

PUBLIC AUDIT COMMITTEE

Wednesday 14 January 2009

Session 3

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PUBLIC AUDIT COMMITTEE

1st Meeting 2009, Session 3

CONVENER

*Hugh Henry (Paisley South) (Lab)

DEPUTY CONVENER

*Murdo Fraser (Mid Scotland and Fife) (Con)

COMMITTEE MEMBERS

*Willie Coffey (Kilmarnock and Loudoun) (SNP)
*Cathie Craigie (Cumbernauld and Kilsyth) (Lab)
*George Foulkes (Lothians) (Lab)
*Stuart McMillan (West of Scotland) (SNP)
*Nicol Stephen (Aberdeen South) (LD)
*Andrew Welsh (Angus) (SNP)

COMMITTEE SUBSTITUTES

Derek Brownlee (South of Scotland) (Con)
James Kelly (Glasgow Rutherglen) (Lab)
John Farquhar Munro (Ross, Skye and Inverness West) (LD)
Sandra White (Glasgow) (SNP)

*attended

THE FOLLOWING GAVE EVIDENCE:

Gary Bogan (Transport Scotland)
Sir John Elvidge (Scottish Government Permanent Secretary)
Steven McMahon (Transport Scotland)
Malcolm Reed (Transport Scotland)
Bill Reeve (Transport Scotland)

CLERK TO THE COMMITTEE

Tracey Reilly

SENIOR ASSISTANT CLERK

Joanna Hardy

ASSISTANT CLERKS

Rebecca Lamb
Jason Nairn

LOCATION

Committee Room 6

Scottish Parliament

Public Audit Committee

Wednesday 14 January 2009

[THE CONVENER *opened the meeting at 09:30*]

Decision on Taking Business in Private

The Convener (Hugh Henry): Good morning and welcome to the first meeting of the Public Audit Committee in 2009. I ask everyone to ensure that mobile phones and other electronic devices are switched off. I welcome to the meeting members of the public and Audit Scotland staff. I welcome, too, the first panel of witnesses for the meeting: Dr Malcolm Reed is accompanied by Steven McMahon, Bill Reeve and Gary Bogan. Thank you for coming along.

The main agenda item is a report on the First ScotRail passenger rail franchise. However, can we first agree to take in private agenda items 3, 4 and 5?

Members *indicated agreement.*

Section 23 Report

“The First ScotRail passenger rail franchise”

09:31

The Convener: We turn to the section 23 report. We have invited Dr Malcolm Reed, the chief executive of Transport Scotland, to our meeting for this item. The line of questioning will be to you, Dr Reed. Obviously, you should feel free to consult your staff, should that be required. Would you like to say anything by way of introduction?

Malcolm Reed (Transport Scotland): I will make a brief introductory statement. First, I thank you for your earlier introductions. Gary Bogan is standing in for David Binnie who is, I am afraid, down with the flu that is doing the rounds. I am grateful to you for accepting that late change in our representation.

We are grateful, too, for the opportunity to provide input to the committee's consideration of Audit Scotland's report, “The First ScotRail passenger rail franchise”. I emphasise immediately that we welcome many of Audit Scotland's findings, in particular the conclusions that First ScotRail is performing well, that Transport Scotland is generally managing the franchise effectively, that the franchise extension was robustly appraised and that it has secured £73.1 million of guaranteed benefits to rail passengers and taxpayers in Scotland. We welcome, too, the report's clear articulation of some of the contractual and commercial issues around the decision to extend the franchise.

I acknowledge that the report also contains a number of criticisms, or suggestions for improvement. We would not seek to question the Auditor General's role in seeking the best possible outcomes for the Scottish public and, in common with the rest of the Scottish Government, we in Transport Scotland constantly look to improve our performance. There are therefore a number of learning points in the Audit Scotland report that we are happy to take on board and which, indeed, we have already begun to implement.

As is usual, Audit Scotland offered us the opportunity to comment on a draft of the report. In this case there were, in the draft, about 70 matters of fact or interpretation that we questioned. In about three quarters of those instances, Audit Scotland either accepted our corrections or agreed to an adjusted form of words in which we had found common ground.

Normally, we would regard that as a good score, but I have to say that in this case we were, just before the report was due to go for printing, presented with significant further revisions that

had not been discussed with us. We therefore did not have the opportunity to engage as fully as we would have wished with the Auditor General's staff on those additional elements in his findings. If we had, I am confident that we would have been able to resolve many of the issues in the report that appear to have caused the committee some concern and which were discussed at length when Mr Black and his colleagues gave evidence before Christmas. Therefore, I hope that we will be able, in responding to your questions, to set the record straight on some of the issues that were raised in your previous meeting.

The Convener: Thank you for that. We want to come back later to the appointment of Mr Houston—I think Nicol Stephen will follow up on that—but can you clarify when Mr Houston was appointed to Transport Scotland?

Malcolm Reed: From memory, he was appointed in May 2006, but I can confirm that later.

The Convener: When did the discussions on extension of the franchise start?

Malcolm Reed: I ask Mr Bogan to clarify that.

Gary Bogan (Transport Scotland): We first examined the options for revisiting the franchise during the summer of 2006. At that point, we were taking a broad-based look at the performance of the franchise and other issues.

The Convener: So, Dr Reed, you were privately starting to think about the franchise, whether it should be extended and what might happen with it. There were discussions among your staff before you started any of that work in summer 2006, and Mr Houston was appointed in May 2006. We will leave that sticking for now.

I will ask you about the meetings at which the franchise extension was discussed. You knew that Mr Houston had worked with FirstGroup. Did you know at that time that he held shares and share options in FirstGroup?

Malcolm Reed: Yes—he declared them in the normal course of events during his first year of appointment.

The Convener: So you knew, presumably, that he had a material interest in the outcome of any discussions.

Malcolm Reed: We need to choose our words carefully. I question whether the word “material” is appropriate. You might want to explore this further as the questioning develops, but the civil service code is very strict on what officials can do if they receive in the course of their employment information that affects their private interests. There is nothing that makes me think that the civil service code was broken in that respect.

The Convener: I did not ask that, nor was I suggesting it. I was asking about material interest. You said that you did not believe that Mr Houston had a material interest. Did he stand to gain if FirstGroup's share price increased?

Malcolm Reed: He stood to gain to the same extent as any FirstGroup shareholder would benefit.

The Convener: So, someone who had sufficient shares to declare would have gained if the share price went up. Do you not think that that is a material interest?

Malcolm Reed: Perhaps I am splitting hairs. I do not regard his shareholding—in view of its size—as a “material interest”, but the underlying point that you make is correct.

The Convener: So, you were not concerned that he was a shareholder and that he held not only shares but share options, which—as you probably know—offer the opportunity to make further gains, depending on what happens with the share price. Had you no worries about his participation in your discussions when you were considering the extension of the ScotRail franchise?

Malcolm Reed: It is important to clarify that. Mr Houston was a participant only at a very late stage in the process. He attended two meetings after the deal had been struck, one of which was simply to discuss the handling of the deal. The second meeting was held after ministers had taken the decision to proceed with the extension. He was, therefore, not a participant in the process and played no part in shaping or negotiating the deal.

The Convener: None whatsoever?

Malcolm Reed: None whatsoever.

The Convener: And you had no worries about his participation at that “late stage”, as you describe it?

Malcolm Reed: No, because the meetings that he attended did not affect the outcome and were not material to the recommendations that we put to ministers.

Murdo Fraser (Mid Scotland and Fife) (Con): I will follow on from the convener's questions. Who provided the financial advice to Transport Scotland on the question of the franchise extension?

Malcolm Reed: That advice came from two sources. We received advice from our strategy investment directorate—a member of that team is here today—but we also received external advice from Ernst & Young throughout the process.

Murdo Fraser: Did the strategy investment team report to the director of finance and corporate services?

Malcolm Reed: No—it is a separate directorate.

Murdo Fraser: I just want to get this clear. You were aware that there was an issue with Mr Houston, given his shareholding in FirstGroup. Was that why he was not involved in earlier discussions about the franchise extension?

Malcolm Reed: No. When the process started, it was not part of his corporate responsibilities. We had a separate rail finance team in Bill Reeve's directorate and all the details of the franchise were kept within that directorate. It is ironic that, as a result of a recommendation by Audit Scotland, we changed that at the beginning of 2008 and that, at that stage, the responsibility passed to Guy Houston. We had in place very clear management arrangements that ensured that there was no conflict and that Guy Houston was not involved in decision making that could affect his personal shareholding. That is recorded in our annual reports.

Murdo Fraser: Okay. When Transport Scotland advised the minister on the franchise extension, did you advise him of the issue with Mr Houston's interests?

Malcolm Reed: It was not an issue. The interest was a matter of public record and ministers were aware of it; I did not advise ministers of it specifically. Mr Houston was not party to those meetings.

Murdo Fraser: Thank you. With hindsight, do you accept that things should have been done differently?

Malcolm Reed: With hindsight, I accept that we could have arranged things differently, but I do not think that what happened materially affected the outcome, or that it affected it at all.

The Convener: You said that ministers were aware of the interest. How do you know that?

Malcolm Reed: Our annual report is cleared by ministers before it is presented to Parliament.

The Convener: Okay.

George Foulkes (Lothians) (Lab): If everything is as you have just described, why is Mr Houston no longer working with you?

Malcolm Reed: I am afraid that I am not in a position to comment on a personal decision that Mr Houston took.

George Foulkes: Why do you think Mr Houston is no longer working with you?

Malcolm Reed: If this were a court of law, an answer to that question would be hearsay. I am afraid that I do not want to be drawn in that direction.

George Foulkes: Can you see why people might have drawn inferences from his resigning at that particular time?

Malcolm Reed: Yes—I can certainly see that.

George Foulkes: You do not think that there might be any connection between a perceived interest and his no longer working for Transport Scotland.

Malcolm Reed: Employment matters are confidential between the employee and the civil service. I do not want to comment.

George Foulkes: You do not think it proper that you should give Parliament an answer to that question.

Malcolm Reed: I am advised that it would not be proper, but you can take up the matter elsewhere if you wish.

George Foulkes: Who has advised you not to answer the question?

Malcolm Reed: I have had advice from the senior staff team within the Scottish Government.

George Foulkes: Was the advice from Sir John Elvidge?

Malcolm Reed: It was from the team that works for Sir John.

George Foulkes: They said that you should not answer the question about why Guy Houston is no longer working with you. You were advised of that by a team working for Sir John Elvidge.

Malcolm Reed: I am advised that such things are confidential staffing matters, which it is not appropriate to disclose, and that such a disclosure would, in fact, be in breach of the Data Protection Act 1998.

The Convener: For the record, will you clarify who in the senior staff team advised you?

Malcolm Reed: Paul Gray.

The Convener: Okay.

Andrew Welsh (Angus) (SNP): You said what the director of finance did not do; you said that he was not involved in decision making. What did he do? Did he provide any information, advice or material based on which decisions were taken?

Malcolm Reed: Absolutely not.

Andrew Welsh: So what did he do?

Malcolm Reed: He was involved in two respects. First, he was involved in discussions on the handling because he had, as well as his financial responsibilities, responsibility for our corporate affairs. Secondly, given that he was responsible for the whole financial management of the organisation, it was important that he was

aware of the impact on other budget arrangements of the deal that was being done. That is where he was brought in, after the deal had been concluded.

Cathie Craigie (Cumbernauld and Kilsyth) (Lab): I want to follow up some of the earlier questioning. In relation to the day-to-day management of the organisation, it must be quite a blow to Transport Scotland to lose such a senior director. When the director of finance and corporate services tendered his resignation, did you try to persuade him not to resign?

09:45

Malcolm Reed: No, I did not. That was a personal decision for him.

George Foulkes: What were the financial terms of his departure?

Malcolm Reed: Again, I cannot comment on that.

George Foulkes: Are you unable to tell a committee of the Parliament how much Transport Scotland—a public authority—paid to an employee who left?

Malcolm Reed: I am not sighted on how much he was paid.

George Foulkes: Who is so sighted?

Malcolm Reed: The senior staff team in the Scottish Government is.

George Foulkes: You are not aware of the financial terms under which he left.

Malcolm Reed: No.

The Convener: I want to clarify a general point. You said that the issue was decided by senior staff in the Scottish Government. Do those people decide all salary-related issues for your senior staff? Do you have no input whatever into the matter?

Malcolm Reed: That is correct. I have no delegated powers or responsibilities for senior civil service staff in our organisation.

The Convener: You are saying that the decision about the package to allow a senior member of staff—whoever it might be—to leave is made by senior civil servants.

