

FINANCE COMMITTEE

Tuesday 28 September 2004

Session 2

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FINANCE COMMITTEE

24th Meeting 2004, Session 2

CONVENER

*Des McNulty (Clydebank and Milngavie) (Lab)

DEPUTY CONVENER

*Alasdair Morgan (South of Scotland) (SNP)

COMMITTEE MEMBERS

Ms Wendy Alexander (Paisley North) (Lab)

*Mr Ted Brocklebank (Mid Scotland and Fife) (Con)

*Kate Maclean (Dundee West) (Lab)

Jim Mather (Highlands and Islands) (SNP)

*Dr Elaine Murray (Dumfries) (Lab)

*Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD)

*John Swinburne (Central Scotland) (SSCUP)

COMMITTEE SUBSTITUTES

Mr Adam Ingram (South of Scotland) (SNP)

Gordon Jackson (Glasgow Govan) (Lab)

David Mundell (South of Scotland) (Con)

Iain Smith (North East Fife) (LD)

*attended

THE FOLLOWING GAVE EVIDENCE:

Ross Finnie (Minister for Environment and Rural Development)

Andrew Scott (Scottish Executive Environment and Rural Affairs Department)

CLERK TO THE COMMITTEE

Susan Duffy

SENIOR ASSISTANT CLERK

Terry Shevlin

ASSISTANT CLERK

Emma Berry

LOCATION

Committee Room 4

Scottish Parliament

Finance Committee

Tuesday 28 September 2004

[THE CONVENER *opened the meeting at 10:00*]

Interests

The Convener (Des McNulty): Welcome to the 23rd meeting of the Finance Committee in 2004. I remind people to switch off pagers and mobile phones. We have received apologies from Wendy Alexander and from Jim Mather.

I welcome back to the committee Alasdair Morgan, who was a member of the Finance Committee in the first session of Parliament. Under agenda item 1, I invite Alasdair Morgan to declare any relevant interests.

Alasdair Morgan (South of Scotland) (SNP): I have no relevant interests to declare.

Deputy Convener

10:00

The Convener: Agenda item 2 is the choice of a deputy convener. The Parliament has agreed that members of the Scottish National Party are eligible for nomination as deputy convener of the committee. I seek nominations.

Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD): In the spirit of cross-party co-operation and in the absence of Mr Mather, I nominate Mr Morgan as deputy convener.

Alasdair Morgan: In the same spirit, I accept the nomination.

The Convener: Are we agreed that Alasdair Morgan be chosen as deputy convener of the Finance Committee?

Members *indicated agreement.*

Water Industry

10:01

The Convener: We move to agenda item 3. At our away day, we agreed to take evidence on broader water issues to follow up on our report, in addition to our scrutiny of the Water Services etc (Scotland) Bill. I am delighted to welcome to the committee Ross Finnie, the Minister for Environment and Rural Development. With the minister are Andrew Scott, who is head of the Scottish Executive's water services division and who has been with us recently, Janet Egdell, Andrew Fleming, and Clare Morley, who is the Water Services etc (Scotland) Bill team leader.

We agreed to ask for written evidence from the construction industry. We have received three responses: from the Civil Engineering Contractors Association; Scottish Engineering; and the Institution of Civil Engineers, whose submission was circulated to members yesterday.

I invite the minister to make an opening statement, after which we will take questions from members.

The Minister for Environment and Rural Development (Ross Finnie): Thank you. I am delighted to see the degree of consensus that exists round the table in the nomination of Alasdair Morgan as deputy convener. Obviously, I have no intention of disturbing that consensus and look forward to it continuing during the evidence session.

I do not want to say very much. The way in which the committee is dealing with the issue is helpful, in the sense that it is examining the bill and considering closely the progress or non-progress in how Scottish Water is developing. Unfortunately, the timing is not ideal. As members know, my department is in regular contact with Scottish Water and I have a series of regular meetings with the board. Those meetings are not with the whole board; I tend to meet groups or sub-committees that deal with various aspects of the company. As it happens, I will meet a sub-group later today.

From the information that we have gathered from our regular meetings, we are much more confident than we were that Scottish Water will substantially deliver its investment programme and that it will do so more efficiently than was originally scoped by the previous water authorities.

When I was last at the committee, I indicated that we had set as a little bit of a touchstone whether the run rate, in terms of capital investment, would get to a figure of £40 million a month. I am advised that Scottish Water achieved

that in both July and August. Two swallows do not make a summer and I am not about to draw definitive conclusions, but I am encouraged that Scottish Water has reached that level of investment. If the company were to sustain that figure for the year, it would achieve a level of capital investment higher than that achieved by any other water company in the United Kingdom. We are not being complacent. I am merely indicating that, in the same way that the committee takes a keen interest in Scottish Water, so do we—as we always have done. That is the level of detail that we have.

