

TRANSPORT AND THE ENVIRONMENT COMMITTEE

Tuesday 12 December 2000
(*Afternoon*)

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TRANSPORT AND THE ENVIRONMENT COMMITTEE

31st Meeting 2000, Session 1

CONVENER

*Mr Andy Kerr (East Kilbride) (Lab)

DEPUTY CONVENER

*Nora Radcliffe (Gordon) LD)

COMMITTEE MEMBERS

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

*Helen Eadie (Dunfermline East) (Lab)

Donald Gorrie (Central Scotland) (LD)

*Robin Harper (Lothians) (Green)

*Janis Hughes (Glasgow Rutherglen) (Lab)

Cathy Jamieson (Carrick, Cumnock and Doon Valley) (Lab)

*Fiona McLeod (West of Scotland) (SNP)

*Des McNulty (Clydebank and Milngavie) (Lab)

*Mr Murray Tosh (South of Scotland) (Con)

*attended

WITNESSES

Professor Alan Alexander (West of Scotland Water)

Sarah Boyack (Minister for Transport)

Katharine Bryan (North of Scotland Water Authority)

Councillor Robert Cairns (East of Scotland Water)

Ernest Chambers (West of Scotland Water)

Dr Jon Hargreaves (East of Scotland Water)

Andrew Maclaren (Scottish Executive Development Department)

Trisha McAuley (Scottish Consumer Council)

John Martin (Scottish Executive Development Department)

Graeme Millar (Scottish Consumer Council)

Colin Rennie (North of Scotland Water Authority)

CLERK TO THE COMMITTEE

Shelagh McKinlay

SENIOR ASSISTANT CLERK

Tracey Haw e

ASSISTANT CLERK

Alastair Macfie

LOCATION

Committee Room 2

Scottish Parliament

Transport and the Environment Committee

Tuesday 12 December 2000

(Afternoon)

[THE CONVENER *opened the meeting in private at 14:07*]

14:31

Meeting continued in public.

The Convener (Mr Andy Kerr): I open the 31st meeting this year of the Transport and the Environment Committee. I welcome to the meeting the Minister for Transport and her colleagues, and those members of the public who have joined us.

Ferry Services (Northern Isles)

The Convener: Our first item of business is the Executive undertaking on northern isles ferries. The committee will consider the draft undertaking that the minister has presented to us. It would be useful if she would introduce the item and update us on any significant events that have taken place, so that we can have a full discussion.

The Minister for Transport (Sarah Boyack): Thank you, convener. Today I wrote to you to clarify a point of detail in the minute of agreement that is attached to the draft undertaking. The background to the letter is that our subsidy assumptions were made on the basis that one of the vessels that NorthLink Orkney and Shetland Ferries Ltd was planning to use would be built at Fergusons shipyards. Unfortunately, the Scottish Executive was informed only late yesterday that there were severe difficulties in concluding the deal with Fergusons because of problems with design arrangements and the timetable for delivery. I am extremely disappointed that at this stage it appears that Fergusons will no longer be involved in building the ship, because bringing jobs to the Clyde was one of the elements of the package to which I was particularly keen to sign up.

To cover the possibility that the arrangements with Fergusons might fall through, NorthLink is working hard to seek revised quotations from the other yards from which they initially sought tenders for the ships. The objective is for the company to obtain the best possible price. However, that may mean that the assumptions in the company's tender about vessel price and the associated

leasing cost will be changed. My letter to the convener brings to his attention the fact that figures included in the table in clause 3.3 of the draft minute of agreement may have to be adjusted in the light of that.

The Executive has agreed to consider with the company the impact of these developments on its subsidy, with a view to reaching an acceptable solution—on the important condition that value for money and the tendering competition are not affected. We are hopeful that a solution along those lines can be arrived at, so that the various agreements can be signed by the end of this week.

If the arrangements with Fergusons fall through, there will also be consequential changes in the tripartite agreement, which includes figures for charter termination payments and rentals in future years for any new operator. Those figures relate to termination of the contract, which would happen only in extreme situations.

I am sorry to bring this to the committee at such a late stage in the deliberations, but I felt that it was right to do so before the committee was invited to approve the draft undertaking. I am, however, pleased to bring that draft undertaking to the committee and to approve the terms and conditions for payment of a five-year block subsidy—from 2002 to 2007—for the northern isles ferry passenger services.

Trying to find the best deal for the taxpayer, while complying with open and fair procurement processes and the European Commission's regulations and guidelines, has presented challenges. The starting point for Executive policy has been a recognition of the importance of lifeline ferry services throughout the Highlands and Islands. We have the power to commit financial support for the services; the partnership is committed to delivering on that. We are also committed to consulting local communities, councils and others who rely on the services. In preparing the draft tender, we consulted exhaustively the islands' councils and others to ensure that we produced terms and conditions that suited their needs. The process was fair and open. The Executive has followed both its own requirements on procurement and the requirements on competition that are set out in the European Commission guidelines that apply to the subsidy of shipping.

Caledonian MacBrayne is part of the joint venture bidding, and we recognised the need for clear arrangements in the Executive to separate responsibilities. I am satisfied that we established proper arrangements that have worked well.

Three companies were involved in the last stage of preparing costed bids. All produced excellent

bids that were carefully and thoroughly evaluated. I announced in October that NorthLink had been appointed as the preferred bidders. Since then, we have had lengthy and detailed negotiations on the final terms of the contract. Members now have that in front of them. To the non-lawyer, reading through the undertaking and the background details can be difficult; it might be helpful if I point out some of the main benefits and improvements.

From 2002, three new vessels will be plying the routes. The vessels will also be available for future contracts in the next tendering exercise under the tripartite agreement that is part of the contract documents. There will be service and timetable improvements on the Pentland firth crossing, with an additional third return crossing on most days. The crossing time will be 90 minutes.

For Shetland, there will be a seven-day, year-round service in each direction; in most weeks at present, there are only six services. There will be improved later departure times on certain services, and earlier arrival times in Shetland. On the Aberdeen services that call into Orkney, there will be increased and improved services, three times a week all year round. The timetabling will be improved.

For all services, there will be an integrated transport timetable for through-ticketing and transfers to coaches or, on the mainland, rail connections. There will be lower average passenger fares. The schedule to the grant agreement outlines fares that are lower by an average of 18 per cent on the average April 2000 prices. In return, the Executive will be paying a reduced subsidy of an average of just less than £10 million at April 2000 prices on current assumptions. That will increase in line with inflation. For members' information, I should add that the current subsidy is £11 million a year.

We have ensured that negotiations between the operator and the harbour authorities are taking place. With the new vessels, investment is required at the harbours involved. Each harbour has different requirements. A lot of detailed work has been carried out and I am satisfied that each of the harbour authorities is completely committed to the project and to securing the necessary finance to meet the timetable. The Executive will be involved in further partnership arrangements.

I believe that, overall, this represents a very good deal for the islands. We have involved people in the process, particularly in the tender specifications. The quality of the services will improve, meeting a key Executive objective and representing good value for money.

The Convener: There will be a number of questions from committee members. I would like to be clear on a few points of procedure first, as

that may flavour our discussions this afternoon. What would be the effect of our not approving this measure, bearing in mind the fact that the committee would be more than happy to meet on an emergency basis to approve what would be—for want of a better phrase—the proper undertaking, once the amendments and changes have taken place?

If we approve the undertaking as it stands and it goes to the chamber having been amended by the Executive, what we have said about it may not count. Would our approval then be immaterial? The undertaking would have to either come back to us or go straight to the chamber. I have had a short discussion with my committee colleagues and we would not wish you to take the latter route.

The document is a substantial piece of work. Having read it, I appreciate its significance and the amount of work that has gone into it. I would like some clarification on the processes in relation to the changes that you mentioned. If other committee members want to ask about the process—with regard to the issues that we have discussed—would they do so now?

Mr Murray Tosh (South of Scotland) (Con): I have a question about the implication of any change. It would be helpful if we were aware of what would happen if the requirement to retender for a ship from another yard meant that the deadline was missed. I am not clear, from what I have taken in of the material, whether it is acceptable to miss that deadline, in terms of the safety regulation. If there must be new shipping on that route by that date and the tenderer cannot deliver, what is the Scottish Executive's back-up plan? Presumably, it would be neither possible nor financially realistic to seek to maintain the current operator in some continuation of the existing service. That is an important piece of information.

Sarah Boyack: Murray Tosh has raised utterly relevant points. On the first point, I was keen to make the committee fully aware of the background to the undertaking. Although the change has come late in the day, I felt that that was important for the purpose of transparency.

Not approving the undertaking this week would have an impact, because the two big ships that are coming from the Finnish yards—the 125 m ships—are eligible to receive support from the European Commission. To do that, the application must go through the Finnish parliamentary process by this Friday. A time scale is marching in on us, which is why it is important that we approve the undertaking this week. That is a major issue in terms of the affordability of the new boats. From my perspective, it is critical to ensure that the undertaking goes through our parliamentary process this week.

On the deadline, all new ships have to meet the new safety of life at sea regulations. They also have to meet the tougher Stockholm requirements that were introduced after the sinking of the Estonia. We now have much higher safety standards on all new passenger ferries. The new boats will be able to deliver all those exacting standards, whereas the existing boats do not meet them all, which is one of the driving factors behind the need to have the new boats. The deadline is October 2002; it was previously the summer of 2002. That gives us a little more time to ensure that the boats are up and running.

The Convener: To allow the process to happen, what do you propose to take to the Parliament for its approval? That is what I find confusing. Will the problem be solved by Wednesday or Thursday of this week if it is to go to the chamber then?

Sarah Boyack: Work is on-going. As we have notified the committee, the critical issue is that the subsidy will not be identical to the subsidy mentioned in the accompanying documents. In terms of value for money, it is important that we are able to deliver the subsidy at a certain level. We also have to ensure that any subsidy arrangements meet the competition requirements so that they are fair to all the bidders in the process. The current figures, which can be found in the revised information that we have given you today, meet the new requirements that arise as a result of yesterday's information.

14:45

Mr Tosh: I did not feel that the minister dealt fully with the point that I raised. I do not know enough about the procurement of ships to comment in detail, but I imagine that it is a fairly protracted and complicated business and the possibility arises that the third ship might not be in service by the right time. I asked what the Executive felt it might have to do in those circumstances. I quite understand if the minister feels that she cannot or should not answer that question at this stage, but I would like to know as much as she can tell us about what might happen in those circumstances.

Sarah Boyack: I am sorry; it is just that I did not write down that point when you asked your question. I shall ask John Martin to tell you about our arrangements for such circumstances.

John Martin (Scottish Executive Development Department): There are a couple of contingency arrangements. First, the preferred bidder is NorthLink, which is part owned by Caledonian MacBrayne. There would be a possibility of bringing CalMac's fleet reserve vessel on to at least one of the routes if the ships were not there in time. There is also a possibility of

the present P&O ships being converted, albeit at considerable cost, on a short-term basis to span the gap between the expiry of the present contract and the new ships coming on stream. That would be a costly process and would not represent best value, but it is a contingency arrangement if all else fails.

Ensuring that the new ships—particularly the big ships for Shetland—are built on time is not only a question of getting the arrangements through the Finnish Parliament to secure intervention money; it is also a question of getting the contracts signed to enable the shipyard to start on the ships, so that they are ready to go on the route from 1 October 2002.

The Convener: Does that answer your question, Murray?

Mr Tosh: Yes.

Robin Harper (Lothians) (Green): I seek clarification on one point. Tell me if I am wrong but, as I understand it, the Finnish contract and the Scottish contract are inextricably intertwined and, for the Finnish contract to go ahead, we must approve the Scottish contract in some way or sign a blank cheque. Is that right?

Sarah Boyack: No. We are coming forward with our estimate on the subsidy that is required, which takes into account alternative arrangements if the Fergusons deal falls through. The critical thing about the timing is that we must be able to ensure that the contracts are signed for the two big ships at the Finnish yard. To do that, we must ensure that the package has been approved so that we can get on with the work.

Bruce Crawford (Mid Scotland and Fife) (SNP): I am not sure whether this is a procedural point or one that will follow later. Is there capacity to separate out the Finnish contracts from the Ferguson contracts so that we can allow the work to proceed in the Finnish shipyards while still holding out some prospect of Fergusons in Port Glasgow getting the other contract? Alternatively, is the whole issue of Fergusons so dead in the water that that is not going to happen? How can we get some leeway in the process to allow the work still to go to Fergusons?

Sarah Boyack: We have to approve a contract with the operator. There is one contract, so we must have confidence that NorthLink will be able to identify an alternative arrangement to provide that third ship. We are satisfied that that is the case. The subsidy level outlined in the documentation is based on information given to us by NorthLink and on lengthy discussions. However, it is not possible to deal with Fergusons as a separate contract. Doing that would mean that we would have to tender for elements of the provision separately.

Bruce Crawford: On the potential for Fergusons to build that ferry, does the problem with the time scale relate to the Finnish yard having a contract ready by the end of the week so that work can start? Is the time scale putting Fergusons in jeopardy? Would more time allow Fergusons to produce a bid and a process that would allow it to continue to build ships? What mechanisms could we use to help Fergusons to reach that point?

Sarah Boyack: The negotiations have continued for the past two months. Lack of time is not the problem.

John Martin: Fergusons was concerned that it would not be able to supply the ship within the time scale that was required to put the contract in place for 1 October 2002. From the information that we have received indirectly from Fergusons, I am not confident that it will be able to fulfil the contract, even if we allow it more time.

It might help if I give a little more detail of the negotiations that have been entered into in the past few days. Only at 6 o'clock last night did we hear that the Fergusons deal was not deliverable. Our concerns are that we get value for money and ensure that the ship is built. Not proceeding would cost the Scottish Executive considerably more than proceeding.