Malcolm Reed: Yes.

The Convener: And signed off within the senior civil service.

Malcolm Reed: That is correct.

Nicol Stephen (Aberdeen South) (LD): Did you have direct involvement in recruiting Mr Houston?

Malcolm Reed: Yes. I was a member of the panel that recruited Mr Houston.

Nicol Stephen: You said that he declared his interest during the first year of his appointment. Did he do so prior to his appointment?

Malcolm Reed: In my recollection, the issue did not come up during the panel interview.

Nicol Stephen: Therefore, when you appointed Mr Houston you were unaware of his interest in FirstGroup.

Malcolm Reed: We were not directly aware. He had worked as a senior manager for FirstGroup.

Nicol Stephen: Were you unaware of his shareholdings? That is an important point.

Malcolm Reed: I was unaware of them.

Nicol Stephen: I think that there are strict rules about such matters in the civil service code. You are saying that when Mr Houston was recruited you were unable to discuss with him how his shareholdings and material interest in FirstGroup should be handled.

Malcolm Reed: Yes—that is the case.

Nicol Stephen: Is it normally the case that someone who applies for such a civil service post should declare a material interest in a company such as FirstGroup?

Malcolm Reed: I am afraid that I cannot speak from broad experience. I do not know what the normal practice is in such situations.

Nicol Stephen: Is the question asked as part of the recruitment process?

Malcolm Reed: The question was not asked as part of the recruitment process that we are discussing and it was not asked of me when I was recruited.

Nicol Stephen: Are you aware that under the civil service code material interests should be disclosed?

Malcolm Reed: Yes.

Nicol Stephen: Was the civil service code incorporated into Mr Houston's contract?

Malcolm Reed: Again, I have not had sight of Mr Houston's contract.

Nicol Stephen: Therefore, we should ask such questions of other civil servants.

Malcolm Reed: That is correct.

Nicol Stephen: When did you first become aware of Mr Houston's interest?

Malcolm Reed: I cannot give a precise date, but it was certainly during the first year of his employment.

Nicol Stephen: What action did you take to implement the terms of the civil service code?

Malcolm Reed: We did two things. First, we ensured that his interest was properly recorded—during the course of the year we are all asked to record our interests. Secondly, as I said, we put in place management arrangements to ensure that Mr Houston was not involved in decision making that could be construed as affecting his interest in FirstGroup.

Nicol Stephen: Was his presence during discussions, at a late but no doubt still important stage of the process, in keeping with those arrangements?

Malcolm Reed: With hindsight, I acknowledge that it would have been more appropriate if he had not been part of those discussions.

The Convener: I wish to clarify something. You are the chief executive of Transport Scotland, but you have no say over the salaries of senior staff; you have no knowledge of the final remuneration package that is offered to any of your senior staff who leave; and you had no knowledge whatever of Mr Houston's contract.

Malcolm Reed: Yes—that is the position.

The Convener: Do the senior civil servants not discuss any of those issues? Before Mr Houston was appointed, did they not discuss with you what was going to be offered to him?

Malcolm Reed: The range of salary was certainly discussed, but it is a matter for personal negotiation between the individual and the Scottish Government.

The Convener: So irrespective of what you, as chief executive—the person running the organisation—might think about a person's worth, someone else, who is not directly involved in your organisation, will make the decision about the individual's salary.

Malcolm Reed: That is correct. We work within very strict rules, which, ultimately, are set by the Cabinet Office in London.

The Convener: And the people who conduct those negotiations do not advise you about what is in the contract that is offered.

Malcolm Reed: Certainly they do not advise me about detailed terms, although they would consult me about the salary levels. As I said, it is down to individual negotiation between the person who is being recruited and the civil service team.

The Convener: So when someone is appointed you have no knowledge of the salary and no knowledge of the conditions of service. The hours to be worked are not discussed with you, nor are holiday arrangements or the length of notice that would be required. None of that is discussed with you—the chief executive.

Malcolm Reed: Perhaps we misunderstand each other. All those items are standard. We work to a standard set of conditions, including holiday entitlement, and we are all appraised on the same basis. The only negotiated element is the starting salary.

The Convener: Everyone works to a standard contract, and there will never be any variations in contract.

Malcolm Reed: As far as I am aware, we all have standard terms of employment.

Andrew Welsh: I remain puzzled. The director of finance should be involved in giving financial advice, but you have said that he was not involved in the decision making. If the director of finance was not involved in the decision making and became involved only after the deal had been concluded, who provided the financial advice on which the franchise extension was based? Somebody had to provide financial advice. That is normally the work of the financial director. Are you saying that he was not involved at all?

Malcolm Reed: No, he was not involved, for the very good reason that rail finance is a complex area and we already had corporate arrangements in place for rail franchise financial matters to be handled within the rail franchise team. As I have also said in evidence previously, the internal advice that we received was validated and scrutinised by external financial advisers Ernst & Young.

Andrew Welsh: Which post was held by the person who actually gave the financial advice?

Malcolm Reed: At the time, that would have been Bill Reeve.

Bill Reeve (Transport Scotland): Yes. At that point, a rail finance manager was working for me. As the Auditor General has pointed out, we had a rigorous appraisal capability within Transport Scotland's strategy investment directorate. Its staff were able to subject the financial numbers in the franchise contract and in the various forecasts that were available to that rigorous appraisal. To ensure that we had done the analysis appropriately, it was validated by external financial advisers Ernst & Young.

George Foulkes: I am not aware of what Mr Reeve's job title is, convener.

Bill Reeve: I am the director of rail delivery.

The Convener: I want to clarify something before bringing in Cathie Craigie. When you were undertaking that process, how did you communicate with people in the organisation? Did you use hard copy, e-mail or both?

Malcolm Reed: We kept the circulation very tight within the organisation, but we used both hard copy and e-mail.

The Convener: In terms of the circulation, was Mr Houston able to access any of that? Was he included or specifically excluded?

Malcolm Reed: There were instances when Mr Houston received copies of papers for information. Generally speaking, he was not part of the team and was not on the routine circulation list for documents that were connected with the franchise extension.

The Convener: But Mr Houston would have been aware that Transport Scotland was looking at an extension. He would have been aware of the general developments that were taking place and whether the discussions were productive. He would also have been aware of some of the broad financial issues that were involved in the discussion. As a FirstGroup shareholder, he had—as we have established—a material interest in the matter. He would have been aware of much of what was being said.

Malcolm Reed: He would have been aware of some of what was being said. Again, I would avoid using the word “material”.

The Convener: And you know what he was able to access and what he was not able to access.

Malcolm Reed: In broad terms, yes. However, if Mr Houston had wanted to access more of the information, I have no doubt that he could have done so. I know of nothing that makes me believe that he did.

The Convener: Okay. I will bring in Cathie Craigie and Nicol Stephen, after which we move on to address the business case.

Cathie Craigie: Mr Bogan told the committee this morning that the option to revisit the franchise was first considered in the summer of 2006. Dr Reed said that Mr Houston was appointed in May 2006. I can only imagine that the interview panel chose the best person for the job. Did Mr Houston's employment history with First ScotRail have a bearing on the appointment? Did it give him the edge at interview?

Malcolm Reed: Not at all. In fact, he was not in the employment of FirstGroup when he applied for the job, although it was on his curriculum vitae that he had worked for the company. The fact that it was that company had no bearing at all on his appointment.

Cathie Craigie: You can probably understand my reason for putting this question. People think that Transport Scotland appointed this person because of his expertise and knowledge of the rail industry, yet the appointment was made at what

could be called the late spring of 2006 and this major piece of work was being undertaken that summer.

Malcolm Reed: I will answer the question in two parts. First, the appointment was not made with any view to the franchise extension process. Indeed, as Mr Bogan confirmed, extending the franchise was not under active contemplation when the appointment was made. Secondly, the member is correct in saying that, when we went to the market for a financial director, one thing that we specified and stated as being desirable was experience in the transport industry. By and large, that is what our business is about. We were looking for a senior finance figure who had knowledge of the way in which the industry works. If one is recruiting in that field, it is inevitable, or it is almost certainly the case, that a recruit will at some stage in their employment have worked for one or other of the major transport companies in Britain.

Nicol Stephen: I am looking at the civil service management code, which makes it clear that

“Civil servants must ... declare to their department or agency any business interests (including directorships) or holdings of shares or other securities which they or members of their immediate family ... hold, to the extent which they are aware of them, which they would be able to further as a result of their official position”.

I think you would agree that Mr Houston's share holding and share options fall into that category.

Malcolm Reed: Indeed.

Nicol Stephen: Who in the civil service is responsible for ensuring disclosure?

Malcolm Reed: I am responsible for the management of the agency. Mr Houston disclosed it to me.

10:00

Nicol Stephen: But you explained that that did not occur at the time of appointment. I presume that he was in post for a period of weeks or months, during which time he would have been in breach of the condition. I repeat the question: who was responsible for ensuring disclosure?

Malcolm Reed: Compliance with the civil service code is a matter of individual responsibility.

Nicol Stephen: Are you suggesting that Mr Houston was responsible for disclosure?

Malcolm Reed: Yes.

Nicol Stephen: Okay. Who is responsible if there is a breach of the civil service code by an individual civil servant?

Malcolm Reed: That depends on the materiality of the breach. I would automatically refer any

significant breach to the senior staff team within the Scottish Government.

Nicol Stephen: When Mr Houston did disclose, you would have been aware that there had been a breach.

Malcolm Reed: No, I do not accept that. He disclosed, and in doing so he was complying with the civil service code.

Nicol Stephen: When did he disclose, and what were the circumstances of the disclosure?

Malcolm Reed: I am sorry, but I cannot give you an exact answer—not because I am trying to evade the question, but because that is not something of which I have current knowledge.

Nicol Stephen: I presume that the interest would have been registered.

Malcolm Reed: Yes. I would need to check the register of interests to find out when he registered it.

Nicol Stephen: So you could provide us with a date.

Malcolm Reed: I will do my best, yes.

Nicol Stephen: Who is responsible for implementing arrangements? As you know, the civil service code goes on to say that arrangements should be discussed for handling interests and that civil servants

“must comply with any subsequent instructions from their department or agency regarding the retention, disposal or management of such interests.”

It is clear that you had decided to manage the interest. Is the responsibility for that yours alone?

Malcolm Reed: That is my responsibility.

Nicol Stephen: When you became aware of the shareholding, did you get advice on the management of the arrangements from the senior civil service?

Malcolm Reed: No. The management arrangements that we agreed seemed to me to meet the requirements of both the civil service code and the staff handbook.

Nicol Stephen: So you did not clear any arrangements with senior management.

Malcolm Reed: No.

Nicol Stephen: Were they aware of the arrangements that you had put in place?

Malcolm Reed: It was a matter of record, as I have said, that we had arrangements in place. No one asked me what the details were and I did not find it necessary to discuss them.

Nicol Stephen: But you could provide us with the date of registration of the interest and a copy of the detailed arrangements.

Malcolm Reed: I am not sure that I could provide you with the detailed arrangements. Again, they are a personal matter because they would disclose the number of shares and share options that Mr Houston held.

Nicol Stephen: Is that not a matter of public record?

Malcolm Reed: I will need to take advice on that.

Nicol Stephen: If it were a matter of public record because share registers are public, would you be able to provide us with the written agreement that was set down?

Malcolm Reed: Yes, indeed.

Nicol Stephen: That would be helpful. Thank you.

Andrew Welsh: Will you remind us of the total costs involved in funding the franchise extension?

Malcolm Reed: There were no costs involved in funding the franchise extension. It was done within the existing financial settlement for the franchise. However, Bill Reeve can comment in more detail on the headline numbers.

Bill Reeve: Malcolm Reed is right. The franchise extension did not alter the envisaged costs of the franchise as extended to 2014 because the franchise contract that we inherited from the SRA included those provisions. It allowed us to secure an additional £73.1 million-worth of benefit without any increase in subsidy. The cost to the Scottish taxpayer remained as expected, but the benefits were increased substantially.

Andrew Welsh: I had better rephrase the question. I was looking for an overall view. What finance total was involved in the financial appraisal?

Bill Reeve: Well, there were £73.1 million-worth of benefits in the appraisal.

Andrew Welsh: That is a substantial amount.

Transport Scotland did not provide the Minister for Transport, Infrastructure and Climate Change with a fully documented business case, instead taking the view that it was more appropriate to provide presentations based on the option appraisal work. However, if I picked you up correctly, you said earlier that financial advice was provided by Transport Scotland's own staff. Why was the minister not provided with a fully documented business case before he decided to approve the franchise extension, leaving him to rely instead on a presentation?

