

TRANSPORT AND THE ENVIRONMENT COMMITTEE

Wednesday 14 February 2001
(Morning)

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TRANSPORT AND THE ENVIRONMENT COMMITTEE

5th Meeting 2001, Session 1

CONVENER

*Mr Andy Kerr (East Kilbride) (Lab)

DEPUTY CONVENER

Mr John Munro (Ross, Skye and Inverness West) (LD)

COMMITTEE MEMBERS

*Bruce Crawford (Mid Scotland and Fife) (SNP)
*Robin Harper (Lothians) (Green)
*Maureen Macmillan (Highlands and Islands) (Lab)
*Fiona McLeod (West of Scotland) (SNP)
*Des McNulty (Clydebank and Milngavie) (Lab)
*Bristow Muldoon (Livingston) (Lab)
*Mr Murray Tosh (South of Scotland) (Con)

*attended

THE FOLLOWING ALSO ATTENDED:

Helen Eadie (Dunfermline East) (Lab)
Lewis Macdonald (Aberdeen Central) (Lab)
Nora Radcliffe (Gordon) (LD)

WITNESSES

Katharine Bryan (North of Scotland Water Authority)
Councillor Robert Cairns (East of Scotland Water)
Iain Gardner (East of Scotland Water)
Andrew Gold (Marybank, Scatwell and Strathconon Community Council)
Jon Hargreaves (East of Scotland Water)
Ron Hughes (Braeside and Mannofield Community Council)
Ron McAulay (North of Scotland Water Authority)
Douglas Millican (East of Scotland Water)
Jim Milne (Dundee Anti-Poverty Forum)
David Reid (Dundee Anti-Poverty Forum)
Sandy Snell (Marybank, Scatwell and Strathconon Community Council)
Doug Sutherland (North of Scotland Water Authority)

CLERK TO THE COMMITTEE

Shelagh McKinlay

SENIOR ASSISTANT CLERK

Tracey Hawe

ASSISTANT CLERK

Alastair Macfie

LOCATION

Committee Room 1

Scottish Parliament

Transport and the Environment Committee

Wednesday 14 February 2001

(Morning)

[THE CONVENER opened the meeting in private at 09:18]

09:36

Meeting continued in public.

Items in Private

The Convener (Mr Andy Kerr): Good morning. I welcome everybody to the fifth meeting this year of the Transport and the Environment Committee. I have received no apologies for absence and I expect that a number of members will join us during the meeting.

Item 2 on the agenda invites the committee to agree to take item 5 in private. That is so that we can review the evidence that we will receive this morning on the water inquiry, if time permits. Does the committee agree to take item 5 in private?

Members indicated agreement.

The Convener: Our next meeting will be on 28 February, when we will take further evidence on the water inquiry from the Minister for Environment, Sport and Culture, Sam Galbraith. Does the committee agree to meet in private at the start of that meeting so that we can consider lines of questioning for the minister?

Members indicated agreement.

Water Inquiry

The Convener: We now move to the more substantial part of this morning's business. I welcome the people in the public gallery and the witnesses from East of Scotland Water. We have with us Councillor Robert Cairns, Jon Hargreaves, Iain Gardner, Jonathan Cape and Douglas Millican. I thank the witnesses for the additional paper that they have sent to the committee. We have all had a chance to read it and take it in. We will be happy for you to make a short introductory statement. The microphones will work magically by themselves, so there is no need to press any buttons.

Councillor Robert Cairns (East of Scotland Water): Good morning. I think that we made the general points that we wished to make at a previous meeting. The water authorities have sent the committee individual submissions with a joint submission on developing the public sector model. I suspect that it would be best to launch straight into questions.

The Convener: We are also happy to launch.

Des McNulty (Clydebank and Milngavie (Lab): I would like to ask some questions about the joint paper on the public sector model. What do you mean in paragraph 3.3 by

"More room to manoeuvre to achieve . . . outcomes"

that are set by the Government? Furthermore, in paragraph 4.3, what do you mean by developing your scope

"in terms of market and product mix"?

Councillor Cairns: We believe that our customers and our owners want us to remain in the public sector for reasons of accountability and commitment to the community. However, we feel that we must develop the model because otherwise we will fail. We need freedom to form partnerships with the various other operators in the industry. We need freedom to enter into joint ventures, to extend the services that we offer and to become involved in work on site, rather than within the public infrastructure. We also need opportunities in the development of bundled services with other utilities. I feel that we have a good track record in developing along those lines. We have had a lot of co-operation from the Scottish Executive and the water services unit in that development.

