LOCAL GOVERNMENT AND TRANSPORT COMMITTEE

Tuesday 31 May 2005

Session 2

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CONTENTS

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LOCAL GOVERNMENT AND TRANSPORT COMMITTEE

19th Meeting 2005, Session 2

CONVENER

*Bristow Muldoon (Livingston) (Lab)

DEPUTY CONVENER

*Bruce Crawford (Mid Scotland and Fife) (SNP)

COMMITTEE MEMBERS

*Fergus Ewing (Inverness East, Nairn and Lochaber) (SNP)
*Dr Sylvia Jackson (Stirling) (Lab)
*Paul Martin (Glasgow Springburn) (Lab)
*Michael McMahon (Hamilton North and Bellshill) (Lab)
David Mundell (South of Scotland) (Con)
Tommy Sheridan (Glasgow) (SSP)
*Margaret Smith (Edinburgh West) (LD)

COMMITTEE SUBSTITUTES

Bill Butler (Glasgow Anniesland) (Lab)
*Mr David Davidson (North East Scotland) (Con)
Colin Fox (Lothians) (SSP)
Mr Bruce McFee (West of Scotland) (SNP)
John Farquhar Munro (Ross, Skye and Inverness West) (LD)

*attended

THE FOLLOWING GAVE EVIDENCE:

Jeanette Findlay (University of Glasgow)

CLERK TO THE COMMITTEE

Eugene Windsor

SENIOR ASSISTANT CLERK

Alastair Macfie

ASSISTANT CLERK

Euan Donald

LOCATION

Committee Room 1

Scottish Parliament

Local Government and Transport Committee

Tuesday 31 May 2005

[THE CONVENER *opened the meeting at 14:05*]

Ferry Services (Clyde and Hebrides)

The Convener (Bristow Muldoon): I call the meeting to order. Agenda item 1 is on the tendering of the Clyde and Hebrides ferry services, for which I welcome Dr Jeanette Findlay of the University of Glasgow's department of economics. She has conducted work and published papers on the issue.

This is the second of our sessions with academics who have published papers on the Clyde and Hebrides ferry services. After today's meeting, I intend to invite the clerks to produce a paper for the committee that updates us on what we have done so far in looking into the issue and highlights subjects on which we may or may not undertake further work. I invite Dr Findlay to make introductory remarks, after which we will have a question-and-answer session.

Jeanette Findlay (University of Glasgow): The first comment that I should make is that, although I am a senior lecturer in economics, I did not complete a PhD, so I am not a doctor.

The Convener: I apologise for giving you an additional qualification. I am sure that you will acquire it one day.

Jeanette Findlay: It is a training degree and I have already been trained.

My interest in the subject extends no further than the piece of work that the Scottish Trades Union Congress asked me to produce. I have done no further work on the question since then. I am happy to clarify anything in my paper.

Mr David Davidson (North East Scotland) (Con): Good afternoon, Miss Findlay—I gather that you are not Dr Findlay.

Jeanette Findlay: You may call me Jeanette, if you like.

Mr Davidson: In the introduction to your paper, the last sentence in the last paragraph on page 2 says that the

"tender would not go ahead if it can be shown that the cost to the public would be less by continuing the present arrangements than by going through a competitive tendering process."

On what precedents did you base that comment? What evidence backs that up?

Jeanette Findlay: The sentence that precedes the one that you quoted says:

"the legal debates as to whether"

tendering must proceed

"are beyond … this report."

I am not a legal expert. I simply made the point that it was said in the discussions when I wrote the report that one way around tendering was to show that the set-up under which Caledonian MacBrayne operates does not abuse state subsidy. If that was shown, it might be possible not to tender. I am not an expert in the law. I simply said that debates at the time suggested that one way to get around the matter was to show no abuse.

Mr Davidson: You seem to be fairly firm about the possibility. I am no lawyer, although a lawyer is sitting next to me. I wanted clarity to put other comments in perspective.

Your document contains several comments about figures. I think that the first is on page 10. It would help the committee if you said where your figures come from and what the basis of those figures is. For example, the paper says that some costs might be in excess of £20 million. How did you build that figure?

Jeanette Findlay: My paper says—although I cannot find the reference immediately—that some of the figures came from industry insiders. The paper is not of the type that I would produce in an academic setting. The STUC asked me to produce the paper, and that is the information that I was given. The figures that I use in my paper seem reasonable—for example, I was given the £20 million figure by someone inside the company. In the paper, I explain why it is likely that the figure will be high. CalMac has a good redundancy scheme, which gives four weeks' wages for every year of service. Because of the nature of the company and the areas from which it draws its staff, it has a low staff turnover and people have built up long records of service, so redundancy payments are likely to be high.

Mr Davidson: I will pursue your point about terms and conditions. From an academic perspective, if a new company or whatever comes along at the end of the process, proceeds to modernise terms and conditions—they would not necessarily be as generous as the present terms and conditions but they would be reasonable in the marketplace at large—how long would it take for the new system to generate a payback that would cover the £20 million?

Jeanette Findlay: Sorry, are you saying that if—

Mr Davidson: If modernised contracts were in place—I am thinking particularly of the packages—

Jeanette Findlay: It is not a question of contracts. The sum relates to redundancy payments. If there are to be redundancies, those entitlements will already have been accumulated. You are asking me how long the savings associated with those redundancies would have to be in place before—

Mr Davidson: If the payments were made—

Jeanette Findlay: Redundancy payments, yes.

Mr Davidson: If payments were made and people were re-employed with more modern employment values—or whatever we want to call them—as seen in the marketplace at large, how long would it take to redeem that amount of payout?

Jeanette Findlay: That is not my understanding of what would happen. A company cannot make people redundant and re-employ them if the Transfer of Undertakings (Protection of Employment) Regulations apply. It cannot make people redundant if the jobs are there, so they would not be re-employed on lesser contracts. There would just be fewer staff.