Another criterion applied in the second bid. As the minister said, we had three bids. The first that we took was the cheapest. For reasons of commercial confidentiality, I cannot tell the committee what the other bids were. However, we have a ceiling with which we can negotiate, which is below the level of the second bid.

The other criterion concerns what it would cost to abort the deal and start again. We are trying to work up an arrangement with CalMac NorthLink whereby we secure the deal. If necessary, CalMac NorthLink will go to another yard. It invited tenders for the ship and received several. The company chose Fergusons, but other yards were on the list. The company is now returning to those other yards for prices, to find out whether it can have the ship in place by the deadline that we have set.

We have negotiated a deal with NorthLink on a maximum figure that we are prepared to share from the additional costs. I think that we have made that deal, but I would be grateful if members did not press me for the details today. The deal is much better for the Scottish Executive than doing nothing or accepting the second bid would be. In the revised undertaking, we hope to make clear the mechanism for the deal, if not the exact figure. That will allow the committee and the Parliament to know how the subsidy will be calculated.

Mr Tosh: I do not want to press for information that might be commercially confidential but, given

the position that we have reached, it strikes me that the balance of risk now moves significantly, because a third ship must be in service by the deadline or a time close to it. NorthLink is procuring the third ship and is approaching shipyards that were not successful in tendering for the ship first time round. The company is approaching those shipyards on the basis that the successful contractor is unable to deliver to the specification within the time scale. Does not that change the balance of advantage in the tendering process by which NorthLink procures the ship from a new supplier? That will feed into the financial equation, which involves the Scottish Executive.

Of course, that is the reason for your appearing before the committee and advising us that there is potential for a variation. What mechanism exists to ensure that the risk does not transfer unreasonably to the Scottish Executive and that the cost does not pass wholly to the public purse? The shipyards have an advantage and, if NorthLink is not tied into an agreement, it can simply pass the issue over to the Scottish Executive, because the Executive must have a ship to deliver the service.

John Martin: We have in place a deal under which the maximum exposure of the Scottish Executive has been settled. The figure that we might have to pay to secure the ship is slightly more than the figure in the subsidy line that the committee saw in the undertaking, but not dramatically more. We have reached a provisional deal that shares the extra cost out so that the Scottish Executive picks up rather less than NorthLink. There will be a maximum exposure for public funds.

Mr Tosh: So NorthLink has a material incentive to ensure that it procures best value.

John Martin: Yes.

The Convener: I invite Shelagh McKinlay to update us on advice that we have received.

Shelagh McKinlay (Clerk): The convener has asked me to set out the advice that we have received on the procedure for dealing with the draft undertaking that is before the committee today. If the committee reports on the undertaking, it will be reporting only on the undertaking that is before it today. If subsequently a change is made to the undertaking before it is debated by the Parliament, the committee's report will be immaterial, because it will refer to a different undertaking.

If the undertaking is changed following the committee's meeting today, the undertaking must either be referred directly to the Parliament for consideration—under rule 10.1.3 of standing orders—or be referred to both the Subordinate Legislation Committee and this committee before

being considered by a full meeting of the Parliament. The key point is that such an undertaking would be different from the one that the committee is considering today. It is not open to members to approve an undertaking today on the basis that it will be changed and become something different. The committee can take a view only on the undertaking that is before it today.

The Convener: Now that the issues have been set out, the process should be clear to all members. As we can consider only the undertaking that is before us, it is now for the minister to move the motion that relates to that undertaking. Do members understand the process?

Bruce Crawford: I understand it. However, given that if we approved the undertaking we would be approving something that we know is not going to exist, would it not be better to make this an information session?

Mr Tosh: Could we not leave the decision until Friday, when NorthLink will sign the contracts with the supplier of the other two ships?

The Convener: We need to get back to the bottom-line question—what are the implications of the decision that we take today? Earlier, I said that we may approve this undertaking, but that it is not the undertaking that will be laid before Parliament. It will be for the Executive to deal with that problem. The committee has a right to discuss whether it is worth approving this undertaking. I would be happy to redesignate this as an information-gathering session—as a first examination of what is, after all, a draft undertaking. The minister will have the information that is needed to update the draft undertaking and to turn it into a finalised undertaking. She must do that as speedily as possible. Minister, how do you intend to deal with the amended draft undertaking?

Sarah Boyack: We are partly in the hands of the parliamentary authorities. We know what we want to include in an amended draft undertaking. I was keen to ensure that members of the committee were aware of the background to this situation and were able to ask questions. Convener, do you want to consider the amended draft undertaking at another meeting of the committee before it is debated by the Parliament?

The Convener: I would like to find out when you expect to be able to present the amended draft undertaking to the Parliament. The committee has indicated that it would be happy to meet at short notice to approve the undertaking, so that it can be debated by the Parliament.

John Martin: Clearly, it is in everyone's interest that we do this as quickly as possible. I cannot say

exactly how much the undertaking will need to be changed, but it will not need to be changed very much. The only changes of substance will relate to the subsidy, which will go up slightly. I hope that we will be able to provide the committee with a new draft undertaking by tomorrow, but I do not know whether that will be possible. This was sprung on us only last night, so I do not know precisely what changes will be needed.

If the committee is generally content with the undertaking and we can assure you that the only changes that we intend to make relate to the level of subsidy and the consequential from that, the minister may be able to write to the committee outlining those changes. I am not sure whether the committee would need to meet to discuss such limited changes.

The Convener: As I understand it—and we have received this advice consistently all day—if the undertaking is amended in any way, our discussions and report to the Parliament will be invalid and immaterial. At some point, the amended draft undertaking must either be considered by this committee or be referred directly to the Parliament under rule 10.1.3 of the standing orders.

I am trying to be helpful by saying that, today, we will discuss every aspect of the undertaking, with the exception of the provisions that may change as a result of your negotiations. The committee will then meet at short notice to approve the part of the undertaking that has been amended so that the undertaking can be referred to the chamber with our full support and in the recognised manner. If we proceed in that way, our discussion of the undertaking will be more tenable and credible. Given that we will all be around over the next couple days, I am sure that a meeting at short notice is feasible.

15:00

Mr Tosh: We cannot meet tomorrow, because Parliament will be meeting. I am not sure about the time scale for suspending standing orders to allow the committee to meet. It may be wise to assume provisionally that we will meet tomorrow, as soon as Parliament finishes meeting, for the purpose of receiving this additional information so that we can dispatch the business as quickly as possible.

The Convener: I was assuming that we would meet either before 9.30, at lunchtime or after 5 o'clock.

Mr Tosh: It would have to be after 5.45.

The Convener: We would also have to fit the Subordinate Legislation Committee into our timetable.

Robin Harper: I was going to suggest a meeting on Thursday at 9 am, at the latest.

Sarah Boyack: I am entirely relaxed about this. If the committee is prepared to meet to discuss this one issue, either just after the Parliament has finished meeting tomorrow or first thing on Thursday, that is fine by me. I will turn up whenever the committee is able to meet.

The Convener: I appreciate that you will be available and that committee members will be available, but when will the information be available?

Sarah Boyack: It should be available by the end of tomorrow, if members are able to make space in their diaries for a meeting then.

The Convener: Are we content to meet tomorrow after close of business in the chamber? Shall we arrange to meet in the chamber?

Mr Tosh: We would have to wait until members' business had finished.

The Convener: Alternatively, we could meet at 9.15 the next morning.

Mr Tosh: That is awfully close to Bruce Crawford's big moment.

The Convener: This will not make good reading in the *Official Report*. We will arrange a meeting and indicate to members when it will take place. Shelagh McKinlay will make every attempt to contact members to ensure that the meeting is arranged for a time that suits us all. That is the route that members would like to take.

Do members have any other questions about the undertaking, apart from the difficulties relating to Fergusons shipyard?

Mr Tosh: I have one other question. Obviously, the undertaking has been considered by the Finance Committee, as parts of it fall within that committee's competence. Does the Finance Committee have to be re-engaged in this process?

The Convener: I have no idea. I will seek clarification on that point and ensure that the Finance Committee is re-engaged in this process if that is necessary.

Fiona McLeod (West of Scotland) (SNP): I have a specific question relating to part 6 of schedule 1 on maximum fares. The schedule includes definitions of low, mid and peak season, but at no point does it explain what children getting 50 per cent off the standard rate means. To what age group will the 50 per cent concession apply?

Sarah Boyack: I understand that children's fares apply up to age 16.

Fiona McLeod: That is not made clear in the undertaking.

Sarah Boyack: The preferred bidder, NorthLink Orkney and Shetland Ferries, intends to define children as people below the age of 16.

Nora Radcliffe (Gordon) (LD): I have an ancillary question. I believe that at least three ports will require works to allow the new, bigger ships to dock. Is that entirely separate from this agreement? Are you confident that all the work is well in hand and will be finished in time for the start of the new service?

Sarah Boyack: Nora Radcliffe is right to say that much additional work needs to be done. Some of it needs to be done because of this contract and some of it needed to be done anyway. We are already in discussion with islands councils and the relevant harbour authorities. A number of proposals have been made or are in the pipeline. Testing is being carried out to assess the design implications of the introduction of the new ships. That work continues.

Bruce Crawford: I have a question about European Community competition. I must be careful how I phrase this, because we have to act as if the previous discussion did not take place. If any part of this contract were not fulfilled, what impact would that have on an EC competition that has already taken place and been advertised in the EC journal? In those circumstances, would EC competition rules require us to start the process again?

Sarah Boyack: We are required to accept the cheapest bid that would deliver the outputs that we have specified in the tender process. That stands, regardless of any potential changes. I ask Andrew Maclaren to outline briefly how the process works.

Andrew Maclaren (Scottish Executive Development Department): The European dimension of this derives from the EC regulation that deals with shipping subsidies, which stipulates that Governments should be non-discriminatory when they give subsidies. We have conducted this competition under that regulation and related guidelines that set out how the competition should be handled. That means that the Commission is being satisfied about the process and the competitive arrangements that have been put in place. The process started a long time ago, with an advert in the *Official Journal of the European Communities*.

Bruce Crawford asked what would happen if anything changed. It would depend on what the change was. If there were a major change to the definition of the competition—in this case, to provide ferry services to Orkney and Shetland—we would have to take advice on whether a new competition and re-tendering were required. If that happened, we would be in very serious trouble, given the timing of the project.

Bruce Crawford: Would a change of shipyard builder be seen as a material or significant change?

Andrew Maclaren: In my view, it would not, because the shipyard contract is not with us, but with the bidding company. We are contracting with the bidding company for the subsidy; a change of shipyard would not be relevant to that.

The Convener: As there are no other questions, we will suspend our discussion of this matter for the moment. At a future date that has yet to be determined, we will meet again to discuss one particular aspect of the draft undertaking. This has been an interesting process. I am sure that both the committee and the minister would have preferred not to have been faced with these difficulties. However, I think that we have managed to deal with them in a way that satisfies the committee and, I hope, the minister, so that this important undertaking can be promulgated. I thank the minister and her officials for their attendance.

Sarah Boyack: Thank you. I am grateful to members both for their questions and for being prepared to listen to the points that I made at the start.

The Convener: While the minister and her team depart, I advise the committee that the chairpersons and chief executives of the water companies will join us shortly. Before we start, the BBC would like to get a picture of them and us together. We will then proceed immediately with business.

15:08

Meeting adjourned.

15:11

On resuming—

Water Inquiry

The Convener: I apologise to our guests from the water industry for the late start to this item. As you will have discovered, due to unforeseen circumstances that have arisen in respect of a previous item of business, we have just had a fairly lengthy session with the Minister for Transport.

I welcome the chairpersons and chief executives of the three Scottish water authorities. We have with us Dr Jon Hargreaves, chief executive of East of Scotland Water, who is accompanied by Councillor Robert Cairns, chairperson of East of Scotland Water; Katharine Bryan, chief executive of North of Scotland Water Authority, and Colin Rennie, chairperson of North of Scotland Water Authority; and Ernest Chambers, chief executive of West of Scotland Water, who is accompanied by Professor Alan Alexander, chairperson of West of Scotland Water.

Thank you for your written submission, which has been most useful in informing the discussion that we are about to have. I understand that Professor Alan Alexander will make a brief opening presentation to us on behalf of all three authorities. I take it that at this point members do not have any questions about the process.

Professor Alan Alexander (West of Scotland Water): Convener, I would like to reciprocate and offer you our thanks for the invitation to address the committee this afternoon. I will make a short presentation on behalf of all three authorities. The committee may then want to question us generally or specifically. If any orchestration is required, I would be happy to indicate who would be the most appropriate person to answer particular questions.

We have been in existence for only four years, and we have achieved a lot in that time. First, we have enormously increased investment in the water industry in Scotland, which has more than doubled in the four years since 1996.

Secondly, we have reduced operating costs, which have dropped by about 25 per cent since 1996. That reads through to increased efficiency in our operations.

Thirdly, we continue to improve drinking water quality. I assume that members of the committee will have seen the most recent report, which demonstrates that the quality of water continues to improve year on year. Each annual increase is slightly smaller than the previous one, as we have much less far to go.

Fourthly, we have reduced pollution. It is difficult to pick a headline to illustrate that, but 51 of the 60 designated beaches passed this year. That is a major improvement.

Fifthly, we have greatly improved customer service and now offer guaranteed standards to our customers. On much tougher standards, West of Scotland Water was 98 per cent compliant this year, whereas in 1997-98 we were 89 per cent compliant. That represents a major advance.

15:15

However, there are still huge challenges. I will outline what we consider to be the most important of them. First, following from what I have just said, there is the challenge of meeting customer expectations, which are rising all the time—people have the right to expect an increasing level of service from us.