That is our general position, but I ask our chief executive, Jon Hargreaves, to amplify those points.

Jon Hargreaves (East of Scotland Water): The first thing that I want to say concerns the

measuring of outputs rather than inputs. This is not a plea for total freedom from public accountability; it reflects a desire to streamline the decision-making processes. As we move further and further into the competitive world, we need to be able to act quickly.

As our chairman suggested, our discussions with the Executive have been very good. There has been good understanding and we seem to be going in the right direction. We are not in any way suggesting that the Executive is holding us back—it is not. I have seen companies go too far, too fast, and get things wrong. I think, therefore, that the steady approach is right.

Everybody needs to recognise that we need to change to survive. Survival will be dependent on our ability to meet the expectations of the market, which will be driven by our customers. What do we need to do? We need to concentrate on outputs rather than inputs. We need those outputs to be clearly defined. We need to set targets and we need to be measured against them. Failure to meet those targets should lead to swift action being taken at my level.

We need also to be able to fund our development. Although we can fund the day-to-day activities that we are exploring, there will soon come a time when we are required to put equity into joint venture companies. We have the option not to do that, but the problem in that would be that we would be seen as the public sector small player that did not get value out of the joint ventures that it had worked hard to get into. We believe strongly that, for the future of the Scottish water industry, it is important that our competitors see us as being able to fight our corner and to provide the additional services that we are as technically capable of providing as they are.

We need cash for that, which raises the question of where the cash will come from. At the moment, it comes from our efficiencies—the money that we save from our operating costs. As our activities grow and we require more money, two possibilities might arise. One is that the equity could come from customers, but our feeling is that that would not be the right approach.

Yesterday, the Government announced an investment of £250 million in Rolls-Royce plc for a project to develop new aero-engines. That money has not been given as a grant; it has been injected as equity with a real rate of return that reflects the risk of the investment. That has led to a debate about whether civil servants know how to assess risk. The answer to that question is, “If they do not, get people that do.”

As our discussions with the Executive move ahead—as we believe they will—the Executive should consider any investment as an investment

for taxpayers. It should not be the case that water customers take it on the nose because they take all the risk. Everybody in this room will recognise that, in such an environment, things do not always work out as one expects. People need to be clear about what they can do to ameliorate any situation, but sooner or later something will go wrong. There is therefore a risk, and that risk requires a greater rate of return.

Des McNulty: You did not say very much on the market and product mix that you expect.

Jon Hargreaves: Developments in the market are not yet clear. However, it is clear to us that customers—by which I mean all our customers, commercial and domestic—will be offered different services. If that is not happening already, it will happen over the next one or two years.

We talk about bundled services, but what are they? How does that market work? Does it require common carriage? We do not believe that it does. Companies are talking to our customers and offering to supply them with gas, electricity, telecommunications, insurance, Automobile Association breakdown services, and water and so on. They do not need to be able to supply them with water; they merely take over the relationship between the customer and us. By bundling services together they can offer an overall discount on the total service. We see that as a major threat to the market. How quickly it evolves will depend on how sure those companies are that they will be able to get water cheaper in the long term—that is how they will make money.

09:45

That is clearly a threat in the domestic market, which we are taking extremely seriously. It is difficult to judge what the turnover will be—the churn is the phrase that we use—but about 30 per cent of customers have swapped suppliers of electricity and gas. Why have they swapped suppliers? Primarily, they have done so for money, but customers are increasingly rechanging suppliers because of poor service. This is not only about pricing; it is about service delivery.

Our strategy is about customers and service. We recognise that we cannot have the cheapest services, so we must provide the best service that we can to customers. The size of the market in monetary terms is difficult to judge at the moment. We have gone to different segments of our customers through focus groups to get market information and it is clear that some groups would change their suppliers tomorrow. Our small business customers are not as loyal as our domestic customers—more than 50 per cent say that they would change supplier tomorrow for the right deal.

Our domestic market is much more stable; a much smaller group of people say that they would swap suppliers. It is interesting to consider those who would. They tend to be people who move house—loyalty gets disrupted during movement—and young people, who are much more likely to change their mortgages 10 times and are much more flexible; loyalty takes on a different meaning.