Mr Davidson: But if they are made redundant and a new company comes into being, what is to prevent that company from employing them?

Jeanette Findlay: If TUPE applies, the new company could not do that. It would have to employ them on the same terms and conditions.

Mr Davidson: Okay. Thank you for that.

The Convener: The Executive has indicated that it is likely that TUPE will apply, so it is unlikely that the £20 million redundancy costs will be incurred. Did you get any indication from industry sources of what redundancies might be possible if a new company sought to make reductions in costs? Assuming that TUPE applies and that all the staff become employees of the new organisation on day one, how might a new company try to reduce the total workforce? As I understand it, the company has about 1,000 employees at present.

Jeanette Findlay: Sorry—I think that I misunderstood the question. You are asking me about a situation in which TUPE applies and a new company wins the contract, but what was the next part of the question?

The Convener: It seems unlikely that all 1,000 CalMac employees would be made redundant. It is likely that TUPE will apply and the new organisation will need to operate all the services, but are there fears within CalMac that employees in certain sections of the company are vulnerable to being made redundant?

Jeanette Findlay: I apologise—I misunderstood the question. The company is severely restricted by the maritime safety regulations in the extent to which it can reduce staffing. That might prevent redundancies in many of the areas in which a new company might want to cut staff to make the savings that might be required. It might also find itself subject to a legal challenge. Again, I am not a lawyer, but there is a legal precedent, in cases in which redundancies are made for efficiency reasons, for staff to reject the new terms, force their employers to dismiss with notice and sue for unfair dismissal. That happened in a case that involved North Lanarkshire Council.

It looks as if the scope for any new company to cut the number of staff who are currently employed would be very limited. There might be room to cut staff in administrative roles. However, if CalMac was divided into two companies there would be two tiers of management and administration anyway.

14:15

Fergus Ewing (Inverness East, Nairn and Lochaber) (SNP): Your paper helpfully breaks down the general issue of tendering into its various components, which allows us to focus our minds. I want to focus on the summary of costs, on page 16. In the first line of the table you indicate that the cost of tendering every five or six years is "unknown". Are you making the point that it is obvious that the process of tendering would involve a cost?

Jeanette Findlay: Yes. Costs have been incurred in relation to the current situation and we have an indication of what those costs are. It is clear that if tendering is to take place every five or six years the same amount of effort will have to go into the process every time, to ensure that the tender is tight and that everything is properly regulated.

Fergus Ewing: The final line of the table indicates that the tendering costs of the first bid, if the process were to go ahead, would be approximately £2 million. I think that you pointed out that that figure does not include an estimate of the cost of civil servant or management time.

Jeanette Findlay: The estimate simply reflects the costs that were indicated by—

Fergus Ewing: They were indicated by Nicol Stephen, in a parliamentary answer to a question that I asked.

Jeanette Findlay: Yes.

Fergus Ewing: The second line in the table shows a large tax liability from cessation of trading, which you estimate at between £5 million and £10 million, whether the operations company—opsco—or a third party wins the tender. Will you briefly explain why that loss would be incurred if—and only if—tendering were to go ahead?

Jeanette Findlay: The tax liability would be incurred at the point at which the company was split. CalMac is entitled to certain tax allowances as a result of its capital expenditure, but if the company were split, opsco would not incur capital expenditure to the extent that vesco—the vessel-leasing company—would do.

Fergus Ewing: Is that because of the public law of tax?

Jeanette Findlay: Opsco would not incur capital expenditure to the same degree as vesco would, because it would not own vessels.

Fergus Ewing: I presume that the Chancellor of the Exchequer could amend tax law if he wanted to, although that is not a matter for us.

Jeanette Findlay: Again, the figure on the tax liability came from someone inside the company.

Fergus Ewing: If the estimate came from someone inside the company, why does it vary between £5 million and £10 million? Why could not your mole provide a more precise figure?

Jeanette Findlay: I think that they could not do so because of the difficulty of assessing liability. I imagine that tax law is complex. The person is very senior, but he could not give me a more exact figure.

Fergus Ewing: Whoever your information emanated from, I remember accountants and tax advisers being vague. However, the figures are very high.

Jeanette Findlay: I make no claims for the figures other than to repeat that I was told that a tax liability would arise from the division of the company, whether or not CalMac won the bid. Those are the figures that someone inside the company gave me. I presume that the committee could question the company on the matter.

Fergus Ewing: I think that the company indicated that it is not in a position to be able to respond to evidence, because of the tendering process—if I have got that wrong, no doubt we can deal with the matter at another time. I think that that is why the company cannot give evidence to the committee, which is an understandable position.

Am I right in saying that the potential cost of between £5 million and £10 million would not apply if the status quo prevails and CalMac continues to provide ferry services as at present?

Jeanette Findlay: Yes. The cost would arise from the splitting of the company and the cessation of trading by CalMac. Under that scenario, CalMac would cease to exist.

Fergus Ewing: According to the table, there will be no pension costs if opsco wins. That is because CalMac will continue to operate. However, if the tender goes ahead and another company wins, you suggest that the cost could be a

"large sum up front of around £10 million".

Will you explain that figure please?

Jeanette Findlay: You will see from the section in the paper on pensions that CalMac's own scheme had a deficit of more than £6 million at the end of the financial year 2003-04. That figure is thought to be around £8 million now. If CalMac continues to exist as CalMac, and if the scheme remains in place, CalMac has plans—described in its annual report—for contribution rates that would

"*'restore the long-term ongoing funding level to 100% within the required timescales'*".

So, provision is already being made for the case in which CalMac continues to exist.

