow, do you want to say anything about relationships and about what your customers do, as well as what you do?

Johanna Dow (Business Stream): Unlike Scottish Water, we are not a huge consumer of electricity. We are an office-based organisation of about 350 people. Nonetheless, we are very focused on how we can reduce our carbon emissions. We set ourselves a target for the year to last April of reducing our carbon emissions by 20 per cent, and we achieved a reduction of 25.3 per cent.

We have had great support from the Scottish Water group, which helped us to determine our starting position and carbon footprint and then to identify the key consumers of carbon in our business. As with most small organisations, those included travel costs and the use of electricity, so we focused specifically on those. As Douglas Millican has said, that means that we need a behavioural change that is focused on hearts and minds. We encourage staff to use energy wisely at work and at home. We constantly remind people of that.

We have a role as a supplier to more than 300,000 businesses across the United Kingdom.

We actively encourage those customers to use less water, on the basis that, if they do that, they will consume less energy, which drives down carbon usage. There is a big focus on working with customers of all sizes, from corner shops and other small consumers of water right through to huge industrial plants. We support them with water efficiency, which, as I have said, in turn drives down their electricity consumption.

Fiona Hyslop: Peter Farrer, please explain how Scottish Water is integrated into the wider public sector. Perhaps you could talk about operational decisions regarding planning. Major housing developments, not least in my constituency, can overwhelm drainage capacity. Also, following on from what Douglas Millican has said, if methane or other emissions are an issue as we move to a circular economy, what connections do you have with the Scottish Funding Council to ensure that research in our universities meets our practical and operational needs regarding product emissions? How central is Scottish Water to the wider public sector firmament?

Peter Farrer (Scottish Water): We do a lot to ensure that we are completely integrated with councils, particularly in housing development. We have close connections with all councils, from early strategic plans right through to more specific work when we make individual connections.

One of the biggest issues is that surface water in our sewers causes flooding and pollution. We are working with a number of councils on schemes to take surface water out of our sewers. One of those schemes is not far from here, at Craighleith. We are working with the council and developers to identify areas where we can remove surface water at source, rather than having to deal with it once it is in the sewers. We have lots of integration with councils right through the development planning process.

You asked about the Scottish Funding Council. I am the chair of the Scottish apprenticeship advisory board. We work with Skills Development Scotland and the Scottish Funding Council to look at funding for different categories of apprenticeships. There is definitely a big move towards more environmental topics—carbon and net zero—and trying to ensure that the policies up front meet the demand that is required from the businesses and business leaders that are part of the Scottish apprenticeship advisory board.

09:45

Fiona Hyslop: That was helpful. I was more interested in research and development, but I am happy for you to come back on that.

Douglas Millican: Deputy convener, are you happy for me to come in on that?

Fiona Hyslop: Yes.

Douglas Millican: We have a lot of interactions with different universities, but probably the most significant is that we are the sponsors of the hydro nation chair, which is based at the University of Stirling but involves academics from a number of universities. They are currently working on about half a dozen different challenges, many of which have a climate change related theme. They are either on decarbonisation or on issues to do with how we adapt to climate change.

Fiona Hyslop: Finally—again, it might be Peter Farrer who is best placed to answer this—what changes in demand have you noticed during the Covid-19 pandemic and also as a result of the energy crisis? They are two separate issues but in the same kind of timeframe. What influences on demand have they had for Scottish Water?

Peter Farrer: By demand, you are talking about—

Fiona Hyslop: Customers.

Peter Farrer: Water demand?

Fiona Hyslop: Yes.

Peter Farrer: It is interesting because, as soon as Covid started, we saw a fairly major change in demand patterns, because businesses had emptied out and people were working from home. Jo Dow will have some other evidence on that. There was a big shift for us, with demand for water and waste water services switching over from business to household use.

That caused us a number of issues, particularly in some smaller rural areas, and particularly with waste water. Waste water treatment works in small rural areas have capacity to deal with a certain number of people. The number of people increased significantly and we started to see some overload issues at waste water treatment works. We had to work on those and ensure that we had additional plant and equipment available to see us through that period.

However, I am pleased to say that we got through two years of Covid continuing to deliver the high levels of service that we delivered to customers before Covid. I am particularly proud of that—a shout-out to our operational people, who kept going all the way through that period, delivering the service to customers and maintaining the high level that you see in the report.

Fiona Hyslop: I think that we all want to thank those Scottish Water workers for what they did during that period.

Has the energy price increase made any difference to you?

Peter Farrer: We have been in a fortunate position in that we hedge our energy in advance of using it. This year, our energy was 100 per cent hedged, so we are still using energy this year at a weighted average price of about £55 per megawatt hour, when the market price is currently up near £300 per megawatt hour. Our total energy use is 447 gigawatt hours per year, 47 per cent of which is tied up with private purchase arrangements that we have put in place in relation to large renewables schemes that we have hosted on our land. Those will run for a number of years, so we are hedged for 47 per cent for that period.

The big issue is that we have to buy the remaining 53 per cent on the wholesale market. As I have said, we are completely hedged for this year, up until March, but we will have to start purchasing that 53 per cent for next year. Based on current prices, the estimate for that energy is somewhere between £40 million and £70 million extra.

Fiona Hyslop: Perhaps Johanna Dow could give us a perspective on customer demand.

Johanna Dow: I will happily do so. There was a fairly immediate reduction of 20 per cent in our business customers' consumption following the introduction of the first lockdown restrictions in March 2020. The vast majority of businesses across the UK had to close their doors overnight. Since then, there has been a steady recovery. Things started to recover, then we went into lockdown again and it dipped off. Today, however, we are almost back to pre-Covid levels of consumption.

The slowest sector to recover has been the public sector. I think that we all understand that that is because a number of large offices and so on remained closed and are now at partial occupancy. There was a fairly immediate impact from that.

Having come through the worst of Covid and the recovery from that, we are now facing the worst economic crisis that the UK has experienced in a number of years. From my perspective of dealing with business customers, we anticipate challenging times for many businesses, particularly small businesses, over the course of the next six months.

The Convener: Looking at the accounts for the period in question, the revenue during the first Covid period appears to be about £54 million down on what it is currently. That is a 10 per cent drop. Was that all down to Covid?

Johanna Dow: Yes, it was. There are consumption-related charges that drive revenue, but there are also fixed charges, which means that the 20 per cent reduction in consumption did not

have a direct correlation with the reduction in revenue, but the drop in revenue was significant.

The Convener: A drop of £54 million or 10 per cent in revenue over that period seems quite large.

Johanna Dow: It is significant—absolutely.

Liam Kerr (North East Scotland) (Con): Good morning. Moving from demand to supply, climate change appears to be having an increasing impact on the provision and, indeed, the cost of all utilities. This summer, we had record temperatures. What impact has that had on your reservoirs? Earlier, Dame Susan Rice said that some had fallen to record low levels. Have they recovered? In those circumstances, what can you do to manage and mitigate the situation? How can you proactively help them to recover?

Peter Farrer: Yes, the weather has had some fairly significant impacts, particularly over the period of the report. I have been in the water industry for 38 years, and last year was the worst weather impact that we have had. We were hit by cold weather at the start of the year, really hot weather in early summer and rain storms in the summer, before going into a drought period at the tail end of the year. We then had storm Arwen and friends at the end of the year. Therefore, it was a fairly significant year of impact for us.