We believe that the public sector model gives us some benefit, because in Scotland there is clearly a brand desire—I will put it no stronger than that—to be supplied by a Scottish company. That comes out clearly from the information that we have received from our customers.

Des McNulty: Could that movement be held back or prevented by exemption from the Competition Act 1998? What is the influence of the Competition Act 1998 on the process that you describe?

Jon Hargreaves: The Competition Act 1998 is about common carriage—access to pipes. We already have competition; it is there with our large industrial users, as we discussed the last time we attended the committee. They use other companies; they take their water from other places and we lose a significant amount of income because of that. Our view is that that could not be stopped, even if there was an attempt to maintain the monopoly supply. The bundle service does not require a change of law; it can be done today or tomorrow. I am not sure whether the effect would be as severe as with competition. Our view is that our job in life is straightforward; we must try to give our customers the best deal that we can. Competition has certainly stimulated East of Scotland Water to respond. I hope that members will have heard that we recently won a significant deal—in partnership with another company—to supply BP and that will be a long-term deal.

We are, if you like, fighting back. That says that there is some loyalty, but it only goes to a certain point. Preventing competition will not be good for our customers. Competition will cause us a lot of pain—we must face up to that. However, if we look at the situation coldly and unemotionally, for both business customers and—ultimately—for domestic customers, competition makes companies respond. I think that we are capable of responding.

Des McNulty: I was asking specifically about the application of the Competition Act 1998. Does that act make it more difficult for you to deal with those pressures in the short term?

Jon Hargreaves: No, I do not think so. Do you mean the Competition Act 1998 generally, common carriage specifically or both?

Des McNulty: Both.

Jon Hargreaves: At the moment, people cannot

go for common carriage. When the act comes into force, the only thing for which we would ask in terms of VAT and a level playing field, is that we are brought in line at the same time as England and Wales. Legislation has been put back in England and Wales, so there is a danger that, if matters proceed in Scotland, we could find that every punter who fancies a go in Scotland does so. We have already been hit in relation to the industrial sector because we look defenceless. We are not, but people think that we are. We have therefore asked the Scottish Executive to consider delaying implementation of the act in Scotland; it should not come into force before it does in England and Wales. If it does, we believe that we will suffer significantly.

Des McNulty: My next question relates specifically to the equity model and your suggestion that the Government make an equity investment. Do you think that, in industry terms, it would make more sense to do that in the context of a single common Scottish water company, or would it be better done in the context of the three present Scottish water operators?

Councillor Cairns: Do we want to get on to the general question about—

Des McNulty: No. I ask specifically about the equity issue.

Jon Hargreaves: In order to have a competitive position, that would be better done under one organisation.

Bruce Crawford (Mid Scotland and Fife) (SNP): The issue of equity intrigues me and I would like to understand a little more about what you are trying to tell us about how it would work. Are you saying that, instead of giving a grant to a joint venture company, money would be invested in return for equity, and that a return would be expected on that money because of the risk that was taken? Where is the advantage to the water authorities in that arrangement? Is not there potential for claims of unfair competition by others who are trying to get in on the act, because of the equity stake that would be taken by the Government, which would, in effect, form a new company involving the public sector?

Jon Hargreaves: I will answer Bruce Crawford's question backwards. I do not think that competitors could—having duly considered the activity—complain if the Government decided that it wanted to invest in the industry. Instead of receiving interest on a loan, the Government would get a dividend. That is how the deal with Rolls-Royce will work. It is not the only such deal that has been struck.

I do not believe that such action would be anti-competitive. In fact, if members examine some of the French companies that we compete with, they

will see that the French Government invests to a huge extent. A big chunk of the French economy is based on the French Government having equity in car manufacturing, steel and other industries.

Des McNulty: But not water.

Jon Hargreaves: No, because of the history of that. However, I do not think that that makes any difference to the general question of whether it is anti-competitive for Governments to put equity in. Suppose that one needed to borrow £10 million. Under the sort of arrangement that I am talking about, one would not invest £10 million; one would invest £1 million and use that for leverage. The rest of the money can be borrowed from banks. The industry can do that and we believe, despite the fact that the benefits of that activity ultimately go back to our customers, that the customers should not bear the full risk of those activities. The Government may decide that there is no difference between voters and water-rates payers, but with increasing competition, there will be.