What about the case in which CalMac does not continue to exist and a new company wins the tender? The draft tender document states that tenderers will be required to

"ensure actuarial equivalent pension schemes and entitlements".

Two things would have to happen. First, the new company would have to set up a new scheme that was actuarially equivalent. However, when we consider recent fears about final salary schemes, we can see that that will have problems.

Secondly, someone would have to manage the present scheme. It would be closed down and nobody else would pay into it, but people would have already acquired entitlements for the future, so the scheme would still have to be managed. If a separate body had to take over the scheme, it would want to take it over with the present deficit having already been made up. That money would have to be paid up front to allow the new company to manage the scheme and to pay out when the people still in the scheme reached pension age.

Fergus Ewing: The last sentence on pensions on page 11 says:

"If Cal-Mac remains as an integrated company, it has plans for contribution rates, certified by an actuary, which would *'restore the long-term ongoing funding level to 100% within the required timescales'*."

That indicates to me that CalMac has plans to plug the £8 million deficit over a period of time; it plans to bring the scheme back to being a 100 per cent funded pension scheme ready to meet all the estimated contingent liabilities.

If other parties were to succeed in the tendering process, what does the Executive say about the obligation on those parties? Will they have to maintain the pension scheme as it is, or will they have to plug the £8 million deficit as well as maintain the pension scheme? Is the answer A or B, or is it not clear?

Jeanette Findlay: Pension rights do not transfer under TUPE even if TUPE applies, so I do not think that such companies would have any liability for the existing pension scheme. However, under the tender document, they have a duty to provide an equivalent pension scheme for any staff that they take on. The bid would have to include the cost of a pension scheme that is as generous as the present one. That is my understanding.

Fergus Ewing: That may be an issue that we could explore with the minister.

Jeanette Findlay: The companies would not have responsibility for the existing pension scheme, which would have to be taken care of elsewhere.

The Convener: Would the pension scheme have to be split, with one part applying to existing retired beneficiaries?

Jeanette Findlay: The current pension scheme would cease; it would be closed down and no further contributions would be made to it. However, it would have to be managed to meet the liabilities.

The Convener: A new pension scheme would have to be established to meet the requirements of the staff who were still employed.

Jeanette Findlay: Yes—of whoever was employed by the new company.

The Convener: Have you finished, Fergus?

Fergus Ewing: Not quite. I was meandering through the summary of costs table.

The Convener: I will allow Bruce Crawford to come in at this point.

Bruce Crawford (Mid Scotland and Fife) (SNP): If the pension scheme is wound up and replaced by a new one when the new operator takes over, is there an expectation that the £8 million gap will be closed? If CalMac remains the operator, it will be able to do that. If not, will the Executive need to fill the gap?

Jeanette Findlay: The existing scheme will have to be managed by someone—either the Executive or someone appointed by it.

Bruce Crawford: However, there will still be an £8 million gap.

Jeanette Findlay: Presumably, the gap will have to be filled more immediately than would be necessary if CalMac remained in existence.

Mr Davidson: I would like to pursue the issues that Fergus Ewing and Bruce Crawford have raised. I have a quick question for the witness.

The Convener: Is it about pensions?

Mr Davidson: It relates to a comment that was made previously, but it is relevant because of the response that was given to Fergus Ewing's and Bruce Crawford's questions.

The Convener: I will allow you in briefly.

Mr Davidson: Jeanette Findlay's comments on tax liability are contingent on splitting the company—in other words, the tax allowances go with the vessels. The same argument applies to the pension fund. Is it correct that, if CalMac continued as CalMac vesco, there would be no loss of tax allowances?

Jeanette Findlay: Are you talking about tax or pensions?

Mr Davidson: I am talking about tax. I think that the point also applies to pensions.

Jeanette Findlay: The tax liability would arise as a result of the division of the company, which would mean that CalMac ceased to exist and was replaced by two new companies. Even if opsco won the tender, the tax liability would remain.

Mr Davidson: If CalMac changed and became CalMac vesco, CalMac would not cease to exist and would be able to use the tax allowances. I speak as someone who has been a company director for most of his life. If CalMac continued on the basis that I have described, there would be a split in the pension fund. The part relating to staff associated with that aspect of the trade could roll forward, which would minimise the £8 million gap that has been discussed. We need to get advice on that point.

The Convener: You have offered an opinion, rather than a statement of fact.

Jeanette Findlay: Is the member saying that, if opsco won the tender and continued to run the pension scheme, there would be no tax liability?

Mr Davidson: I am saying that if CalMac continued to own the vessels and, instead of dividing itself into two companies, remained one company but hived off part of its operations, it would get the tax benefit. In that situation, there would be variance in the amount of deficit in the pension fund. We need to get professional advice on that point.

The Convener: You are drifting into a different area. Does Fergus Ewing have any further questions for Jeanette Findlay?

Fergus Ewing: I want to go through the table, as it is a summary of the extremely helpful paper.

It would be useful to us to get that summary on the record. We have got as far as pension costs. Jeanette Findlay already indicated that redundancy costs may be more than £20 million.

Jeanette Findlay: They are likely to be very large, given the generosity of the scheme and the very low turnover of staff. All the numbers were supplied by someone in the company. I have simply indicated why the sum is likely to be very large.

Fergus Ewing: I appreciate that you are not claiming any expertise in quantification of the claim. You are setting out categories of possible cost.

Jeanette Findlay: Where I can, I have indicated where I have been given information. I am not arriving at the sums by any process that I could convey to the committee.

Fergus Ewing: They appear to be broad-brush figures, although they come from sources that we would expect to be reliable.

Jeanette Findlay: I would not have quoted them to the people who commissioned the report if they had not been.

Fergus Ewing: I am familiar with the situation. The figures that we have add up to a total of between £40 million and £42 million. They refer to costs that may arise but could be avoided if tendering did not go ahead.