Specifically in relation to the hot weather, we started to go into drought in the latter part of the summer and reservoir levels dropped to levels that we had never seen before. In South Lanarkshire in particular, a couple of reservoirs dropped down to levels that we had never seen. The impact was that there were manganese issues. Manganese is a naturally occurring element that is tied up in the silts in the reservoirs. When we got down to such low levels—it was the driest period that we had had in that area for 160 years—manganese was released and went to the treatment works. Because we had never had manganese issues at those treatment works before—Daer and Camps water treatment works—they did not have the treatment to take the manganese out of the system.

We therefore had a fairly major incident, which involved hundreds of Scottish Water people delivering bottled water to customers who were experiencing dirty water. Some really smart process scientists came up with a temporary treatment solution, which was to inject chlorine into the water between two stages of the existing treatment processes. That precipitated out the manganese and allowed us to take not all of it, but a lot of it, out in the treatment process. As a result, we were able to return our service to near normal, but it did not completely recover until the reservoir levels started to rise.

To pick up on the question about where we are just now, the reservoirs are currently 94 per cent full. We have 300 reservoirs and we monitor them weekly. Through drought conditions, we implement many actions, which can include tankering water or moving water around different distribution systems from different areas and different treatment works. We can find additional raw water supplies. We do everything that we can to ensure that drought does not impact our customers. The final thing that we do when we are concerned is that we put communications out to customers to ask them to use water wisely.

Liam Kerr: I presume that one challenge that arises in relation to the climate change mitigations that you have to put in place will arise when you come to replace some of your ageing infrastructure. I will ask about capital expenditure in my next question, but when you do that replacement, how do you ensure that what you replace the current infrastructure with is future proofed against what appear to be increasing impacts from climate change?

Peter Farrer: The materials that we use are all governed under strict regulations by the Drinking Water Quality Regulator for Scotland. We cannot use anything in our infrastructure unless the regulator has approved it through regulations.

Douglas Millican: That is a really big question for us across all our infrastructure, because we are no longer dealing with a stable environment or a stable climate.

The challenge is to understand the myriad of possible different impacts over the lifetime of our assets. When we build new infrastructure, it lasts for 50 to 80 years or longer. It is very difficult to know precisely what the future path is for the climate. We do not yet have an agreed path to climate stability, so the question is: what are plausible impacts that we could have to deal with? We try to ensure that we make investment choices that are wise and will represent good value for money, while giving us reasonable confidence that they should enable us to deal with whatever future impacts come along.

Peter Farrer mentioned Lanarkshire, so I will use that example. On the back of having discovered the presence of manganese in a supply system, which we had never previously experienced, in conjunction with the Drinking Water Quality Regulator, we are looking at our risk position in relation to manganese right across Scotland to ensure that the way in which we plan our assets and infrastructure takes account of that risk.

That is a subset of a broader thing that we are doing, which is looking at all the different risks to our water supply systems. Those risks could be to

do with the availability of water or the quality of water. We are ensuring that, when we plan interventions, they are designed in what we hope is the most effective and cost-effective way of dealing with whatever the myriad of challenges or hazards might be in that area.

It is hard to give a single answer to your question, other than to say that future proofing is an integral part of our planning.

Peter Farrer: There is another part to that. As part of our strategic review 15 regulatory contract, we did a number of climate change studies to feed into our 25-year supply and demand balance. We carried out 54 water supply zone climate change modelling exercises to identify what the future impact of climate change would be on water supply zones. Out of the 54 that we did, five showed an increase in water availability and 49 showed a decrease.

On the back of that, we ensure that our investment is targeted at the areas that will ensure that customer services today and in the future are protected. That has led to our carrying out a number of resilience schemes: we have a big one that is linking Glasgow and Ayrshire; we have had a south Edinburgh resilience scheme and one that linked Blairlinnans to Milngavie and protected the supplies to 40,000 customers. Those schemes were established on the back of the studies that we carried out, and much more investment is planned.

10:00

Liam Kerr: My final question is for Douglas Millican; I will put the same question to Johanna Dow. Earlier, you talked about capital investment. As I understand it, your income is comprised of Government loans and the income from the bills that you put out. Your costs for things such as electricity will go up significantly—notwithstanding the fact that that is hedged, we heard that it will cost you £70 million extra. We have also heard about the cost of new treatments for manganese, drought supply vehicles and so on, all of which put extra costs on you.

What are the implications of those extra operating costs for the capital expenditure that you have presumably planned in for upgrades for the move to net zero, which we heard about earlier?

Douglas Millican: There are many different elements there, which I will try to deal with. In a very broad sense, the costs that we incur generally move in line with inflation in the economy as a whole, which is why regulated industries such as water tend to have long-term regulatory settlements in which the price limits that are set are related to a general pricing index.

Historically, the prices that we could set for regulatory settlements would be set by reference to the retail prices index; they are now set by reference to the consumer prices index. That is a broad proxy, but it is a pretty good hedge for the increases that we will experience. In the same way that we can get a big increase in the energy costs that we incur, we have an eligibility to reflect that in prices to customers—the extent to which we do so is a different question, but we have that eligibility. That broad regulatory set-up serves the sector well and has done for a long time.

One element of that regulatory arrangement is how capital investment is defined. Historically, in previous regulatory periods, there were two different categories of investment: there was what was known as capital maintenance, whereby, in effect, we got an allowance to invest in replacing and maintaining our assets; and, on the enhancement side, there was a very detailed list of all the projects that we would deliver in the next five or six years by way of upgrades.

In this regulatory period, in agreement with our economic regulator and the Government, we have moved to a more flexible approach towards investment planning and delivery. In effect, at the start of the process, we identify—often with the Scottish Environment Protection Agency and the Drinking Water Quality Regulator—what improvements might be needed. We then agree with the Scottish ministers the needs that will be investigated and in which, ultimately, we will probably invest, after which we appraise the different options around meeting those needs and come up with the most cost-effective solutions for delivering the objectives.

Our challenge is to ensure that we can meet all the needs in front of us and deliver ministers' objectives for that period inside the financial allowance that has been set for the period.

Liam Kerr: I understand. Does Johanna Dow have anything to add?

Johanna Dow: There is a slightly different context for my business, because we do not invest in infrastructure. Given the upward pressure on costs, which we know impacts not just on us but on our customers, the challenge for us is how to keep our prices for end users sufficiently low, recognising the challenges that they face. About 80 to 90 per cent of the amount of charge that we pass on to customers in Scotland is as a result of treating the water and taking away the sewage for treatment.

The other difference is that we operate in a competitive market—we have about 16 or 17 active competitors in Scotland, which is a further challenge for us. We know that we have to keep prices low for customers anyway, but that if a

customer is not happy with the price or the quality of service that we offer, they will go somewhere else.

Liam Kerr: Thank you. Peter Farrer has something to add.

Peter Farrer: I would like to talk about cost and efficiencies. Since Scottish Water was formed in 2002, we have completely transformed the service that we provide to customers, both on customer service and cost. Back at the start, in 2002, we were benchmarked as delivering one of the worst services to customers at the highest cost. We have completely transformed that over the past 20 years to deliver a leading service at one of the lowest costs.

Throughout that period, we have focused significantly on efficiencies. There are cost increases that we face each year, but we have a culture of driving efficiencies in our business and always looking for better ways to do things. Even now, we are in the second year of a transformation plan that will deliver significant efficiencies.

The Convener: Before we move on, I ought to declare that I am a customer of Business Stream. I would like to ask Johanna Dow how Business Stream does all its meter readings. Are they done manually by people who go out to customers? If so, are there plans to streamline that in the future?