Des McNulty: What would you do if the Government said no? You must either fund that activity from charges or find some other equity partner.

Jon Hargreaves: That is very simple. If the Government said no, it would say no not only to putting in equity, but also to our using customers' money for that. That would put us in the position that I described earlier. The only things that we would have to offer then would be assets and people, and we would become a very junior partner. For example, we were a 50:50 partner in the BP joint venture, which is a big deal. If we could not put equity into that, we would not be a 50:50 joint venture partner. Our earnings from such a deal would be commensurate with what we could put into it.

Des McNulty: What do you mean by "an incremental investment" for new business development? How much cash do you think that you need access to, and over what period?

Jon Hargreaves: At the moment, we should need relatively small amounts of money. However, who is to say how successful we will be? We believe that we can be successful, and not just in our area—some of our customers want to take us out of our region. If the Government wants us to be successful and to earn returns for our shareholders and customers, we might need considerably more money. It is an evolving market and at the moment it is extremely difficult to determine even the size of that market, never mind how much equity it would require should we win 25 per cent of it. We are, however, talking about a few million pounds rather than tens of millions of pounds.

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

You made the point that not very much money is required and, in response to Des McNulty's previous question, you talked about replacing £10 million of borrowings with a £1 million injection of equity. Are you saying that, given that you have a limited borrowing consent, you can make it work better for you by taking some of it in equity? We see the impossibility of the authority expanding its borrowing limits significantly, but if you are saying that you could borrow less if you had equity, but still generate more money, we would be interested in that.

Jon Hargreaves: Those deals are structured so that two joint venture partners set up a company into which they both put equity. Let us say that the company required £10 million; both companies would put in 10 per cent or 15 per cent of the £10 million as equity. The partners then go to a bank and borrow the rest of the money on the back of the future earnings of that business.

A private finance initiative is no different. When I was on the other side of the fence, we raised money from banks by putting our equity at stake while using it to leverage bank borrowing. The rate of return that the banks require—the interest on the loan—depends on the view that they take on the risk of the project, and of who the parent companies are. If the banks see the parent companies as solid citizens that have a good rating, they will lend money more cheaply than they would to somebody who had no backing. It is very important that we choose partners of substance; they give us the leverage to borrow money.

We cannot borrow all the money against the project—banks will not, or are at least unlikely to, give us 100 per cent, so we have to inject some equity to leverage the rest of the funding. However, that is done against the future earnings of that particular joint venture. In a way, that creates a fire-break.

The Convener: Is it appropriate for the Government to do that on the basis of internal Scottish competition? The Rolls-Royce model that you referred to is based on international competition—the Government is taking a stake in a UK company that is in competition with a US company. Would that be appropriate in the context of other water authorities against which you would be competing, or other public utilities that have been privatised?

Jon Hargreaves: Do you mean competition between the three authorities or between us and the players from down south?

The Convener: Both, or even all the utilities in Scotland. There is no reason why Scottish and Southern Energy plc—or anybody else, for that

matter—might not enter the water market in the bundled services structure that you mentioned. Would it be appropriate for the Government to have a stake in one company to the disadvantage of other Scotland-based players?

Jon Hargreaves: I will give a quick answer, but perhaps Douglas Millican can answer more fully, because that is his job at the moment. That is a decision that the politicians must take. I see nothing wrong with the shareholder deciding that he wants that organisation to survive and thrive because that is what he has set up. If he knows that the organisation will not thrive if he does not support it, I cannot see how that can be interpreted as anti-competitive, given that all our competitors—apart from the other two water authorities—are in the private sector and have total freedom to source money from their shareholders and from banks.

You have asked whether Government should support public sector bodies to help them compete in a market. That is a different and interesting question. Our belief is that that is what our shareholders want us to do to develop a public sector model that can thrive. Perhaps Douglas Millican can add something to that.

Douglas Millican (East of Scotland Water): The question is straightforward and lies at the heart of what the Government wants to achieve by ownership of the Scottish water industry. If the Government is committed to continuing to own the Scottish water industry and making it a strong and successful industry, there is no option. We have some fierce competitors.