I remain concerned, as we all are, that development constraints have emerged in the past while. I can only reiterate that development constraints were not referred to as a major matter by any of the consultees during the consultation that took place at the point of developing the £1.8 billion programme. Those matters have arisen subsequent to that programme's being laid down. We are trying very hard to address the matter in discussions with Scottish Water and the company is actively reviewing at local level, in conjunction with the Scottish Environment Protection Agency, where so-called embargoes can be lifted and where we can divert expenditure to try to overcome the problem. I have indicated to the convener previously that I think that we can deal with some of that matter, but we will need to take a different look at how we fashion the capital investment programme for the next phase. That is why we are engaged in an active level of consultation and are encouraging wide consultation. As part of that consultation, I was in Aberdeen yesterday to meet representatives of the business community in the Aberdeen and Grampian area.

We continue to see, within the operations, slow but steady progress on delivering the efficiency gains that are essential if we are to stabilise the pricing regime in any way. That is at the heart of how we improve the situation. We have reached the point at which, over the two years, a saving of some 20 per cent has been achieved, which amounts to about £1 million a week compared with the situation when Scottish Water was established. By 2006 that saving could double if the current rate of progress were to be sustained, but I am not claiming that that will happen; I am saying that, at the present rate of progress, that is where we could get to.

The committee is taking evidence on the Water Services etc (Scotland) bill. We believe that the principles of the bill are right and that we have met the minimum requirements of the Competition Act 1998. We do not believe that it would be in Scottish Water's interests, Scotland's interests or Scottish consumers' interests to lay the water industry open to full competition. We believe that

the provisions that we have enshrined in the bill are wholly legal; that they are tested in terms of what the bill will allow us to do; and that they will allow us to have a publicly owned water company that will meet the minimum requirements of the Competition Act 1998.

The Convener: Thank you very much.

I will start the questioning by talking about capital spend and end-year flexibility. We will then ask about the Water Services etc (Scotland) Bill and its implications.

One of the interesting points in the responses that we have received from the construction industry bodies is that, as you indicated, some very positive messages seem to be emerging in respect of both the spend beginning to follow through, so that the industry can see that investment, and the commitment of capital spend. There is also welcome stability in the system, which the industry bodies see as crucial in ensuring that the spend continues. Having established and pushed forward Scottish Water Solutions Ltd, do you have anything more to say about how you see that going forward, or are you still taking a view on that matter in the context of your discussions with Scottish Water?

Ross Finnie: You took separate evidence from the civil engineering groups. I, too, have met those groups and I welcome their acknowledgement that greater stability is entering into the placing of work on the ground. That is crucial. We all understand that that level of capital expenditure is not achieved unless stability is perceived in the marketplace.

I regard maintenance of the current run rate as a crucial test; I am pleased by the information that I have received, but, as I said in my opening remarks, I do not regard performance over two months as the test. Two points arise. First, the opportunity for a wider range of contractors to be engaged in the process almost automatically arises from that level of expenditure. Scottish Water and Scottish Water Solutions never intended that everything would be held in-house. The issue is about gaining competence.

Secondly, on Scottish Water Solutions, my position is the same as any shareholder's position would be: the company must be judged by its performance and can in no sense regard itself as a permanent piece in the jigsaw. As long as Scottish Water Solutions continues to contribute expertise in managing major capital contracts and achieves for Scottish Water and Scottish consumers the efficiencies and quality that are required in such capital programmes, there will be a case for it to continue. However, it is perfectly proper that Scottish Water Solutions, like any other body, must be subject to review. I do not

suggest that we are about to consider Scottish Water Solutions not being there, because to do so would be to reintroduce instability. However, as we look forward, we cannot give a guarantee on a body that was established specifically to bring in expertise; we must measure its performance, as we measure all performance within Scottish Water.

The Convener: The background to the Finance Committee's concern is the persistent slippage in capital spending. Two swallows do not make a summer, as you said, but there are signs that the situation is improving. The Finance Committee is concerned about the financial headroom of around £200 million above and beyond the actual capital expenditure and about the endless problems of water end-year flexibility, which have arisen again this year. Is the progress that Scottish Water and Scottish Water Solutions are making on committing capital spend making inroads into the persistent EYF issue? What are the limits on that, from the point of view of the Executive?

Ross Finnie: Your questions raise two issues. First, we had and still have a guarantee of arrangements of 100 per cent EYF to fund any remaining investment from the quality and standards II programme, should the need arise post 2005-06. That is helpful, because otherwise a degree of instability would be introduced that might suggest that the programme had fallen off the cliff.

We are consulting on what the next programme will be, but by all accounts it will still be a major investment programme. The critical issue is the capacity within Scottish Water to manage the position effectively, whether or not it does so in collaboration with Scottish Water Solutions, as is currently the case. The Executive and the committee have heard evidence that there is clearly still capacity within the civil engineering industry in Scotland to take up what is being built. We set a programme of £1.8 billion in 2000 and there is no doubt that unless a run rate of about £40 million a month can be maintained there will be slippage, which will lead to all the complications of under-commitment, underspend, under-borrowing and EYF, and will take us into the vicious circle about which came first. Scottish Water's capacity to manage is critical, which is why—I am repeating myself—although I do not claim that the problem is solved, I am encouraged by the fact that Scottish Water is demonstrating that it has the capacity and ability to manage a run rate of £40 million a month. One would hope that any commercial enterprise would demonstrate such ability. That run rate, if it were to be sustained, would put Scottish Water in the upper echelons of any list of companies of comparable size and capacity.