Johanna Dow: We supply customers the length and breadth of the UK, and different metering technology is deployed in different regions. With some of the meters that we read in the south of England, that is done by drive-by meter reads, which means that a physical visit is not required. That is not the case in Scotland—we have to use a third-party service provider to go out and read meters on behalf of our customers.

The Convener: Are there plans to change that?

Johanna Dow: Again, we do not own the metering assets—they are owned by Scottish Water—but there is investment in Scottish Water at the moment to look at what we call smart meter technology, which would allow for more automated provision of meter reads.

Peter Farrer: Maybe I could come in on that. We are looking at putting far more instrumentation and monitors on our networks. At the moment, we are running a pilot in Inverness—which we are calling the smart city—that involves putting loads of monitors on the network. Those include smart meters for businesses so that we can identify where the demand for water is. That will also help us operationally, because we will be able to predict failures on the network and go and fix them before they have any impact on customers.

The Convener: Perfect. I might see one of those appearing in my constituency office, then.

Jackie Dunbar (Aberdeen Donside) (SNP): Good morning, and thank you for coming along. The strategic plan says that Scottish Water is going to

“promote blue-green approaches and drive innovative solutions to reduce flooding.”

With that in mind, can I ask what progress has been made in adoption of blue-green infrastructure to manage surface water, and whether you have any examples of projects? Douglas Millican, I will direct that question to you, as you are looking at me.

Douglas Millican: That is fine—either Peter Farrer or I could answer that question and, in fact, Peter cited one of the examples, which is Craighleith in Edinburgh.

People get excited when they hear about this concept. It is about how we can hold more rainwater on the surface and slow down the rate at which it comes into sewers, which would reduce issues with flooding. It could also be used as a source of placemaking on the surface, which sounds exciting—and it is exciting—but the challenge with doing it in practice is that many parties need to be involved, and they need to agree that using land for storing rainwater in rather congested areas, such as Edinburgh, is a better use of that land than developing it for industrial or housing purposes. The first challenge is getting all the interested parties onboard and for them all to agree that doing that makes the most sense in the interest of society as well as the particular organisations or businesses. The concept is easy for people to grasp.

A couple of months ago, I was at a meeting in Edinburgh with a number of chief executives of local authorities, and we were looking at how we can create water-resilient places in the country. I can point to Craighleith in Edinburgh, St Mary’s in Dundee and parts of Glasgow as examples of where we are making progress. There are encouraging green shoots, but they are green shoots and we have a long way to go before we have collectively transformed the urban environment to store surface water on the surface.

We are absolutely committed to doing that, and that is why we are engaging with so many different parties and why we are often in partnerships. We have had a long-standing partnership in Glasgow for nearly 20 years, which is called the metropolitan Glasgow strategic drainage partnership. We have one here in Edinburgh and the Lothians with the City of Edinburgh Council, East Lothian Council and Midlothian Council, and we have partnership working in Dundee and Aberdeen as well.

There are lots of encouraging signs, but I think that it will be some years before we see a

transformed urban landscape. However, there is no shortage of effort on our part to achieve that.

Jackie Dunbar: In speaking about joined-up working with partners, you spoke about your work with local authorities. Will you go into more detail about the joined-up work that you have done with the Scottish Environment Protection Agency and other public authorities?

Douglas Millican: SEPA is one of our sectoral regulators. We have significant interactions with SEPA at the most senior level, down to the most local level. On the operational side, we engage with SEPA on a variety of issues, and Peter Farrer might be able to touch on those. On the strategic side, we have engaged heavily with SEPA on a sustainable growth agreement for the whole water sector.

Everything that we do on the water resource angle and to improve the urban water environment is done in conjunction with SEPA. For example, about a year ago, we published our “Improving Urban Waters—Route Map”, which looks at how we will make yet further improvements to the urban water environment. The route map was developed very much in conjunction with SEPA in order to support it with its river basin management planning objectives. That the quality of Scotland’s water environment is so much better than it was many years ago—it is by far the best water environment in the UK—is a tribute to how well we have worked together over the past 20 years.

Peter Farrer: I will build on what Douglas Millican has said. By working very closely with SEPA over the years, we have been able to target significant amounts of investment at the parts of the water environment that need it the most. There have been significant impacts from that, as Douglas Millican said. The quality of receiving waters in Scotland is significantly higher than it is in Europe and the rest of the UK.

Jackie Dunbar: Thank you.

Mark Ruskell (Mid Scotland and Fife) (Green): Good morning. I want to raise the issue of sewage discharge, which has been very high in the public’s mind this year. It does not appear that there is a clear picture on sewage discharge in Scotland. That point was made by Environmental Standards Scotland in its recent sector baseline evidence review, so I have a number of questions about what that picture is in Scotland.

At the moment, only 3 per cent of combined sewer overflows are monitored. Is that enough to get a clear picture?

Douglas Millican: If you allow me to give a little bit of context, I will come on to your specific question. We have worked constructively with SEPA—that links back to the previous question—

ahead of any regulatory period to identify the priorities for improvement. About 20 years ago, the big priority area related to where sewage was discharged and the continuous outflows from sewage treatment works, and we did a lot of work to improve those.

About 15 years ago, SEPA said that the next big area for improvement related to the points of intermittent discharge in the sewage system—we have emergency release valves that go off when there is very heavy rainfall. Back then, we had discussions with SEPA and the Scottish Government about how we should spend our finite amount of money. We could have installed monitors on the intermittent discharge points, or we could have used the money to make improvements. There was universal agreement across SEPA and the Government that we needed to deploy our money on making the physical improvements that have delivered the improvement in the water environment that we have seen over the past 15 years.

A conscious and collectively agreed decision was made to prioritise improvements over monitoring. That is the reason why, today, we have relatively low numbers of discharge monitors in Scotland. However, given all the progress that we have now made, we all recognise that the next stage of improvement will involve having a much finer understanding of precisely what is going on with discharges.

We have agreed that we will not take a blanket approach of putting monitors on all our discharge points but will instead target those release valves that might pose the highest risk of having an adverse impact on the water environment. Those are the overflows in which we will install significantly more monitors over the coming years.

10:15

Mark Ruskell: That is useful context but, to come back to the question, I asked you specifically about the figure of 3 per cent. Is that enough? Do you have a figure for how many combined sewer overflows you should be monitoring in order to capture that environmental impact and to understand it?

Douglas Millican: I hope that, by my earlier answer, I have indicated that it is not enough. We have agreed that, given where we are now, we need to install more monitors. We have an agreed programme with SEPA to install monitors on approximately 1,000 overflows.

To give a bit of context, we have about 3,600 emergency overflows across Scotland, and SEPA has said that, broadly, about a third of them need to be monitored as the highest priority. There will be many benefits from that, not least that it will

give Peter Farrer's team much earlier insight if an overflow is going off at a time when it should not be. We might imagine a day of continuous dry weather. If an overflow is going off in those conditions, that probably indicates that there is a blockage in the system, and we need to get out and clear it. That insight will enable Peter's team to get out there and fix those issues much more quickly than we currently do, and to give information to members of the public.

Mark Ruskell: You have given me a proportion there—you said that you will move towards introducing monitoring on a third of overflows. What about the two thirds that are not monitored? Are you saying that those are not problematic? How do you know that they are not?

Douglas Millican: We rely primarily on SEPA's views as to where the risks and threats to the water environment are. The good thing about SEPA's approach is that it starts from an outcome angle, by asking what the condition of any water body, or the health of any river, in Scotland is. It then works back upstream from that and asks what needs to happen either to maintain really good status or to improve status. As part of that thinking, SEPA has said that we should prioritise putting monitors on that one third of overflows.