Secondly, we face the challenge of completing necessary investment. We are on track to complete the investment that is necessitated by existing UK, Scottish and European requirements and we are about to start on the investment that is necessary to improve the condition of our assets, particularly our underground assets. There will be a continuing need for investment; we need to raise the finance that is required to fund it. We have only two sources of income: customer charges and permitted borrowing under our external financing limits. We receive no direct subsidy from general taxation. That is an important factor in how we manage the service.

As I said earlier, we have already improved efficiency by about 25 per cent since we started four years ago, but we still face a great challenge. Our public limited company comparators south of the border have had 26 years in which to work at a regional level, 13 of them in the private sector. We have had four years, so we have to close the maturity gap between us and our comparators as quickly as possible. That affects how we respond to increasing competition. Competition is here already. It is not being created by the Competition Act 1998, although that will sharpen competition and put pressure on us to sharpen our response. All the water authorities are suffering from revenue erosion because big customers, in particular, are managing their consumption and are considering multi-site management deals with other providers.

Our fundamental objective is customer satisfaction via a redefined and sustainable public sector model. First, that model must be sustainable for both domestic and business customers. Secondly, we have to be transparent and accountable—this inquiry is a contribution to that. However, we need to recognise that, increasingly, some of what we do will be

commercially sensitive. Thirdly, a redefinition of the public sector model is an inevitable consequence of competition. We would like to reach the position where we proactively manage that change instead of react to pressure from others.

There are three prerequisites to success. First, we need to change the nature of the debate in Scotland. As well as concentrating on some of the short-term issues, we need to discuss the long-term viability of this model. I hope that the debate that the inquiry generates will be part of that process. Secondly, we would like to think that we will receive strong public political support for the development of the model. I say that in the knowledge that there seems to be no real contest on the principle of a public sector water industry. We need to reach agreement on how the model will be redefined. Thirdly, it needs to be accepted that, although collaborations and alliances in the provision of water and waste water services will involve the three Scottish water authorities, they will inevitably go beyond them. We need to do that to win efficiencies and to respond proactively to competition.

I should apologise for the next slide, because it might be thought to be apocalyptic. There is a price for failure. We believe that that price is our becoming no more than the provider of last resort. We do not think that that would be acceptable to the people of Scotland. Our fixed costs in providing water and waste water services are inelastic. We lose customers, but we do not lose the cost of providing the service. Those costs amount to 50 per cent of our businesses. If we lose customers, particularly big customers, we end up having to maintain stranded assets that we no longer need. That leads directly to higher charges for the customers who remain. That may sound apocalyptic, but it is what will happen if we do not do things right. I hope that it is obvious that being no more than a provider of last resort is not a redefined and sustainable model for the delivery of water and waste water services in Scotland.

We will try to field any general or specific questions in the most appropriate manner.

The Convener: Thank you. You have given us a very good overview, which will allow us to make a good start to the discussion. Your summary paper was also useful.

It will be difficult to organise the right member for the right question, but we will try to do that as well as we can. I think that we all share your fundamental objective and agree that we need to put some meat on the sustainable public sector model. We all begin with that premise and are looking for the solution.

Members and witnesses should keep their

questions and answers as tight as possible.

Robin Harper: It is clear from your presentation that you feel that restructuring has enabled considerable advances to be made in the water industry in Scotland. Does any aspect of the new structure particularly commend itself?

Ernest Chambers (West of Scotland Water): I have worked with both systems. I believe that the structure that was introduced in 1996 has had a number of advantages for the Scottish water service and for our customers. The revised structure introduced three organisations of a strategic size, comparable with those in England and Wales. That has been beneficial, as it has provided the opportunity to develop economies of scale, to benchmark our performance against that in England of Wales and, I hope, to learn from any mistakes that have been made there.

The organisations have been able to focus on the provision of water supply and waste water services. Because of that focus, we have been able to build up expertise that the 12 councils and the Central Scotland Water Development Board did not have the capacity to provide. As Professor Alexander has highlighted, we have been able to increase markedly the level of investment and, more important, develop a clear understanding of the investment that will be required in future. We are able to increase our efficiency by maximising economies of scale. Having more strategic organisations has allowed us to improve customer services.

The new structure has distinct advantages. Since the formation of the water authorities, we have built a platform from which we can launch efforts to face the new challenges.

Mr Tosh: I apologise for asking a question on the structure that looks backwards, but this has been part of the debate since reorganisation. Would any benefits arise from restoring the provision of water and sewerage services to local councils—perhaps to consortia of councils that would replicate the areas of the regional councils rather than to the current councils?

Professor Alexander: Your question implicitly concedes that the institutional structure of Scottish local government does not suit our needs. I am not convinced that any other form of return to local government—through joint boards or consortia—would enable us to make decisions as quickly as we will have to in the context of competition. That is what has changed over the past four or five years. To make decisions without the necessary reporting back that is implied by a joint board structure, we need a structure that involves a single purpose authority. There are some good international examples of utilities that have tried to operate in such a way in a competitive market and

have found it very difficult.

One of the issues around a return to local government is accountability and transparency. The accountability argument—as evidenced by the fact that we are appearing before the committee—has moved on considerably since 1996.

Bruce Crawford: Responsibility was taken away from local authorities some time back, there were many changes to the structure and you are now beginning to consolidate the arrangements, so I understand your answer to Murray Tosh's question and why you may have some concerns about revisiting a former position. However, would you consider the potential of companies limited by guarantee that are wholly owned by local authorities? That would give flexibility in relation to decision making, but would allow greater local accountability.

Professor Alexander: There is a problem of scale. It would be very difficult for one local authority to wholly own a company that would be big enough to do the job that we currently do. That would push us back into the consortia arrangements, which would present the same problems. I cannot find a way round that.

Bruce Crawford: Under the old mechanisms, you would report back to councils. If it were a wholly owned public company made up of a consortium of people, would that not maintain accountability—through the annual report and the responsibility to internal shareholders—to the local authority but still allow decision making?

Professor Alexander: The area covered by West of Scotland Water includes 13 local authorities. If 13 local authorities owned the company, I would expect that local accountability to demand a degree of reporting back. I do not see how that could do anything other than make the process of decision making more cumbersome than is fitting to the kind of environment in which we have to work.

Robin Harper: In your submission you say that you

“substantially reduced sea and river pollution.”

You mentioned that 51 out of 60 beaches had passed. That is generally thought of as a basic minimum rate. A beach that passes European standards still has levels of pollution in the water. Could you quantify the reductions that you have made? How far is there still to go to meet European standards under the urban waste water treatment, bathing water, shellfish waters and other directives?

Professor Alexander: I suggest that the chief executives answer that question individually, in respect of the area for which they are responsible.

The Convener: As long as we keep the answers fairly tight.

Dr Jon Hargreaves (East of Scotland Water): In terms of the urban waste water directive, we have four or five—because circumstances at Eyemouth have changed—undertakings that will not be on stream at 31 December 2000. Those undertakings, which were given by the Government, are Levenmouth, St Andrews, Kirkcaldy, Dunfermline and Eyemouth—over which there is a question mark. That is not to say that we have not made any progress. Seafeld—which treats a large proportion of Edinburgh's sewage—will be on stream and compliant.

We are 90 per cent compliant with mandatory standards for bathing waters. The two beaches that are outstanding are Portobello and western Eyemouth, and they will be on stream next year. However, I must point out that several of our beaches—this applies across Europe, but is particularly relevant to northern Europe—are subject to run-off from streams that carry large amounts of pollution. That means that some beaches will not comply until something is done about diffuse pollution.

The shellfish water directive does not directly affect East of Scotland Water. The progress has been significant. We are on course to meet the undertakings that we have made. Apart from Levenmouth—which will comply with the urban waste water directive in 2002—the beaches will be done next year.

Robin Harper: Can I clarify whether you are talking about slurry as the pollutant in streams?

15:30

Dr Hargreaves: I am talking about general run-off from streets, agriculture and so on. Streams carry bacteria and run into beaches. They go into the high water or low water, depending on what is happening, and that is where the sampling is done. That causes localised pollution, which is a major issue. It is a bigger issue on the west coast, where there are slower currents, but the east—particularly the estuary—suffers from it, too.

We hope to be 100 per cent compliant by this time next year, but there is the caveat, which the Scottish Environment Protection Agency and the other regulators understand, that we may not be 100 per cent compliant for the reasons that I have just given. To be honest, I do not know how we solve that problem.

Katharine Bryan (North of Scotland Water Authority): In the north, 65 per cent of our sewage goes into the sea untreated. To tackle that from the angle of the urban waste water treatment directive, we have four private finance initiatives

around our coastline and another scheme at Montrose, which is being built without PFI. Those schemes have either been built or are under way. By early 2002, all our sewage treatment plants will be fully up and running. By that time, the amount of sewage going into the sea without proper treatment will have fallen from 65 per cent to less than 20 per cent. That is very good news. Those schemes are Highland, Inverness and Fort William, Tay—a £120 million scheme taking in Dundee, Carnoustie and Arbroath—and Aberdeen. Aberdeen is another large PFI scheme, which covers Aberdeen, Peterhead and Fraserburgh. The Moray scheme, which will be put in place a little later than we would like, will cover Lossiemouth, Buckie, Banff and Macduff.

Ernest Chambers: West of Scotland Water complied with the 1998 deadline to stop the disposal of sludge at sea. We are now able to recycle most of our sludge to reclamation—that is on an interim basis. We have 12 works to be completed under the urban waste water treatment directive, with undertakings throughout 2001. Those works are within a few months of being on programme. There have been some planning difficulties. Regrettably, sewage works do not seem to have best neighbour status, and planning difficulties have led to delays. However, those works are under construction and will be completed by late 2001 or early 2002. There are a further 30 projects to come on stream by 2005. At the moment those are progressing through various stages of planning and contract procurement. We hope to meet that deadline.

Bathing water is a particular problem on the west coast. We have been working closely with Professor David Kay of the Centre for Research into Environment and Health. We have shown categorically that, even when we have completed our works, during periods of heavy rainfall the beaches will still not pass. We are working with the Scottish Executive on a project with farmers to try to understand where diffuse pollution is coming from. We have about two years to sort out diffuse pollution to ensure that we get the full benefits from the urban waste water treatment directive. Shellfish water is also an issue for us. We are working with the Scottish Executive to redefine where the shellfish waters designations apply and to bring the systems up to date. A lot of work is going on, but it is very close to completion. It is encouraging.

There are some 40-odd communities around the west coast of Scotland where we are still discharging untreated sewage, as happens in Katharine Bryan's area. All will be catered for within the next five years.

Robin Harper: Moving on, is our drinking water of a comparable standard to the rest of Europe?

Dr Hargreaves: The right answer is that we are getting there. Rather like sewage, the situation with drinking water is complex, as the standards keep changing. We are all at 99 point something per cent compliance—99.8 per cent is very close to 100 per cent. Like everyone else in Europe, we are all chasing the dream of 100 per cent compliance. In small communities in certain parts of Scotland, as in England and Wales, compliance will take longer than it does with large supplies to cities such as Edinburgh or Glasgow.

While I speak for East of Scotland Water, all the Scottish water authorities have invested. East of Scotland Water has brought on stream three major schemes in the past 18 months and the vast bulk of our water now meets the standards. Over the next five years, we will also pick up a number of small schemes, which tend to be related to dealing with the taste, odour and colour of water rather than with water that poses a health risk.

We have made great progress and are going to be as good as anyone else in Europe. A large proportion of our customers are drinking top-quality water that is of an equivalent standard to water found anywhere in Europe and that is a lot better than some European water supplies.

Robin Harper: So you do not think that any specific problems remain?

Dr Hargreaves: Each of us has small specific issues, although some are bigger than others.

Katharine Bryan: It gives me no pleasure to say that NOSWA's drinking water is the worst in the UK. We need that investment of £400 million in order to bring the water up to standard.

My colleague Dr Hargreaves is right to say that we are all about 99 point something per cent compliant and our standard of improvement has been enormous since 1996. However, I am still not at all pleased with our standards, which must be improved.

Ernest Chambers: There has been a transformation since 1990, when Strathclyde Regional Council started on a programme of 146 projects to modernise the water treatment facilities throughout its area. Those projects were due to be finished by 2004, apart from the Milngavie project for Glasgow, which I will come back to. We think that that programme of projects will be finished about 18 months early, so we are now in the final stages of upgrading the smaller supplies in Argyll.

We also inherited some fairly major problems in Dumfries, which have involved major investment and which are progressing through various stages. That will bring all the water at treatment works up to standard.

A project is under way to provide filtration at Milngavie, which is the main supply for Glasgow.

Up until now, the quality has been so good that we did not need to provide filtration, but as standards have improved and as we have gained knowledge, we are working to provide filtration in the most cost-effective way. Our target for completing that project is December 2005. We have made huge strides, but we must close the minor gaps that remain.

Nora Radcliffe: It would be helpful if the witnesses would comment on private water supplies and where they fit into the system.

The Convener: Who would be the best candidate to answer that question?

Ernest Chambers: I can speak about the situation in the west of Scotland, where there are about 1,050,000 houses, of which all but 19,000 are connected to the public water supply system. The shortfall tends to be made up of small communities or individual properties that are not connected to the public supply, generally because they are so far away from the system. Using the normal criterion of costs, it would not be economic to connect them.

The West of Scotland Water board decided to invest £1.5 million a year in providing supplies to communities that would not fall within the usual scope of our system. That investment is based on the number of properties or on the quality of the water and on need. Despite that investment, it will take about 15 years to deal with about 5,000 houses, and we will still be left with a small number of shepherds' cottages and so on that are beyond our supply. The legal responsibility for monitoring private supplies falls on local authorities, although we help in any way that we can.

Katharine Bryan: Three per cent of the population in the NOSWA area is served by private supply.

Dr Hargreaves: We have a smaller proportion of people who receive private supplies than either NOSWA or West of Scotland Water, but we face the same issues. Whether people are drinking safe water from private supplies is an issue that affects both Scotland and the rest of the UK. The responsibility sits with environmental health, but we provide support where we can.