The privatised English water companies—most of which are either publicly quoted or are subsidiaries of publicly quoted companies—have limited scope for growing their businesses in their home patches and they have had to look for growth outside the regional territory. They have looked around the UK and see Scotland as a relatively soft market, because our authorities were set up much later than the English water companies, which were set up in 1973. We have got some fierce competition in the Scottish market. Four English companies are very active in Scotland. Unless we have the cash, the skills and the product and service range to compete with those incomers, we will not have a strong and sustainable future.

10:00

Councillor Cairns: I want to make a point that was made at the previous meeting. We do not want competition between the three water authorities in Scotland to mean that one will target the business of another. However, in cases where business is being targeted by third parties, our

view has been that it is better that part of the business remains with the public water industry in Scotland, rather than it being lost.

The Convener: Others have said that if one wanted to establish a single-supplier deal with a Scottish-wide chain, there would have to be a discussion with other water authorities about that relationship. One assumes that there would be infractions on each other's areas.

Jon Hargreaves: Unfortunately, I cannot give the committee details, but we have a couple of wins under our belt that have involved carrying out activities in the areas of the two other authorities. The chief executives of the companies are well aware of those activities. Douglas Millican and I asked a chief executive of a company whether we could bring the other authorities into the deal, but we were told that the company wanted a single supplier and that, if we could not deliver that, the company would go to Vivendi Water Systems, or some other company.

I do not believe that the other two authorities see us as a threat. They share our view that there is a threat to their customers and that it is better that one of the Scottish water authorities keeps water supply in Scotland. We are not talking about two-year deals in this context; some of the deals will be over 25 years. We do not want that income to be lost to the Scottish water authorities and so we have to live with any difficulties that the arrangement might create. I do not think that the three authorities have a serious difficulty about the matter anyway. East of Scotland Water has had to make such arrangements sooner than the other two authorities, because our market was the most exposed and was attacked the earliest. If we had not responded last year and again this year, we would have lost an awful lot more money than we have.

The Convener: We will have to motor along. I ask Murray Tosh to ask about issues relating to capital investment.

Mr Tosh: We spent a long time last week discussing with West of Scotland Water the comparisons between PFI and public-private partnership procurement and conventional procurement. The representatives of West of Scotland Water gave us a breakdown of its analysis of the various cost components at Dalmeir.

You have given us more of a financial summary than a breakdown. That has given us the bottom line. It tells us that the PFI approach gave rise to costs of £156 million, whereas the conventional approach would have led to costs of £248 million. That appears to be a very convincing margin of difference. I am not sure whether our adviser is to receive more detailed information from you on the

breakdown of the figures, but the committee would be interested to know what the components are of the difference between the conventional route and the PPP route. Why has PPP produced the savings that are suggested by the figures that you have given us?

Councillor Cairns: We have more detailed figures. I will ask Douglas Millican, who negotiated both our large PPP schemes, to comment.

Douglas Millican: With regard to a more detailed breakdown, a lot depends on what you want to see. We could go into a lot of detail. In our submission, we tried to present the information that was of the greatest relevance. Although the projects are complex, with all sorts of cost elements, when we consider them at a summary level in terms of the contract with our service providers, the arrangement is in fact very simple.

We pay our service company, based on the volume of waste water that we treat, at a given number of pence per cubic metre. Effectively, that means that we make a single annual payment—paid, however, in monthly instalments—for the service company to treat our waste water to the standards that are set under the urban waste water treatment regulations and to dispose of the sewage sludge. The service companies are faced with meeting all the capital costs, operating costs and financing costs. If they outperform compared to their cost expectation, they will make enhanced returns; if they underperform, they will make diminished or no returns. As our paper says, the expected cost for the Almond valley and Seafield project is £152 million over 30 years.

You asked why we have achieved significant value from such projects. Although we picked the example of Almond valley and Seafield for our submission, the pattern is the same across our three PFI projects: the expected cost to the water authority is significantly below the public sector comparator.

When we set up the projects, we were keen to have a robust public sector comparator. We engaged outside consultants to prepare the work, and that was reviewed by our financial adviser. The greatest comfort that our board took at the robustness of the public sector comparator was that, in our two largest projects, for which we had four bidders, there was always at least one bidder whose bid was more expensive than the public sector comparator. We do not have some artificially inflated public sector comparator; it is prepared on a robust basis, to the same standards and time scale as apply to the bidders, which are operating in a competitive environment.