Once we have monitors on those overflows—and once we have delivered further improvements to overflows, as we also have an improvement programme in place—we will determine whether it would be effective, and cost effective, to put further monitors in place.

Peter Farrer: To build on that, SEPA has indicated that it does not believe that the remaining 2,000-odd overflows are having any impact on the receiving water. As Douglas Millican said, the most important thing here is targeting the investment in order to have the biggest impact. That is why SEPA starts with river quality and works back to ask what investment is needed, and therefore what monitoring should be put in place to identify the right investment to deliver water quality.

Mark Ruskell: Of the discharges that you know are happening, and which you recognise are problematic and are therefore monitoring, what proportion are deliberate and what proportion are accidental discharges?

Douglas Millican: The sewerage system operates as a gravity system, so any water that comes out of an overflow is a function of the amount of rainwater that lands on the ground and finds its way into the sewerage system. During really heavy storms, when the total amount of water coming into the sewerage system exceeds the downstream hydraulic capacity, the overflows go off. I do not know whether that is deliberate or

accidental, but that is part of the way in which those systems are designed to operate.

Mark Ruskell: So it is totally dependent on rainfall—there is no control over it. You cannot predict when there is going to be a flow from the combined sewer overflows, because it is all dependent on rainfall.

Douglas Millican: The volume of rainwater is the primary driver. With regard to prediction, we now have a much more sophisticated understanding of what is happening with weather patterns, and we are able to correlate that with our understanding of the sewer system. For example, if we can see that a big storm is coming in, Peter Farrer can, through the work of our intelligent control centre, mobilise his squad to get out and ensure that we try in particular to prevent our customers from suffering problems with flooding.

The only other situation in which overflows will go off is if there is a material downstream blockage that means that the full flow of rainwater cannot get downstream in the sewer and will divert out through an overflow.

Mark Ruskell: It might be useful for the committee to get evidence on the work programme on a third of CSOs, including the investment for that and how the work will be scheduled.

I move briefly on to a related issue, which is water quality. Douglas Millican said earlier that Scotland's water quality is excellent. Despite that, however, Environmental Standards Scotland, as part of its sector review, highlighted the fact that a number of the river basin management plan targets have been missed, and that we still have an issue with barriers to fish and lamprey migration, along with a number of other issues relating to the operation of Scottish Water assets.

How do you prioritise environmental compliance? I give you the example of Loch Venachar. I am aware that SEPA wrote you a letter last month confirming that four of your fish passes, not on the side channel but on the main channel, are not compliant with your permit. You are in effect acting outwith your permit conditions—in other words, you are operating illegally. How seriously do you take environmental compliance?

Douglas Millican: I will respond to the general question, and Peter Farrer can talk about Loch Venachar. We take compliance with all our legal obligations very seriously indeed. The need to ensure that we are able to discharge the full suite of legal obligations that we have is probably one of the top on-going topics in our boardroom.

Part of the reality, however, is that we have a huge infrastructure. We have approximately

100,000km of pipeline and thousands of above-ground assets. With the best will in the world, things will happen, and things will go awry that might—although Peter Farrer’s team are superb at getting on top of and dealing with those issues—cause us to breach compliance with one aspect of our regulatory obligations.

Nevertheless, the mindset of the organisation, and our orientation, planning and investment planning, are all geared towards ensuring that we comply with the suite of obligations that we have.

Peter Farrer: I will pick up on the point about Loch Venachar, which is an interesting structure that was built in the 1850s. It is unusual—we have many reservoirs, but this particular one has a dual channel that is fed from the reservoir into the river. One of the channels is fed through the sluice gates from the reservoir, which we operate in line with compensation flows that are set out in legislation by SEPA. The other channel is fed from the spillway channel, which is effectively the overflow from the reservoir, when the reservoir is up at top level—

Mark Ruskell: I am sorry to interrupt you. I am aware of the local geography and everything else; I think that the issues are with the main flow. The general point is around compliance. If SEPA writes you a letter like that, what do you do? Do you say, “Well, there’s actually still a problem here, but we have to put it into the investment programme over time,” or do you jump and take action on the—

The Convener: Sorry, Mark—can we hear from Peter Farrer in answer to your question? After that, I would really like to hear from Alan Sutherland—I am giving him prior warning—if he would like to add anything, because he may have a role in that regard.

Peter Farrer: I can assure the committee that we absolutely jump when a regulator tells us something like that. We have worked with SEPA on the Loch Venachar issue to find the right solution, and SEPA has requested that we carry out a longer study to try to come to a joint solution. We absolutely have actions in place to deal with that.

Alan Sutherland: With regard to investment, what we have changed—as Douglas Millican mentioned earlier—is that we have moved away from a heavily defined ex ante list of projects and made broad allowances for Scottish Water to spend on priorities as and when they develop and as and when that is needed.

Scottish Water now has far more flexibility to respond to situations. In the past, had investment been required for the fish pass that you mentioned, that would have required a change in what we call the “technical expression”, which is the long list of projects. Once that change was

made, that investment could go ahead. That would not have to happen now, because Scottish Water can reprioritise money, based on an appraisal of the situation that it faces.

The Convener: Monica Lennon has some questions.

Monica Lennon (Central Scotland) (Lab): We heard in the opening statement that there is little sign of inflation or the cost crisis slowing down. I will ask my questions in that context.

My first question is for Douglas Millican. Is it fair to hike up household bills by 4.2 per cent during a cost of living crisis?

Douglas Millican: Almost everyone in Scotland—about 97 per cent of the population—is a Scottish Water customer. We do a huge amount to engage with our customers and to understand what is important to them about the services that Scottish Water provides and the way in which we do that. What comes through loud and clear is that people have incredibly high expectations about the service that we provide for them. They expect to be able to turn on the tap every day and get good, clear, high-quality drinking water or to be able to flush the toilet, or to do the industrial equivalent of that, and have us take care of that to a really high standard. They also expect, on the very few occasions when something goes awry, that we will get on top of that and deal with it. That is undoubtedly the overwhelming priority for our customers across Scotland, and we must pay the greatest attention to that. That is my first point.

My second point goes back to the answers to earlier questions. We must meet a range of legal obligations, many of which are about protecting water quality or environmental performance.

Crucially, we must do all that in a way that is always sensitive to the position that our customers are in. There is no doubt that customers are in a really challenging position at the moment, as they have been for many months, and there does not seem to be a better day coming. When we were looking at what we had to do in setting charges for the current year, we did that not by looking only at this year but by viewing that in the context of future years. We will take the same approach to charge setting for next year. We try, first, to ensure that we fulfil our customers’ expectations about our level of service and, secondly, to ensure that we are really sensitive to the pressures on customers today, while recognising that there will be pressure next year and thereafter. That mix of factors goes into how we think about our charging decisions.

Monica Lennon: There is a lot in that answer. My question was whether it is fair to put prices up by 4.2 per cent. You did not answer that, but you did suggest that things will not get better in the

immediate future, which sounds quite gloomy. Does that mean that households should brace themselves for further increases? The 4.2 per cent increase is pegged to CPI, but we know that inflation is now at about 11 per cent or even higher. What will increases look like in future years? You talked about customers' high expectations. Will we see higher prices?

Douglas Millican: My comment about things looking challenging was based on what all the general economic forecasts seem to be predicting, which is that there will be a tough period ahead for the economy, people and society in the next two or three years. That is the context. It is not about water; it is about the undoubted pressures on households and businesses across the country.