Malcolm Reed: I will clarify what happened. In March 2008, we went to ministers having reached a deal that we felt that we could recommend to them. What is referred to as a presentation was actually a detailed walk-through of all the key issues in the deal. We went to ministers to ask them whether they wished us to conclude that deal, and they self-evidently felt that we had given them sufficient information to take that decision because they gave us that instruction. The presentation included a table—which we gave to ministers in hard copy—of all the headline numbers and how they were affected by the options that we recommended.

Andrew Welsh: Surely you would accept that a business case is all about financial viability, practicality and detailed scrutiny of the proposals, whereas a presentation is more a general introduction. Presentations, especially presentations on such a complex and major project, are not fully documented business cases. Surely any minister would want to rely on a robust business case, of which expert advice would be an important part, rather than only a presentation.

Malcolm Reed: That is a question that you would want to address to the minister. I am satisfied—and, I believe, ministers were satisfied—that the information that we gave was more than adequate for ministers to take a decision on the franchise extension. We did not press them for an early decision and made it clear that further information was available if they wished it. We presented to them the outcome of what you have described: a very robust, independently validated appraisal with very clear numbers that made the case themselves.

Andrew Welsh: Did you not consider the need for a business case to be available for scrutiny after the franchise extension was announced?

Malcolm Reed: A business case is available.

Andrew Welsh: When was it available to the minister?

Malcolm Reed: It was available whenever he wanted it.

The Convener: You had a business case but you did not give it to the minister. Will you clarify that?

Malcolm Reed: We made it clear to the minister that a business case had been completed and was available. We gave him the headline numbers in that business case.

The Convener: So there is a business case.

Malcolm Reed: There has always been one and I am surprised that the evidence that you heard before Christmas suggested that there was not.

There is a very robust business case for the extension and I am happy to talk you through it.

George Foulkes: Are you saying that the minister did not ask to see the business case?

Malcolm Reed: He did not ask to see it at that stage, but he was subsequently given it.

George Foulkes: Had he seen the business case to which you just referred before he made the decision?

Malcolm Reed: The minister saw a sufficient summary of what, in his view—

George Foulkes: No, no—did he see the business case to which you have just referred before he made the decision?

Malcolm Reed: If you are asking me whether he saw the document, the answer is that he did not, but he saw the output from it.

The Convener: Why did you not offer the document to him?

Malcolm Reed: We did not withhold it from him.

The Convener: I did not say that you withheld it. Why did you not offer it to him?

Malcolm Reed: Because, when we went to him, we went to report on where we had got to and to seek his advice on how we should take the process forward. At that meeting, he was sufficiently convinced of the strength of the case for extending the franchise that, in effect, he instructed us to conclude the deal immediately.

Murdo Fraser: I would like to get clarity on this matter, because it is an important point in the Auditor General's findings. The evidence that we took from him told us that it was good practice for people who were making such a decision to review the business case. The minister did not do that in the situation that we are discussing. We need to be absolutely clear about whether you offered him the full business case. Did you do that?

Malcolm Reed: Within the presentation that we gave to him, there was a table that summarised the business case. We did not actively offer him the detail behind that summary but, equally, it was open to him to request it if he so wished.

Murdo Fraser: Do you accept that that was a failure to follow good practice?

Malcolm Reed: No, I do not. First, as you will know, advice to ministers is confidential. Secondly, it is for the minister to reach his own view on what information he requires in order to make a decision.

Andrew Welsh: You had a business case and material information about any decision that was

to be taken. I therefore presume that a decision was taken on what I would think was insufficient information. How normal a practice is what you described? In any business, for such an important decision, we would ask for the business case that backed it up. Surely, if you were advising the minister as to what the situation was, you should have pointed out that there was a business case.

Malcolm Reed: We did point out that there was a business case. We go to the minister with many significant investment decisions. It is very rare that we are asked to provide the business case in extenso. Ministers look to advice from the civil service, and we provided that advice on the basis that I, as accountable officer, was satisfied with the business case that lay behind our recommendations.

Andrew Welsh: Is that normal practice?

Malcolm Reed: It is the practice that I have worked to. I have never sought to withhold information from ministers. I have provided ministers with the information that they have wished.

The Convener: Can I clarify that, when Audit Scotland was conducting its investigations, you advised it that there was a business case and offered it the opportunity to examine that business case?

Malcolm Reed: If you look at the *Official Report* of the meeting before Christmas, when Mr Black appeared before the committee, you will see that he acknowledged that there was a business case. What he then went on to talk about is a business plan. During all our discussions with Audit Scotland, the question of a business plan was never raised with us. I do not believe that it is mentioned in the report. As I said, Mr Black has acknowledged that there was a business case. He has also acknowledged that the process was robust and that the conclusions that we reached were well founded. The suggestion that there was no business case therefore seems to me to be a very profound misunderstanding.

The Convener: A misunderstanding on whose part?

Malcolm Reed: I suspect Audit Scotland's.

The Convener: So, there is a misunderstanding on Audit Scotland's part and it is also incorrect in what it said about good practice.

Malcolm Reed: Good practice is a matter of opinion. Obviously, Audit Scotland can reach a view on good practice.

The Convener: You disagree with that view.

Malcolm Reed: I am not saying that I disagree with it. What I am saying is that we worked within the framework that ministers wished.

The Convener: Okay. We might return to this, Dr Reed.

Willie Coffey (Kilmarnock and Loudoun) (SNP): Just to continue on the theme of business case, business plan and rigorous appraisal process, I feel confused about what each of those actually is and whether each provided sufficient detailed information, as far as Transport Scotland was concerned, to present a case for the minister to make a decision on. Can you clarify that it is your view that what you presented—whatever it was called—was sufficient to make the case?

Malcolm Reed: I can confirm that absolutely.

Willie Coffey: Are you calling it a business case, a business plan or a rigorous appraisal process?

Malcolm Reed: I am calling it a business case. All our decisions, in accordance with Treasury guidance, are taken on the basis of a valid and validated business case. If the committee wishes, I can ask Mr McMahon to talk you through the process that was followed and the shape of the document that we assembled.

Willie Coffey: Just to confirm, it does exist in document format.

Malcolm Reed: Absolutely.

The Convener: That is something that we can come back to.

Stuart McMillan (West of Scotland) (SNP): I have a wee question that follows on from what Willie Coffey just asked. What information would be in a business case that would not be in a business plan, and vice versa?

Malcolm Reed: A business case is essentially the evaluation of a proposition. A business plan is the detailed working out over time of that case. In fact, that exists—that is actually what the franchise agreement amounts to. It is a detailed business plan for the life of the franchise, which we amended as a consequence of the franchise extension. That is backed by a very detailed and elaborate financial model. If the question is whether we have a business plan as well as a business case, the answer is yes. However, so far as the actual decision making is concerned, we followed best practice. As I said, we followed a robust process that was independently validated and which produced the advice that we were able to offer to ministers.

10:15

The Convener: We move on to the issue of the investment decision-making board.

Cathie Craigie: How can Transport Scotland be sure that the private, behind-closed-doors negotiations regarding the franchise extension offer the best possible value to the Scottish taxpayer?

Malcolm Reed: In two respects. First, as Mr Reeve explained, we reached an outcome that achieved bankable benefits for the Scottish public. Secondly, the view that we took on the value that we could obtain from the deal was independently assessed by our financial advisers, Ernst & Young. We exceeded the value figure that Ernst & Young estimated that we should be able to achieve from that transaction.

Cathie Craigie: Has Ernst & Young advised you that you can be fully confident that those bankable achievements could not have been reached had the franchise gone out to competition?

Malcolm Reed: The franchise agreement was not constructed in such a way that we could, at that point, have terminated the agreement and gone back to the market. The franchise agreement, which I should remind the committee was negotiated under the previous Administration, contained an express provision for extension, and was drawn up with that in mind. If we had sought to go to the market for alternative bids at that stage, I am pretty sure that we would have been in legal dispute with the existing franchisee.

Cathie Craigie: But you are correct in saying that it was a provision—it was never a definite. Extension was an option that ministers or Transport Scotland could take. Were there any soundings or tests of other providers or other organisations that could provide the same sort of services?

Malcolm Reed: No. Not only would that have been in complete breach of the contractual relation we had with the existing franchisee, it would have broken any provisions about commercial confidentiality, within which we have to conduct the discussions.

Cathie Craigie: Moving on to the confidentiality aspect, the Transport Scotland investment decision-making board assists you—the chief executive—with major investment decisions. However, no non-executive board members sat on the IDM board. Why did Transport Scotland choose not to inform its non-executive board members of the franchise extension?

Malcolm Reed: Again, this is an area where we have not been helped by the previous discussion of the issue. I do not understand why the Auditor General has chosen to focus so heavily on the

place of the non-executive directors in the franchise extension process. The formal position, which is accurately stated in paragraph 70 of the Auditor General's report and in some of his evidence, is that we are an executive agency and that I am the accountable officer. The role and place of non-executive directors are clearly established throughout the Scottish Government. Indeed, in response to a specific question on the matter by Mr Foulkes, the Auditor General stated:

"The arrangement that George Foulkes is asking about is very much four-square with the arrangement that prevails across Government."—[*Official Report, Audit Committee*, 10 December 2008; c 782.]

I am concerned that, despite that apparently clear understanding on Mr Black's part of the role of non-executive directors in Government, he chose to offer further comments to the committee that in my view may have created a false impression. I do not dispute the fact that the non-executive directors were not part of the franchise extension process. Equally, two of our executive directors were not involved in the process until after the deal was agreed with ministers. To focus on the role of non-executive directors is, at best, misleading. In that respect, our process is entirely consistent with the process followed by the Department for Transport, which restricts consideration of franchise matters to a small group of its executive directors. Further, the DFT has confirmed to me that its non-executive directors play no part in that process.

On the wider issue of the role of the non-executive directors in our IDM process, I do not understand why Mr Black placed so much emphasis on the matter. The franchise extension was considered at only one IDM meeting, which took place after the decision had been taken by ministers. The role—or lack of role—of the IDM board in the process is a marginal issue.

It is misleading to say that we excluded the non-executive directors from the process. Non-executive directors were party to the decision that they should not normally form part of IDM boards. The decision was made for two good reasons. First, the non-executive directors form our audit committee. It was their view that their independence as an audit committee would be compromised if they were part of decisions that they would subsequently scrutinise. The second reason is a simple matter of practicality. IDM boards often have to be called at short notice to deal with an emerging investment decision, and IDM meetings often last for half a working day. Our non-executive directors have other jobs to do and we cannot expect them to attend at short notice, to accommodate the diary of what is in essence an internal process that is designed to support me in the advice that I offer to ministers as accountable officer.

Cathie Craigie: Did you say that non-executive directors were party to the decision not to be involved?

Malcolm Reed: That is correct.

Cathie Craigie: How was the decision taken? Also, how many people were involved in the group that negotiated the franchise extension?

Malcolm Reed: The decision that non-executive directors should not be involved in the IDM process was taken at a full board, in which the non-executive directors participated fully.

At the heart of the franchise extension process no more than five or six people were involved. Three directors were involved—Bill Reeve, Frances Duffy, who is director of strategy and investment, and me. A very small team also worked directly on the negotiation and the evaluation, two of whom are present today.

Cathie Craigie: It would be useful to have a paper that set out the trail of decisions that were taken not to involve non-executive directors. I can see that my colleague wants to ask a question, but I wanted to move on—

The Convener: Before I bring in Nicol Stephen, I want to clarify something. Which two executive directors were not involved in the process?

Malcolm Reed: The two executive directors who were not involved were our director of trunk road network management, Jim Barton, and our director of major trunk road investment—at first that was John Howison but latterly it was Ainslie McLaughlin. They were the functional directors who had no real involvement in the franchise process.

Nicol Stephen: When other rail franchise contract extensions have been agreed, has there always been strict confidentiality or has there been openness and consultation? You mentioned the *Official Report* of the committee's most recent meeting, so you will be aware that I asked Mr Black about that. I am interested in hearing about your experience.

Malcolm Reed: As far as I am aware, this is the only case in which a franchise has been extended by negotiation during the course of the franchise. To that extent, we were breaking new ground.

On the general issue, there have been occasions when the Strategic Rail Authority extended franchises for other reasons, most notably to fit in with the remapping of particular franchises or to acknowledge that negotiations could not be completed within the term of the existing franchise. As far as I am aware, such negotiations were conducted on a commercially confidential basis between the franchisee and the department or the SRA.