A lot of how we derive the benefits came down to our approach towards managing the PFI programmes and structuring the projects. The first

factor that we were aware of was that about 12 waste water treatment projects were due in the Scottish market in a short time scale, because of the pressures set by the UWWTR deadlines. We recognised that it was important to market those projects as strongly as possible. We knew that we could not just sit back and wait for bidders to come to us. We needed to go to the marketplace and persuade potential bidders of the attractiveness of bidding for our projects.

Next, we tried to structure our projects so that it was clear to bidders what was required of them, and, ultimately, so that the projects would derive significant value for us. Instead of specifying the inputs, we focused on the performance requirements or outputs that needed to be met in terms of the quality of waste water to be discharged into the Firth of Forth, for example. We did not specify the nature of sewage treatment or the type of sludge treatment facility that needed to be built.

The Almond valley and Seafield project covered five different waste water treatment works. Various solutions were proposed for the project, ranging from bringing all the waste water down to Edinburgh to continuing to operate the five treatment works.

We were also flexible about the length of contract, which we did not want to prescribe. We left it open for bidders to work out the optimal contract length based on their capital solutions and financing proposals. As a result of that approach, the Almond valley and Seafield project has a 30-year contract, whereas Levenmouth has a 40-year contract. That recognises the different capital solutions and financing proposals.

Our next benefit came from clearly defining the risk allocation at an early stage and maintaining competitive pressure throughout the process. We did not cut to a single preferred bidder until we had resolved all the key issues, not only with the bidders, but with the funders. They did not like that and complained that it cost them much money, but we were happy to exploit the fact that two bidders were still keen to win the project and to ensure that we got the benefit of nailing down all the key issues before we arrived at a single preferred bidder. Managing the process tightly and conducting the operation professionally enabled us to deliver huge value from the programme.

Mr Tosh: So you are saying that you harnessed the successful contractor's ability to save on the capital by innovation.

Douglas Millican: That is correct in part. However, it was interesting that, although the total costs of the two lowest bidders for the Almond valley and Seafield project were very similar, their capital costs were significantly different. The

capital costs of the bidder with which we did not proceed were £12 million lower than those of the bidder with which we did proceed, because the bidders took different approaches towards capital investment rather than operating risk and operating cost.

The Convener: Bristow Muldoon has said that he has a supplementary question, but I must caution all members and witnesses that answers and questions must be kept a bit tighter, to ensure that we cover the territory that we want to.

Bristow Muldoon (Livingston) (Lab): I would be interested in a detailed analysis of the differences between the public sector comparator and the successful private bid. It is not clear where the differences are, and they are significant—you are talking about a difference of 50 per cent in the public sector comparator. What assumptions are made about the life of the plant and the volume that the plant is likely to deliver? Was everything strictly comparable?

Last week, the committee spoke to West of Scotland Water. The example that it showed us contained differences in the expected life of the plant and significant differences in the plant's expected volume. Could not the gains from innovation that you have talked about also be gained through traditional procurement and innovation in the design?

The Convener: I appreciate the points that Douglas Millican may want to make, but those questions were detailed and he has already said that he will pass on information to the committee. Ian Jones will also meet East of Scotland Water to discuss some of the issues that have been raised. Therefore, I suggest that we request an additional paper from East of Scotland Water. The detail required to respond to Bristow Muldoon's questions would take up some time. I am happy for the questions to be put to the witnesses, but a more detailed response in writing would be more appropriate. That also takes account of confidentiality, about which we are happy to give undertakings.

Bruce Crawford: I ask that we receive that information on the same basis as the information that we have received from other water authorities, so that we can compare the private sector model—or the PFI—against the public sector model and also make comparisons between authorities.

The Convener: Ian Jones assures me that he will take care of that.

Councillor Cairns: I am not sure whether making comparisons between authorities is appropriate, but if you let us know clearly what information you want, we will provide it.

Jon Hargreaves: I was a bidder, so I have sat on both sides of the table, and perhaps I can contribute a little to the discussion. The processes that the three authorities followed were different in some respects—the ways in which they approached the market were different. I will not say which was best or worst, but they were different. Therefore, a bit of a health warning needs to be given before we put together the numbers and the comparators.