Jeanette Findlay: That is right.

14:30

Fergus Ewing: This is my final general point. If there is time after other members have asked their questions, I will come back to one or two technical points.

The remit of your paper, as specified in the terms of reference letter of 17 December, is outlined in the introduction, the first paragraph of which states:

"the STUC is looking for a

'comparison of the cost of continuing to run lifeline ferry services through the existing integrated structure, compared with the revised structure as now proposed by the Scottish Executive, but incorporating the costs associated with tendering'."

We are talking about very large sums of money and, ultimately, we want the money to benefit the passenger or user. That is our aim when we consider the topic; we are not just considering the interests of a company and its staff, because we have to be neutral about those matters. We are investigating the issue from the perspective of the customer.

Did you consider whether any element of the existing costs of CalMac's operation were, in your view, excessive? Did you examine the head office facility and its function? I say that because, although my constituency does not contain CalMac's head office, it is notorious, with people from outwith the head office tending to blame it for all sorts of ills. It has been suggested to me that if savings or efficiency savings are to be made at CalMac, those might primarily come from Gourock.

Given that the remit of your paper is to compare existing costs with the tendering costs, it seems to me that that might logically have involved an examination of how CalMac operates and how efficient it is. Part of your paper might have considered whether the passenger could get the same or a better service at a lower cost to the public purse.

Jeanette Findlay: I agree. If I had had more time to produce a lengthier paper and to investigate those matters, I certainly would have done so. However, I say on page 14 that there are clearly problems with CalMac. No one is suggesting that CalMac is perfect. There are areas in which CalMac is falling short of expectations. I refer on page 14 to the Caledonian MacBrayne users committee, which might have something to say about these matters. In the period that I was given to produce the paper, I did not have time to investigate the matter in any detail, but my information, such as it is, is similar to yours. There is an issue about ticketing facilities and about head office costs, where some savings might be made.

Fergus Ewing: Thank you very much. I did not mean to suggest that your paper was incomplete. You are right to point out that you have covered the point in your paper.

Dr Sylvia Jackson (Stirling) (Lab): I am not sure whether I can go further. My point is based on the question that Fergus Ewing asked. Last week, we heard from Professor Kay about the public service obligations. You do not seem to mention them in your paper. Would you like to comment on that? Your paper appears to suggest that nothing can really be altered. We have already heard that the residents of some of the islands would like a more frequent service and would like various other changes to be made.

Jeanette Findlay: I am certainly not suggesting that nothing can be done. I am sorry to labour the point, but I had a very specific remit. Professor Kay has come at the matter from a slightly different angle, and Dr Bennett has come at it from a slightly different angle again. I agree with Professor Kay's proposals and with the type of things that he mentions; I also agree with Dr Bennett's paper. We have approached the matter in different ways. I have not covered issues that are covered in the other two papers because my remit did not give me enough time to do so.

I do not think that anything in my paper suggests that nothing should be or could be changed. I was trying to outline the broad categories of costs that would apply under each of the different options. The three scenarios were: no tender; opsco winning the tender; or another company winning the tender. I broke things down into those three separate scenarios to provide a clear exposition of the kind of costs that might arise under each of those different scenarios. The question whether there will be additional services or whether services can be improved is completely separate from the question that I was trying to address, because the Executive has already tightly set out in the tender document the services that are to be supplied. As a result, those services will be present in all three scenarios.

Dr Jackson: Which of the various options for tendering might be more amenable to making improvements for local people? Perhaps I should contextualise that question by pointing out that, towards the end of your submission, you say that the activities in which CalMac is currently involved add value to the community. What incentive would there be for any other arrangement to provide the same services that CalMac provides at present?

Jeanette Findlay: If you are asking about the best way of improving services, I think that the Executive could write service improvements into the tender document and then ask bidders to bid on that basis. My point is that the ethos and culture of a publicly owned company or organisation are geared towards providing a public service. Whatever else they do, they are not pursuing profit. The main obligation of a new private company or new opsco—which, at that point, would be a private company—is to make a profit while meeting the tender specification at least cost. That is not a bad thing, but it will be very difficult to write a tender document that covers every one of CalMac's current activities, so a profit-maximising company would seek to reduce its activity and costs by targeting the services that are not specified in the document.

My view is that the best way of operating a lifeline service is through a publicly owned company. Because that is the company's whole ethos, the tender document does not have to specify everything. Much evidence suggests that such documents are difficult to write and monitor and problems can arise from unforeseen events during the period of the tender.

Dr Jackson: On page 7 of your paper, you say:

> "All aspects of the service are outlined and mechanisms for handling any unforeseen matters are contained"

in the tender document. Is there nothing to prevent the Scottish Executive from changing the document to incorporate some of the suggestions that the CalMac users committee has made?

Jeanette Findlay: Not as far as I know.

Dr Jackson: On page 8 of your paper, you say that vesco

> "is likely to be set up with the minimum number of staff to operate its main function. The additional burden of monitoring the maintenance of the fleet which is being operated by a third party may well be beyond its resources."

Are you saying that, if we move to the new system, the maintenance of the fleet could be a problem?

Jeanette Findlay: Yes.

Dr Jackson: I was just checking.

Jeanette Findlay: I think that Professor Kay also takes that view. In economics, there is what is called the moral hazard problem. In this case, the people who will maintain the fleet will have no incentive to do so—or, indeed, no interest in doing so—for beyond the period for which they are responsible for it. You would not necessarily look after a hired car as well as you look after your own car, because you have responsibility for it only for a fixed period. I think that analogy has been used before. A private operator of a fleet who has no guarantee that the contract will be renewed at the end of a fixed period will spend only the amount of money that is required to keep the fleet going for that period rather than worry about maximising the fleet's lifetime.