The Convener: There is a risk of a hiatus between the 2002-06 Q and S II framework and the Q and S III framework that will come in from 2006. What steps are you taking to ensure that there will be no fall-off in the capital commitment process and the drive forward on investment? Would any policy change from Q and S II to Q and S III have an impact on that?

10:15

Ross Finnie: Two difficulties arise in that context. You highlight the more practical difficulty, which is that it would be a bit silly to wait until the last minute to seek parliamentary approval for the Q and S III programme if, by doing so, we left Scottish Water in a position in which it could not plan, so that there would be a long gap before the programme could start—I think that that was the burden of your question. We do not wish to trample on parliamentary toes in relation to the need for the appropriate authority, but we are closely considering ways in which we might be able to secure approval for an early start to some of the projects that will come within the 2006-10 programme. I suspect that that will be possible largely in relation to matters of a statutory nature—in other words, in situations in which we must meet regulatory requirements.

We are very aware of the situation and have had discussions with Scottish Water, because as Scottish Water has got its act together it has become evident that it must soon start to consider the planning process if there is to be a seamless move from the 2002-06 programme to the 2006-10 programme. The matter is very much on our agenda. We must consider how we handle the niceties of getting agreements to the appropriate parliamentary authority for the programmes, but I do not think that any member of the committee—or anyone else—would be unsympathetic to our aim of trying to identify projects that might require earlier approval, if that means that the efficiency and delivery of the programme are in the best interests of consumers in Scotland.

The Convener: Let me pursue you slightly on the matter. You said that projects that have a regulatory driver might be brought forward. You will be aware that there are concerns throughout Scotland about development constraints that business and housing developments face as a result of issues around connectivity to water and sewerage supplies. Is there a prospect that such development constraints might be brought forward and addressed before Q and S III kicks in?

Ross Finnie: Your question raises two issues. First, the planning process for major developments that are not currently in the programme has not started.

I would welcome guidance from the committee on the second issue. I suppose that I was being cautious when I suggested that regulatory requirements would be less controversial. If we were to make harsh choices between a bundle of development constraints—if we added them all up, there would be an enormous total—people would have to understand that such choices had to be made. It is easier to make those political choices if we can see the whole picture. My mind is not closed on the matter, because I am very aware of the point that the convener makes. I was merely trying to suggest that if we were to try to select a few projects in advance of agreeing the big picture, it might—I stress the word “might”—be easier to do so on a regulatory basis than in a way that pre-empted a decision about which development constraint to address.

The Convener: My view is that if there are—

Ross Finnie: If there are obvious candidates, one might get into that—

The Convener: Major planning frameworks are being pushed forward in some areas. An obvious example is the Clyde gateway project, in relation to which it would seem to make sense to consider development constraints along with other forms of transport investment. I am sure that there are many other such examples.

Ross Finnie: That is exactly my difficulty. I mean no disrespect to your good self, convener, when I say that you regard that project's case as self-evident, but I see that the committee's recently appointed deputy convener is like a coiled spring ready to suggest that Dumfries and Galloway has an equally pressing case. As I look round the table at members of the committee, I sense that the same could be said for all the local authorities and planning areas that have been in close consultation with me. I think that that illustrates the problem. We are certainly very conscious of the problem, but I am not about to pronounce on the matter; we must consider how to recognise competing influences and manage the situation.

The key thing about delivery is that we find a mechanism that will allow the Q and S II programme to move smoothly into the Q and S III programme without there being a building hiatus because we, the politicians, are still argy-bargying about the final picture of the big investment programme.

The Convener: We turn to Dumfries and Galloway in the guise of Elaine Murray.

Dr Elaine Murray (Dumfries) (Lab): I will push the minister a little further. In Dumfries and Galloway, a lot of background work is being done for the priority investment—I am certain that that is happening in many other local authorities as well.

There may be a huge raft of investments that could help to improve development constraints, for example, throughout local authority areas, but most local authorities probably know what their pressing priorities are. Therefore, if it turns out that some of the priorities that were identified in Q and S II cannot be progressed until the next Q and S period, would it be possible to ask the local authorities for their suggestions of priority areas? That would at least reduce the plethora of projects that might be proposed. I am not necessarily suggesting that you should start a bidding war, but that local authorities could suggest particular issues to you.

Ross Finnie: In a sense, we are doing that, because, notwithstanding the fact that we are consulting on Q and S III, we are in discussion with local authorities. We are not having silly conversations with them; we meet all sorts of people, and when we meet the local authorities, we do not say, "By the way, we're only talking Q and S III." We want to talk to the local authorities and get them to be clear and open with us about a range of projects that might go forward to 2010. If they have specific, immediate priorities that are not already being considered—many priorities are being considered—we want to know about them, because we want to get a sense of priority across the piece.