It is a matter of record that there have been occasions when individual franchisees proposed franchise extensions. By and large, the franchisees put their proposals in the public domain. That is an entirely different arrangement: in a sense the franchisee is coming to the public sector with a proposal, which it has chosen to put in the public domain.

Nicol Stephen: So the First ScotRail franchise extension was unusual, in that it was a first. No doubt you would have been interested to obtain the views of external bodies and stakeholders who have an interest in the future of the rail network. However, is it correct to say that you felt unable to obtain those views, because of market sensitivity and the potential for a breach of financial regulations?

Malcolm Reed: That is absolutely the case.

Nicol Stephen: Will you explain what is meant by "market sensitivity"? What was the potential for a breach of financial regulations?

Malcolm Reed: There is market sensitivity because as soon as negotiations start both parties to the deal have inside knowledge. All the individuals involved are in a position to take financial advantage of that knowledge, if they choose to do so. In that regard, my situation was no different from that of Mr Houston. If I had been minded to breach the civil service code, I could have traded in FirstGroup shares. Of course, I did not do so. The civil service code prohibits such activity, which is also an offence under the Financial Services and Markets Act 2000.

Nicol Stephen: Is not disclosure a way round that? Is not the problem removed if the market knows that an extension is being considered?

Malcolm Reed: No. Disclosure removes potential value that could be obtained from the deal. That is an important point. If we had let the market know that negotiations were going on, in effect the share price would have discounted the outcome of the negotiation and we would not have been able to achieve the full value that we achieved. If you like, Steven McMahon can add more detail.

Nicol Stephen: I am interested in hearing more.

Steven McMahon (Transport Scotland): For clarity, I should say that my role is economic adviser in the strategy and investment directorate.

I will go back to the first principles of the deal. The project was objective led, with a view to removing the barriers to growth that were inherent in the previous agreement. Two core documents constituted the business case. The first document contained detailed financial modelling, which considered options for removing barriers to growth; the second contained the rationale behind

the franchise extension, compared with the alternatives.

The value of the deal that was secured—£73.1 million—was based on an assessment of future revenue growth, on the base case that we were working with, which was agreed with First ScotRail, plus a premium that was built in for risk and uncertainty, which related to FirstGroup's ability, under the new revenue share and support mechanisms, to achieve growth that was above the base case and thereby additional value, from which we would be excluded, because of the adjustments in the mechanisms.

Additional value was secured from our estimate of the worth of the deal to FirstGroup as an entity. We could have lost value in that element of the deal if our intention to extend the contract had been disclosed to the market.

Nicol Stephen: I do not understand why. What happens at the point of disclosure that creates a problem?

Steven McMahon: Our estimate of the additional value to be derived was based on numerous factors, one of which was anticipation of how the franchise extension might positively impact on FirstGroup's share price. We wanted to achieve some of that value, and if disclosure to the market had had an impact on the share price we would have lost that value.

The Convener: Was that a subjective assessment, which was not based on evidence? Was it just your opinion?

Steven McMahon: The assessment was based on the modelling that we had undertaken.

The Convener: We need to move on.

George Foulkes: I want to clarify a couple of points. Dr Reed, as well as being chief executive, are you chairman of the board and the IDM board?

Malcolm Reed: That is correct.

George Foulkes: Is that normal practice?

Malcolm Reed: It is normal in Government.

George Foulkes: Is it a wise practice?

Malcolm Reed: It is an entirely wise practice. I am the accountable officer. That is why I have appeared before the committee this morning.

George Foulkes: You said that you, Mr Reeve and Ms Duffy effectively made the decision, which you presented to the minister without a business case. Where is the public accountability for the largest financial contract that has been agreed by the Scottish Government?

10:30

Malcolm Reed: My accountability is to ministers; ministers are in turn accountable to the Parliament. That is the line of public accountability.

George Foulkes: Do you think that that is an open and transparent line of accountability?

Malcolm Reed: It is the line of accountability under which I and the rest of the Scottish Government operate. I am not in a position to change or question it.

George Foulkes: But we are in a position to change and question it—that is the whole purpose of elected members. Do you think, objectively, that you and two colleagues making a decision and presenting it to the minister without a business case provides sufficient public accountability?

Malcolm Reed: I do not accept the suggestion that it was presented without a business case. It was presented on the basis of what the Auditor General has described as a robust process and a business case. I do not accept the first part of what has been said. Secondly, it is consistent with my responsibilities as accountable officer, and I have no difficulty working within that model.

Stuart McMillan: I will return to some of Dr Reed's opening comments. You said that Transport Scotland is already implementing some of the recommendations from the Audit Scotland report. Can you provide some more information and some examples of what is happening in relation to that?

Malcolm Reed: I can give you a couple of examples immediately, and my colleagues will probably provide more. First, we are implementing Audit Scotland's recommendation that there should be a single web page on which all information about the franchise is collated. Secondly, in view of the comments that Audit Scotland made about disclosure of interest, we now request declarations of interest at the start of every meeting as a matter of practice, even though those interests are already recorded in our register. Those are two instances in which we have already put in place the report's recommendations. I do not know whether my colleagues want to add to that.

Stuart McMillan: Would it be possible for us to receive some written information about the other actions that Transport Scotland is implementing?

Malcolm Reed: Yes, certainly.

The Convener: We will move on to the criteria for awarding the extension, but first Cathie Craigie has a question.

Cathie Craigie: I want to have a final go at the consultation and involvement aspect. I am concerned that such a major extension—which

takes us many years down the road—was not consulted on. I accept what you said about commercial confidentiality, but stakeholders in organisations are every bit as capable as senior management of holding confidential information. Why did you not feel that it was appropriate to involve senior stakeholders, or at least to advise them that discussions were on-going? I am thinking about the service users and trade unions in particular.

I will ask a second question in case the convener does not let me come back in. When did the minister first know that discussions about the extension were under way? You said that the presentation took place in March 2008, but when was the minister first aware?

Malcolm Reed: It is probably easier if I answer the second question first. As the Auditor General's report makes clear, ministers in the previous Administration were made aware in November 2006—

Bill Reeve: December 2006.

Malcolm Reed: They were made aware in December 2006 that extension was an option. Without disclosing the advice that we gave to ministers, I can tell you that—as you can imagine—I would not have proceeded with the process if ministers had indicated that it was not something that they wished us to consider.

We advised ministers in the current Administration in either June or July that we had been considering that option, and we asked them whether they wished to pursue it. Again, we had confirmation. Mr Bogan can probably comment on that in more detail.

Gary Bogan: We went back on 18 September. That is the date on the cover of the material that I had that day, so it might be a day out—if so, do forgive me. We walked the new Administration through an introduction to the franchise and the issues in its performance that had caused us to speak to the previous Administration.

Cathie Craigie: Was that in September 2007?

Gary Bogan: Yes.

Cathie Craigie: So, the answer about June and July was not correct.

Malcolm Reed: No, that was correct. What happened at that time was a heads-up: when new ministers were appointed, they spent a whole day with us as we brought them up to date on where we were with all our projects. We said that the franchise was work in progress, on which we would come back to them in more detail.

Do you want me to reply to the point on consultation?

The Convener: Yes please.

Malcolm Reed: There are two reasons why we felt that it was appropriate not to consult. The first is that there was no precedent for consulting in such a situation, and we were concerned that by consulting we would expose third parties to all the insider issues that I described earlier. Ultimately, the responsibility is mine: if I pass on that sort of information and it is then abused in whatever way, the trail leads back to me. I felt that it was not appropriate to create that sort of exposure.

Secondly, one has to ask what the consultation would have achieved. The fact that the provision for an extension existed was on the record, and it is fair to say that when the franchise deal was announced by ministers there was no suggestion that there would be consultation before the extension clause was implemented. The Strategic Rail Authority's annual report, which was published immediately after the franchise was awarded, records that the franchise was awarded for seven years, with an extension for three years that would be dependent on good performance. By any manifest, objective test of good performance, First ScotRail satisfied that criterion, so there was nothing to consult on. If we had consulted, we would have delayed the realisation of the substantial benefits from the franchise extension, some of which have already begun to flow.

What ministers asked us to do, which we were happy to do, was to consult about how we apply the benefit from the franchise extension. That consultation has just concluded, and we have had about 50 responses from stakeholders throughout Scotland. Ministers will take those responses into account when deciding how to allocate the rest of the value that we have got from the franchise extension deal.

Nicol Stephen: The original contract included an extension clause. Was that public knowledge?

Malcolm Reed: Absolutely. I think that you will find that it was in the press statement announcing the franchise award.

Nicol Stephen: Indeed. On that basis, surely the fact that Transport Scotland was discussing the contract extension with FirstGroup would have been unremarkable.

Malcolm Reed: No, because the time at which we chose to start those discussions would immediately have been market sensitive.

Nicol Stephen: I do not understand that answer in the context that the original contract included a clear extension clause requirement. I do not understand why the fact that you were opening up discussions with FirstGroup would have been in any way unexpected, given that there was an extension clause in the original contract.

Malcolm Reed: It would not have been unexpected but, as soon as we made that public, the stock market would have reacted and the price would have been affected.

Nicol Stephen: I want to press you on that. Surely the market would require to receive information about the nature of any contract extension. For example, if the market perceived that it was a good deal for FirstGroup, the share price would go up, but if the market perceived that it was a poor deal for FirstGroup, the share price might go down. The market would need to have knowledge about the nature of the agreement; it already knew about the extension opportunity.

Malcolm Reed: Yes, but none of those aspects would have been apparent at the start of a negotiation.

Nicol Stephen: Exactly. I agree.

Malcolm Reed: There would have been a market impact.

We do not do things in isolation or without taking advice. We have discussed the principles of franchise extension with the Department for Transport and looked at the advice that it has published. As part of its guide to franchise procurement, it has put on the public record the clear statement that the best value for taxpayers and passengers can be extracted only if commercial confidentiality is observed. I am firmly of the view that the nature of the deal and negotiations, and the market sensitivity around them, made it entirely appropriate for the negotiations to be conducted in private. I am pretty sure that you would get the same response if you asked other financial advisers or analysts.

The key thing is that, once the negotiation is in play, its course will be watched like a football match. If we had failed to reach agreement with FirstGroup, its price would have suffered as much as it might have risen at the conclusion of a successful negotiation. To me, the approach that you mentioned in your question seems to break the basic principles of such a commercial negotiation.

Nicol Stephen: Do you not understand the counter-argument that the fact that you were opening up negotiations for a contract extension was already known and was unremarkable—it was public knowledge because it was in the core contract—and that your approach was unnecessarily cautious and confidential? With the benefit of hindsight, your approach might not have been in the public interest because it removed the opportunity for those with an external interest in the rail industry, including stakeholders and passengers, to contribute to the process.

Malcolm Reed: I do not accept that. Through you, convener, I re-emphasise that we secured £73.1 million-worth of benefits. I do not believe that we could have secured those if we had conducted the negotiation in the public gaze. I also repeat the question that I asked earlier. What would we have gained by telling stakeholders that we were conducting the process? Some stakeholders who have their own views of how the railway industry should be organised would have used that as an opportunity to say, “You should not extend it.” That is their view, but frankly it is not relevant to the decisions that ministers had to make.

We had already consulted the public on Scotland’s railways, and we published a document in the winter of 2006 that set out clearly what the stakeholders wanted from the railway network. We had the benefit of access to the draft regional transport strategies, so we knew the regional transport partnerships’ aspirations for the railway services in their areas, and we were fully engaged with the partnerships in discussing those proposals. We were fully sighted on what the stakeholders were looking for from the railway network, and I cannot see how an additional round of consultation would have added any value to that process. What it would have done, without a doubt, is delay the realisation of the benefits that we have now achieved.

The Convener: Before I bring in George Foulkes for the final questions, I want to tease something out. In your previous answer, you asked what benefit there would have been in going to the stakeholders and suggested that you could have predicted their responses. Could that not be said of any decision that Government makes? What is the point of going to stakeholders, given that in most cases we have a fair idea of what they will say? Why bother with consultation?

Malcolm Reed: That is not what I am saying, convener. I am saying that—

The Convener: This case is different.

Malcolm Reed: There had already been an extensive consultation on what stakeholders wanted from the railway network. In that respect, the process that we conducted for the extension was no different from the process that was followed when the initial franchise was let. All the consultation took place before we moved into the commercial phase.

The Convener: Okay.

Malcolm Reed: There comes a point when one must move on from consultation to implementation, and that is what we sought to achieve through the deal.

10:45

The Convener: Okay. Did you make the decision to maintain confidentiality and not to hold an open discussion, or was it made by the civil service?