Dr Jackson: Surely it must be in the interests of vesco to ensure that the fleet is in good condition.

Jeanette Findlay: There should be monitoring of the fleet's condition, but that can be difficult and expensive and might cause tension in relation to the overall aim of cutting costs. Vesco will simply be a vessel-leasing company. The cost of the number of staff who would be needed to keep a close eye on how well a vessel was maintained over five years might be expensive. My concern is that vesco would be unable to monitor the condition of the fleet or would have to spend a great deal of money doing so.

Dr Jackson: I cannot quite see your logic. If there are no ships, there will be no vesco. Surely, therefore, vesco will have some interest in ensuring that the ships are maintained.

Jeanette Findlay: Some of what will happen is unknown and will become known only at the end of the first tender. The vesco's role will simply be to lease the ships and to ensure that they are suitable for the new company or the company that previously held the lease, if it wins the contract back. The lease will be for five years and at the end of that period, there will be a new tender. Whoever wins that tender will lease the ships again. In between times, vesco will, I presume, upgrade the ships or otherwise get them into the state that they need to be in. If the ships have not been well maintained in the five-year period, the costs of doing that will be much higher. There is something written into the document about maintenance but, again, that needs to be monitored. It is a condition of the contract that the company that leases the ships has no financial incentive to meet, except insofar as it is part of the contract. The company would do better to pay less.

Bruce Crawford: Do you think that the cost of leasing the vessels from vesco should also involve an asset liability cost to the operator, which should be paying vesco for its upkeep of the vessels and to fund a future replacement programme? That would ensure recognition of the true cost transfer in the process, through the tender.

Jeanette Findlay: That would be one way of doing it. Not only am I not a lawyer, I am not an engineer, so I am unclear about whether failure to maintain vessels over five years can be rectified at the end of that time or whether that would minimise the vessels' life expectancy.

The contract could include a requirement for the operating company to pay vesco to refit the vessel to its previous standard, but I do not know whether that would cost more than the cost of maintaining the vessel at a higher standard throughout the five years.

Bruce Crawford: There must be historical information on depreciation costs and replacement costs that could be built into the tender. We know what Caledonian MacBrayne's costs were in terms of depreciation and replacement, so it should be possible to build that into the tender such that it would transfer the costs from vesco to the new operator.

Jeanette Findlay: I am sure that that could be done, but my point is simply that there is a conceptual issue about incentives.

Bruce Crawford: I understand that—it is a good point.

14:45

Michael McMahon (Hamilton North and Bellshill) (Lab): My point is not dissimilar to Sylvia Jackson's. I cannot help thinking back to the discussion that we had about the trunk road maintenance contracts. We knew then that there were problems, but we have since discovered that the problem was not the private sector's wanting to get the contracts, but that the Scottish Executive, in drawing up the tendering contracts, did not make them specific enough and did not get the specifications right, which made it impossible for the existing operators to match the private sector bids. I am not sure what you know about the trunk road maintenance contracts, but is it true that the issue is not whether there is a tendering process, but how well defined the tendering contract is and what regulation takes place to ensure that the contract is operated appropriately?

Jeanette Findlay: That is part of the issue, but it is not the whole issue. Let us say that the tendering contract was written up perfectly, that everything that had to be done was done and that all the incentives were properly built in—that is not likely to happen, but let us argue that it has happened. In that case, there would still be issues in relation to a number of the additional costs, particularly the problem about the operator of last resort. At present, if a company won the tender and there was no longer an opsco that could take over, the whole structure of the industry and the system of incentives would change. The Scottish Executive would be in a completely different position in relation to its negotiations with the company that was operating the service, because there would be no other company that could take over the service. That problem will exist whether or not the tender document is written perfectly.

Michael McMahon: In relation to regulation, your paper states that the new operator, whoever that might be, would be

"subject to a performance regime … on a rolling four-week basis"

and that monthly performance figures would have to be

"made publicly available."

That regulation would be much more intense than the current regulation is. Does the fact that the new operator would be accountable so rapidly overcome some of your concerns?

Jeanette Findlay: Regulation would have to be put in place, which is one of Professor Kay's proposals with which I tend to agree. My submission simply points out that the costs that would be associated with the increased regulation do not exist in the current circumstances.

Michael McMahon: But so long as they are—

Jeanette Findlay: The costs that are associated with the regulation of a private company that seeks to maximise profit do not exist to the same degree in regulation of a company that has a public sector ethos.

Michael McMahon: I understand that, but if the costs were built into the tender process, would that make the process fairer and more open and transparent?

Jeanette Findlay: It is imperative that, post tendering—if tendering takes place—a strict regulation regime be put in place.

Michael McMahon: If a private sector operator wanted to tender and it knew up front what the regulation and costs would be, would that have an impact on its ability to tender?

Jeanette Findlay: Yes.

Bruce Crawford: I have a number of follow-up points. On Michael McMahon's point, the regulatory work that will necessarily fall to the Executive—such as monitoring to ensure that the process works and that we get the best from the tender—will incur costs. Would it be reasonable to argue that those costs should form part of the tender costs, so that the private sector contractor or the opsco paid them and everyone could see that? If that is not the case, the Executive will need to bear the new costs for the on-going tendering process, whereas it used simply to trust a public sector company to run the ferries efficiently and safely.

Jeanette Findlay: As far as I am aware, there is no sector in which regulated companies pay the cost of their being regulated.

Bruce Crawford: I agree, although what you say does not make my suggestion unreasonable.

My main question concerns page 7 of your report, which rightly recognises that the tender document will set in stone requirements on issues such as timetabling, fares and passenger facilities. Beyond that, there are issues such as the oil costs and maritime safety regulations. Given so many constants in the environment in which the successful bidder will be asked to work, your report suggests:

> "In terms of the scope for increasing efficiency/lowering costs there is very little room for any firm to manoeuvre."