On the change in the level of housing demand in the past two and half years, if one was a big economist considering the rate of population decline in Scotland, one would not automatically assume that there would be a 10 to 20 per cent increase in demand for housing—perhaps we should not get economists to examine such matters too closely—but the fact is that there is such an increase.

To answer your question directly, we are keen on getting some priorities into the discussions, and that will feed back into what the convener said about how we examine the situation.

Dr Murray: I seek your comment on a related issue that some private sector operators have raised with me. They have advised me that they have proposed possible private solutions—that they could undertake some work to the same standard as Scottish Water—to allow various developments to progress, but that SEPA will not allow them to do the work. Do you have any comment to make on that? It seems to be difficult for SEPA to give permission to the private sector to undertake such work.

Ross Finnie: I am puzzled by that. SEPA's only role in the matter, particularly if we are talking about a sewage discharge operation or something similar, is to analyse the solution that is being proposed and advise whether it meets the statutory and regulatory requirements. SEPA is

not in a position to suggest that A, B or C cannot build or is not fit to tender, but if A, B or C were working up their own solution, SEPA could advise that the solution, which might be very efficient, would not meet the regulatory requirements.

Dr Murray: The sort of case about which I am talking is, for example, housing in a rural area where a solution might be to have septic tanks. The information that I have received is that that type of application is not meeting SEPA's approval at the moment.

Ross Finnie: It is not a question of SEPA having the ability to judge the capacity or capability of an individual firm. The refusal must be made on the basis that the suggested solution does not meet the regulatory requirement.

Dr Murray: That is helpful.

Mr Ted Brocklebank (Mid Scotland and Fife) (Con): Welcome, minister. I enjoyed reading the report from CECA, the Civil Engineering Contractors Association—there are so many such names: CECA, SEPA and so forth—which says:

"Scotland's contractors are acutely conscious of previous 'false dawns' in Scotland's water sector but believe there is a genuine will amongst all concerned in the water industry to get work out on the ground this time."

CECA also says that it has no doubt that its members have the capacity to undertake whatever extra work comes their way. That is a little different from what you told the committee on 3 February 2004, when you questioned whether Scotland's civil engineering sector had sufficient capacity. You appear to be more reconciled to the view that the sector has the capacity. Is that the case?

Ross Finnie: I have no idea. I am not clear exactly what the headroom is within the current programmes—the way in which they are organised, the way in which we are putting them out or the way in which they are being managed—although I am sure that there is some headroom. I do not know that I ever said that there was a lack of capacity, but I have said consistently that, if Scottish Water is delivering at the rate at which it ought to, that would represent 50 per cent of all civil engineering contracting business in Scotland, which is a substantial amount.

I am much more concerned about Scottish Water being able to manage major capital works as effectively as any business should be able to without compromising quality. I am concerned that, for Scottish Water to do that, it must get the maximum efficiency, as we would expect from any other company. I am also concerned that Scottish Water's delivery should be comparable with that of private sector companies, as the water industry commissioner will make that comparison.

I do not think that there is any disagreement between me and CECA; there was none when we met. I am much more concerned that Scottish Water demonstrate to me and to Parliament through the committee that it has the capacity to manage the skills and expertise that are necessary to manage a major capital investment programme.

Mr Brocklebank: Do you accept what CECA says, which is that it

“does not believe that industry capacity has been or will be a barrier to the programme”?

Ross Finnie: To be honest, my doubts have been about Scottish Water. Since we created Scottish Water, it has become abundantly clear that the three predecessor authorities, which initially signed up to the £1.8 billion capital programme, simply did not have the capacity for the programme. The facts have demonstrated beyond peradventure that the previous water authorities were incapable of delivering that programme individually or collectively. That is why the delays have happened and why Scottish Water has sought the expertise of Scottish Water Solutions. I am pleased that it has done that, because it means that we can open up some capacity, although there are still limits on how much we can manage. As I said in my earlier remarks, if we achieve the £500 million a year programme, it will be the biggest that has been achieved by any water authority in the United Kingdom.

Mr Brocklebank: As you know, the committee expressed concern in its report on Scottish Water that, because the water industry commissioner is not only responsible for representing the interests of the consumer, but is the economic regulator, his actions could run counter to the interests of the consumer. How would the proposed water industry commission fulfil its role of promoting the interests of all customers, including those in the retail sector?

Ross Finnie: One criticism that has emerged is that investing all that extremely important regulatory responsibility in a single individual is extremely difficult, if not impossible, as we have all learned from experience. Having seen the operation of a commissioner—and I do not care who that was, because it is not a personal issue, but simply about the magnitude of the task—I think that the water industry commission will be better because it will have a small group of independent non-executive directors and therefore we will get the opportunity to discuss a range of issues.

Given that Scottish Water is a monopoly provider, the point of having a water industry commissioner is to ensure that the taxpayer sees the water company operating at the same level of

efficiency as comparable companies. In this case, the most obvious examples are to be found in England and Wales. I think that the water industry commission will be well equipped to do that. I do not think that that necessarily represents a conflict of interest.