Nora Radcliffe: So it is an environmental health responsibility if it is a private water supply?

Dr Hargreaves: Yes.

Mr Tosh: What exactly constitutes compliance? Are you saying that if we have 96 per cent compliance, the water is only 96 per cent as good as it should be? Or are you saying that 4 per cent of your customers get water that is not quite up to the standard? Or are you talking about the people who are not connected at all to whatever grids you

have—the people with the private water supplies? I want to be clear about what the goal is when we are going for 100 per cent compliance and who, if anybody, is left outside that.

Katharine Bryan: I look to my colleagues for support on this point, but I think that we need to distinguish between supplies provided by the water authorities and those provided privately. We do not have a remit on the private supplies.

The statistics that you are looking at are not in the region of 96 per cent, but in the region of 99 per cent. I should make that clear for a start. We take hundreds of thousands of samples every year, which are audited by the Scottish Executive to ensure the safety and security of supplies. There is a basket of about 56 parameters or measures that we consider, covering such things as colour, trihalomethanes and lead. The figure of 99.5 per cent, or whatever, covers the majority of supplies from many aspects. The remainder accounts for the incidence of supplies that have failed some of those characteristics.

Robin Harper: The state of the infrastructure is crucial to water supply, and asset management planning should be achieved through the quality and standards process starting in 2002. Have you completed surveys of your overground and underground assets? If so, what state are they in?

Councillor Robert Cairns (East of Scotland Water): I have an exhibit here. It is part of our infrastructure—a piece of unlined cast-iron pipe from Pittville Street Lane in Portobello. Apparently, it was originally installed in 1903 and replaced in 1999. As far as the underground water infrastructure is concerned, we have something like 12,000 km of pipe. Approximately 70 per cent of those pipes are in the same condition as the piece I have here. The other 30 per cent are not quite so bad, but they are certainly not satisfactory by modern standards.

We replaced about 200 km of cast-iron pipes in the past financial year and we hope to hit the same level, or perhaps slightly below it, in future years. Replacing them all will obviously be a long-term programme. We have invested considerable sums in an asset management programme and what we call an integrated network management system, so that we know about our pipes and about how the system works.

When the water authorities took over, much of the knowledge about the underground assets was written down in little black books owned by certain employees. It was not integrated into any kind of public register. We have devoted considerable time and expense to remedying that situation and putting that information on a much more professional and objective basis. Our system is now attracting a lot of attention from other water

companies, north and south of the border.

The situation for underground sewerage infrastructure is similar. The recent floods in Edinburgh gave rise to questions about capacity. Again, we are making great efforts to establish exactly what the condition is of the underground sewerage infrastructure. As with the water supply infrastructure, renewing those assets will be a major and very long-running programme.

Professor Alexander: There is very little difference between the west and the east in that respect, because the assets went in at roughly the same time. As I said in my introduction, having got close to the point at which, as a result of the investment of the past four years, we are able to meet the directives that we have been discussing, investment must now swing towards infrastructure, so that we can deliver the kind of service that we need.

Robin Harper: Do you have a rough idea of the percentage of water that is lost through leakage from those old systems?

Councillor Cairns: Various figures have been bandied about, but it is somewhere in the range of 30 to 50 per cent. In older parts of Edinburgh, it will be at the higher end of that spectrum; elsewhere, it will be less.

Dr Hargreaves: One of the things that we are finding is that some of the infrastructure that was put in place in the 1950s and 1960s, when plastic first came in, is now deteriorating and falling apart. That is true not only of Edinburgh; it is happening everywhere. Some of the 100-year-old stuff, such as the piece of pipe that you have just seen, can be revitalised by scraping and relining and will last another 100 years if given a decent coat of lining material.

15:45

Robin Harper: Is the urgency of finding the finance to replace this piping quite considerable?

Dr Hargreaves: We are not using water as efficiently as we might be, and removing leaks has a cost. The impact of replacing pipes not only would involve the cost of the pipes, but would entail ripping up the streets of Glasgow, Edinburgh and everywhere else, causing massive disruption. The pace at which that is done has quite an impact on the economy. The other impact is on prices. Our job should not be driven by reducing leakages, but by the quality of service to our customers and the performance of our assets. We are not comfortable with or proud of the fact that we have large leakage, but solving that problem is secondary to the performance of the assets for the delivery of the service.

Robin Harper: So you will just have to live with

the situation for the foreseeable future.

Dr Hargreaves: We just keep going at a sensible rate.

Ernest Chambers: We must remember that Scotland is different from England and Wales in that there is no real shortage of supply. We are fortunate in having a surplus of supply over demand. We had a remarkable dry spell in the west this summer, from the beginning of April right through to September, and we managed to get through the whole summer without imposing any restrictions on the supply, despite wastage. We had to do some clever things with shifting water round the countryside, but we managed to maintain supplies without putting restrictions on. I agree with Jon Hargreaves that a balance must be struck between academic leakage figures and what is in the best interests of the customer.

Bruce Crawford: Going off on a slight tangent, if 30 to 50 per cent of water is leaking out in Edinburgh—and I do not know the figures for other areas—

Katharine Bryan: It is about 30 per cent in our area.

Bruce Crawford: Right, so about half of the water supply could be leaking into the ground. I recognise the economic impacts of trying to sort out all those problems at once, as well as the infrastructure cost issues. However, if we have overcapacity, does that not give us the prospect of exporting water to private systems south of the border that need to buy water from Scotland? That seems pretty obvious to me.

Professor Alexander: The infrastructure does not exist for moving water in bulk from the north to the south of these islands. I know that one of West of Scotland Water's predecessors considered the possibility of taking water by tanker to the south of England, but even that was not an economical way of moving water about. There are oil terminals, but there are no water terminals where pipes can be plugged into the boat so that the water flows into the mains. Theoretically, it could be done, but it would involve a huge amount of capital expenditure, at this end and at the receiving end.

Ernest Chambers: Water is unlike electricity and gas. Water is water is water. You cannot change its density or properties. You can compress gas and change the voltage of electricity.

Professor Alexander is right to say that we considered piping water down to England from Strathclyde. That was some years ago, and it was going to cost around £1.6 billion to get a pipeline down to the south coast of England to shift 100 million gallons a day. The economics just did not

stack up. It had to be pumped over Beattock and over Shap, and pumped every 50 km thereafter because of its weight. We considered transporting it in tankers. That would be possible as there are redundant facilities on the Clyde that could be used. However, there was no way of transferring the water at the other end.

Regrettably, England is considering desalination, which is a costly way of dealing with the problem. If transporting the water became economic, the economics of leakage would be changed, which would mean that we would have to consider the issue in a different way.

Robin Harper: Would you like there to be improvements in the way in which water is regulated? I am thinking in particular about the lack of regulations governing boreholes and abstractions.

Katharine Bryan: In a wide sense, we welcome regulation on the economic and the environmental side. Businesses need strong and independent regulators. We want to work with SEPA to achieve benefits for Scotland. Environmental regulation is good not only for the environment, but for business and quality of life. Our market research backs that up strongly. Results that we have had recently on the pollution of beaches show that 98 per cent of the people felt that the pollution of beaches was a problem and that 82 per cent felt that it was a serious problem. That gives you an idea of the number of customers who want such matters sorted out.

We want to work with SEPA to fulfil our statutory requirements. We hope that, in the quality and standards consultation that will be carried out, we will be able to do that. SEPA wants us to make other environmental improvements, which we need to discuss. We want to meet our statutory requirements and enter into discussions with SEPA to arrive at a manageable and affordable programme of further improvements. We welcome the dialogue that we have with SEPA, particularly in relation to the development of new regulations and input into European directives.

On the specific point about boreholes and abstraction, I am used to the system in England and Wales that regulates abstraction from boreholes and rivers by a system of licences. In Scotland, that may or may not come with the framework directive that this committee will consider at a later date. I would welcome that development as it represents a huge opportunity for Scotland to get a better strategic approach to its use of water resources. We look forward to the debate on that.

The Convener: I ask members to focus on priority areas as we have lost some time today. Bear in mind the fact that we will see the

witnesses again.

Mr Tosh: I want to go to the heart of the water industry as it affects MSPs: the e-mails and letters that we receive about water prices, particularly in the north of Scotland. People tell us that the industry has got the balance wrong between the needs of investment and compliance with directives and the ability of customers to adapt to rapidly increasing prices in the past couple of years.

Have you got the balance right or are you being driven to solutions that are being imposed by the directives and are not what you would want to do from the point of view of efficiency? Are there solutions to that? I particularly want to pick up the point that Professor Alexander made in his presentation about the fact that the industry receives no subsidy from the taxpayer. Under European rules, is it allowable to subsidise the industry from taxation? Should we subsidise the industry or will the customer have to grin and bear it?

Professor Alexander: Any subsidy from general taxation would be likely to fall foul of European competition rules and would lead to the kind of debate that surrounds the motor industry and shipbuilding industry.

Mr Tosh: I understand that. What about increasing the borrowing consents and the external finance limits? Would that allow you to put less pressure on revenue charges and, therefore, less pressure on your customers?

Professor Alexander: To an extent. However, the cost of the borrowing must still be paid. The servicing of the debt would have to be paid for from customer charges.

Dr Hargreaves: The question is difficult but it keeps coming up. The balance between what the Scottish water authorities raise to pay for investment through revenue and what comes from external finance limits borrowing is, rightly or wrongly, about the same as the balance that can be seen in the English public limited companies. Although we are driven by different factors, everyone in the sector is driven by factors such as rates of return on investment, and on the affordability at the time and what is being stored up for future generations to pay for.

Although it is unpleasant and we wish we could solve the problem another way—we take no pleasure in introducing high charges for people who cannot afford to pay—the balance between what we are paying for today and what we, through borrowing, are putting off for tomorrow is about right. If we borrow more, not only is there less money available for other needs in society but, at some point in the future, so much of our costs will be fixed due to interest payments and

depreciation that we will have no room for manoeuvre. We work in a competitive environment and our competitors are not putting themselves in that position. Borrowing more than we are doing would not solve the problem.

Mr Tosh: If the Scottish Executive were to say that, in the new context that has been created by competition and having considered all the costs of investing elsewhere, it is prepared to double the external finance limits, would you decline to take advantage of that on the grounds that you have the balance pretty well right?

Dr Hargreaves: We would have to think about that carefully. I can only speak for East of Scotland Water, obviously, but I think that our reaction would be that we would take advantage of the offer to a certain extent but not to the full extent as that would quickly lead us to a position in which we would not be able to pay our interest. Whether one operates in the public sector or the private sector, interest cover is a key financial parameter. If income went down and interest payments went up, we could end up bankrupt at a point not too far in the future. The answer is not, "Just give us a load of money and let us solve the problem." We must get the balance right with regard to the pace at which we move.

You ask whether we think that the European directives are sensible and move at the right pace. Part of the answer to that relates to the fact that the UK started work on the projects a bit late and Scotland started even later than the rest of the UK. We are having to try to do in five years what the public limited companies have done in 10. That has put a lot of pressure on charges and on the industry in general.

Is the European Community right to ask us to take the steps that it is asking us to take? In answer to that, I ask myself whether we want raw sewage lying on our beaches. I do not think that anyone does. That is the sign neither of a civilised society nor of one that is looking after its environment. For 50 years, however, we have taken the easy option and it is unfortunate that this generation must pick up the bill. I do not think that the EC has got the answer wrong. The matter is one of pace and scale. More than anything, Scotland needs time to catch up.

Colin Rennie (North of Scotland Water Authority): I would like to respond to the reference that was made to charges in the north. It is important to put that into context. We are sorry that it has been necessary to increase charges, but we know from survey work that we have done with our customers that most people do not know what they pay for their water and that those who think that they know generally tend to think that they are paying more than they are.

I want to take this opportunity to remind everyone that households in our area pay 65p a day for water. If we place value on people getting an unlimited supply of good, wholesome water delivered to their home, which is important for their health, and on removing the waste before returning the water to the environment, we will see that 65p a day is a sum worth paying.

We need to tackle the issue of the infrastructure. The pipe that Bob Cairns showed you is new, compared to some—I do not say that by way of exaggeration. We were recently in Perth, replacing mains that had been laid in 1862. For the historians among you, Abraham Lincoln was the American President then. Those pipes have served us well, but we need to tackle the backlog in investment, and the time to do that is now.

The Convener: Murray Tosh was just a boy back then.

Mr Tosh: Fiona McLeod has just reminded me that the United States actually had a President then.

16:00

Bruce Crawford: This is a key area for the water industry. I would like to make a number of points about the balance that must be struck, and how we deal with the matter in the future.

Borrowing obviously has a cost, in the form of interest payments. A private finance initiative carries long-term revenue implications. The industry has clearly done its sums on which option will be the most beneficial to how it is run in the long term, but not necessarily which will be the most beneficial to the public purse.

I want to hear from the industry representatives what the impact will be on the customers, and what their preferred option is. I know that the representatives will say that the customers do not have a preferred option, because of EFL, as it is known in your industry—otherwise referred to as the public-sector borrowing requirement. I do not know why on earth the water authorities are on balance sheet, but do not take anything directly from the public sector, while all their costs are paid for by the customers. There are similar arguments in some parts of Scotland about housing. People wonder why it comes under the PSBR or EFL, when it is all financed by its customers—the tenants. Water authorities appear to be in a similar situation. My question is two-pronged—the first part was about the cost of long-term borrowing with interest rates versus the long-term costs of PFI. The second thing that I would like to know is whether you would prefer to have extra borrowing consent, or to involve yourselves in what some commentators describe as the expensive, long-term process of PFI? Why are water authorities on

balance sheet?