Malcolm Reed: It was my decision, but—

The Convener: What about the advice that you took on the impact on shares? You said that you took advice on intricate issues such as whether the share price might go up or down. Who gave you that advice?

Malcolm Reed: People such as Mr McMahon can provide that advice, and we had Ernst & Young to give us a view, although we did not explicitly raise with it the issue of consultation. Our discussions with Ernst & Young and within the organisation were conducted on the basis that we assumed that commercial confidentiality would prevail throughout the transaction, as has been the case with every other franchising transaction.

The Convener: So Ernst & Young was not involved in the decision to maintain confidentiality because of a potential impact on share price.

Malcolm Reed: I will ask Mr McMahon to confirm this, but my view is that Ernst & Young would have given us different advice on the value that we could have achieved if we had said that we would disclose matters publicly.

Steven McMahon: Yes, I think that that is true.

The Convener: Was Ernst & Young involved in giving you advice about the impact on shares?

Steven McMahon: Not specifically. Ernst & Young reviewed the material that I presented to inform the business case.

The Convener: Yes, but we had a discussion about the potential impact on shares and the concerns about commercial confidentiality. For the record, is it the case that Ernst & Young gave you no advice on that?

Steven McMahon: As you said earlier, it is a subjective issue. Ernst & Young commented and provided advice on the additional value that we sought to obtain.

The Convener: I am not talking about the additional value; I am talking about the specific issue under discussion. Ernst & Young did not offer you any advice on that.

Steven McMahon: That is correct.

The Convener: So the professional decision that you made about the potential impact on share prices was not based on any external advice; it was based on internal advice and the extensive knowledge of such matters that exists within Transport Scotland.

Malcolm Reed: Absolutely.

The Convener: Is extensive advice about the potential impact on markets available in your organisation?

Malcolm Reed: I have personal experience of such matters. I have been involved in the letting of the ScotRail franchises since 1994, so I know the basis on which such transactions are conducted. I am fully sighted on the requirements of the Financial Services and Markets Act 2000, and I have worked under the regimes operated by the Department for Transport and the Strategic Rail Authority. I know that commercial confidentiality is the overriding principle in those negotiations.

The Convener: Okay. Thanks for that.

George Foulkes: You have made it clear that the decision to extend the franchise was very much your decision and that you did not think that any further consultation was necessary before you took it. What criteria did you use to decide whether to award an extension of the franchise?

Malcolm Reed: Thank you; that is a very helpful question.

George Foulkes: You should not be surprised.

Malcolm Reed: It allows me to correct the apparent misapprehension that there were no extension criteria. The statement that there were no extension criteria in the contract is absolutely correct—I do not dispute that—but, when we began to consider an extension, the first thing we did was develop criteria that we felt could inform an objective decision about whether to extend the existing contract or whether to retain it.

George Foulkes: Could you tell us what those criteria were?

Malcolm Reed: Yes. I will ask Mr McMahon to talk you through them.

Steven McMahon: Once the financial modelling had suggested that an extension to the contract might optimise value for money, we assessed the rationale for extension against alternative approaches. There were five key areas of assessment: the performance up to that point of the franchisee; the economic and policy context; incentives for future growth; transaction costs; and risk and uncertainty.

HM Treasury endorses a five-case model for business cases, which is the Office of Government Commerce's recommended standard for the preparation of a business case. The OGC requires that a business case should contain information covering five key aspects: strategic fit, which ensures that the rationale underpinning the change that is being proposed is strong; options appraisal, which means demonstrating value for money; commercial aspects; affordability; and

achievability. We are content that our business case satisfied all of those requirements and was consistent with those principles.

George Foulkes: Those are very general issues. I am impressed that you think that you will impress me by quoting the Treasury and the Department for Transport—that really does not make any difference.

I am not clear by what criteria you decided to go for an extension rather than to go to open competition at a later stage and let National Express and Stagecoach come in, which might have produced substantially greater benefits for the taxpayer.

Malcolm Reed: That is precisely what informed the business analysis that we took part in. As the Audit Scotland report clearly identifies, there were three options. One was to do nothing and to let the franchise run its term. The second was to renegotiate the existing franchise within its existing term. The third was to activate the extension option, which was already available to us within the contract. Part of the business modelling was to test all three propositions. That is what we did.

George Foulkes: I am still not clear about the basis on which you tested the models. How did you come to the conclusion that extension was the best option?

Malcolm Reed: We reviewed the financial outcomes from all three options and extension was clearly the best option.

George Foulkes: How did you know what the financial outcome of going to an open tender would be?

Malcolm Reed: We could effectively have gone to an open tender only at the end of the seven-year period, in 2011.

George Foulkes: Exactly.

Malcolm Reed: We had to project—on the best information that we had—the likely outcome of that situation.

George Foulkes: So in fact you wanted a quick buck?

Malcolm Reed: No.

George Foulkes: You did. You wanted money up front, quickly, rather than what might have been a longer-term, substantially greater benefit to the taxpayer.

Malcolm Reed: I totally refute that suggestion. I cannot accept it.

George Foulkes: I am not asking you to accept it.

Malcolm Reed: We were concerned about the long-term development of the franchise. We had reached a point in the franchise at which, as the Auditor General's report makes clear, the commercial incentives to growth had disappeared because the franchise was let at a very difficult time in the railway market in Britain. The SRA went to market three days after Railtrack had gone into administration, and ScotRail had been affected by a long period of industrial uncertainty, which had taken away five years of growth within the franchise. When the original franchise was let, we went to market with an uncertain proposition. FirstGroup was able quickly to restore the growth of the franchise and to put the franchise on an upward trajectory.

It is important to remember that part of the value that we have secured from the transaction is not simply the £73.1 million that we have mentioned. We estimate that, when the time comes to re-let the franchise in 2014 in whatever model Government chooses, we will have lifted the baseline for that deal by £50 million. By going to the market in 2014, with a new proposition, we think that we have got £50 million in the bag every year from the start of the new franchise.

George Foulkes: If you are so sure about that, and so proud of the achievement, why have you decided to retire early?

Malcolm Reed: I am not retiring early. A civil servant can retire at any point after age 60. I was over 60 when I was appointed, and I have taken the view, in discussion with colleagues, that now is an appropriate time for me to step down. I have no problem in sharing that information with the committee.

The Convener: We will draw the discussion to a conclusion there. I thank you, Dr Reed, for your extensive contribution, although we reserve the right to come back to you. You have raised a number of issues about Audit Scotland and the Auditor General that we may wish to reflect on; depending on that, we may return to you.

Malcolm Reed: I am happy to give you further information.

10:54

Meeting suspended.

10:57

On resuming—

The Convener: The next part of the meeting is a discussion with Sir John Elvidge, the Scottish Government permanent secretary. Thank you, Sir John, for making time to come to the meeting; I

realise that your diary has been extremely busy. Do you wish to make any opening remarks?

Sir John Elvidge (Scottish Government Permanent Secretary): Only to thank you personally, convener, for your flexibility on the timing. Otherwise, I think that you are well into your stride and I do not want to break your flow.

The Convener: Dr Reed has outlined issues about his responsibility and the relationship with the senior civil service. He talked about accountability. In accountable officer terms, to whom is Malcolm Reed accountable?

Sir John Elvidge: To me.

Murdo Fraser: Good morning, Sir John. I want to pick up some of the points that we were discussing earlier with Dr Reed about the appointment of Mr Houston at Transport Scotland. Were you aware at the time of Mr Houston's appointment to Transport Scotland that he had an interest in the form of shares and share options in FirstGroup?

Sir John Elvidge: No. As I think Dr Reed made clear, there was not awareness generally. Even if there had been awareness, I would not necessarily have expected anyone to communicate that to me, provided they were taking steps to ensure that it was managed properly.

Murdo Fraser: But as part of Mr Houston's appointment process, would he have been expected to disclose the fact that he had that interest?

Sir John Elvidge: It is helpful if, in the recruitment process, candidates raise the issue of potential conflicts of interest. Candidates know much more about their personal affairs than anyone else does. They are in the best position to identify the fact that something might be an issue. Normally, I would expect candidates to say something about that.

11:00

Murdo Fraser: You will understand the concern in relation to Transport Scotland; everybody who is involved in transport knows that FirstGroup is a major transport company in Scotland. At the time of Mr Houston's appointment, it held the ScotRail franchise and it was envisaged that the franchise could be extended. If anybody in a senior position in Transport Scotland held an interest in FirstGroup, that would have given rise to a potential conflict of interest. I find it surprising that there was no mechanism at least for flagging up that potential conflict of interest at the time of Mr Houston's appointment.

Sir John Elvidge: There is a mechanism for flagging it up once someone is employed, but I agree that it would have been better if the matter had surfaced during the recruitment process. It need not have made a difference to the outcome, but it would have been better if everyone had been aware of the issue during the process.

Murdo Fraser: When we asked Dr Reed about the circumstances of Mr Houston's resignation, he told us that he was unable to expand on that for reasons of employment law. Are you in the same position?

Sir John Elvidge: Yes. To be clear, the reason is data protection law rather than employment law, but I have the same advice that he has about the legal constraints.

Murdo Fraser: You can appreciate our difficulty. Dr Reed made a robust defence of Transport Scotland's position. To paraphrase, he said that nothing that was done in relation to Mr Houston's position and the extension of the contract was amiss, and in that respect he took issue with some of the comments that the Auditor General made in his report. Transport Scotland's position is clearly that there was no problem. It therefore seems something of a coincidence that Mr Houston decided to resign shortly after the matter came to light.

The committee acts as the guardian of the public interest in relation to financial matters, so it has a legitimate interest in pursuing the matter and working out what happened. If, for example, Mr Houston had left Transport Scotland and received a substantial pay-off from the public finances, that would be a legitimate matter of public interest and would concern the committee. I am sure that you will appreciate our frustration that we are unable to get further into the detail of the matter.

Sir John Elvidge: I absolutely understand your frustration, and to some extent I share it. To be frank, I would rather be in a position where I could explain information about these things, but it is not within my power to set aside the law.

If I may say so, the committee's approach to the matter has been helpful. You rightly identified as the first question, "Is there any evidence of wrongdoing around the contract that would provide a starting point for making a connection between events around the contract and Guy Houston's decision to leave the organisation?" I suggest that the first step in that chain has to be to establish evidence of wrongdoing. So far, it seems that the thrust of the discussion does not run in that direction.

George Foulkes: Convener, may I clarify something? Can Sir John tell us who gave him the advice that he mentioned?

Sir John Elvidge: My staff who are paid to give me legal advice. I cannot see any value in personalising things and stating which individual—

George Foulkes: No. So it was lawyers in the Scottish Executive. What provisions in the data protection legislation prohibit you from giving us the information?

Sir John Elvidge: I did not ask them that, but I am happy to provide the information.

George Foulkes: You did not ask them? Did you not see fit to ask them which provisions prohibited you from giving us the information? You knew that you were going to be asked the question, did you not?

Sir John Elvidge: Yes. This is—

George Foulkes: But you did not think it was appropriate to ask, “What prohibits me from giving the committee this information? Can you show me chapter and verse?”

Sir John Elvidge: I did not, partly because the advice was not a surprise to me. I am not unfamiliar with what I can say in public about our dealings as an employer with our employees.

George Foulkes: So, under the Data Protection Act 1998, you cannot even say why Mr Houston is no longer working for Transport Scotland or what financial terms were agreed as part of his departure.

Sir John Elvidge: I cannot tell you why he is not working for Transport Scotland because that was his decision. It is true that the advice is that the Data Protection Act 1998 precludes me from disclosing the details of any financial transactions that we have with him.

The Convener: I accept that. You say that you will get back to us on the specific provision that prevents you from giving us that information. We may want to come back to the civil service code of conduct and what was said at the interview and after that, to follow up the point that Nicol Stephen pursued but, sticking with the issue that Murdo Fraser raised, I accept what you say about data protection and we will receive clarification about the provision that prevents you from giving us the information.

We heard from Dr Reed that Mr Houston's salary was determined by senior civil servants and that that was not a matter for Transport Scotland. We were told that advice was sought from staff in the senior staff team and that Dr Reed received advice from Paul Gray. The salary package is determined by the senior civil service. Dr Reed told us that the conditions of service are the same as those in the civil service. Mr Houston was employed for a period of two and a half years when he chose to leave. Normally, when staff at

that level have worked for two and a half years and choose to leave, what notice are they required to give?

Sir John Elvidge: Normally, three months' notice is required.

The Convener: And that can be waived.

Sir John Elvidge: That can be waived.

The Convener: By whom?