If the operating environment is to be such that all the costs and other parameters such as targets—which you outline on page 13—will be set down, will CalMac not be pretty vulnerable to external predators, given that such companies will know that the only place to seek savings or efficiencies is the head office, as Fergus Ewing mentioned. Any predatory company will know that it must simply consider head-office facilities to win the contract. If your mole were to give his opinion, what would he make of that? Indeed, what might she make of it? I had better not tie down whether it is a he or a she, because I do not want to increase by 50 per cent the chances of the person being named.

Jeanette Findlay: My paper points out that there is not an awful lot of room for manoeuvre outside perhaps the two specific areas of maintenance and staff. If the maintenance of the vessels was monitored ineffectively, such that the company could cut back on maintenance, there could be dangerous implications for safety and finances. However, if staff are covered by TUPE, as seems likely, there will be little room for manoeuvre.

If your point is that the slack that people seem to agree exists at head-office level—although I did not investigate that matter—could be cut by an incoming company, that is a valid point. However, we must remember that, if CalMac is split into an operating company and a vessel-leasing company, the operating company will have a separate head office that is likely to have fewer associated costs than is the case currently, because CalMac's head office also carries out functions that are connected with maintenance of the fleet. Therefore, the head-office role will change. There may also be changes to things such as ticketing arrangements. There is no reason why all those changes could not be made by CalMac, which will need to reconsider its head-office facilities because the head-office function will change when the company is split.

Bruce Crawford: My final question is about the costs that tendering will involve regardless of whether the opsco contract is won by CalMac or another company. Fergus Ewing suggested that your paper gives total costs of £42 million.

Jeanette Findlay: My report mentions tendering costs of £2 million.

Bruce Crawford: I am trying to relate the tendering costs to the issue that David Davidson asked about earlier. The final sentence on page 2 of your report states:

> "However, it is possible that a tender would not go ahead if it can be shown that the cost to the public would be less by continuing the present arrangements".

I am trying to understand where that thought came from. On what basis is that claim made?

Jeanette Findlay: When I wrote the document, nobody was absolutely sure whether tendering was necessary in order to comply with EU regulations. That is possibly unclear even now. Although I have done no work on the issue since I wrote the paper, I attended a seminar on it and, from discussions that I have had, my understanding is that tendering is not a legal obligation. Nevertheless, tendering may or may not be the best way to meet the obligation. When I wrote the paper, that question was unresolved; to a certain extent, it still is. There is nothing in the regulations to say that a tender must take place; however, many people appear to believe that tendering is the only way to comply with the regulations as they are written.

Professor Kay has suggested an alternative, which is to impose regulation and auditing. The issue is not whether there is monopoly power; it is whether there is abuse of that power. Monopoly power or dominance is not, in itself, a problem either in terms of EU law or in terms of economic theory; the problem arises if it is abused. A system of regulation and auditing would uncover whether monopoly power was being abused, and that might be sufficient to meet the requirements of the regulations.

In my paper, I simply made the point that, if the costs were made transparent and we did not have to rely on what was said by a mole—if people could see that there was no abuse or slackness in the company—and if no great savings would be made by tendering, the case could be made for not having that process.

Bruce Crawford: The perverse thing is that CalMac is going to be as obtuse as it can be in the meantime. The last thing it would want to do in this environment would be to allow anyone to understand how the company is being run, because that would give a competitor the chance to compete from a better position. It is daft, but we cannot get the transparency because of the tender situation.

Jeanette Findlay: That is the perverse situation that arises.

The Convener: Fergus Ewing and Bruce Crawford have referred to the figure of £42 million. Let us be clear about that. The £42 million comes from a sum of all the figures in the table at the back of your paper, some of which are worst-case scenarios. I do not think that you are suggesting that there will be a cost of £42 million for going through the tendering process; I think that you have identified some risk areas. In particular, there is the one that we talked about earlier—the redundancy issue. The cost of redundancies would be unlikely to be £20 million unless the new tenderer got rid of the whole workforce. You are not saying that £42 million would be the cost of tendering.

Jeanette Findlay: Yes, that is correct. In a paper such as this, the eye is attracted to specific numbers that are given. However, my view is that some of the areas for which I am unable to estimate costs are where the real problems might arise. Issues such as the cost of regulation, the degradation of the vessels and the operator of last resort probably give rise to bigger problems. There are costs that I have not been able to put a number to but which should be taken into account.

15:00

Mr Davidson: We have got an awful lot of things into the open, but we have not got an awful lot of clarity. You say that it is all about the quality of the contract because, if the wording of a contract is not right, people do not know what they are bidding for. They will certainly not supply things that are not in the contract if they are not going to get any recompense for that, and that would be the case even if CalMac won the opsco contract. There are issues about taxpayers' money having been spent on subsidising the Mòd and other cultural activities, for which there is a separate minister with a separate budget. Why should such funding come out of the transport budget? It is a non-core service.

There are a number of issues that you have not addressed in full, though you have hinted that current audit may not be as vigorous as it perhaps ought to be by now in the development of CalMac. One issue that you have not addressed is the Executive's desire to transfer risk, which is one of the other reasons for going to a tendering operation.

Your mole has supplied you with some thoughts on the type and suitability of the vessels that are currently in use. It is an unusual set-up. The tender is not for someone to deliver a particular service so many times a week at a certain price; they are actually being limited to using vessels that in many cases contain crew accommodation that is not required, which represents an additional capital cost, an additional maintenance cost and additional weight, which means that there is a fuel cost and so on. It prevents anybody coming out with—

The Convener: Can you get to the question please?