Monica Lennon: Do you have a view on the fairness of the charging scheme?

10:30

Douglas Millican: The way in which the charging scheme is set up is a matter for the Scottish ministers, who set the principles for water charging in Scotland. The difference in charging levels between those who are most vulnerable and those who might have a greater ability to pay is significant, and it is much greater in Scotland than it is elsewhere in the UK.

In the pricing review, ministers took further steps to strengthen the protection for those who find it most difficult to pay, by increasing the discount that is available under the water charges reduction scheme. To give you a sense of that, more than half of Scottish households receive some form of reduction in their water charges.

I am sure that the Scottish Government will keep the matter under review, but huge strides have been taken in thinking very carefully about how we ensure that water charges are as affordable as possible.

Monica Lennon: You mentioned the Scottish ministers. I have looked back at what the Cabinet Secretary for Net Zero, Energy and Transport said about the price increase. Back in February, he said:

“every pound raised is re-invested in our water industry.”

Many customers will therefore be wondering why you have £500 million in cash reserves. I know that you will be able to give some explanation for that, but have you looked at what more can be done to support customers? Clearly, you understand that many people in Scotland are struggling to afford household bills, regardless of their expectations of quality of service. Can you say a little more about the reserves? From reading some of the papers, my understanding is that they sit at about double what they would normally be.

Can we expect that to continue in the coming years, or will you use those reserves in any way to help customers with their bills?

Douglas Millican: There are a number of elements in that. As Peter Farrer said, we have a continual drive for efficiency, which is about how to spend the least amount possible on, for example, delivering a new investment project or the day-to-day service. That is part of the motivation behind the transformation programme that he referred to.

However, when it comes to finance, everything that Scottish Water does is paid for by our customers. We might borrow money to fund some of the investment programme, but that involves interest—ultimately, it is all paid for by our customers.

The easiest way to think about our cash balances, which vary from year to year, is that they are primarily a function of the relationship between when we borrow from the Government and when we invest. A level of cash balance will always be needed just to manage the bumps in the road that come with running a large organisation. Our current view is that we should probably always have a minimum of about £200 million, just so that we can deal with whatever pressures come along. However, any cash that we have at the moment in excess of £200 million will be invested over the coming years.

As we exit this regulatory period, those cash balances will come down. We are ramping up our investment significantly. In this regulatory period, in agreement with the Water Industry Commission, we have been financed for a 30 per cent increase in investment, and we are getting on and delivering that. Last year, we delivered a little more than £620 million in planned investment. This year, the figure will be at least 10 per cent higher than that. As our investment programme ramps up, those cash balances will get drawn down.

Monica Lennon: I am keen to come to Alan Sutherland in a moment but, Johanna Dow, what increase will non-domestic customers see in their bills?

Johanna Dow: For the new year, I cannot honestly say, because the wholesale cost of water has still to be agreed. However, to go back to my earlier point, we know that we face a challenging time.

Between 70 and 80 per cent of our customers are small or medium-sized enterprises—small businesses. Those are akin to domestic users of water; they might have a tap and a toilet. From our perspective, it is about trying to keep prices as low as we can.

The other big factor is how to encourage customers to use less water. The majority of our customers are metered customers so, if they use less water, they pay less—which is obviously better for the environment, too.

We are trying to tackle the issue on a number of different fronts, but there is no denying that it will be a really challenging few months for small businesses.

Monica Lennon: I turn to Alan Sutherland for the view of the Water Industry Commission for Scotland. I asked Douglas Millican about the fairness of the charges. What is your view?

Alan Sutherland: I am not really allowed to have a view on that.

Monica Lennon: Do you have an assessment of it?

Alan Sutherland: I can have a personal view, but not a corporate view. In essence, my job is to take the objectives of the Scottish ministers and their principles for charging and to tease out how much that needs to cost. I have to do that in a way that has regard to the interests of future customers.

In the settlement for 2021 to 2027, we started a journey towards the levels of investment that we think will be required in future, and the price caps that we set are in place. Scottish Water must operate within those price caps and must deliver the objectives that the Scottish ministers have set out. That is what we will monitor its performance on.

Monica Lennon: Are the price caps fit for purpose? Are they appropriate? If the maximum charge is based on the consumer prices index plus 2 per cent and if inflation is about 11 per cent—which might increase—will that still be the best approach?

Alan Sutherland: The question is how you want to understand the future obligations that we will all have to meet. If you want a water industry that is sustainable and is able to replace its assets, when the time comes, and if you want it to meet net zero challenges and to be able to adapt to climate change, it will have to make the investment, and we as a society will collectively have to pay for that in some way. That is not a quick journey because, as has been said frequently, we are dealing with some very long-life assets, so we have to operate in a way that is fit for purpose.

In essence, the price caps provide an indication of a reasonable path between now and the middle of the century—2040 and beyond. The variations in charging within those caps can be significant, but the caps are broadly what will be required over time.

Monica Lennon: I know that it is never polite to talk about people's salaries and remuneration, but I will put this question to Dame Susan Rice, because it would not be fair to put it to the officers. I just want to get this on the public record.

There has been a lot of interest in the bonus structure for senior officials. We are talking at a time when members of the public are struggling to afford the absolute basics in life, including water charges. There has been mention of considering efficiencies. Is there any on-going reflection or review of the bonus structure for Scottish Water officials?

Dame Susan Rice: The bonus structure that was agreed with the Government some years ago has been in place for a while. The bonus structure for the executives in the organisation is based on what we call outperformance, which is measured at a very fine level. There are expectations, goals and targets—as all businesses have—and ours is a business that strives to outperform those, for lots of reasons. If executives work hard and achieve that level of performance, they will get some bonus, for which there is a computation. It is not paid every year, and it is varied. There is not just an assumption that people will get it.

I point out that everyone throughout the organisation who works and performs at an appropriate level is eligible to receive something. The bonus programme is very modest compared with those in the commercial sector—forgive me for saying that to my colleagues. It incentivises—which is what that kind of programme should do—very hard creative work that is needed to go beyond what are considered to be acceptable levels of performance and to move the business further and faster.

Douglas Millican spoke at the beginning of the meeting about services being high in cost and low in quality 15 or 20 years ago, but that situation has now completely reversed, as we are one of the providers that charges the lowest costs in the UK and our quality is right at the top of the charts. That comes from the outperformance that we are rewarding. The judgment of the board is that the programme works. We discuss it on the remuneration committee, and those matters are also discussed by the full board. The feeling is that the programme is effective and that it works.

Monica Lennon: Given that my initial questions were about fairness and the assessment of fairness, it was important to take the temperature on that issue.

The Convener: I have some questions on the accounts, which form a huge part of your report. They caused me a certain amount of heartache when I was trying to understand them last night, but you will shed some light on them. Page 153

shows that administrative expenses for the latest year were reduced by £16 million, which was an 8 per cent reduction. Briefly, how did you manage that?

Douglas Millican: Can I have 20 seconds to refer to the underlying element? I will pause for a moment, because that is a consolidated number across Scottish Water and Business Stream, and a lot can come down to the way that costs are classified.

The Convener: Douglas, rather than put you on the spot, I am very happy to take a written answer to that question if you do not have it to hand.

Douglas Millican: I would prefer to do that. In the financial commentary, we break down into more detail the key cost elements across Scottish Water and Business Stream. In 30 seconds, I could find the precise—

The Convener: I am happy for you to refer to all the elements in writing rather than answering that now.