Sir John Elvidge: By agreement.

The Convener: In this case, was the requirement for notice waived?

Sir John Elvidge: Yes.

The Convener: Who in the civil service made the decision to waive the requirement for notice?

Sir John Elvidge: I was certainly aware of the decision to waive it.

The Convener: You were aware of the decision, but who made it?

Sir John Elvidge: Our senior staff team routinely handle discussions with any senior member of staff who is leaving the organisation.

The Convener: So that team advised you before Mr Houston left that he had asked to go and to waive the requirement to work three months' notice.

Sir John Elvidge: Yes.

The Convener: When somebody leaves and it is agreed that they can leave without working the three months' notice, I presume that they are paid up to the date that they leave and have any accrued holiday entitlement paid to them, but that they are not paid anything else, as it is their decision to leave. Mr Houston had been there for only two and a half years. Without going into the details, can you confirm that no enhancement was made in this case?

Sir John Elvidge: I need to say to you that the arrangements are not standard, so I cannot comment further on that.

The Convener: You cannot comment. Is that because you do not know or because you do not want to comment?

Sir John Elvidge: I cannot comment because we are into the territory in which the Data Protection Act 1998 starts—

The Convener: I am not asking for details; I am asking, on a matter of principle, about a man who worked for two and a half years and who asked your team whether he could leave early because he wanted to do so. Did you give him any enhancement over and above that to which he

was entitled for the period for which he had worked?

Sir John Elvidge: You are asking a specific question about an individual. There is no standard answer to the question about what happens when someone leaves before the end of their notice period.

The Convener: Okay. Let us look at the issue from another angle. In the civil service, when someone has worked at a senior level for two and a half years and requests to leave, is it normal for the requirement to work a period of notice to be waived and, if that requirement is waived, is it normal for an enhanced package to be offered?

Sir John Elvidge: Normal is a very difficult term because we are not dealing with something that happens so often that I can say, "Oh yes, there's a standard set of arrangements." Such decisions tend to be individual decisions made in the circumstances of the case.

The Convener: In your experience since you became permanent secretary, would it not be very unusual for a senior civil servant who had worked for the civil service for only two and a half years—not someone who has come up through the ranks—to leave early and receive an enhanced package? Would that not be exceptionally unusual?

Sir John Elvidge: You are asking me to search a mental database that I am not carrying with me.

The Convener: Come on, Sir John. There cannot be that many people who have come into the civil service from outside who have left after two and a half years after asking for their period of notice to be waived. Unless we are all missing a trend in Scottish society, there cannot be so many that such a case would not fix in the memory.

Sir John Elvidge: You are probably right to say that there cannot be that many. Your assumption that it would fix in the memory is the one that I am having trouble with, partly because I never have any personal knowledge of the precise details of most of those cases.

The Convener: Okay. I will make my last point on this issue now, and I will think about whether I want to come back to it later.

In a hypothetical situation, if someone at a senior level who has less than three years' service decides to leave and there is agreement to waive their period of notice and you or any of your senior team make a decision about an enhanced package, I presume that that decision is made without reference to ministers. Would ministers be aware of it?

Sir John Elvidge: No, it would normally be a civil service decision.

The Convener: Yes; so here we have something of public interest that ministers do not know anything about, and we cannot be told about it even though a small group in the civil service may have decided to use public funds.

Sir John Elvidge: You could be told if we had misused our reasonable authority, could you not? That is essentially why you have auditors.

The Convener: Yes, but how would we know whether you have done something that is exceptional in this case if we cannot be told about it?

Sir John Elvidge: I suggest that we have audit processes to give you a channel to know about things that might be of public concern that cannot be disclosed simply through routine disclosure.

Stuart McMillan: I have a quick question to follow on from the convener's questions; I assume that I know the answer already, but I will ask the question anyway.

The guidelines under which the civil service operates are United Kingdom guidelines and there is no separate set of guidelines for Scotland. Is that correct?

Sir John Elvidge: If we are talking about the senior civil service, it is correct. The situation is entirely different for those below senior civil service level.

Stuart McMillan: Have any alterations been made to those guidelines in the past couple of years that might have a different effect in Scotland than in the rest of the UK?

Sir John Elvidge: Not that spring to mind readily. What sort of thing do you have in mind?

Stuart McMillan: I did not know the answer to that part of my question, but thank you.

The Convener: If Nicol Stephen wants to ask about the code of conduct, I will bring Cathie Craigie in after him.

Nicol Stephen: That would be helpful.

Sir John, you have explained that conflicts of interest are not routinely raised with candidates at the interview stage. Is that correct?

Sir John Elvidge: It probably is correct. Certainly it is not my experience that candidates in most recruitment processes are routinely asked to identify any conflicts of interest that they might have.

11:15

Nicol Stephen: It is not part of the application form or the interview, although it could be raised during the interview.

Sir John Elvidge: I have been in interviews in which the issue was raised, but it is not my experience that it is routinely raised.

Nicol Stephen: Is the issue raised when the position is offered to a candidate? Or is it raised when the contract is signed? As I understand it, at the point when the contract is signed, the civil service management code applies. Is that correct?

Sir John Elvidge: Indeed. Is it raised explicitly more than the other obligations on people? Probably not, but at that stage we try to ensure that people understand the obligations that they are entering into.

Nicol Stephen: So by the time Mr Houston signed the contract he should have been aware of the obligation. It is not a subjective issue; disclosure is required. Is that correct?

Sir John Elvidge: Yes. He would almost certainly need to go to the civil service code rather than to his contract because we do not write the whole civil service code into people's contracts, but he would be aware at that point that he was subject to the civil service code.

Nicol Stephen: Are you aware of when the disclosure was in fact made?

Sir John Elvidge: No. I do not have better information than Dr Reed on that. The disclosure arrangements are within Transport Scotland. I think that I am right in saying that they would not be now because, with the introduction of our e-human resources system, we now have an electronic record of interests across the civil service. That did not exist when Mr Houston joined Transport Scotland.

Nicol Stephen: So you remain to this day unaware of when the disclosure was made?

Sir John Elvidge: Yes.

Nicol Stephen: Can you explain to us what, in your view, should have happened?

Sir John Elvidge: Good practice must be for disclosure to happen as soon as possible. In general, if we just leave aside for a moment the electronic era and the introduction of our electronic register of interests, the guiding principle has been for people to disclose an interest as soon as they see a working issue to which it might be material. We have explored the nature of Mr Houston's interests and it seems to me that, given the nature of Transport Scotland's business, one would come to the conclusion that disclosure was appropriate at an early stage. Having interests in FirstGroup is clearly directly related to a number of aspects of Transport Scotland's business.

Nicol Stephen: So disclosure should have been made when he accepted the job, rather than at the time of interview?

Sir John Elvidge: It would have helped everybody if the interests had surfaced during the interview, but the obligation kicks in when he is in employment.

Nicol Stephen: The civil service code and the documents around it make it clear that a conflict of interests could be a material issue in the employment of an individual in the sense that there is the option for the department to require an individual to divest. Am I correct?

Sir John Elvidge: If one were going to require an individual to divest, it would need to be done before one reached the stage of appointment.

Nicol Stephen: Exactly my point. So you need to be aware of the interests before you can have that discussion. However, the civil service code makes it clear that the civil servant

"must comply with any subsequent instructions from their department or agency regarding the retention, disposal or management of such interests."

I assume that those words are still in force.

Sir John Elvidge: Indeed. The right to instruct someone to divest persists, but that can be a significant financial decision for an individual. That is why I believe that best practice is to identify and resolve issues before someone has taken the decision to accept a job.

Nicol Stephen: Do you think that there should be a review of these matters in light of the case that we are discussing?

Sir John Elvidge: Absolutely.

The Convener: I would like to tease something out on that point. If there is not timeous disclosure, which would allow you to make the huge decision about divesting, should you require to do so, is that a breach of the code?

Sir John Elvidge: That is a tricky question. It is certainly a breach of the code if anything happens during the person's employment in relation to which it would clearly have been desirable for an interest to be disclosed. It would be useful for thought to be given to the issue of timeousness. You are probably all conscious of the fact that in the past year there has been a shift away from a ministerial code that did not specify a timescale for disclosure towards one that does. It would be helpful to have a parallel shift on disclosure by civil servants.

The Convener: I want to stick with that point for a minute. You say that a shift would be useful, but also that a failure to disclose is not a breach of the code unless something material happens.

Sir John Elvidge: I think that that is right.

The Convener: What is the point of having a code if nothing happens when people do not disclose? You might as well scrap it.

Sir John Elvidge: Nothing happens when a person is not involved in anything. Over the years, people have concentrated on disclosing things that are material to business in which they are involved, not on disclosing the totality of their interests on a just-in-case basis. The new electronic system that I have described shifts us to a different place. It is more like the register of interests system with which you are familiar.

The Convener: We have a peculiar situation. If a senior official who has been a member of the senior civil service for only two and a half years fails to disclose timeously—which, as you said, they should usefully, and usually do, do—but does so later on, which is not best practice, they can be asked to leave early, be told that they do not need to work their notice and get an enhanced payment. It is rather strange that someone who may have breached the code might get an enhanced payment. Can you understand our puzzlement?

Sir John Elvidge: I understand your line of thinking, but I think that we are compressing two completely different sets of decision making. If there were concern about a breach of the civil service code, it would be right to deal with that through some sort of management process. I will try to be a tiny bit more helpful about generalities than I have been able to be so far. When someone leaves the organisation, there are obviously two parties to the negotiation, each of which is seeking to identify its interests. Determining whether it is in the organisation's interests for the individual to go at one time rather than another is a practical business decision; that is the point that tends to inform the negotiation. It is pretty much unconnected to any other range of issues. The questions that need to be asked are: what is the right thing for the business, and what is that balance of interest?

The Convener: Earlier, when Stuart McMillan asked about a United Kingdom standard, you indicated that the position was different for lower grades and that at those grades it was more up to you. In the areas that you can influence in Scotland, would you encourage managers to consider giving civil servants at lower levels with short periods of service enhanced payments when they leave?

Sir John Elvidge: We should be careful about the use of the word “enhanced” in that phrase. I would encourage everyone to make a business decision about the balance of advantage for the organisation when someone leaves it. If it is in the interests of the organisation for someone not to

go, and for them to work out their period of notice, it would not be a sound business decision to pay them any money in lieu of notice. However, if there is a business reason for their moving on, it might be in the interests of the organisation to co-operate in securing an earlier departure. Those are pretty commonsense principles.

The Convener: But, when someone goes to an employer and says that they want to leave, why would that employer give a payment in lieu of notice?

Sir John Elvidge: If the employer believed that it was desirable for the person to leave—

The Convener: Yes, you would just let them leave.

Sir John Elvidge: If people just resign and say, “I’m going out the door,” that would be simple, although there would still be a discussion to be had about the fact that they would be departing from their contract and would therefore be depriving the employer of the right to demand three months of their working life.

The Convener: Yes, but if they are depriving the employer of that right, why is the employer paying them?

Sir John Elvidge: If the employer believes that an early departure is in the interests of the business and will bring the negotiation discussion to a speedier end—because there must be such a discussion, as the employee does not have a unilateral right to depart—that might be the right business decision.

The Convener: Yes, but if the employee comes to you and says, “I want to leave now,” and you believe that it is in their interests and your interests that they go immediately, would you say, “All right, and, by the way, we’ll give you three months’ pay”? That is bizarre.

Sir John Elvidge: If the situation were as simple as you describe, and we had come to the conclusion that the employee’s early departure was consistent with the interests of the business, I am sure that we would just say, “Cheerio.” Often, however, the situation is more complicated.

The Convener: Yes. However, some people take the cynical view that such arrangements happen for the higher-paid people in our organisations while the punters at the bottom are kicked out the door without so much as a by-your-leave.

Cathie Craigie: We have come here today to find out information, so I find it astonishing that we cannot learn from either yourself or Transport Scotland when exactly Mr Houston’s interest was disclosed. I imagine that you have a great deal of back-up in the civil service, and, if anyone in the

civil service is watching what is happening here today, perhaps they can find out that information via the new electronic system and get a message to you, so that you can tell us when that disclosure was made. It would be useful if someone could work on that during the meeting.

How many senior civil servants in Scotland have left the service of their own will and been paid for three months' work without working their full notice? I appreciate that you will not have that information on you today, but could we have it in writing at an early date?

Sir John Elvidge: I will certainly try to get that information to you. There is a problem that you might recognise from parliamentary questions, which is that, if the numbers are very small, we cannot give anonymised data without, in reality, giving data about individuals. However, subject to that caveat, I will be delighted to try to give you that information.