10:30

Mr Brocklebank: Will you remind us why the decision was taken to allow non-domestic users to use other suppliers whereas domestic users are to be stuck with Scottish Water which—as the WIC told us last week—will be considerably more expensive than its competitors from elsewhere in the UK in the foreseeable future?

Ross Finnie: The first proposition is not totally unfettered. The wholesale supplier to non-domestic users will still be Scottish Water, as is self-evident. Secondly, in terms of trying to maintain the critical mass of expertise and delivery in Scotland, if we simply allow open competition, one does not have to be Einstein to see that external suppliers will simply cherry pick in the central belt of Scotland. That would return us to a situation in which people in Dumfries and Galloway, the Borders, the Highlands and Grampian would be left to bear the cost of operating a water company on their own.

My position in that regard is quite clear. I want a Scottish water company to deliver a commodity that is not like gas and electricity. Given that people must simply use the water that is supplied, the matter impinges hugely on public health and other considerations—the Executive is quite clear about that position. As I said, the Competition Act 1998 places upon us a requirement to have regard to that act. The provisions that we have outlined meet the minimum requirements of the act by allowing access to customers in the non-domestic sector—although we specify that the wholesale supplier will be Scottish Water—while also saying that external suppliers cannot enter the domestic market because we believe that there are interests specific to supplying potable water that need to be maintained and improved by Scottish Water.

Alasdair Morgan: On development constraints, do you agree that many developers feel frustrated by the current situation? Small developers in particular find not only that they cannot get sewage connections for their planned developments, but that they cannot find out when they are likely to be able to get those connections. They are told that work is being undertaken in that regard but they cannot find out whether their development will be included in that programme.

Ross Finnie: I accept that people feel frustrated by the current situation—we were discussing that on the way to the committee. Two questions are

involved. Do we know whether the area for which planning permission is being sought has outline planning permission that says simply that the land is suitable for development? Do we know whether there are plans or proposals to service the site? A person who was involved in, for example, the illustrative example that Alasdair Morgan gave might want to know that. Such information is not sufficiently well worked up and is not sufficiently well worked into the planning system.

I do not think that the matter is a planning matter; rather, it is about communication. I want to take that up with the relevant people because I know the frustration that the current arrangement causes. If Scottish Water is getting a handle on delivery, managing contracts and forward planning, it could inform local authorities much earlier about its plans and proposals and their phasing. A combination of Scottish Water's keeping local authorities advised about the progress of its capital investment and the establishment of much better information on the ground—not just in relation to outline planning permission, but in relation to the prospects of infrastructure development—would greatly help to alleviate the sense of frustration that you identify.

Alasdair Morgan: I agree. In its evidence to the committee, the Civil Engineering Contractors Association said that it had been heartened by the closer engagement between Scottish Water Solutions and the local authorities. However, I have to say that CECA has said that in advance of its actually happening in many cases.

Ross Finnie: We have a lot of work to do in that regard. The more confident Scottish Water can be in saying that it is meeting its targets, the more it will be able to engage with local authorities. We agree about what the theoretical position should be and I will continue to make it clear to Scottish Water that I hope that it will continue to develop much better and closer relationships at that level.

Alasdair Morgan: Earlier, you mentioned parliamentary approval in relation to the quality and standards III programme. I am not clear what it is that you seek parliamentary approval for.

Ross Finnie: We probably have to get some kind of approval in relation to borrowing—we will have to get general approval for levels at any point in the borrowing programme. I hope that I am making myself clear. I do not wish to become prissy in relation to the issue, but there are—on the other hand—parliamentary issues that need to be cleared. I am trying to get into a position in which we have a plan that is predicated on certain levels of borrowing, for which we would have to get the appropriate parliamentary approval. However, we do not want to get ourselves into a box and do nothing about the programme until everything is tied up. I have to find a way to

ensure that we can get into the planning stream projects that allow us to move seamlessly. Des McNulty has quite correctly challenged us about how that choice is made and about how certain immediate development constraints could be dealt with while that process is under way.

The Convener: It might be useful if there were an exchange between the clerks and your officials to identify how that process can be moved on.

I appreciate what you said about encouraging Scottish Water to link with local authorities and others. However, given that growth is the priority and that we now have “The Way Forward: Framework for Economic Development in Scotland” and so on, to what extent is the management of water investment, as we shift from a compliance agenda to a growth agenda, being governed by Government policy frameworks and decision making—to which you referred—and being subjected to a systematic process that goes beyond water issues and broadly considers economic and other requirements of particular areas?