I will throw in another thing—I am sorry that this question is lengthy, convener, but it is important to ask it so that we can address the longer-term situation. As far as longer-term borrowing opportunities are concerned, I am told—maybe wrongly—that the euro zone countries can borrow money on a long-term basis more cheaply than we can. Given that, would being in the euro zone provide the authorities with opportunities to borrow long term at lower rates? Would it make your repayment process, dealing with customers and keeping your balance sheet right easier? I am sorry—there were a lot of questions in there.

The Convener: I am not sure that the witnesses are responsible for being off balance sheet or for the euro zone, but we can try and get their views. Who will Alan Alexander throw into the ring to answer that?

Professor Alexander: I ask Bob Cairns to kick off.

Councillor Cairns: The convener is right to say that those issues that should not really be addressed to us. The Treasury, as I understand it, determines what is on balance sheet or off balance sheet.

On the PFI, I can give some examples from our experience at East of Scotland Water. We have two major PFI projects which, between them, will cover about 50 per cent of our sewerage customers when they are completed. One covers the Almond valley and the Seafeld waste water treatment works—around which I had the pleasure of showing Mr Tosh a couple of weeks ago—and the Esk valley in Midlothian. The previous net present value, which was the capital cost plus the cost of running the project for more than 30 years under a previous local authority scheme, was about £280 million. Under the PFI scheme, it is £179 million. A major saving has therefore been made. As far as Levenmouth is concerned, the net present value of the original local authority scheme was £122 million, but it is £79 million under the PFI scheme. I consider that both those schemes have delivered value for money.

On borrowing and interest rates, Jon Hargreaves's point should be borne in mind: that a little extra borrowing would help at the margins. That is not, however, the solution to our major investment problems, because we would create a debt mountain and the crossover point would come when our income was not sufficient to meet interest charges, even if they were a 0.25 per cent or 0.5 per cent lower.

Dr Hargreaves: On the euro zone question, I believe that, even if we went to the bond markets in the euro zone, we would not be able to borrow any more cheaply than the accumulated

adjustments account—AAA—rating at which the Government borrows. Any advantage would be very marginal.

The Convener: Do you want to follow up on that, Bruce?

Bruce Crawford: This perhaps shows my ignorance, but Bob Cairns used some terminology, about accountancy mechanisms, with which I was not entirely familiar. I am not sure whether I am getting a picture that tells me that we are comparing like with like—Bob Cairns compared local authority schemes with existing PFI schemes.

Mr Tosh: I will help to clarify that, if I may, convener.

Bruce Crawford: I am sorry—my question was on Murray Tosh's area of questioning.

Mr Tosh: I have a question about customer relationships, but let us skip that one and go straight to PFI. The core issue is PFI—or public-private partnerships—versus traditional procurement. We have viewed this in terms simply of funding mechanisms, and of deciding how to generate the capital to do something.

If I understand what Councillor Cairns put to me when I visited Seafeld a couple of weeks ago, he was talking about the relationship between the procurer and the contractor—who share the risk, explore technical innovation and consider asset management as part of the long-term value of the asset. They do not simply set up a loan. Those seem to be the areas in which value for money could be demonstrated. Instead of me telling people that, it would be instructive if the witnesses took a few minutes to tell the committee about how they see PFI or PPP projects as part of a dynamic, innovative process that gives greater value for money. That will help us to get over what is—for many members—an instinctive ideological reaction against them. If we can get past that and understand how PFIs work and how they deliver, we might be able to move the debate on.

Councillor Cairns: I might have been too fulsome in my praise of PFIs, but they are very suitable for large-scale projects, such as the two that I mentioned. The downside of PFIs is that there are extensive initial costs. There must also be legal and technical advice before projects can be set up. PFI is not suitable for every small water treatment works or every waste-water treatment facility. In the case of large projects—or bundles of smaller ones—as in the case of NoSWA, PFIs have been successful.

Outputs are specified, and innovation by the various bidders is encouraged to achieve those outputs. In the cases of Almond valley and Seafeld, completely different and more cost-

effective solutions were proposed. They were output driven, rather than engineering driven, and innovation was the result. However, PFI is not a panacea for all the problems of the water industry.

Dr Hargreaves: I agree with what is being said about risk. The risk for the future—with changes in legislation—is in trying to get somebody other than the customers in the east of Scotland to provide the finance. Risks are tied up in today's price: if a PFI gets it wrong, it loses money. That is a major difference from conventional procurement, under which we would have to deal with changes that might happen after 10 years. Under a PFI the partnership would have to do that.

Fiona McLeod: I am conscious that we have been hearing about PFI from one authority. I want to explore whether the situation is different for the other water authorities, who have different projects. One authority is doing small projects; another is doing two very large ones. I cannot quite remember—

The Convener: Perhaps we could ask each authority to establish their principal headline attitudes towards PFI/PPP projects.

Colin Rennie: My view is similar to that of Bob Cairns. PFI/PPP is more suited to larger projects. The North of Scotland Water Authority is involved in smaller projects that are grouped together. Our guiding principle is that our financial deal needs to be broadly similar to—or better than—that which would be reached through the usual public sector procurement process. We have, for example, rejected a PPP scheme for Montrose. Financially, the proposal did not stack up and was a worse deal than that which was obtained through the normal public sector channels. We therefore followed that route rather than using a PPP. In general, PFI/PPP is better suited to larger schemes. I wonder, therefore, whether we are now at the end of the process: most of what we need to do from now on is on a smaller scale.

Ernest Chambers: In the west, we have three PFI contracts, which will procure four waste-water treatment works and a sludge treatment centre. Those are big projects.

Mr Tosh touched on one of the lessons for the future, which is that the working partnership between the procuring authority and the contractors offers opportunities. Generally, in the construction industry and increasingly in the Scottish water industry, we are seeing a move towards involving the authorities and their contractors in a closer partnership, to try to drive down costs. There has been fairly strong evidence from some institutions and committees of civil engineers that such partnerships can produce significant savings. PFI has a role in major projects. We are now considering smaller projects,

but we can learn lessons from PFI and take those projects forward in partnership.

Professor Alexander: In the west we have projects around the coastal areas and we are trialling a much less bureaucratic—if I can describe it that way—public-private partnership than PFI sometimes turns out to be. The committee should not lose sight of the point that Bob Cairns made. Some of the big contracts can be done well and in ways that compete with other methods. However, there are high transaction costs in developing such contracts. That is especially true if a project is being conducted to deadlines such as those that we have recently had to meet. There are other ways of establishing partnerships across the public-private divide that could produce greater benefits to us in the next five to eight years.

Mr Tosh: I picked up from a recent visit to East of Scotland Water that PPPs and PFIs are not the only ways of involving private sector expertise and capital. That is the point on which Alan Alexander finished. I would like to hear what the witnesses think the committee should do. If the Executive is to allow a set of public sector agencies to enter new and innovative relationships with the private sector, it will have to change the parameters. That issue is part of our investigation. I would be grateful if the witnesses gave the committee a start on that.

Professor Alexander: In assisting the water authorities in responding to competition—that is, which imaginative arrangements across the public-private divide will help—the Scottish Executive has recognised the need to give us consent quickly when it is required under section 94 of the Local Government etc (Scotland) Act 1994. I would like pressure to be exerted for that section's repeal. We need to be allowed to make necessary arrangements on the basis of a business case that is generated by a rigorous assessment of risk against the objectives that the authorities must achieve.

Mr Tosh: Would you fund projects that fell under that category entirely from your current charges, or would you use your external finance limits?

Professor Alexander: That would depend on the project. For obvious reasons, it is difficult to give details. We need the flexibility that will allow us to forge a partnership without the interference of a long drawn-out process of approval.

Dr Hargreaves: The money can come from only three sources—borrowing from the Government, charges on customers, or the joint venture partner—which would have access to different funds from us. All three must be available to us if we are to defend ourselves and get the best out of the partnership arrangements. The third option is

interesting. The more the partner invests, the less we must invest and the more the partner has control. If we want the Scottish water industry to stand up and be counted, to defend itself and to succeed in this competitive market—which I believe it can—the industry must be able to control its destiny. That means that we need access to cash. We can have that, but we give away our soul every time we let somebody else provide the cash, because they take the majority share.

I have been in post for only a few months, but I think that the Scottish Executive has responded superbly to our requests—and demands—to examine our needs quickly. We are not simply flirting with the future, but defending our existing customer base. That is a serious issue for East of Scotland Water. The Executive has bent over backwards, but even it is constrained by our powers, as Alan Alexander said, and by the public purse—the right to borrow. That returns us to the opening statement about redefining what we need to be.

The Convener: I will be patient and allow Murray Tosh one follow-up question.

Mr Tosh: I suggest that, rather than expanding on the issue now, we could usefully pursue it with exploratory work on the recommendations that we might make to the Scottish Executive. It might be more appropriate to ask the relevant people for further information along those lines, which we could consider subsequently.

16:15

The Convener: As Murray Tosh said, the matter of PPPs is one of the major parts of the investigation. Therefore, we would welcome such information.

Bruce Crawford: I would like much more detail. I realise that we will not manage to obtain that today, so could we ask the three boards to give us the cost-benefit analysis of a project that has been completed? I would like details on net present value, whole-life costs from conception to end-life and what the cost to the public sector would have been if the project had been financed through normal borrowing. I understand about risk transfer and bringing in new innovations, but we need to get a feel for the costs at the end of a process.

The Convener: I see that the witnesses are nodding. The information should encompass the alternatives that we talked about and should take in all the financial issues. When we see the witnesses again, perhaps we will explore those issues in more detail.

Professor Alexander: May we liaise with your clerk on what the committee wants and the level of detail that is required?

The Convener: After consulting committee members, we will prepare a specification, which we will pass to you. If there are elements that you find difficult because of commercial confidentiality and so on, you can let us know.

Mr Tosh: If we are happy that we have resolved that issue satisfactorily, I will jump back to the question that I wanted to ask about customer surveys. Councillor Rennie had just about started to touch on surveying customers. He talked about their having a less than precise grasp of how much water costs them. I am sure that that is true across all three authorities.

Will the witnesses explain what they have done to try to communicate costs to their customers and to win consent from customers for the levels of charge that have been imposed? The witnesses made a good case for the charges. Perhaps the problem relates particularly to the north of Scotland. We see evidence that not everybody there is happy. It would be appropriate to question the representative of that authority on how it responds to genuine evidence of customer dissatisfaction.

Colin Rennie: We have put a great deal of effort into explaining the necessity of charge increases. We have attended community council meetings—we do that regularly; we have briefed every local authority in our area and all the MSPs; we have attended numerous public meetings; and we have worked with the media as closely as we are able. Our board meetings are open to the public. We produce a leaflet that we include with the bills that the local authorities send out. I can pass an example to committee members, who must ignore my scribbles.

It is clear that we need to do more. The public are confused about our charge increases but, sometimes, the debate has not helped. To be frank, some comments about the impact of our charging have been exaggerated. As I said, 65p per household per day is a reasonable cost for most people. I appreciate that the situation is different for those who are on benefits. We welcome the Government's recent announcement on helping those people. We do a lot of work, but I am sure that we could do more.

Mr Tosh: Do you feel that the work that you have done has established consumer consent for the charges, or are you toughing it out because you know that you must take the money and that they must pay?

Colin Rennie: One of the significant changes that I have witnessed in the past 12 months or so is that many members of the public and their representatives—such as councillors or MSPs—say that we should phase our programme of work over a longer period. When we have explained

that 65 per cent of waste reaches coastlines and estuaries untreated, people have regarded that as wholly unacceptable in this day and age.

Generally, water quality is very good in the large towns and cities in our area. In remote rural areas, that is not the case. Most people believe that every household has a right to a good, clean and wholesome supply of water. Attitudes have changed—we may not have fully closed the gap between support for an investment programme and willingness to pay for it, but we have closed it to an extent.

Mr Tosh: That did not quite answer my question, but the question was loaded, so I suppose that that is fair enough.

Professor Alexander: There is almost no dispute that investment is necessary, but when we go one stage further and say, "This is what it will cost", we have a problem. We have tried to deal with that in the west by customising our mailing by local authority area, instead of sending a blanket mailing. I have an example that says:

"Investing in the future of Dumfries and Galloway".

We did that for all the local authority areas, in an attempt to make the link between the council tax bill and investment in the water infrastructure. We have a long way to go to get people to realise that we have no alternative and that the benefit to them will come further down the line. There is one direct mailing a year per customer, so we have to consider carefully the information that we put into it.

The Convener: Consent for charging is an interesting target to try to achieve, but there you go.

Councillor Cairns: We regularly meet the local authorities—I met Mr Crawford when he was leader at Perth and Kinross Council. The regulator carried out a survey on satisfaction with the various utilities in Scotland, and water came out top. I have just been provided with figures—

The Convener: As if by magic.

Councillor Cairns: The number of complaints about the level of charges did not exceed double figures. If you consider the scale of the charge increases last year, that is significant.

Katharine Bryan: We are concerned about how, on the one hand, we make customers aware of our charges and what they are for and, on the other, how we keep the charges at an acceptable level. That is a challenge. In trying to do both those things, we undertake market research and listen to focus groups and so on. A surprising thing that I learned recently was that 75 per cent of one group did not know how much they paid. We have done surveys on the level of satisfaction before

and after increases, and it remains high. However, rather than have me warble on, would it be helpful to the committee to see some of the results of our market research?

Mr Tosh: It would be fair to exchange that with the individual that we nominate to be a member of that focus group. [*Laughter.*]

Katharine Bryan: Well, the offer stands.

The Convener: Before we move to issues of efficiency and competition, we have further witnesses to see so, in the interests of the committee's efficiency, I ask members to be concise and focused with their questions and I also ask witnesses to do the same in their responses. Do not get me wrong—this is an interesting and useful debate, but we have other matters to deal with.