11:30

Cathie Craigie: And can you give a nod to anyone who might be watching in your office that they should try to get that date to you before the end of the meeting? Without giving too much away, I can say that members still have a number of questions to put to you today.

Sir John Elvidge: I am sure that, if we can give you that information before I leave, we will do so. I should warn you that the electronic system will not help us in this regard, as the date of the original disclosure will not have been captured by the electronic system because it came into operation after that disclosure was made. However, I have no doubt that, as we speak, someone is searching through some paper records.

Cathie Craigie: Will you accept a note that arrives with the date in it?

Sir John Elvidge: Of course.

Stuart McMillan: Is it standard practice for candidates, prior to an interview, to receive information about what they should disclose at the interview or later, if they are employed?

Sir John Elvidge: Probably not. In the generality of our recruiting, declarations of interest tend not to be an issue, so it is probably not a standard part of what we send out to candidates.

Stuart McMillan: Earlier, you suggested that it would be helpful if candidates raised potential conflicts of interest at the recruitment stage.

Sir John Elvidge: It might be that, in the process of review that Nicol Stephen suggested and I agreed was desirable, that is one of the issues that we should pick up.

The Convener: I understand why such information would not be sought at the interview stage—although I accept that you might revisit that—but, when you make the offer of the job, is the person aware that they have to make a disclosure?

Sir John Elvidge: They will have seen their draft contract but, as I said to you earlier, the full contents of the civil service code are not embodied in the contract, which means that this issue might not leap out at them.

The Convener: Do you accept that the contract should definitely highlight the requirement to disclose any material information?

Sir John Elvidge: That seems to be a sensible suggestion.

Stuart McMillan: When was the code introduced and when was it last updated?

Sir John Elvidge: The code has existed for decades and decades—I cannot give you a precise date. It was last updated about a year ago.

Stuart McMillan: Was that a UK-wide update or was it just for Scotland?

Sir John Elvidge: Both. There is a separate Scottish version of the civil service code, although there is no material difference in its substance.

George Foulkes: Have you started the process of finding a replacement for Mr Houston?

Sir John Elvidge: No, not yet. There are working arrangements in place to—

George Foulkes: I am not worried about that.

Sir John Elvidge: Have we started advertising for a replacement? No.

George Foulkes: Why not?

Sir John Elvidge: Because there are business issues to be thought about before we do that.

George Foulkes: What do you mean by “business issues”?

Sir John Elvidge: I think that the need for that post in that form should be reconsidered. I think that this is a natural moment to ask whether we want to replicate the precise set of management arrangements.

George Foulkes: Very interesting. Do you know where Mr Houston is working now?

Sir John Elvidge: I have no idea.

George Foulkes: He is not working anywhere in the civil service.

Sir John Elvidge: Not as far as I know.

The Convener: Mr Houston took up the post in May 2006. Was it a new post at that time?

Sir John Elvidge: I believe so.

The Convener: So, a post was created, he took it up and, now that he has left, you are wondering whether you ever needed it in the first place. Is that right?

Sir John Elvidge: Do not misunderstand me. The question is not to do with whether it was an unnecessary post.

The Convener: It is to do with whether you will need it in the future.

Sir John Elvidge: The question is more to do with the shape of the post and accountabilities than with whether one needs to have a senior person to take responsibility.

The Convener: However, you are now thinking that you might not need the post in the future. The post was established only in May 2006, and you brought in someone who was not able to participate in a major part of the business process because of a potential conflict of interest. What was the point of bringing Mr Houston in?

Sir John Elvidge: The point of bringing him in was the range of skills that he applied to the things that he did. It would be wrong to assume that a different individual would have participated more fully in the things that we have been talking about today. I thought that Dr Reed brought out clearly that the senior responsibility for the rail franchise was always intended to rest somewhere else in the senior team.

The Convener: Do you accept that a cynical view might be taken of a situation in which, with the ScotRail franchise coming up for extension, someone with significant links elsewhere was brought in, appeared not to participate in the process and decided to leave, and it was then decided that that post was not really needed in the future?

Sir John Elvidge: I am in danger of misleading you. I am sure that we will need a post. I think that we need to think about the precise shape of that post.

George Foulkes: Dr Reed has intimated that his contract is coming to an end. Have you started the procedure for finding a replacement for him?

Sir John Elvidge: We have communicated internally the identity of the replacement for Dr Reed.

George Foulkes: Their identity?

Sir John Elvidge: Yes.

George Foulkes: What do you mean by that?

Sir John Elvidge: I mean that we have appointed someone.

George Foulkes: But that has not been announced publicly.

Sir John Elvidge: That is correct. We do not routinely announce our appointments publicly.

George Foulkes: When you made that appointment, did you check whether the person had any shares in any transport company?

Sir John Elvidge: I know that he does not have any shares in any transport company.

George Foulkes: How do you know?

Sir John Elvidge: From a conversation with him.

George Foulkes: You asked him specifically.

Sir John Elvidge: Yes.

Nicol Stephen: Am I correct in thinking that, once the shareholding interest became known, it was apparent that that might constitute a breach of the civil service code?

Sir John Elvidge: No. Having the shares is not a breach of the civil service code. The interest has to be managed.

Nicol Stephen: I will press you on that point. The civil service code states:

"Civil servants must therefore declare to their department or agency"

any interests, including shares, if they would be able, as a result of their position, to further those interests. That is the qualification that you mentioned earlier—a civil servant is allowed to have shares and it is only an issue if their job or role might allow them to affect the value of those shares. I would have thought that that was clearly the case in this instance. The role concerned could affect the value of the shares, because of the significant dealings, which are revealed in Transport Scotland's annual report. It was a sufficiently serious interest to be disclosed in the organisation's annual report.

Sir John Elvidge: There was the potential for the interest to be affected if a set of arrangements for managing it were not in place. However, a set of protocols for managing it was put in place; they centred on ensuring that Mr Houston could never sign off decisions that might be material to his interests.

Nicol Stephen: That is interesting, because it is the issue that I will now come on to.

First, was it made known to you, or to the senior civil service in your organisation, that the disclosure had come late?

Sir John Elvidge: We do not yet know when the disclosure came. Before we all took more of an interest in the issue as a result of Audit Scotland's

report, I was aware that the interest existed—I was aware of it through Transport Scotland's 2006-07 annual accounts—but I was not aware of the details of how it had been declared.

Nicol Stephen: Is it correct to say that you were not aware of the arrangements that had been put in place to deal with the interest?

Sir John Elvidge: Yes—well, to be fair, I took some assurance from the fact that the accounts registering the existence of the interest and referring to the additional practices put in place had been signed off by the auditors. My question would naturally be whether those were robust arrangements. That is from where I took my assurance.

Nicol Stephen: Are you aware whether any advice was sought outwith Transport Scotland from the senior civil service?

Sir John Elvidge: I recollect that I heard Dr Reed tell the committee this morning that it was not.

Nicol Stephen: In respect of the arrangements that were put in place, Mr Houston was permitted to remain present during discussions on the extension of the contract, albeit at a late stage in the discussions. Is that acceptable?

Sir John Elvidge: As Dr Reed said, it would have been wiser not to do that. Was it acceptable? I think that it is consistent with the thrust of the arrangements that were in place, which were designed to prevent Mr Houston from influencing decisions that might be material to his interests. As we have clear evidence that his involvement in meetings was post the decision being made, I do not think that I would describe it as unacceptable.

Nicol Stephen: Have you seen the detailed arrangements?

Sir John Elvidge: Yes.

Nicol Stephen: Is it correct to say that they would permit Mr Houston to remain present while matters relating to FirstGroup were being discussed?

Sir John Elvidge: From memory, I think that they are silent on attendance at meetings; the controls are around involvement in decision making. I would need to check that, but that is my recollection.

Nicol Stephen: Is there a senior civil servant, who has direct contact with you, who is responsible for those issues within the Scottish civil service?

Sir John Elvidge: As Dr Reed made clear, he is responsible for propriety within his accountable officer command.

11:45

Nicol Stephen: I presume that that would apply to each accountable officer.

Sir John Elvidge: Yes. The source of advice to which people can turn is the director of corporate services, the director general for finance and corporate services or another of the senior members of the corporate services chain who have senior level responsibility for all senior staff. There is a chain of people who have generic expertise in HR matters to whom accountable officers can turn if they feel that they need to. There are also the lawyers, of course.

The Convener: I want to clarify something. You say that, prior to the issue going into the public domain, you became aware of Mr Houston's shareholding from the 2006-07 accounts. Did you ask any questions at that time?

Sir John Elvidge: No. The fact that there was a statement about practices and that the auditors had signed off the accounts seemed to me to be an adequate assurance.

The Convener: So, although you are the accountable officer for Dr Reed, the issue never came up in your conversations and you never thought that it was relevant to ask about it.

Sir John Elvidge: No. As Dr Reed said, we must contextualise the matter in Transport Scotland, which was set up with the explicit objective of drawing in a substantial number of external people who had direct experience of the transport industries. I knew that much of the recruitment that was undertaken had resulted in precisely such people coming into the organisation. It was not in any sense a surprise to me that there were people in Transport Scotland with past interests that might need to be managed. That is fairly unusual in the context of the Scottish Government as a whole, but it did not strike me as surprising or unusual in the context of Transport Scotland. My only question would be whether the right arrangements were in place. That is the kind of issue on which I take considerable comfort from the audit judgments.

The Convener: You say that, in the context of Transport Scotland, it is useful to have that external experience at a senior level. Dr Reed came from outside the civil service, too.

Sir John Elvidge: Indeed.

The Convener: But you have appointed his replacement from within the civil service.

Sir John Elvidge: I have appointed an existing civil servant.

The Convener: Given what you said about the relevance to the organisation of external experience in transport, why did you revert to the

custom and practice of appointing from within the civil service?

Sir John Elvidge: The value of external expertise is about team mix, rather than individual posts. Conceivably, we might have appointed someone with a civil service background when we appointed Dr Reed, but we did not. We appointed Dr Reed when there was a new organisation to be established and created. The right characteristics of chief executives change at different points in an organisation's history and development. The fact that, several years in, one thinks that a particular skills mix is right for the organisation does not mean that one took the wrong decision about the skills mix that was appropriate on day 1.

The Convener: Does Andrew Welsh want to move us on to the business case?

Andrew Welsh: Sorry, I am just fascinated by what has been said. A continuing and fundamental conflict is involved here. I can see that, when any industry is being dealt with, expertise might be sought, but that expertise or experience comes at a cost. We notice that the particular individual neither spoke nor participated in a meeting, but I presume that there was a need for his expertise, which is why he was appointed to the post. In other words, although one might argue about whether or not he should have been present at the meeting, his interests affected his work and his ability to advise on or participate in a crucial, major decision. Is it not important to have robust rules that can cover such situations? Inevitably, the desire to recruit expertise will lead to such potential conflicts. It also means that senior officials will not be able to do the job that they are appointed to do. If such officials can be present at a meeting but cannot speak or be involved, what is the point of their being there? Is it not important to get a clear set of rules to ensure that this does not happen again?

Sir John Elvidge: It is important to have a clear set of rules. When we come to consider how we ensure that this does not happen again, we need to be clear about what it is that is not to happen again.

To go back to your starting point, you are absolutely right that it is desirable to have external expertise and that there is a need to ensure that individuals' interests do not affect the advice that they give or how they do their job. As so often in life, there are two desirable things that do not fit easily and neatly together, so the interaction between those two desirable things must be managed in some way. The question must be how good the management arrangements are for balancing the two things.

My perception is that we have heard no evidence that that balance was not properly

managed in dealing with the rail franchise. There is no evidence that someone who was essential to the decision-making process was excluded from it. Another team whose expertise was specifically in the rail industry was—and always would have been—charged with that process. The individual concerned was kept out of what was deliberately a very tight, need-to-know process in the organisation. It is not clear to me that the public interest has been damaged, although that is quite different from saying that I do not understand why the issue has generated concern and interest. However, whether damage has been done and whether it is understandable that people should be interested and concerned about the issue are different questions.

Andrew Welsh: But this situation could continue. Even in hiring advisers, you would still have to ask whether the advice given was totally objective. However, we are dealing here with in-house staff, which amplifies the problem.

Sir John Elvidge: Yes, indeed. One way of describing the Transport Scotland model is as a move away from relying on external advisers to trying to internalise some of that expertise within Government. As I said, that creates tensions that must be managed, but it is intended to have clear benefits, not least of which are financial benefits. Buying external expertise is expensive compared with hiring that expertise internally—if one thinks that one will have a regular need for that expertise. A judgment is required. There is no perfect answer.