Ross Finnie: The key phrase in what you said is, “as we shift from a compliance agenda to a growth agenda”. That is a phrase that we could explore fully if we had another four hours. I am more than acutely aware of the need to move from compliance to development, but it would be wrong not to appreciate that when we have considered all the evidence that has been submitted to the Q and S III programme, we will still be disappointed about the level of regulatory compliance that will have to be met. There will still be increasing standards for drinking water quality and the recent adjustments to the bathing water directive will place further constraints on us. While not diminishing the point that the convener makes, I say that we cannot simply assume that there will be an obvious or great fall off in the regulatory requirement. That will be one of the difficult balances in the Q and S III decision; it will be very difficult indeed because we will still have to meet serious regulatory compliance.

Kate Maclean (Dundee West) (Lab): You said that you will be reasonably happy if Scottish Water has a handle on delivery and if the run rate of £40 million per month, or £500 million per year, can be met, which would mean that there was more investment than ever in the water industry. How long will you allow the situation to run on and what steps will you take if that target is not met?

I share other members' frustration about strategic development—in Dundee and elsewhere in Scotland—but relatively small-scale investment is needed in some of the existing infrastructure, which is causing real problems in some areas. I can give examples from Dundee, but I have had great difficulty in getting Scottish Water to come

and examine them with me, which I want to have on the record. The examples include the foundations of people's houses having become flooded with raw sewage and their having the unpleasant task of going out to pick up sanitary towels and used condoms from their gardens after heavy rainfall. Obviously it is very difficult for me to explain to residents in my constituency that there is a huge underspend when they cannot get their problems solved. I think naively that people should have the right to live in a house that is not filled almost to the floorboards with raw sewage.

If Scottish Water does not meet your and our expectations, what steps will you take?

Ross Finnie: I am obviously concerned that Kate Maclean is getting no response on an issue that is about not only water, but public health.

On performance, I should make it clear that when I met Scottish Water two or three months ago, I pressed it on its timescale for reaching the £40 million run rate. As the effective shareholder, I made it clear to Scottish Water that if it was not achieving that run rate by the back end of the summer, it would have a problem; there would be no question but that the directors and Scottish Water Solutions would be considered to be not performing. Scottish Water would, in that case, have to consider whether its preferred assistance, through Scottish Water Solutions, was delivering. We will continue to keep that pressure on Scottish Water.

As I said in my opening remarks, I do not regard two months' performance as being the answer. Performance has been encouraging, as is the civil engineering business, but we continue to insist that Scottish Water maintain that. Once it has achieved the target and shown that that can be done, it will have to have pretty good explanations for the board, and for me as minister, if that rate drops; that's life. Scottish Water is committed to delivering on a capital programme, and to achieving efficiency in the company. The company is under exactly the same pressure as one would expect any major operator to be under.

Kate Maclean: What steps will you take as the minister?

Ross Finnie: If the company is not performing, there will be areas of corporate governance for which the board will have to answer. The company is tasked and paid to perform; its remuneration is not geared on a classic public body ratio; it is tied to performance. If the company does not perform, its directors will be in the same position as any director in any company that is not performing—their future will be in jeopardy. We are not at that stage, but that is where we would be if the company consistently did not perform.

10:45

Jeremy Purvis: The evidence from CECA indicated that a considerable amount of the backlog is ordered to SEPA and local planning authorities. Evidence that we received at Easter this year showed that a high proportion of the delay in the capital programme was due to planning consents. Scottish Water could therefore not meet delivery targets for its capital budget, but that would have been out of its hands. The problem is not the performance of the board; rather, it is local authorities' planning procedures and SEPA. If that was the case before Easter, it will not be any different at Christmas, next Easter or next summer.

Ross Finnie: If I was having a conversation with the board of Scottish Water and its position was "Oops! Oh—goodness, gracious me! Gosh! We never thought we'd need planning permission. That's a bit of a surprise," I would be concerned about its professionalism in its dealings in respect of individual plans and programmes. I would want to be satisfied that it was genuinely the case that a third party had given rise to difficulties.

I would not be satisfied unless I had evidence that the board had taken all reasonable steps properly to plan its capital programme, to seek planning permission at an early stage, and to discuss and clear it with SEPA that the proposals would meet the regulatory standard. If that was all satisfactory, I would feel much more comfortable about coming back to Kate Maclean to tell her that I was not—because Scottish Water had acted professionally and had taken all reasonable steps, but planning committees had taken long time so Scottish Water's plans had not worked—about to sack the board. That is a different proposition. Scottish Water will not get out of jail by blaming SEPA or the local authorities. It has to demonstrate to you and to me that it is planning its capital programme intelligently. In discussions in past months, I have found rather disturbing the extent to which planning by Scottish Water and its predecessor bodies was piecemeal.

Jeremy Purvis: What kind of risk reporting are you getting? Before Easter, when we received indications as to what were the reasons for the delay with the capital programme—the lion's share of which consisted of delays by local authorities and delays in the planning process—I asked the Deputy Minister for Finance and Public Services whether the risk analysis had been monetised and whether the risks had been factored with percentages for the remainder of the investment programme until the end of 2006? I also asked what impact that could have on a delayed programme or on the finances. We have not received answers, so I still seek confidence that you and the water services division have a risk strategy that will cover from now until the end of

the investment programme. If there is no such strategy for that period, that will eat into the next investment programme and there will be no balance—such as you said you are trying to achieve—between lifting development constraints and achieving quality and standards, which I know are not mutually exclusive.