Mr Davidson: Yes. It prevents someone from coming out with alternative ways of delivering the service. Have the people to whom you have talked come up with any thoughts about how the tender could be varied to allow for modernisation and an improvement in service as well as a reduction in costs to make the service more efficient?

Jeanette Findlay: First of all, I did not say that the issue was all about the tender. I said that there is an issue about how a tender is written and how contracts are made. There is a lot of academic literature to suggest that that is where problems can arise. I have indicated that there may be other problems beyond that.

I understand that the vessels are purpose built and designed specifically to meet the conditions in which they operate and that there may be safety or cost issues associated with using different vessels. I did not investigate that in detail and I did not discuss it with anybody, other than to take part in the discussion in which that comment was made. The vessels are specifically designed for those routes and there is no question of varying the type of vessel. I was not asked how I would improve the tendering process; I was asked to compare the three options on the basis of the draft tender document that existed.

As I said, I have not discussed with anybody how to write a better tender nor have I spent much time thinking about it. However, although one could certainly write a tender document that would address some of the issues that you raise, there are other issues beyond those. As I said, the matter is not all about the tendering. Other issues will pertain regardless of what type of tender takes place—if a tender takes place.

Mr Davidson: You brought up the issue of maintenance not being covered in a positive, proactive manner in the tendering process, so I assumed that you had looked more widely at the issue.

Jeanette Findlay: I looked at it from the viewpoint that vesco will only lease the vessels. However, the vessels will have to be maintained. A moral hazard arises from the fact that the people who will be maintaining the vessels over five-year periods will have no interest in them beyond those five years. For those who understand the engineering principles behind that, it is a serious matter. At the moment, CalMac refits are extensive and they maximise the life of the vessels. However, that might not be the case with the kind of refit that is undertaken by other companies—unless they are well monitored, and monitoring has a cost attached. I am simply identifying another cost.

Mr Davidson: The cost is presumably already being spent by CalMac in monitoring its own vessels.

Jeanette Findlay: A company does not have to monitor itself, does it? If it is the one doing the refits and that is part of what it does, there is no additional layer of monitoring. That situation does not exist now, but it would exist later.

Mr Davidson: Do you think that the vertical integration of CalMac covers that aspect?

Jeanette Findlay: Yes.

Fergus Ewing: I have two points. First, the second part of the remit on page 2 of your paper, from which I did not quote earlier, says:

"it was requested that

'the report should also consider the EC definition in tendering these lifeline services and state whether it is achievable that services can be improved with lower costs to the taxpayer".

Michael McMahon made the good point that we are primarily considering whether tendering is necessary, but other questions are whether the terms and conditions that are specified in the tender documentation are correct and appropriate and whether they dictate the answer to the question in the remit about the scope for savings.

I will put to you Professor Kay's thesis. The tender spec document specifies the vessels that are to be used and leased—the document has pictures of them, in case we do not recognise the names—and the routes, the service frequency and the fares. A free-marketeer such as my colleague David Davidson could argue that such specification removes flexibility for another company to say, "I'll give you these routes and the services. I'll provide my own vessels and do it more cheaply by doing it my way." With reference to the second question in your remit, the Executive's specification—[*Interruption.*] There are noises off, but we will ignore them. The tender spec limits severely the scope for any different approach that some companies might argue was the way to provide a less expensive service.

Jeanette Findlay: That is absolutely right. The big costs that are associated with running the services include staff costs. I have tried to address what might happen in different circumstances but, if TUPE applies, it seems that little can be done with such costs. Fuel costs are the same in any circumstances. Those are the big costs. If the tender document is written tightly enough to ensure reasonable maintenance, that will deal with a large part of the costs. The vessels that are specified must be used and they are designed to be route specific, so it is difficult to see how anybody can do much better.

We talked about the Caledonian MacBrayne users committee, which has concerns about some aspects of the service and takes the view that improvements could be made. It is unlikely that a perfect company will be found, so areas for improvement are likely to exist. What is in question is whether those improvements would be sufficient and whether they would produce cost savings. Cost increases might be associated with improvements. CalMac might be doing things that could be improved, but it might require more funding to make improvements—I do not know; I have not investigated that. I simply point out that, if we take into account the big costs that are involved in running the service and the safety aspects, there is little room for any operator to do much better at reducing costs.

Fergus Ewing: I thank you for that and for pointing us towards the CalMac users committee's findings, whose criticisms we will probably need to identify.

I will play devil's advocate for a moment. Does CalMac have an operator of last resort?

Jeanette Findlay: Not as far as I know.

Fergus Ewing: I thought that, notionally at least, the Secretary of State for Scotland—and now, I presume, the First Minister—was the operator of last resort, as with the railways.

Jeanette Findlay: That is what is written. I thought that you were asking whether another company is waiting in the wings somewhere—it is not.

Fergus Ewing: No. That applies even when the First Minister is in Malawi, although he is known to be a versatile chap.

The Convener: As well as being a chief in Malawi, the First Minister is a captain of CalMac.

Fergus Ewing: There is no need to salute.

The serious point is that no operator of last resort exists at the moment, because the service is publicly funded and relies heavily on subsidy. I think that no one has asked whether there is a reason why one of the other ferry companies could not be an operator of last resort. Let us assume for a moment that company A wins the tender. Surely in that case companies B, C and D could apply to become the operator of last resort.

Jeanette Findlay: Yes, they could, but that company would have to be told that, at an hour's or a day's notice at most, at some point unspecified, they would be expected to provide a full ferry service on the Clyde and to the Hebrides. Although it would be possible to pay a retainer to a company to do that, there would be a danger in adopting that approach.

I think that Professor Kay has addressed the issue. He outlined a hypothetical scenario in which someone in Barcelona is phoned up in four or five years' time and told, "You remember that you said you'd provide ferry services for us. Could you come and do that tomorrow?" He suggested that it was unlikely that a service would be provided the next day.