Helen Eadie (Dunfermline East) (Lab): In response to the convener's appeal to members to be concise, I ask the clerk to get me the answers to two of my questions.

In its submission, West of Scotland Water says that it still has a long way to go to meet the efficiency levels of its English counterparts. What more do you need to do? What are the obstacles to progress?

Ernest Chambers: Our efficiency objective is to minimise charge increases. It was said that our investment was in the interests of the authority, but all our investment is in the interests of our customers. From the outset, the authority has recognised that the investment programmes would result in increased charges. The efficiency challenge has been how to minimise those increases.

There are two distinct areas where we will achieve our efficiencies. One is by doing everything we do better. There is the question whether we can purchase our materials more cheaply and get greater productivity from laying pipes and so on—what I call unit cost efficiencies.

The second area, in which there is a big gap between us and England, is that the authorities there have been able to invest in upgrading their plant to make it more effective. Some sewage works in England are now visited monthly and, because they have been upgraded to modern plant, they have key monitors. The monitors send signals back to the centre and, provided they say that everything is okay, the works are visited monthly. In many cases, our plants are visited daily. We need to improve our procedures and processes, but we also need to invest—to spend to save—to achieve long-term savings. That will be the big challenge over the next four or five years.

The Convener: Is that a fair assessment of

what is going on?

Colin Rennie: Some plants are not only visited daily—they are manned every day. The equipment in the waste-water treatment plants is so antiquated that investment is necessary.

Fiona McLeod: I want to follow that up. In your submission, you state:

“We are exploring opportunities for collaboration between the three water authorities”.

Will you give us examples of where you are doing that?

Ernest Chambers: The authorities have been working on a project to consider all our activities: our asset management arrangements; our procurement arrangements for capital projects; and how we provide information technology services, finance and laboratories. That project is at an advanced stage, but we have not yet reached any conclusions. That will happen in the next few months.

Helen Eadie: You do not have shareholders and the need to make profits, as your English counterparts do. That goes to the heart of the difference between the structure of the industry in Scotland and that in England and Wales. Is that a help or a hindrance?

Dr Hargreaves: It is a help in the sense that most people who started their career in the water industry 25 years ago, as I did, did so for the public service element of it. I have worked on both sides of the game.

Only one thing militates against what I have just said, which is that shareholder pressure and the drive for profits sometimes cause people to try harder to make efficiencies than is the case in the public sector. However, that is because the public sector model has not met that challenge before. I am under no illusions about how difficult the challenge is for us, but I am confident that we will meet it, probably more humanely than the private sector equivalents have done. We can do it without dividends; customers should—and will—get the benefits.

Nora Radcliffe: You mention incursions by competitors into the Scottish market—will you quantify that for us? Have you, in turn, made proposals to English or Welsh domestic or business customers? Have you worked with any of the English or Welsh water companies—or companies further afield—with a view either to meeting competition and investment challenges or to efficiency savings?

Dr Hargreaves: The east of Scotland gets the short straw—we have the most industrial customers. Fifty per cent of our income comes from industry and we supply 20 per cent of our

water to industrial customers. That is much more than the other two authorities. In the past 18 months, one way or another, we have lost about £20 million of income. It is not just about competition; it is about industry getting smarter and small businesses going on to meters and saving 50 per cent or 60 per cent on their bills. To be honest, because we have inherited charging systems from councils, it is also about some people having been billed incorrectly in the past. However, when it is all added up, there is £20 million of income that we had a year ago that we do not have today.

Five major companies throughout Scotland are in the process of selecting a different partner—a private sector partner—to manage their water affairs, with the simple and obvious objective of reducing their costs. In the east of Scotland that includes our top three customers. In the west it includes one of Ernie Chambers's major customers. The process is just starting. We are responding through partnerships, because we do not have all the skills. I am more than confident that we are starting to fight back. East of Scotland Water has signed deals with 62 of its major customers, which has bought it some time.

16:30

We are going back to those customers; I have met 24 of our key customers in the past month to have individual or collective discussions with them. I have asked them to give us a chance and told them that we are not going to let them down. Their response has been to say that they will give us a chance, but that we must deliver.

Scotland can fight its corner. Customers do not want to leave us, but they are not prepared to put up with the service that they have had in the past or the prices that we are charging when they know that both those aspects can be improved by going to our competitors. That is a stimulus to us all. We are all responding fast because we have had to. Watch this space—you will see Scotland fighting back in the next few months.

Professor Alexander: About a fortnight ago, at the request of the water industry commissioner, I chaired a forum for large users, about what was happening to the industry.

One of the things that struck me in that discussion and in discussions with our customers is that we think of water as a utility, but big customers think of it as a commodity. It goes straight into their cost base, so they are putting huge pressure on us. I should tell the committee that it is unsentimental pressure. If we can do the deal, most of those big customers would want to stay with us, but some of our big customers have taken a "no more Mr Nice Guy" approach and

said, "You must deliver or we will find another way of providing that commodity, in the same way as we would find another supplier of steel or widgets." The idea that we are a public utility is not a defence against erosion of our revenue.

As I said in my presentation, if that revenue were to erode, the cost would go straight to the remaining customers, who disproportionately would be the domestic consumer.

Dr Hargreaves: We can operate south of the border, but we cannot own assets; that is not written into the act. Our ability to do border raiding is therefore severely limited. However, in our case and in the case of the other two authorities, we are forming partnerships with people who will take us across the border. When one business has multi-sites, it may have six sites in England and four in Scotland; it will do a deal with one organisation to service all of them. I think that through the partnership arrangements that we are putting in place, we will find ourselves south of the border.

The Convener: That covers efficiency and competition unless other members want to address the subject.

Bruce Crawford: I do not know whether, when I was out of the room, any members asked about the implications of the Competition Act 1998. What do the witnesses understand to be the implications of that act for their organisations?

Dr Hargreaves: We have competition without common carriage. When common carriage comes through competition, as part of the revision of the Water Act 1989 that addresses that issue, our view is that whatever else it needs to be, it needs to be fair. There is a great possibility of cherry-picking. We are concerned that, especially in places such as Edinburgh, there will be areas where it would be great for a company to take a couple of hundred thousand customers, but they would not want to take the guys who would have payment difficulties.

We are working with the Executive to find a system that will, as far as is possible in a competitive environment—we need to be clear about that—create a level playing field so that there is no cherry-picking. If a company takes an area, it must take all that is there. It will have to pay an access charge to use our pipes. That charge must reflect the social engineering that we have as part of our charges. It must reflect the fact that we have spent a load of money uprating our assets. The company should not get the benefit of nice new assets for nothing. Therefore, it should pay for access through the access charge, and thus contribute to maintaining and improving those assets.

Bruce Crawford: It is useful to understand the pressures that you will face in respect of cherry-

picking. Is there any argument that suggests that the water industry in Scotland should not be subject to the Competition Act 1998 and that you could opt out because you do not receive a public subsidy?

Dr Hargreaves: Our collective belief is that competition, although it may be difficult and tough, ultimately produces benefits for customers. We are here to serve customers. Protecting us from competition would not benefit customers in the long term. It has already provided a stimulus to customer service and to paying attention to costs. As long as it is a level playing field, there is no reason why we in Scotland cannot provide those benefits to our customers.

Bruce Crawford: That is not really the answer to the question.

The Convener: I think that the point is valid. Have you taken legal advice with regard to whether you fit under the exclusion bracket in the legislation—I think that section 3 of the Competition Act 1998 deals with that? We accept the point that you have made that competition is taking place anyway, but have your lawyers decided that you are excluded? Could that point be argued in a European court?

Dr Hargreaves: Our lawyers have considered that point, but we cannot use that as a way out of the situation.

Des McNulty (Clydebank and Milngavie) (Lab): I want to explore what you mean by efficiency and the relationship between efficiency and the cost of the service. When you say that you are a long way behind the efficiency levels of your English counterparts, does that mean that your cost levels of delivery are higher? Could you say something about cost comparisons?

Ernest Chambers: We must consider all the costs incurred in the provision of the service. That will improve as we procure new assets at a lower cost and improve efficiency in the way in which we lay pipes and so on. That will reduce the total cost of providing the service. The second way will be by investing to lessen the demands on our system. Out of that will come a situation wherein the true cost of providing 1 cu m of water will reduce.

Des McNulty: I appreciate that you are comparing the efficiencies that are involved in the laying of pipes and the provision of treatment services and so on, but that is an issue about what your business does. I want to know about the situation from the point of view of the customer. Does the underlying framework of the Scottish water industry—the rainfall into the reservoirs, the fixed infrastructure and so on—mean that the water provided here is more costly than it needs to be? Are there other factors?

Katharine Bryan: That is a helpful question. As Ernest Chambers has said, the efficiency savings that we have made already are on the back of the reorganisation of the three authorities. On average, we have made savings of around 25 per cent on what it cost to run the service in 1995-96. We are not content with that and want to compare ourselves with the UK companies—not only our operating costs but the cost of delivering the capital programme. We have also talked to the water industry commissioner about those issues.

The nature of our terrain in Scotland is important. We have had to catch up rapidly, as has been mentioned, at a time when we are delivering huge capital investment programmes. How do we deliver our efficiencies when we are doing that? We just have to do it and do it well for all sorts of reasons such as the customers, competition and so on.

The terrain is divided among the three authorities. In the north of Scotland, we have a rural area with vast tracts of water mains and sewers that cost a lot to maintain and replace. That means that we must be careful when making direct comparisons with an urban area in England, for example. What we need to establish is the fact that high costs do not necessarily point to inefficiency. That is the key point that I would like the committee to understand.

Des McNulty: That might take us in a different direction. It might improve your business efficiency if the three water authorities were to be amalgamated—there might be some efficiencies of scale—but it would not necessarily lead to lower costs for the water consumers in the west of Scotland, for example.

Katharine Bryan: It is important that we note the work on collaboration. We are seeking to reduce the inefficiencies without the disruption that a large-scale reorganisation would create.

The Convener: We have a few more questions, including a very quick one from Nora Radcliffe, before we move on to other business.

Nora Radcliffe: To what extent are the water authorities in competition with one another? What is the interrelationship?

Professor Alexander: We are not in direct competition. It is impossible to rule out absolutely that we might be, particularly as Jon Hargreaves said earlier, where a major customer goes to the market with an invitation to tender to supply all its water. If such a major customer has sites where water is being delivered in an area that is covered by more than one authority and if a stand-off cannot be negotiated through our current collaborative initiatives, we cannot rule out the possibility that we would be competing for the same contract. Whether that is the same as

competing against one another on a continuous basis is a different question. It would be dishonest to say that we could rule it out entirely. However, members can probably tell from my tone that we would not want that to be the usual modus operandi of the Scottish water industry.

Councillor Cairns: The line that we have taken is that it would be wrong for us directly to compete with one another, so taking money out of the Scottish water industry. Where that might happen anyway through competition from the private sector, it is as well for one of the water authorities to be lost, to ensure that some of that business is saved for the water industry as a whole.

Fiona McLeod: I would like to talk about the water industry commissioner whom Professor Alexander mentioned. The committee would like to know your views on the impact of the establishment of that office. Does the arrangement whereby the water industry commissioner represents users and suppliers work?

Katharine Bryan: The commissioner has been in place for only about a year. It is clear that the office has had a significant and helpful impact on the water industry in Scotland. Many things have happened in a short time and we welcome the robust regulation on the economic side that that brings. Earlier, we referred to the benchmarking that we were doing anyway, but the commissioner's work has added to that. We also mentioned the efficiencies that we have already achieved. Discussions with the commissioner have brought a different focus to that. The commissioner has provided a helpful input, particularly on the information requirements to enable better asset management.

In fulfilling his role on price setting and regulation and in advising the minister, the commissioner can bring a balance of need between different customer groups. In turn, the commissioner can balance that against the water authorities' need to invest to improve water quality and the environment. However, good customer relationships are not just about price, but about quality and satisfaction. The water industry commissioner is not a substitute for our direct relationship with domestic and non-domestic customers. We want the water authorities to retain that primary focus.

However, when it comes to customers, the commissioner has a role in setting standards—indeed, we mentioned the guaranteed standards earlier—and we very much want to be involved in that. The commissioner has a further role as what might be described as a long stop on some long-standing or intractable complaints.

Have I understood your question?

16:45

Fiona McLeod: Yes.

Perhaps your most obvious relationship with customers is when they turn on their taps. However, the other relationship with customers centres on bill paying. What do local authorities think of relating water charges to council tax bands? Is that the best way of approaching water charges?

Professor Alexander: Just as East of Scotland Water faces the greatest challenge with the erosion of business income, West of Scotland Water faces a great challenge with the collection of domestic income. We have a serious problem with bad debt because of low collection levels in various areas. That raises the question whether in future there might be a better—or different—way of collecting money, which might lead to direct billing. However, that measure is some way down the line, because our reliance on the council tax banding process for collecting charges has made it unnecessary for us to produce our own data on domestic customers. We would have to generate those data, ensure that they were clean and work out the costs and benefits of such a system. That said, some of West of Scotland Water's collection levels are so low that we must at least think about selective direct billing.

The Scottish Executive raised the other issue about tying water charges to council tax bands in its paper, "Consultation on the Affordability of Water and Sewerage Charges". Tying charges to council tax is a rough and ready way of responding to the customers' ability to pay, which suggests that any movement away from that approach would require the industry to consider how to deal with the issue of affordability in a way that did not distort business. Although that raises big issues, coming from West of Scotland Water, I have to consider the balance of advantage between outsourcing the hassle of collecting water charges to the local authorities and not getting in a large chunk of the income due to us. As with the erosion of revenue on the non-domestic side, the cost of uncollected charges from some parts of the domestic customer base must be passed on elsewhere. We must examine those issues carefully over the next three to five years.