Ross Finnie: During the past few months Scottish Water's corporate government has established a separate sub-committee, in addition to the Audit Committee and the usual committees that would aid its governance. The board has charged Mr McMillan, the non-executive director who has experience in the utilities sector, to chair a sub-committee that will address exclusively Scottish Water's performance on capital delivery. That has been done with a view to separating out the physical run rate and to monitoring what that means in terms of the board's financial commitment and financial spend. That will give Scottish Water a better handle on how to give us access to its monthly board papers, to its quarterly capital monitoring progress, and to its regular meetings. It also gives us a better handle on how Scottish Water is progressing.

Therefore, I am in a very much better position than I was even a few months ago to express the view that Scottish Water will substantially deliver its capital programme within the timescale because of the way in which it has addressed the concerns that Jeremy Purvis, other members of the committee and I have put to it separately.

Jeremy Purvis: Are the reports published?

Ross Finnie: I do not know. We get them, but I do not know—

Jeremy Purvis: Do you think it would be appropriate for the monthly and quarterly reports to be published?

Ross Finnie: That would depend on the information that they contain. There are issues about placing contracts. I am keen for Scottish Water to continue to place contracts externally, but I am not terribly keen to interfere with the contract process. Can we answer that question later?

John Swinburne (Central Scotland) (SSCUP): The document that I have in front of me says that the minister would, under the bill, continue to set objectives for Scottish Water and to define the principles of charging that the commission must follow in setting charging limits. Earlier in your discourse you talked about the best interests of consumers in Scotland, but you were obviously eliminating from that a quarter of the population—the 1.2 million senior citizens, many of whom live below the poverty line, on whom you still impose a charge for domestic water use, which has gone up by 5 per cent while their pension increase has gone up by only 2.5 per cent.

Ted Brocklebank touched on the same topic when he talked about acting in the interests of all consumers, but you are certainly failing miserably in your attempt to act in the best interests of senior citizens. What right does Scottish Water have to make our livelihood even worse than the Government manages to make it? What right has a water authority to impose such charges on every senior citizen in the country—a quarter of a million of whom are living below the poverty line?

Ross Finnie: You are not correct to say that we are ignoring the issue. If you read the whole consultation document you will see that we are concerned that if there is going to be any relief—

John Swinburne: Does that indicate a rebate?

Ross Finnie: I would like to finish my answer. If you read the document in full you will see that we are concerned that the lowest-income households in Scotland should get more targeted support for paying their water charges. We have a number of schemes in place that do not target the lowest-income households, which is why we are trying to do more. At the moment we are working on the basis that discounts flow automatically from council tax discounts, but they do not necessarily serve well those who have the lowest incomes. In the consultation paper there is a suggestion about how we might address the lowest-income households through a more targeted approach. As part of the consultation we will seek views from people on low incomes. I acknowledge that the water industry impinges on public health, so what we are talking about is not identical to making a choice between having gas or electricity.

The Convener: I want to move on to the setting up of the subsidiary and its implications for staff and operational effectiveness. At the time of Scottish Water's creation, we saw that organisational upheaval produced quite a bit of disruption to the continuity of investment planning, and that intra-organisational upheaval affected staff. How will you prevent similar experiences in the creation of the subsidiary? What discussions have you had with staff representatives and unions about how the process might be effectively managed?

Ross Finnie: We have made clear the general principles of how Scottish Water has to manage its employees and we will ensure that it follows best practice in that. I accept that the disruption that was caused by the merger of the previous three water companies was substantial. The new arrangements will certainly cause disruption, but I do not envisage that disruption's being anything like what arose in the context of the merger. That said, there remain issues about operational efficiencies and manpower levels across the industry, which will continue to be exposed to comparison with the performance of other

companies. The major disruptions to staff are behind us and we expect Scottish Water to perform in the same way as before. The creation of a subsidiary will affect many people, but I do not envisage its creating anything like the same degree of disruption as the initial merger, which was a major undertaking.

The Convener: How many staff will be affected and can you give any assurances about continuity in conditions of service, which I know was an issue in the—

Ross Finnie: I do not have that information. I would have to write to Scottish Water to get that level of detail. I have taken note of that.

The Convener: That information would be welcome.

I move on to the water industry commissioner. One of the things that concerned us in considering the Water Services etc (Scotland) Bill was the difference in the predictions that came from Scottish Water, on one hand, and those that came from the WIC, on the other hand, about the financial costs of setting up the retail subsidiary. Given that the water industry commissioner is your adviser and that Scottish Water is your delivery agent, it must be a concern that such different assessments have been made. What steps have you taken to resolve the differences?

Ross Finnie: I have seen the differing estimates from the two bodies. However, although I have seen the figures that were presented to the committee of the total quantum of Scottish Water's estimates, I did not see why the committee posed the initial question. We took the view—as did the commissioner—that the water market was fairly simple because not every customer is metered; only a minority of non-domestic customers are metered. In the electricity market, companies estimate usage every half an hour, 24 hours a day. That seems to me to be a very different and much more complex arrangement, which must incur substantial costs.