Fergus Ewing: If anyone were to come from Barcelona to provide the service, you would not need to persuade me that an element of cost inflation might be involved.

To revert to your paper, you pose the serious question of possible extra cost if another company were to win the contract. If CalMac were to win, there would be no operator of last resort. In your paper, you talk about what would happen if a third-party company were to win and point out:

"section 1.3.6 of the draft tender document … states that

'*VesCo will also be responsible for providing an Operator of Last Resort function (in the event of termination of contract, breakdown of contract, or similar event)*'".

You say that section 1.3.6 states

"that this can be done

'*either at VesCo's own hand or through an arrangement with a shipping provider by way of retainer.*'"

You have not specifically quantified the cost in your summary table, however. You said earlier that the operator of last resort would have to step in at a day's notice. The company would certainly have to come in quickly, for the simple reason that the ferries provide essential services, such as food provision and the movement of animals and goods. It is inconceivable that there could be no ferries operating to the islands for longer than a few days. Did you try to quantify in any way, or seek information from anyone on, the extra cost of procuring or retaining an operator of last resort?

Jeanette Findlay: No, I did not. I have no idea of the size of retainer that would need to be paid to a company in those circumstances. I do not address in my paper what would happen if a company were to be called on to take on the function of operator of last resort. I make the point now, however, that if the company that had taken on the retainer was expected to perform at 24 hours' notice, the situation would be precarious, especially as that company could be situated anywhere in the world.

Fergus Ewing: Yes, but presumably—

Jeanette Findlay: I would be concerned about safety and other aspects.

Fergus Ewing: If the situation arose through liquidation, surely the liquidator—or receiver, if that was the vehicle of insolvency—could be instructed on a temporary basis by the Executive to take over.

Jeanette Findlay: Yes, if the company had the staff in place who were ready to take over.

Fergus Ewing: But, by definition, that would be a temporary arrangement.

Jeanette Findlay: I would have thought so, but, again, I am not sufficiently knowledgeable about the operation of the industry to know whether that would be the case. Let us say that the contract goes to tender and opsco does not win, but the company that wins goes bust. The situation will depend on who is employed and whether those people are available to be employed by the receiver. Let us say that the tender is won by a company that eventually replaces the staff with foreign seamen—those seamen would go home when the company went into receivership.

Given that we are talking about a lifeline service, there are a number of imponderables. We would need to try to anticipate what is likely to happen over a period of time and we would need to be sure that an operator was ready to come in. It would be possible to make arrangements around that, but there would still be some uncertainty about how it would work in practice.

15:15

Fergus Ewing: You may not be able to answer this question, which I should perhaps have put to Professor Kay last week. If that is the case, I apologise, but I put the question now. Do you envisage that the operator of last resort function will itself have to go out to tender?

Jeanette Findlay: I must confess that I had not thought about that.

Fergus Ewing: Neither had I, but I think that Professor Kay mentioned it briefly last week. It is my fault for not pursuing it, but no doubt Professor Kay will read the *Official Report* of this meeting and we can come back to the matter. I think that he said that it might be necessary, because of EU procurement laws, for the operator of last resort function to go out to tender. That would be a further twist to the story.

The Convener: It seems to me that we can consider the railway industry as a parallel. The operator of last resort at the point of railway privatisation was a residual British Railways Board—BRB (Residuary) Ltd—which was retained as a public sector body and can step in to operate a company that has financial problems or fails to meet its franchise requirements. In a recent case, that happened and BRB (Residuary) Ltd took over the operation of the franchise.

If we go down the tendering route, would it not be better to develop a public sector operator of last resort than to have another private sector company in the wings to take over the tender? The public sector operator would be similar to BRB (Residuary) Ltd. That might involve vesco being the operator of last resort. Alternatively, that function could belong to the new strategic transport agency that the Executive is establishing. Is that a realistic model?

Jeanette Findlay: I have concerns about the use of another private company in those circumstances. Because of the nature of the services, it would have to step in at short notice and you might be right that it would have to go through another procedure.

I cannot understand how vesco could take on that role. It will be a vessel-leasing company so it will not employ staff who are able to operate services. The people who can operate services will go with opsco. If opsco does not win the first tender, it will cease to exist. I am concerned about who would be there to operate services in those circumstances.

The Convener: In the analogy that I used, BRB (Residuary) Ltd retained, at the public's expense, a number of individuals who had experience of running railway companies. In that model, some key individuals would be—

Jeanette Findlay: That gives us another option, but the matter has to be examined seriously so that the provision is in place.

Bruce Crawford: Whether the operator of last resort is an equivalent of BRB (Residuary) Ltd or is the vessel-owning company, is the matter as complicated as it seems? The service is delivered by the operatives—the guys on the quayside and the guys on the ships. They will exist regardless of whether the company goes down. Is it not the case that all that would be replaced is the management of the system at the higher level? Is the problem as big as people think? I struggle to see why it is such a huge issue.

Jeanette Findlay: If the people who sail the ships and the people on the quayside are still in place and it is simply a question of finding somebody else to manage them—to sort out the scheduling and do whatever else has to be done—that does not seem to be a big problem. However, we do not know where we will be in five to 10 years' time, after the first and second periods of tender. Who knows whether the staff will still be local people or whether they will have been replaced by foreign seamen, who might return home if the company goes bust? If the tender goes out and the winning company goes bust six months later with the same staff still in place, that is not a problem. If the company goes bust five or 10 years later, that could be a big problem.

Bruce Crawford: So, in those circumstances, the issue is loyalty and ownership on the part of those who work for the company. I understand your point.

The Convener: That completes our questions. I thank Jeanette Findlay for her evidence.

We now move into private session for agenda item 2.

15:20

Meeting continued in private until 17:49.

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