I am also concerned about taxation going from £7.9 million to £158 million. I understand that there was some tax differentiation due to corporation tax, but that is a massive difference. Again, you can write to the committee with an answer on that, if you like.

Douglas Millican: That one is easier to answer. There is a particular note on page 168 of the accounts. The key thing to highlight is that we pay relatively little in corporation tax. Most of the tax charge relates to a deferred tax liability that may be payable in the future. That is to do with the timing of when taxable profits are earned relative to the unwinding of capital allowances. The primary reason for the change is to do with the anticipated increase in the corporation tax rate to 25 per cent.

The Convener: From 19 per cent.

Douglas Millican: Yes. That is the primary reason.

The Convener: It seems a huge jump. Is it all down to that tax increase?

Douglas Millican: Corporation tax rates are UK Government decisions. If we track that back over many years, we would have had a favourable credit to our accounts when the UK Government was reducing the rate of corporation tax. When it signalled the increase, those favourable credits were then reversed.

The Convener: In one year, corporation tax went from 19 per cent to 25 per cent and your tax went from £7 million to £158 million. That seems quite a large increase.

Douglas Millican: That is simply because we have a significant deferred tax liability. That is tax that may be payable but has not yet been paid. It is purely about how that is revalued from 19 per cent to 25 per cent.

The Convener: Page 164 shows that the operating surplus for Scottish Water has gone up by £20 million and that Business Stream has gone from loss to credit. Those changes involve some quite substantial figures. Can you expand on that? Again, I am happy to take a written answer.

10:45

Johanna Dow: I can comment on the Business Stream aspect. There are a couple of different drivers there, but the key one is the recovery in consumption levels that we mentioned earlier, which was a result of the pandemic winding down. The second driver is that we had carried quite extensive provisions for bad debt in anticipation that a number of customers would find it really difficult to pay their bills because of Covid.

Our reported results for 2021-22 include a release of almost £29 million from the Covid bad debt provision, which is a significant driver in that swing from a loss in the previous year to a profit this year. There were also additional efficiency savings, which were generated as a result of synergies from acquisitions in recent years.

The Convener: Douglas, do you want to add anything?

Douglas Millican: It is probably best if I provide something more granular in writing, but there are several factors at play. When we look at a water company's finances, the cash flow statement is the key thing. I say this as a chartered accountant: accounting standards can have strange impacts on the way that the accounts of a utility company are presented, and particularly on the way that the costs that are associated with long-life assets are reflected in income statements from year to year. I always find that the cash flow statement is the key thing to look at.

One factor that is at play is that there was a 2.5 per cent increase in our charge income in that year. Our customer base typically grows by almost 1 per cent per year, which is a function of new house building and house connections across Scotland. On the cost side, there is a continuing drive towards efficiency. However, there will be one-off adjustments that are caused by the application of accounting standards, so we should probably provide a written answer to your question.

The Convener: My final question is about staffing costs. Wages and salaries increased from £168.7 million to £173.4 million, which I

understand to be an increase of roughly 3 per cent. Where do you predict the figure will be after addressing the cost of living crisis? Will it be considerably higher? When do you negotiate wages and agree staff costs?

Douglas Millican: Our pay deal for this financial year was agreed with our three trade unions back in May. The pay uplift for all our people has been agreed for this year and has been paid. We will address the pay deal for next year with our three trade unions in the context of the relevant public sector pay policy for the next financial year.

The Convener: I am sorry—I missed part of your answer. What increase was agreed in May?

Douglas Millican: The average increase was 4.9 per cent.

The Convener: Is it likely to be higher next year? Was that a one-off agreement for one year?

Douglas Millican: That was the pay deal for last year. The average was 4.9 per cent, but there was some differentiation within that. People on lower pay bands typically got a higher increase. It is too early to say what the parameters of next year's pay settlement will be.

Fiona Hyslop: My question is for Alan Sutherland from the Water Industry Commission for Scotland. Do your statutory responsibilities give you sufficient scope to challenge Scottish Water on delivery of its net zero commitments?

Alan Sutherland: The statute is fine. We have the ability to ask whatever questions we believe we need to ask. We are engaged in an iteration of questions and answers, and that process has not yet finished for the year that ended in March. There is some way to go, but we are hoping to have it finished before the end of the year. I am partially holding my breath that it will be done by then, because we had rather a lot of queries this year.

The powers are in place. We are of the view that the triple challenge that I mentioned earlier—investing in adapting to climate change, mitigating such change, and replacing assets in an optimised way—is really significant. For example, we would be replacing meters with the modern variants and not just the same types as we had before.

At the most recent price review, we went on the record as saying that the challenges that Scottish Water faces going forward are at least as significant as the ones that it addressed incredibly successfully when the three authorities were brought together to create Scottish Water back in 2002. There are real challenges. Monitoring will continue to be robust and evidence based, and we will report on that process.

Fiona Hyslop: Why did you have so many queries this year?

Alan Sutherland: That is a good question. I would like to know the answer. There have simply been a lot more queries over the past two or three years.

Fiona Hyslop: Are they from you or from elsewhere? You volunteered that point, and it would be interesting to know the answer.

Alan Sutherland: We have an annual return, which is a detailed document. The baby form of that was developed by the Treasury back in the 1980s. It was used by Ofwat in the 1990s and we adopted it here back in 1999 or 2000. It considers all aspects of performance, assets, levels of service and climate change, and it is completed every year. It is extensive and it requires commentaries. We go through the document pretty forensically and check the consistency of the report to ensure that we are happy with it.

Fiona Hyslop: I also want to ask about your relationship with SEPA, which will clearly cover not just net zero and the climate change emergency but the biodiversity crisis that we have to deal with, too. Peter Farrer mentioned SEPA in particular, but other regulators are involved. Does that regulatory set-up work when we are facing those twin crises? How do you work with SEPA in its regulatory role?

Alan Sutherland: We sit down with SEPA regularly, both as part of the wider stakeholder meetings that happen, on average, a couple of times a month and for separate bilateral conversations to ensure that we understand what is important to it and to share our views on matters such as progress on investment.

Fiona Hyslop: Finally, I will ask Susan Rice about the priority for the board on the strategic challenge. To what extent does the biodiversity crisis sit within that, alongside the climate change emergency? Is the board addressing those issues? Are there any difficulties with the regulatory constraint whereby SEPA is on one side and the water commissioner is on the other?

Dame Susan Rice: You have raised an important point on biodiversity, and implied in that is the relationship to net zero and targets. Scottish Water has its own net zero target, which it has undertaken to achieve five years sooner than the Scottish Government's target. We are working to try to get there even faster.

If you talk to external pundits in that space, they will say that no one will achieve the net zero targets without dealing with biodiversity—it is fundamental to making all of this work. The issue is a personal interest of mine, and I work on a lot

of aspects that are related to it outside Scottish Water.

Scottish Water has focused on biodiversity since well before the climate emergency was declared in Scotland some years ago. For instance, there is a massive tree-planting operation. That does not solve all problems, but it is important. Scottish Water is also very interested in peatlands because, if they are healthy and restored, it helps the quality of water, and if we get better-quality water, we expend less by way of money, chemicals and carbon in treating the water.

Those matters are absolutely tied together and they are very important for the board. I mentioned my personal interest, but the whole board has an interest, and several of our non-execs have backgrounds and specific experience in the area of biodiversity, climate change and emissions.

The Convener: I will bring Mark Ruskell in if he will be very quick—unless his question has been answered.