I have not seen the detail, although I have asked for it—this might form part of our discussion later in the day—that explains how Scottish Water came up with a totally different figure for using the indicators. Our view is that there is a totally different market in the water industry from that in the other utilities, which costs should reflect. I have to test that, because I am not satisfied. I need to know the answer, but I would be surprised if Scottish Water believed that it was in a similar position to the electricity companies, for example.

The Convener: I suspect that we might need to pursue that in further correspondence, especially if you have not had information from Scottish Water.

Ross Finnie: I have asked for detailed information, which you would expect. It seems to me that the nature of the water industry is different to that of the electricity industry—I used the electricity market merely as a comparator. The complexity in how electricity companies monitor usage is totally different to the situation that pertains in the water industry. I can well understand why the electricity market would regard that as a costly and complex issue. I do not know—to be fair to Scottish Water I await an explanation—why it regards itself as being in a similar position.

11:00

Dr Murray: I do not have the *Official Report* of the meeting, but when I raised the issue with Scottish Water it indicated that the IBM consultants who produced the figures had based them on experience from other countries.

Andrew Scott (Scottish Executive Environment and Rural Affairs Department): We have not seen the IBM figures in detail so we cannot comment.

Dr Murray: The committee asked for them, but they were not provided to us either.

The Convener: We now have them, but—

Ross Finnie: Therein lies the slight puzzle, but, as you say convener, you are perhaps—

The Convener: Perhaps we need to pursue that matter in correspondence once we have had a chance to reflect on the issues.

I have a question on the role of the regulator. There is an argument that the role of the WIC is evolving. Initially, it was seen as a benchmarking role in relation to other water authorities south of the border. From our consideration of the issue, it seems that there has been a shift in what might be expected of the regulator; for example, to examine the process by which investment is committed and to oversee some of the constraints on Scottish Water in developing the business. Do you see a shift in the role of the regulator, away from a market testing and market-benchmarking role to a different role? In the context of the establishment of a commission—as opposed to a commissioner in the narrow sense—do you plan to give any advice or do you plan to shift emphasis as a result of the establishment of the new water industry commission as a corporate body?

Ross Finnie: No, I do not. The WIC has an extraordinarily important role to play, but the board of Scottish Water also has an important role to play. We are going to see a clear separation between ministers, who set policy objectives, and the water industry commission which—because of the monopolistic position—calculates targets and

quantifies what Scottish Water's capital investment programme should be to make it effective and efficient. The people who are responsible for delivering on that are the board of Scottish Water.

We would get into a confused position if we were to place the water industry commissioner in a position in which we not only asked him to set the framework and the numbers because of the lack of competition, but asked him also to second-guess each decision of the board. I am not saying that you were suggesting that, convener, but there is a danger that that might happen. We are entitled to hold Scottish Water's board responsible for running, managing and delivering the objectives and standards that the water industry commissioner imposes.

The Convener: I thank the minister and his officials for coming this morning; it was a useful exercise. We will seek clarification on the parliamentary processes and we will exchange correspondence on the discrepancy that we identified.

Financial Memoranda (Scrutiny)

11:03

The Convener: Item 4 is scrutiny of financial memoranda. We agreed at our away day—and subsequently endorsed the decision at our meeting on 14 September—that we would introduce a revised system for scrutiny of financial memoranda.

We have a paper on the Gaelic Language (Scotland) Bill, which was published yesterday. Members will see that because of the costs involved, we propose under our new regime to implement level 2 scrutiny; that is, we will seek written evidence from bodies upon which costs will fall, then we will take oral evidence from Executive officials. In summary, the costs are £10,000 for preparing a plan, between £0 and £155,000 per annum for implementing the plan, and £355,000 per annum for the staffing and operating costs of Bòrd na Gàidhlig. Are members content to operate level 2 scrutiny of the bill?

Mr Brocklebank: I think so, although—from a cursory examination—the figures do not strike me as being particularly realistic, given the aspirations of the bill and the powers that it seeks to give to Bòrd na Gàidhlig. I think that costs have been underestimated rather than overestimated. I am not suggesting that the costs would be vastly greater—although it is difficult to judge at this stage. We must examine the issue in some detail, because the figures have been underestimated.

The Convener: The proposal is that we take oral evidence from Executive officials, so we will get the opportunity to pursue that strand with the people who can best answer the question. On that basis, do we agree?

Members indicated agreement.

The Convener: I ask members to agree that the questionnaire at annex 2 of the papers be adopted from now on. I think that it was Jim Mather who suggested that we provide a questionnaire on all bills in order to give us basic information. Are members content with that?

Members indicated agreement.

The Convener: Good. At our last meeting, we agreed that our next three items—consideration of our budget seminar and two draft reports—be taken in private. On that basis, we move into private session.

11:06

Meeting continued in private until 11:32.

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