Dr Hargreaves: In England and Wales, there has been millions of pounds' worth of work on finding a fairer and more equitable system than tying water charges to council tax banding. Admittedly, those companies have been pushed by their regulator towards metering, which is not a sensible option in this part of the world. For a start, it costs a lot of money and is a different issue in other places.

After all that work, the companies have

concluded that, as the system is about as good as we can get, it is better to stick with a scheme that will not cause disruption, even though it might contain an element of unfairness. Either we stick with council tax banding or meter everyone, which costs billions of pounds and causes huge disruption. We must ask ourselves whether that is the best way of spending customers' money; in this part of the world, the answer is no.

Bruce Crawford: I think that my question on metering has just been answered. The three organisations represented today seem to have made it clear that metering is categorically not on the agenda.

Dr Hargreaves: For domestic customers.

Bruce Crawford: I understand that. So hoteliers—

Dr Hargreaves: However, if customers want metering, they need to have the choice.

Colin Rennie: Legislation dictates that if customers want a meter—

Dr Hargreaves: —we have to give them one. We cannot deny our customers meters.

Professor Alexander: However, as our policy is that domestic metering is not a good idea, we would not wish to promote it.

Bruce Crawford: That could lead to a difficult situation. If people found out that metering on demand was available, low water users could start demanding meters, which would increase costs for other users.

Dr Hargreaves: That is another risk—
[*Interruption.*]

The Convener: We need to avoid collective answering, otherwise the official report will have no chance of working out the position of each representative from the water industry on some of these issues.

Bruce Crawford: Okay.

The Convener: Not you, Bruce. I am sure that the report will get you right.

Bruce Crawford: Is there a desire for metering, particularly from low water users? If so, what impact would such a trend have on your industry?

Professor Alexander: There is no trend—

Colin Rennie: Very small numbers—

The Convener: Hang on a second—who is answering the question? Professor Alexander, you are the ringmaster.

Professor Alexander: I was just saying that there is no such trend. Very few domestic meters have been installed in the west of Scotland. I do

not think that there has been any research on how such a trend would affect our income; however, it would certainly have an impact at certain levels.

Dr Hargreaves: If the current 66,000 domestic customers in the east of Scotland switched to metering, we would lose about £5 million of revenue. As the customers most likely to choose metering are in the higher council tax bands, we are vulnerable to another set of income losses and are investigating how to mitigate against that eventuality. That constitutes another risk in the domestic customer market.

Councillor Cairns: Such risks might be mitigated by ensuring that charges for domestic customers reflected the fact that a high proportion of water industry costs are fixed and are not affected by water consumption. However, I repeat that metering is not a major issue.

Bruce Crawford: I understand that.

That leaves us with a big final question on the way ahead for the industry.

The Convener: It is a very big question, and it is all yours.

Bruce Crawford: Your presentation made it quite clear that the industry must establish a redefined public sector model that is stable and permanently viable. After everything that I have heard today, that model does not seem stable and I am not sure about its viability as I cannot see it clearly. The committee would find it useful if you could suggest proposals for redefinition.

Professor Alexander: Stability is not on the agenda for the short to medium term, as redefining the model will be an unstable process.

Secondly, we collectively take the view that ownership of the industry is not in question. However, if we are to drive in the efficiencies and drive up the standards that we have been talking about all afternoon, we need a high degree of commercial freedom and to efface the boundary between the public and private in the industry's operation in a way that does not compromise its ownership in the public sector.

It is difficult to be more specific than that, as the process is very much organic and will take place over the next five to 10 years. That process will happen only if we have commercial freedom and the capacity to make the necessary quick decisions in the customer's interests. I strongly believe in the interests of Scotland and the Scottish economy. Although being any more specific would get us into areas that we might not want to make public, I will emphasise the need to be able to move quickly and not to have any no-go areas in the operation of the business. That is my idea of redefining the public sector model; however, I will throw the question open to my

colleagues.

Dr Hargreaves: Probably the closest comparison that everyone will understand is the Post Office, which has had to respond to competition. Although that model might not be perfect, it provides some freedoms while maintaining what is essential for our business—control over our daily activities for the people of Scotland instead of having the freedom to go and do business elsewhere in the world. The Post Office is quite a good model, in the sense that it demonstrates what those freedoms can mean.

Colin Rennie: Bruce Crawford asked what we would look like. We can say with certainty that we will look different from how we currently look. We are not sure how we will look, but there are enormous competitive challenges ahead of us. All six of us were in public service before we took on our current jobs. We are determined to ensure that the public sector works, that it works efficiently and that it competes. That is an enormous challenge that few public bodies have ever had to face. However, we are committed to taking it up and to making things work.

Bruce Crawford: That begs the question of when a public sector organisation is a public sector organisation. More and more of your assets and infrastructure will be owned by the private sector, as it will build, operate and own them. You have told us about the public-private partnerships that you have. How much outsourcing of administrative jobs and so on now happens in your industry?

Professor Alexander: Most of the work that we do in construction and infrastructure renewal is contracted out, so there is outsourcing there. That will continue. If a private company outsources part of its business, such as information technology, that does not compromise ownership of the business by the shareholders. I do not believe that outsourcing certain of the operations of the Scottish water industry compromises the ownership of the industry by the Scottish people. For me, that is the test.

Dr Hargreaves: The issue is quite simple, but it is complex in its simplicity. There is no reason why outsourcing should be cheaper and better than doing the work in-house. We need to deal with the things that prevent us from doing the work as well in-house. None of us has a hidden agenda to outsource everything within three years. Apart from anything else, we would then not have jobs. We owe it to our customers to make the work cost competitive. There are huge challenges in doing that. We need not only to determine the skills that are required but to deal with the custom and practice of the industry over the past 50 years. Like any business, we face big human resource issues.

Colin Rennie: The critical test of whether an industry is in the public sector is not how many assets it owns, but to whom it is accountable. We are accountable to the minister and, through the minister, to the Scottish Parliament. That is why we are here today. In my view, as long as that framework is in place, the water authorities will be public sector bodies that are able to meet the demands that are set by the Scottish Executive and the Minister for Environment, Sport and Culture.

The Convener: That is an appropriate point at which to end our discussion. We look forward to the development of this model, which keeps the industry in the public sector but is adaptable, flexible and sustainable and, above all, provides the service that consumers want.

Although the session was disrupted at the start by other difficulties that the committee has had to deal with, I think that it was very useful. Thank you for coming today. We will see you again and we look forward to receiving the additional papers that were mentioned. We will prepare the specifications for those and send them out to you.

Before we invite representatives of the Scottish Consumer Council to join us, Shelagh McKinlay has some news about the matter that we discussed previously. It is appropriate that we deal with that now, in case we lose members towards the end of today's business. There are some issues that I am not happy about, but we can discuss those after Shelagh has updated us on the situation.

Shelagh McKinlay: We have been investigating the possibility of the committee meeting tomorrow afternoon to consider the draft undertaking that was discussed earlier. Unfortunately, on procedural grounds it is not possible for us to meet at half-past 5 to do that, because the motion to approve the draft undertaking on Thursday would have to be lodged before half-past 5 on the previous day. Also, it cannot be lodged before committees have made their recommendation.

The only other option open to the committee is to meet first thing tomorrow morning. From a purely practical point of view, it will be difficult in the time available for the clerks to organise meetings of the Subordinate Legislation Committee and this committee, and for the Finance Committee to decide whether it needs to reconsider the undertaking.

I am providing members with that information so that they can decide whether they still wish to pursue the option of meeting again to consider the instrument or whether they accept that, on this occasion, the best way forward might be to utilise the provision in rule 10.1.3 of the standing orders. Under that provision, on a motion of the

Parliamentary Bureau, agreed by the Parliament, the undertaking can be considered by the Parliament. Members would, of course, be able to contribute to that debate.

17:00

The Convener: If we were to meet tomorrow morning, would that move us any further forward?

Shelagh McKinlay: The Executive has said that, if we are able to give it a deadline, it will let me know first thing in the morning whether it can produce the necessary material for that time.

The Convener: That is a wholly unacceptable response.

Fiona McLeod: Why cannot we meet at lunch time, which would give the Executive a bit longer to come up with the material? We did it last week, when we suspended standing orders to allow the Education, Culture and Sport Committee to meet to consider for the fifth time its draft report on the Scottish Qualifications Authority inquiry.

Robin Harper: It is urgent, for Scotland in general and for the parts of Scotland that would be served by those ferries in particular, that this problem be solved before Friday. That has been made clear to us. It might not be appropriate for us to stand on our dignity and say that we have not been consulted properly. This is a very unfortunate situation and it is wrong that things should happen in this manner, but we must find a way through the difficulties. Perhaps rule 10.1.3 is the only way forward. However, would it be appropriate for us to move during Thursday's meeting of the Parliament that standing orders be suspended, so that the ministers' advisers may be with her for a 15-minute question session?

Mr Tosh: I am less anxious about this than I was when we started the discussion earlier this afternoon. We have now heard from the minister and had the opportunity to ask all the questions that we wanted to ask. We know that the Executive will come back with slightly increased figures. Frankly, I was not particularly aware of what the original figures were. I was more interested in the way in which the contract worked—the deadlines and so on. I do not think that any of that will change. If I come up with more questions, I am happy to think that I will have an opportunity to ask them in the chamber.

Like Robin Harper, I do not think that disrespect has been shown to the committee, as we have had an opportunity to discuss the undertaking. The process has not worked in quite the way that it should have. However, like the witnesses from whom we have just heard, let us focus on outputs. In this case the output is to put the mechanisms in place for the subsidies to be paid that will allow the

ferries to be provided. I am happy to do whatever has to be done. We can meet at lunch time tomorrow, if other members want to do that, or we can go straight to the Parliament.

The Convener: I saw many members nodding when Robin Harper and Murray Tosh were speaking. Shelagh McKinlay advises me that other issues would make it difficult to hold a meeting at lunch time tomorrow. Notwithstanding my unhappiness at the circumstances, I can live with the idea of passing the draft undertaking straight to Parliament. If others members agree, we will allow the Parliamentary Bureau to deal with the matter under rule 10.1.3 of standing orders. However, I will write to the minister to express my deep concern about what has happened today. I hope that it will not happen again.

I apologise to the Scottish Consumers Council—this has been a trying day. We appreciate that you have had to hang back to give evidence. We have half a dozen or so questions for you. Janis Hughes will lead the questioning, although other members will indicate if they wish to ask about particular issues. We have received your A4 sheet of summary bullet points, which has been most useful. I offer you the opportunity to make a short opening statement and then we will go straight into questions and answers.

Graeme Millar (Scottish Consumer Council): I found the discussion interesting. It is not insignificant that the previous witnesses did not find it interesting enough to hang on to hear what their customers think about the issues, but the committee can form its own view on that.

I will not rehearse everything that is in our submission—I am conscious of the time, and will allow members to ask questions instead. The Scottish Consumer Council is here because there is no independent consumer representative organisation for the water industry. There was at one time, although, perhaps because of its composition and nature, it did not quite work. There is a structure that is aligned to the commissioner. I will speak about that, as issues arise about its independence and its ability to articulate fully the interests of consumers.

We know that the water industry requires substantial investment and we recognise the benefits for consumers in the long term, in terms of purer water and the environment. We do not argue for the cheapest prices, but recognise that there is a major investment problem. However, we also recognise that financial recovery will take place over a very short period. For those people who are least well off and not necessarily on benefit, the steep rise in prices is a strain.

I heard someone mention a cost of 65p a day, which works out as £17 or £18 a month. There are

at least 200,000 people in Scotland who would consider that to be a major problem. Although water does not seem to be an expensive commodity, that is cost equivalent to about 80 per cent of the average electricity bill. The gas and electricity utilities that were privatised by Westminster ended up being covered by a fair amount of legislation, and completely independent consumer organisations were set up to represent the interests of consumers to Parliament and the industries.

It has emerged in the meeting that there is a need to close the loop in communication so that customers understand what they receive. At the moment, the amount of money that one pays for one's water bill is not obvious because it is enclosed in the council tax bill. Many people do not even know that it is there, as they look only at the bottom-line sum. Because the water bill is tied in with the council tax, it is more difficult to help people who need help. I know that the welfare system is a reserved matter, but the Scottish Parliament can raise any issue if it thinks it important enough in the Scottish context.

I will concentrate on customer and consumer representation, which is currently through the commissioner. There are three consultative committees, which are chaired by the commissioner, so they could not be perceived to be independent. The companies do not tap into that knowledge base, so there is no middle ground or closing of the loop on behalf of the consumer.

There are many models of representation. I know that the last thing that Parliament needs is another independent organisation that may be perceived as a quango, but there are other models. For example, we could remove the commissioner's responsibility to chair those committees and give it to an independent individual, with the right to speak to the companies as well as to the regulator. I use the word "regulator" because the commissioner is an economic regulator, who works well with the three authorities while holding the industry within the public envelope. The authorities seem to work well together to try to achieve what I would call the efficiencies of sector in England and Wales. I understand that the benchmark there is the best in the world because that sector has been at it the longest. All of us would want the same thing.

To have an independent consumer body in that structure is not about pulling out the soap box and criticising, but about helping everyone to understand the issues and to communicate to the consumers why charges have to rise at a certain rate and what they get in return for that in terms of clean water and clean bathing, for example.

Four agencies are involved: the Scottish Executive, the Parliament, the commissioner and

the authorities. The authorities are nowhere near the level of efficiency that is required—a level that, as the commissioner would tell me, has been achieved by their English and Welsh colleagues. We recognise the difficulties that they face. Consumer advocacy, in a more independent environment, would improve the situation.