Mark Ruskell: It is a slightly different question, convener. I will be very quick. I want to ask Johanna Dow about the privatised market for the billing and sale of water to business customers. Do you feel that that is working? Have there been efficiencies? Could you operate just as effectively as a state monopoly?

Johanna Dow: I can answer the first part of that question, but not necessarily the second part. We have operated in a commercial, competitive environment for 15 years in Scotland and for five years in England, and I can definitely attest to the fact that significant benefits have been delivered for customers, not only through reduced charges but through innovation and better service experience. I am a big advocate of the competitive market. I think that we can demonstrate quite clearly that it has delivered benefits for customers and that it will continue to do so.

Liam Kerr: Douglas Millican talked about 97 per cent of Scotland getting high-quality water, but we have also heard about the very challenging cost of delivering that. It has been argued that, because domestic water is not metered, the true cost and value of the product to the end user is not sufficiently appreciated. We have also heard about the importance of encouraging people to use less water, but the argument would go that, if it is not metered, people will not do that. The flipside, which we heard from Johanna Dow, is the costs of metering, which include the costs of installation, maintenance and meter reading. What is Scottish Water's current view on meters for domestic customers?

Douglas Millican: The current view is that any domestic customer can ask for a meter and we will supply it, but that, in accordance with the effective

principles of charges that apply for this period, they will need to pay for its installation. The reality is that there is quite a significant cost to installing, reading and maintaining meters and issuing bills. As well as addressing issues around affordability and some of the differentiation that applies, the set-up that we have in Scotland, where we have unmeasured customers, helps to keep the cost of the whole system down.

That brings me to how we incentivise water efficiency. I am not wholly convinced that a meter does that. Maybe the idea has some bearing for somebody who is struggling and for whom every penny counts, because they will watch their water meter, but many customers do not do that. The approach that we are taking is to try to inform people and make them aware of the scope for them to save money by saving water, largely through their energy bills. We have done some work over a number of years with the Energy Saving Trust to identify the percentage of people's energy bills that is associated with heating water. Over time, we have been to various events to try and engage customers in and around that.

We have a campaign running on mainstream and social media under the title "Water is always worth saving". Peter Farrer referenced earlier the fact that, in times of drought, we might go out to customers with messages that encourage them to save water. However, we intentionally launched our key messaging campaign in a wet Scottish autumn in order to convey to people across Scotland that water is worth saving all year round. We have particularly tapped into the savings that they can make on their energy bills by reducing the amounts of water that they consume and heat.

Liam Kerr: That is fascinating. Thank you.

The Convener: Jackie Baillie has been sitting very quietly in the corner. I am sure that she has some questions that she would like to put now.

11:00

Jackie Baillie (Dumbarton) (Lab): I thank the convener and the committee for allowing me to ask some questions. First, I should say that I have indeed seen the adverts that Douglas Millican has mentioned, and they are very effective. However, my questions are in the context of the cost of living crisis, which is probably the worst in more than a generation.

I turn first to the Water Industry Commission for Scotland, whose website reveals that it wrote to Scottish Water on 3 February 2022, after the latter set a charge level 2 per cent below the figure that the commission had determined would be required. Mr Sutherland, your letter makes it clear that

“Our Final Determination set out a 2% average annual real increase in charges from 2021-22 to 2026-27”,

which is CPI plus 2 per cent, and it goes on to demand an explanation of Scottish Water as to

“how it will ... deliver the required investment, in a manner consistent with our Final Determination of Charges”.

The letter also makes it clear that

“charges would now need to increase by more than CPI+2%”.

Further correspondence to Scottish Water on 10 March, 25 April and 1 July demands information that demonstrates that Scottish Water is doing what you want. With inflation at 11.1 per cent, would that not imply that, if it were to follow your approach, Scottish Water would have to raise its charges by at least 14 per cent next year? However, a recent answer to a written parliamentary question that I lodged makes it clear that there are

“no powers to require a particular outcome in the charge setting process beyond setting the charge caps”.—[*Written Answers*, 4 October 2022; S6W-11011.]

It does not appear, therefore, that you have the powers to demand what you are actually demanding of Scottish Water. Will you now withdraw the letter of 3 February and take the pressure off Scottish Water to have inflation-busting rises forced on customers during a cost of living crisis?

Alan Sutherland: As you have said, Ms Baillie, we have no power to compel Scottish Water to do anything. We have set a charge cap that we believe is the “lowest reasonable overall cost”, which is the statutory test, for Scottish Water to deliver on all the objectives of Scottish ministers, consistent with Scottish ministers’ principles of charging.

If there is less revenue coming into the system—unless there is offsetting efficiency, which we would want to understand—there will be less investment. If there is less investment, we simply want to understand how Scottish Water is going to meet the full objectives set out by Scottish ministers. If there is going to be a shortfall, there needs to be a process to discuss that.

That is, quite simply, the question. The objectives are there, and an amount of money is required—which, in our view, is the “lowest reasonable overall cost”. What will give in the system? If you take less money, that is fine—it is under the charge cap—but will you then be able to deliver on the objectives and promises that have been made to the people of Scotland?

Jackie Baillie: Given that you acknowledge—I think—that you have no power to demand what you were demanding in your letter of 3 February, will you withdraw that letter? If ministers, who

ignored what you said last year, ignore you again and come down on the side of householders, is it not the case that it really is up to ministers, and not you, to act?

Alan Sutherland: Ultimately, it is ministers, through the Parliament, who own Scottish Water. They get to work with Scottish Water to decide whatever they want.

The question is this: a set of objectives has been set out, and we have, in good faith, costed those objectives and come to a conclusion on the amount of money required to meet them, having included a fairly substantial efficiency challenge of 1 per cent compounded in both operating costs and capital costs. If you have less revenue in the system, you are going to have less investment. In that case, unless you have efficiencies over and above the efficiencies that have been set—which are already very challenging, and ahead of anything that has been set south of the border—what will have to give in the system? It is quite simple. Yes, we can decide not to pay now, but then we will have to pay later, or we will not get what we were told that we were going to get.

Jackie Baillie: As I think that you will acknowledge, circumstances can change. We are now in a cost of living crisis, which I do not think that you anticipated when you put forward your determination of charges. Given that ministers effectively overruled that determination last year—and one would hope that they give the same consideration this year—is it not the case that, when circumstances change, you should change, too, or have you had a discussion with ministers about revising their objectives?

The Convener: I am sorry to interrupt, Ms Baillie. I am finding this questioning very interesting, but as I understand it—and correct me if I am wrong; I am just looking for clarity—the situation is that, as you are trying to point out, Scottish Water will not be able to meet its objectives unless it puts the prices up to the level that you have suggested. There is a balance between investment and non-investment. Surely, then, it is for Scottish Water to explain what projects it will be unable to achieve if the price does not go up. Have I got that completely wrong?

Alan Sutherland: No, convener, you are absolutely correct. That was what we were seeking to ascertain when we issued the information request to Scottish Water in March, and it is something that we are still working on. We are trying to understand exactly what will have to give in the system. As of today, there is less money in the system; the charge caps are there and the facility is there to take the money. The decision might be that that cannot be afforded, but that means that there will be less investment coming less quickly into the system. Things might

happen later; they might have to wait for a new regulatory period; and ministers might accept a shortfall in their objectives. However, that is for ministers to decide.

We are simply saying what is happening and how much it costs. We are just holding up a mirror to all of us in society.

The Convener: Thank you for clarifying that. I thought that I was off track there.

Jackie Baillie: It might be helpful if I share with the committee a copy of the letter of 3 February, which is quite specific. It says:

“As a result, charges would now need to increase by more than CPI+2% in each of the next four years”.