Andrew Welsh: However, it is important to know that that expertise is not biased and does not have other interests to cope with.

Sir John Elvidge: It is important to know that that is being managed effectively. Some industries are smaller than others. The risk that people will have a relevant past is greater in some contexts than it is in others. Pragmatically, I think that the effectiveness of the management arrangements in this context will always be the key question.

Andrew Welsh: Convener, sorry for not moving on, but I think that we all share a common interest in ensuring best practice.

Nicol Stephen: Before we move on, I have one further area of questions on this issue.

The Convener: Okay. I will come back to Andrew Welsh.

Nicol Stephen: Thank you.

You mentioned the role of the auditors, Sir John. I assume that you accept that the primary responsibility for ensuring that conflicts do not arise is an internal one. However, the auditors raised the issue, which is why we are having this discussion today.

Sir John Elvidge: Indeed.

Nicol Stephen: When you became aware of the public criticism from Audit Scotland, what action did you take?

Sir John Elvidge: I took a considerable interest in understanding the arrangements much better and in seeking to replicate the process that you are going through to try to assure myself that no identifiable damage to the public interest had occurred.

Nicol Stephen: Did that involve discussion with Audit Scotland, internal colleagues and Transport Scotland?

Sir John Elvidge: Yes. I took steps to understand a bit better the issues that had concerned Transport Scotland. Primarily, I needed to understand what had actually happened, which required me to concentrate on talking to colleagues in Transport Scotland.

Nicol Stephen: Did you consider taking any action that would have involved sanctions?

Sir John Elvidge: By the time that Mr Houston decided to leave, I had not had sufficient time to consider all the issues. I do not want to create a false impression—I am not contradicting my point that, so far, I have identified no damage to the public interest that occurred in practice from Mr Houston's interaction with the ScotRail franchise.

Nicol Stephen: What is your view of Transport Scotland's handling of the issue?

Sir John Elvidge: As Dr Reed said, with hindsight, some things could have been done better. We both agree that it would have been better for Mr Houston not to be present at any meetings on the franchise, even after the decision was made on it. That is more about respecting public concerns than about the realities of decision making. Nevertheless, we all agree that it would have been better to make the judgment in a different place.

Andrew Welsh: What was your role in the contract?

Sir John Elvidge: None. I would not routinely have a role in such a contract unless particular difficulties emerged about which ministers were concerned. I knew that the issue had reached ministers, that they had taken the decision and that they were satisfied with the basis of the decision making. Frankly, it would be wrong for me to try to second-guess the considerable expertise that we have built up on that very technical contract area.

Andrew Welsh: It is a major contract. Were you informed about it, or did you at least have an indication of progress and that all was going well?

Sir John Elvidge: I knew that the contract and negotiations had delivered substantial public benefits. If I had been told that we were thinking of concluding a contract extension that would cost us money, I might have responded differently, although it is unlikely that I would have said, "Step aside, I'll roll up my sleeves and redo the work." That is not the reality. However, if the news about the outcome had been bad rather than good, I would have wanted more exploration of the issues.

Andrew Welsh: I imagine that your desk is not unbusy, but do you receive or seek regular reports on such important contracts?

Sir John Elvidge: It varies from case to case. The commercial confidentiality that we have talked about so much is a factor. Transport Scotland rightly took the view that, on the basis on which it was operating, I did not have a need to know about progress.

Andrew Welsh: Do you have a system whereby a red light can flick on? In other words, would you be alerted to significant problems on a need-to-know basis?

12:00

Sir John Elvidge: I would expect to be alerted through my routine discussions. In this case, the discussion would not be directly with Dr Reed. Although Dr Reed and I see each other one to one from time to time, I am not his line manager. I think that that point was brought out by the Auditor General in a previous evidence session when someone asked about what, in the parlance of the trade, is called the Fraser figure—the senior civil servant who exercises oversight of an agency. That figure is Dr Goudie. Therefore, when I am reviewing the transport sphere generally, I review it in my very frequent discussions with Dr Goudie, rather than directly with Dr Reed. There is a separate chain—the accountable officer chain—that runs direct to me. That is partly why Dr Reed and I sometimes have one-to-one conversations.

Andrew Welsh: You also have the other side, which involves the Cabinet. To what extent was the Scottish Cabinet advised of or involved in the decision to extend the contract? Indeed, should the Cabinet be advised of or involved in a decision on a contract of this size?

Sir John Elvidge: That is a matter of judgment. I will tread carefully on the question of who was involved because it is always important to respect the privacy of ministers' decision-making processes. However, I think that it is right to say that the decision was taken by portfolio ministers rather than by the Cabinet.

As a bridge to the second part of your question, let me say that I was consulted by Dr Reed about

whether, as the most senior person responsible for supporting the Cabinet, I thought that that was an acceptable and correct judgment. I said that I saw no reason to challenge the view of portfolio ministers that the decision did not need to be taken to their Cabinet colleagues.

Such issues are always a matter of judgment. Some of the tests that I apply include whether the outcome will materially affect the interests of other members of the Cabinet. For example, if the decision had involved consuming resources rather than bringing benefits to the public purse, I might have thought that, because consumption of resources in one place has opportunity costs in another, the decision should come to the Cabinet. However, given that the decision involved putting money into the public purse, it did not seem to me that that test was brought into play.

In addition, I normally ask myself the question, "Is it likely that any member of the Cabinet would feel difficulty in being bound by collective responsibility for the decision?" Under previous coalition Governments, I would have been more inclined to answer yes, rather than no, in response to that question. Under a single-party Government, my experience—both here and at the UK level—suggests that the boundary of what ministers are prepared to let their colleagues decide for them tends to be in a very different place. I concluded that there was no reason for me to second-guess the portfolio minister's judgment that the decision would not put strain on the collective responsibility of the Cabinet. I think that the evidence has demonstrated that the portfolio minister's judgment was correct.

The Convener: Can I clarify that? Did you not think that the finance minister had an interest in how much extra money would be brought into the account?

Sir John Elvidge: The finance minister is the portfolio minister.

The Convener: Of course he is, ultimately. Was the First Minister kept informed?

Sir John Elvidge: He may well have been kept informed by the portfolio minister, but that is not—

The Convener: But not formally, in terms of—

Sir John Elvidge: That is not the question that I was being asked.

The Convener: But the First Minister would not have been copied formally into the routine correspondence—I accept that he may have been kept informed by the finance minister.

Sir John Elvidge: I cannot say for certain without checking, but I think probably not.

The Convener: That is interesting.

George Foulkes: You mentioned the portfolio minister and the Cabinet as a whole. When there is a minority Government that does not reflect the majority within the Parliament, do you not—in this as in other matters—have a wider responsibility?

The Convener: I do not want us to get into that philosophical discussion.

Sir John Elvidge: Let me just say that I do not have a wider responsibility than to the Cabinet. The question for me has to be whether any member of the Cabinet would feel that their reasonable expectations of involvement in decision making had been thwarted. That is the only question that I was addressing.

Andrew Welsh: I understand the sensitivities involved in your overview role, but were you aware that the minister had made the decision to extend the franchise contract without a fully documented business case, even though such a business case existed? If not, why not?

Sir John Elvidge: I was aware that the minister—or ministers, to be more precise—were satisfied that they had a basis for decision making.

During Dr Reed's evidence, I could not resist thinking that the distinction between there being a business case and giving the document to ministers sounded at times like civil servants saying to ministers, "You're not allowed to make this decision unless you agree to read those 100 pages." That is not the right relationship between civil servants and ministers. Ministers are, by and large, the best judges of when they have sufficient information to satisfy their accountability for the decisions that they make. To say to a minister, "You must read this before you make a decision," is a bit like saying, "Eat your greens."

George Foulkes: Yes, Sir Humphrey.

Sir John Elvidge: I do not regard that as a Sir Humphreyish point. I think it is clear that ministers thought that there was a strong business case for taking the decision. They were satisfied—

George Foulkes: It was political.

Sir John Elvidge: That is your assertion. It is ministers' right to decide when they have the basis for a decision.

Andrew Welsh: You will understand that the Public Audit Committee is concerned about value for money and good business practice. Our objective is to ensure value for money. I am still concerned about the difference between a minister receiving a presentation and a minister receiving a business case. I presume that a business case would involve risk analysis, an assessment of whether value for money was provided, and other sound practices and essential management tools that are part of good business practice. It concerns

me that the minister did not have a business case. I would have thought that, if a business case existed, it should have been drawn to the minister's attention to ensure that there was a proper risk analysis and all the other things that make for good business practice.

Sir John Elvidge: I heard Dr Reed say that the conclusions of the business case were what was presented to ministers—preconceptions about what a presentation is are not very helpful.

At the risk of being Sir Humphreyish again, the fact is that many ministers prefer to make decisions after something that resembles discussion and dialogue rather than by reading lots of paper. That is a perfectly legitimate ministerial preference.

The crucial question is whether the analysis was available and whether the key information was in front of ministers. The Audit Scotland report seems to me to say in the most unambiguous terms that there was a robust and thorough analysis of the issue. Dr Reed has said clearly that the conclusions of the business case were communicated to ministers as the basis of their decision. I do not see a flaw in the chain of evidence that led to the decision.

The Convener: The last question will be from Stuart McMillan.

Stuart McMillan: Sir John, did either you or Dr Goudie see the presentation or the business case before or after the information was given to the minister?

Sir John Elvidge: I cannot speak for Dr Goudie, but I certainly did not, and would not have expected to.

The Convener: Willie Coffey wants to clarify one point.

Willie Coffey: On the issue of the business case appraisal process and the business plan, with the benefit of hindsight and looking to the future, can we anticipate that guidance will be issued on what kind of documentation might be expected in such cases so that there is no lack of clarity about what constitutes a business case or a business plan? From Dr Reed's answers, it is clear that some rigour was applied. As Sir John said, the minister has discretion over exactly what he deals with and what he asks for. However, I think that there is a lack of clarity about what might be expected on such a major decision. It would be helpful if guidance was issued on what documentation should be expected.

Sir John Elvidge: I think that that is right. I do not mean to appear flippant, but generally speaking I do not encourage my colleagues to concentrate on watching their backs rather than on getting the business of government done. I think

that not just Transport Scotland colleagues but other colleagues might reasonably draw the conclusion from people's concerns—which I recognise are legitimate—that it might have been better to have just a little bit more emphasis on process, even if that was not for the benefit of ministers but for the benefit of other audiences.

The Convener: I just want to tidy up one issue about Mr Houston's departure. You feel that you cannot give us the details of the package that was made available—

Sir John Elvidge: Let me say—without getting into the territory that I am trying so hard to stay out of—that I would not want us to work on the assumption that something called “a package” exists.

The Convener: Well, a decision was made about the terms of his leaving, which you cannot go into. Can you tell us the reason why notice was waived?

Sir John Elvidge: Yes, I think that I probably can help you there.

I often take the view that, when someone senior is going to leave the organisation, it is better for the organisation not to continue to work with someone who will not live with the consequences of the decisions in which they are involved. I think that work will progress better if people are not in a state of uncertainty about whether what a senior manager says today will be the instructions under which they will operate in two months' time. I think that there is often a business case for making breaks cleanly. Where there are any other factors that might complicate that—it would be naive not to recognise that Mr Houston's name was in the public domain, which was bound to complicate the conduct of business—there is another reason for saying that the business of the organisation is likely to go forward better if the break happens sooner rather than later.

The Convener: I will let Murdo Fraser have what will be absolutely the final word.

Murdo Fraser: I have one final point that I want to clarify. In the normal course of events, would someone leaving the civil service in circumstances similar to those of Mr Houston sign a confidentiality agreement?

Sir John Elvidge: I would make a distinction between two types of confidentiality. In relation to confidentiality about anything that people learned while they were in employment, they are clearly bound—by the Official Secrets Act as much as by anything else—not to misuse knowledge that they acquired while in office. In relation to confidentiality about the terms of their departure, the employer's obligation to preserve confidence on that tends to be symmetrical to that of the

employee. The reality is that, if the employee chooses to disclose those terms, we are a bit less likely to dash off to the courts than the employee might be if the boot were on the other foot. However, the starting obligations are symmetrical.

The Convener: Thank you very much for your attendance. If we have any further questions following today's meeting, we may revert to you in writing.

George Foulkes: Will we be provided with the provisions of the data protection legislation?

The Convener: Sir John has already agreed to provide that information, which we look forward to receiving.

We now move into private session.

12:16

Meeting continued in private until 12:28.

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