We should consider the issue of equity. The three authorities have been set up along arbitrary geographical lines and have three different pricing mechanisms. In other public sector organisations, such as the Post Office, there is a universal service—we are charged the same wherever we are in Scotland. People in the north of Scotland think that they have more water than anybody else does, because there is more around them, but, unless we are considering cost-reflective pricing, there is no argument for them to pay at least a third more than people in the east and west, who pay about the same as each other. The public do not understand those issues in the same depth as those of us around this table and so take a negative view of increased charges. They do not understand why they are paying more. The attitude is: "As we have so much water, we would love to find a way of shipping it down south and charging them double or treble to address the imbalance."

The Competition Act 1998 would introduce cost-reflective pricing to Scotland. There is no complete exemption from the act, but there is partial exemption in some areas. Under those exemptions, it would be possible to avoid cross-subsidy and allow a universal service in water, if that was the desired route. That could deal with the problem that one part of the population does not fully understand why charges are different in different areas.

I heard a representative from one of the authorities say that, according to their information, the number of people who understand their water bills is not even in double figures. If we separate the water bill from the council tax, the elements are clearly identified and the consumer can begin to consider the cost more seriously.

When we represent consumers in the public sector, our experience, certainly in dealing with local authorities and others, is that there is not much choice in the services. We input as much as we can—the Scottish Consumer Council is, effectively, funded by the population to do that. Not to give the public at least the opportunity to have independent representation would be a negative approach.

Trisha McAuley (Scottish Consumer Council): We recognise the need for investment, but we must find a way of making that compatible with ordinary people's ability to pay the charges. For us, that is the crux of the matter. Legislation is

forthcoming in the Scottish Parliament—we see that as an opportunity. We also see our attendance at this committee as an opportunity.

The Scottish Executive's consultation paper, "Managing Change in the Water Industry", recognised the effects of the Competition Act 1998. However, as was said, that act was intended to protect the water authorities and to prevent cherry-picking. That is good, because the business users will eventually go somewhere else and the water authorities will still be needed to provide water to domestic consumers. We hope that new legislation will go further than the Scottish Executive's consultation paper and use as many exemptions to the 1998 act as it can to help customers directly, rather than in the longer term through protection of water authorities.

It is interesting that the consultation paper did not mention the schedule to the 1998 act to which the convener referred. The director general of fair trading and the Office of Water Services in England have issued guidelines on the application of the 1998 act to water and sewerage. In that document, they identify the fact that the exemptions exist for services of general economic interest. The director general of fair trading also gives an undertaking that he will apply the 1998 act in the same way outwith England and Wales. There is a lack of joined-up thinking but there is also an opportunity for us to make improvements in the future.

17:15

Graeme Millar: The water industry has a different relationship with consumers from the one in the utilities and the postal services. In the water industry, it is only the commissioner's general function to promote the interest of customers, whereas, in the utilities and postal service, it is the regulator's primary function to protect customers. I represented consumers in the electricity and gas sectors for about six years. The environment in those sectors is far more robust. The regulator must produce their own environmental action plans and social plans. Those tasks are not placed on the commissioner in Scotland. It could be argued that the commissioner has only to look over the border to find the standards with which we want the authorities to comply.

The Convener: You have certainly added to the issues that are raised in your submission.

Graeme Millar: It was useful to listen to the debate earlier.

The Convener: That brought out several of the points that you made.

Janis Hughes (Glasgow Rutherglen) (Lab): Trisha McAuley acknowledged the great need for

investment. We have seen some examples of that need today. The council is concerned about the consumer's ability to pay, but investment must be funded somehow. How do you balance those concerns?

Trisha McAuley: That takes us back to the earlier debate. We have no answer to that question. The Scottish Consumer Council wants to focus on the people who cannot pay the charges. That does not mean everyone, but the poorest people in our society pay a larger proportion of their income on basic services, and that proportion has been continually rising.

The debate is not focused on some people's ability to pay. We do not have the answer to how investment should be paid for. However, we are concerned that the Scottish Executive has made a general presumption that nothing can be done to help people who cannot pay, because benefits are a reserved matter. It is incumbent on the Parliament and the Executive to try to find a way round that.

Janis Hughes: I want to ask you about disadvantaged domestic customers. You talked about how £17 to £18 a month was a substantial amount. Are you saying that the industry must improve the way in which it deals with such customers but that you have no ideas about how it could do that?

Graeme Millar: The industry could probably do a lot more to help such customers simply by giving them advice on how to handle the situation. Other agencies, such as Money Advice Scotland, can help. I attended the launch of its report yesterday. Such advice would be a major tool to help people in such a situation. The authorities must understand that they have an obligation to help customers, as do society and government. We have an obligation to concentrate on those who are disadvantaged, by whatever definition.

The companies can help, for instance, by giving information to people to educate them about the use of water, how to manage their finances and funds and the methods of payment that are available. The other utilities have started to offer more flexible methods of payment. There are now special co-op type banks, which allow the most disadvantaged to plan the whole process, usually set up in partnership with organisations such as Money Advice Scotland.

A lot of what can be done is a matter of perception. The fact that people perceive that they have been helped does not in itself take the sting out of the 65p a day or £17 a month that they have to pay, but the feeling that they are being helped to manage their money, rather than just being told "You must pay or else", is important.

Janis Hughes: You mentioned the fact that

Scottish domestic customers are different from their English and Welsh counterparts because of the level of service that is provided by the industry in England and Wales. Is the level of service and choice that we get in Scotland comparable to that received elsewhere?

Graeme Millar: What I said was that companies in England and Wales are perceived to be more efficient. That does not necessarily mean that they provide a better level of service. There has been an industry-wide debate about that. The three companies in Scotland are trying their hardest to deliver a good service—that is a theme. When I have spoken to the companies' chief executives, I have sensed that, individually and collectively, they try to provide. One problem is that the companies often do that in isolation; they do not tap into information sources about what good customer service means. Often, it costs very little to provide good customer service, but people need to know about the science of providing it to individuals.

Our greatest concern, which our colleague the chief executive of East of Scotland Water touched on, is loss of business—£20 million in the past year. That money must be recovered. If money is lost from the industrial sector, it can be recovered from only one place—the domestic market. If companies do not become as efficient as their counterparts in England and Wales on management style, overheads and so on, bearing in mind the constraints of funding and borrowing, we will end up having to make disproportionate increases in the amount of money that domestic customers—all of us—have to pay to ensure that companies can achieve the environmental standards on clean water that the EC demands of us. That is a major problem. Customers, or independent consumer organisations, would like to help companies to get there, at least on customer service. Perception is a strong element.

Fiona McLeod: How important is having a choice of water supplier to the domestic consumer?

Graeme Millar: That is an interesting question. I know that surveys carried out about six years ago in Strathclyde made it clear that people wanted the water industry to stay within the public sector. That implies that there would be no choice, but that does not mean that consumers do not want the highest quality and want beaches to be clean.

Fiona McLeod: I am not talking about quality, but about choice.

Graeme Millar: From my standpoint, choice is always a useful lever on the marketplace to improve efficiency. However, I do not think that domestic consumers are as concerned about choice as they are about ensuring that, however

much they pay, they get a good, clean, safe product and sewage does not appear on the beaches. Those are the criteria for water, but the criteria are different for other utilities. For example, price is the main criterion in the electricity and gas markets. Water is life-blood, so society has a slightly different attitude towards it.

Janis Hughes: Given the attitude of many consumers to price and the fact that people sometimes do not know how much they pay and how, do you think that consumers are persuaded of the need for domestic bills to rise over the next three years, as the commissioner recommended in his most recent strategic review?

Graeme Millar: Not at all. The commissioner has not made the argument for that. His attitude is that he is an economic commissioner who must achieve a target rapidly and hope that the three companies can meet their efficiency targets within that time scale. However, we have a history of under-investment in the water industry, which is why I started by saying that we recognise that there is a need for investment. Whether we can find other mechanisms to allow those who can least afford such a steep rise to pay over a longer period of time is part of developing more sophisticated payment methods.

I do not think that the public understand the need for that rise in any way. That is why the e-mails, the letters and the press releases are necessary for those who are becoming more aware of the issue. Even today's debate, the fact that you have to go through this process, will increase the profile of water charges as an issue. People will become more aware of it and will want to articulate that in what one might consider a negative and not necessarily constructive way.

Janis Hughes: Do you think that the consultative committees are giving customers a loud enough voice in the industry? Are they an improvement on the old-style customer councils?

Graeme Millar: Trisha will answer that question, as she was involved in the old-style councils.

Trisha McAuley: I was a member of one of the area committees of the Scottish Water and Sewerage Customers Council. Graeme mentioned that there were problems in the previous system, and that was one of the reasons why the council was disbanded. We had a public voice and I attended meetings all around the country.

I am not sure what the area consultative committees are doing. They may be carrying out good work, and I understand that they have started to hold public meetings. The issue that I face, working as I do on the policy portfolio of the Scottish Consumer Council, is that we do not know enough about what those committees are doing. If the commissioner is doing good work, he

is not shouting loudly enough about it. He may well be doing good work. If the area consultative committees are carrying out good work, their job is still to advise the commissioner.

The committees are still chaired by the commissioner. They are not properly resourced consumer bodies that can identify issues and take them to an arena such as this; neither are they a consumer advocate body. They are not independent and will not be perceived as being independent by consumers. That is our view.

Graeme Millar: In discussions with the commissioner, we must recognise that he has been in post only for a year and that he was put into a structure that was laid out for him. At some stage, you will want to talk to the commissioner, and if you ask him a similar question you might be surprised. I am led to believe that he would value a more independent input from the consumer body. He has so many meetings to chair, and a year down the line he is starting to understand the benefit of mature consumer input in the process of communicating the policies that he is advising the Scottish Executive and the Scottish Parliament to carry out.

Fiona McLeod: You heard what the water authorities said when we mentioned that to them. They seemed adamant that they want a direct relationship between them and their customers, and that they felt perfectly capable of establishing such a relationship without an independent body to represent the customers. I presume that you would take issue with the water authorities over that.

Graeme Millar: I was somewhat surprised by that. I do not think that Katharine Bryan went so far as to rule out independent bodies. The water companies start from the standpoint that they look after their customers and that they have to defend that position. However, through the Scottish utilities forum I have been involved in discussions as part of the Parliament's pathfinder process, in which the chief executives have individually recognised the value in having a consumer organisation to supplement the relationship with the customers that the water companies have. They interact with customers, and the whole population of Scotland consumes water. The big issue is not just whether people should pay for that, but whether the public health is impacted upon if the service does not come up to scratch.

The water companies could easily be persuaded that there would be benefit in having an independent consumer input into their discussions. If you spoke to any of the companies in the electricity and gas industry, they would tell you the value, over the past many years, of involving independent consumer organisations. They supported the setting up of the modern

manifestation of that, Energy Watch, which the convener is aware of.

The Convener: Indeed.

Trisha McAuley: We did not regard the one as not being possible without the other. It is obviously of benefit to consumers that the water authorities have a good relationship with their customers. However, when things go wrong, what should they do? The water authorities say that they conduct market research. That is not the same as a consumer body identifying the issues through complaints data and working at policy-making level with organisations such as ours, and through being able to speak to other people in the field, gather data and take action on behalf of consumers. That is not the same as a water authority doing market research. To fix things when they go wrong, a consumer needs an identifiable place, person or organisation to go to. The one method complements the other.

17:30

Graeme Millar: In the relationship between any consumer body and the industry, the consumer body must understand the problems of the industry, so that when things go wrong, it is not just jumping up and down, saying, "This is a disaster for everybody." The consumer body must recognise what is happening. It is the conduit between the consumer, who pays the money, and the industry. The consumer body has to be able to say to the consumer that, although something is inconvenient, it is not a complete disaster and can be explained. It has to be able to assure consumers that it is in contact with the companies or the regulator on their behalf. That is a mature way of considering what an organisation that is representative of consumers should be. That is an organisation of today and tomorrow. Perhaps such organisations have not been perceived in that way before.

Trisha McAuley: There is one other thing to remind the committee of, although I am sure that members are aware of it. The current structure serves business and domestic consumers, unlike a lot of the other utilities. The water authorities are right to say that they are concerned about business users walking away and leaving them. However, there is no proper voice for consumers in the framework for domestic and disadvantaged consumers. Advocating their concerns does not seem to be an aim.

The Convener: The point about domestic customers and those with particular needs has been made loud and clear.

Fiona McLeod: The last bullet point on your submission says:

"Strong and impartial enforcement powers will be needed and this should rest with the Water Industry Commissioner, not with Ministers".

Could you expand on that a little?

Trisha McAuley: We are looking for a framework that does not act non-competitively. We are not convinced that we could say that any minister, no matter how wonderful, could never be non-competitive. More important, a regulator has the expertise and the impartiality to do the job properly. Complex legislation and structures are involved, and we have to get things right. That should be free from political interference. The person responsible for enforcing things has to be someone who knows the ins and outs of the industry.

Graeme Millar: That is correct—bearing in mind the fact that the regulator is accountable to ministers and to Parliament, and also the vehicle for holding companies to account. That system works well in other sectors.

The Convener: Thank you, Graeme and Trisha, for staying on with us. That was a most useful session.

Colleagues, I am in your hands. Some people have left and some people are flagging. We still have a couple of important items to discuss, but I do not think that we can do them justice after the amount of work and effort that we have already put in. The meeting has gone on for a fair time. I suggest that we leave those items until the next meeting. With Shelagh McKinley, the clerk, we will prepare a couple of reports that I hope will help to stimulate debate on those items and make the discussion more focused. To assist members, there will be a paper on the selection of advisers on the water inquiry.

We will be taking evidence from the Minister for Environment, Sport and Culture at our next meeting, on Tuesday afternoon. We will also take evidence from the campaign for lower water charges and the Scottish Council for Voluntary Organisations. Do members agree that we should meet in private before the start of the meeting to agree on questions for witnesses?

Members indicated agreement.

The Convener: Thank you. It has been a marathon session, but it is over.

Meeting closed at 17:33.

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