There is very little mention of the narrative that we have just heard about what projects would require to be cut. I think that I have made the point, but I just wonder whether there has been any discussion with ministers about revisiting objectives. Perhaps I can ask that question now, before I turn to Scottish Water.

Alan Sutherland: I have had no conversation with ministers about revising objectives.

Jackie Baillie: You have not sought such a conversation.

Alan Sutherland: I have not sought a conversation. It is for ministers to say to me what objectives they have and what period they want advice for.

The Convener: I presume that Scottish Water has given you an explanation about what projects it will be unable to deliver without those things that we have discussed. That is part of the discussion, is it not?

Alan Sutherland: Yes, that is part of the discussion. The process is on-going.

The Convener: The flipside is that Scottish Water could ask the Scottish Government for more money—if it had it—because it is not getting the investment from revenue to allow it to carry out various projects.

Alan Sutherland: Scottish Water will have to answer that for itself, but the circle needs squaring.

The Convener: Do you want to respond, Susan or Douglas?

Dame Susan Rice: Douglas, do you want to take that?

Douglas Millican: This is probably the dominant topic on our board agenda and has been so for months now. As our annual report was referred to earlier, I will anchor what I am about to say to that.

In my chief executive's section on page 19 of the report, I discuss the charging decision that we took last year. I recognise that this is really difficult territory. There is no doubt that households and businesses are under immense pressures and I think that—and this refers back to an earlier question—they will continue to be under pressure, not just next year but beyond.

Customers still expect services. Because those services are delivered through infrastructure, investment is required. On top of that, we have a whole raft of legal obligations on us through primary legislation and in ministers' objectives. We cannot resolve this situation on our own. We are accountable to you in the Parliament, through the Scottish ministers, and an active dialogue is going on between our board and our cabinet secretary on how we move through here. There are only so many different moving parts.

The question is: to what extent can we reduce our financing burden in this period through the success of our transformation programme and efficiencies? We hope that there will be something of that in there but, as Alan Sutherland has said, it comes on top of the pretty stretching efficiency targets that have already been put in. We are considering how we contribute to lessening demand.

There might—and I stress the word “might”—be some scope at the margins to move investment from this period into the next, but that will be at the margins and only if agreed with the quality regulators. Even if that is agreed, all it will do is shove a burden from the customers in this six-year period to the customers in the next six-year period.

The big picture is that most of the money that is set out in the determination will be required across the six years. We could argue that, by limiting the price increase for this year, we have already forgone £140 million of the finance that we were eligible for and have effectively committed ourselves to £140 million-worth of pedalling harder.

How do we fill that financing gap over the rest of the period? Only three things can move: what happens to charges next year; what happens on average to charges in the following three years—that is, years four to six of the regulatory period; and whether the Government would want and would choose to put any additional borrowing into the system. Those are the only variables.

I should make it clear that the charge cap that the commission sets is an average of CPI plus 2 per cent across the period, which does not mean that the figure is CPI plus 2 every year. For example, one of the other principles of charging is the importance of stability for customers. Wherever we end up this year, it will take

cognisance of where inflation might go during the rest of the period and ensure that we are not doing anything undue in this year of what might well be peak inflation.

We must balance the different sensitivities and pressures; indeed, that is why there is on-going dialogue with Government. We have a bit of time, because charges have to go through a regulatory process and do not have to be published until late January or early February.

The Convener: I will let Jackie Baillie ask another question, if she is very quick.

Jackie Baillie: I will certainly try, convener.

My question is for Scottish Water. Last year, you listened to the minister and reduced the charge increase from 6.2 to 4.2 per cent. As I have said, the Water Industry Commission wrote to you on 3 February to try to unpick that. The consequence of that might be that you could impose eye-watering rises of something like 14 per cent on households and businesses, all of which are pedalling harder, and I would like to hear a commitment from you today that an above-inflation price rise is off the table and that a price freeze remains open for consideration.

Douglas Millican: The board has not yet made a decision, but it is under consideration. It is absolutely looking at what we need to do to be sensitive to customers' economic predicament both this year and in the following years of the price review. We must also ensure that we meet customers' expectations and the obligations upon us. All those factors will go into the mix and will ultimately determine what percentage we land on for next year.

Jackie Baillie: I suppose that it depends whose side you are on: the regulator or households.

The Convener: That was quite harsh.

Jackie Baillie: It was not.

The Convener: I have given you a fair crack of the whip, Ms Baillie, but the fact is that a balance has to be achieved here. I do not need to stick up for Scottish Water; I know that the regulator and the minister will take an interest in that.

Ms Baillie, you have also made your point about the difficulty of price rises—we all understand what they are. We have heard from Scottish Water that it is trying to grapple with the question of what it needs to raise in order to invest in and run its business while taking customers into account. You have had, if I may be so bold, a fair crack at this.

I thank everyone and apologise profusely to Susan Rice for not inviting her to give her opening statement. I am in her debt for forgiving me. I thank everyone for their efforts and contributions,

and I suspend the meeting to allow us to set up for the next item.

11:14

Meeting suspended.

11:19

On resuming—

Subordinate Legislation

Electricity (Applications for Consent and Variation of Consent) (Fees) (Scotland) Amendment Regulations 2022 (SSI 2022/310)

The Convener: Agenda item 3 is consideration of a piece of subordinate legislation. As the instrument has been laid under the negative procedure, its provisions will come into force unless the Parliament agrees a motion to annul it. At this stage, no motions to annul have been lodged.

Do members wish to make any comments on the instrument?

Mark Ruskell: It is clear that the regulations are about resourcing the applications system in a better way, and I note the move to full cost recovery. The question is: what will they do to performance? According to evidence that the industry has given the committee, it can take seven years for an application to be determined. The whole system is very slow, whether it be applications going to councils, going to the planning division of planning or going through the system of environmental appeals in the Scottish Government. Will these regulations make a significant difference to those timescales for determination? We are in a climate emergency, and we need business certainty. Applications need to be approved or rejected on a reasonable timescale, so will the regulations properly resource the decision-making structure and process?

The Convener: Does anyone else have any comments?

Fiona Hyslop: Mr Ruskell makes a fair point, but it is clear that the new national planning framework 4 is partly about improving timescales for approvals. As for expenses, that is a question that we could come back to after we wait and see whether the regulations improve matters. Of course, they will not be the only factor. We know that we have to move towards recovering the costs for supporting planning applications—it is just a sensible thing to do—but we will see the proof only after the regulations come into effect, and we can monitor them together with the changes to regulations in NPF4.

The Convener: These are sensible regulations to put through, but there is nothing to stop us writing to the minister, saying that Mr Ruskell has raised these concerns, and seeing if we get a response. We could then monitor the issue in future, as the deputy convener suggests, to see

whether the regulations have had an effect. Alerting the minister would be the way forward, and of course, the points are now in the *Official Report*.

Mark Ruskell: I have no concerns about supporting the Scottish statutory instrument; the question is more about what it is trying to achieve and what the outcome will be. I expect that the outcome will be better timescales for determination, but I would like to know from the Government whether that will actually happen.

The Convener: If the committee is happy for me to do so, I will write to the minister to relay those points. My substantial question, though, is: are members happy not to make any further recommendations—or, indeed, any written recommendations—regarding the instrument and happy for it to go through?

Members indicated agreement.

The Convener: That concludes the public part of the meeting. We now move into private session.

11:22

Meeting continued in private until 12:05.

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