Having been a bidder against other competitors and a successful bidder in two cases, I can say without question that the competitive process has driven down prices to figures that I did not believe, and I have run capital programmes south of the border of £200 million a year. We did not get close to what was coming out of that process. Ever since, I have been intrigued by how that can be achieved through normal procurement. The bottom line is competition. As Douglas Millican said, he kept two bidders hanging on to the end. The bidders might have spent £2 million and would not want to walk away. They would be desperate to do the project. The rates of return that are quoted in the information to the committee are rock bottom. I guess that most companies—unless they are insane—would not do the project.

In my experience of five years of international bidding, the Scottish market required the fiercest bid, because everyone wanted a slice of the pie. Only time will tell whether that is a valuable quality, because things change. However, the risk transfer has not been addressed. Much risk that sits with us on our other projects has been placed on the bidders, such as a change in law or prices. Such risks have been transferred and are not necessarily reflected in the figures that the committee has. They will evolve over time, which is why it is difficult to judge them. From a bidder's point of view, the market is extremely competitive.

10:15

Mr Tosh: The witnesses' answers have thrown up several supplementaries. The difference in East of Scotland Water's comparison between PPP and conventional procurement shows much greater gains than West of Scotland Water or North of Scotland Water Authority achieved on comparable bases, according to the evidence that the committee has seen. What did East of Scotland Water do that was different? You seem to have achieved a greater margin of value. That question may be unfair, as it asks you to comment on comparisons with other authorities. However, to achieve the saving that is presented, you must have harnessed the competitive pressures in the market rather better. How was that done? What did you do that was qualitatively better?

Councillor Cairns: Douglas Millican may have

talked about that process, which concerned the way in which the various bidders were managed and kept in the frame until what we judged was the appropriate point.

Douglas Millican: It is difficult for me to compare our methods with those of the other authorities, because I was not involved in their processes. The feedback that we received from bidders was that the approach that we took was somewhat different and perhaps somewhat tougher. The only other piece of evidence that I can give is that, in the *Scottish Business Insider* review of PFI deals that were undertaken last year, we won the deal of the year award for the Almond valley and Seafield project. In part, that reflects the approach that we took.

Jon Hargreaves: The value that is obtained from the process depends on the project. For some projects, there is no difference, no matter how it is procured. Almond valley and Seafield was a great opportunity to involve every innovative thought that one had ever had. The Esk project was brought into that project—it was originally meant to be left with a separate treatment plant and a long sea outfall. The innovative approach brought that into Seafield and drove out 50 per cent of the cost of that project at a stroke.

In projects elsewhere in Scotland, such scope does not exist. It is much more difficult to make such gains when dealing with a single site. That involves the finer details of reducing volumes and taking more risk on the volumes, for example. The outcome depends on the project. My experience of the whole market is that Almond valley, Seafield and Esk gave the greatest opportunity for innovation. The project was the biggest and was in the capital, so people were trying that bit harder to win it. That is how the market works.

Mr Tosh: That was helpful.

My second point concerns the 40-year term at Levenmouth. Last week, the committee had a long discussion with West of Scotland Water about the advisability of a 23-year or a 40-year model. The authority was firmly of the view that 40 years incurred much risk because of the possibility of standards being changed, the need for reinvestment and the pace of technological innovation, which could mean that people were no longer satisfied with the facilities. West of Scotland Water seemed to think that 40 years was not clever. You have just told us that you have entered into a 40-year model at Levenmouth, which is different from what you have done elsewhere. Why was a different approach taken there?

Douglas Millican: We took the same approach to all the projects. We set out performance requirements that had to be met consistently throughout the span of the contracts. It does not

matter whether it is year one, five, 25 or 40—the service company must meet the same standards throughout. If it does not, it will not receive the full payment that it is expecting. If it is in serious breach of its performance obligations, it risks the termination of the contract and the loss of a significant amount of money.

The other element that we built in was that, whether bidders wanted a 25-year or a 40-year contract, at the end of the contract, they had to be able to hand back the facilities to us in a particular condition and with a certain amount of functionality. It was up to each bidder to take a view on the optimal contract length, based on their capital investment programmes and capital replacement cycles. There is no greater risk to water authorities in having a 40-year rather than a 25-year contract as the risk allocation, and the performance obligations on the service companies are the same.

Mr Tosh: That is interesting and perhaps something that we can pursue, as it appears to be slightly at odds with the evidence that West of Scotland Water gave last week.

On risk, you say that service companies will need to meet the same standards throughout the period of the contract. I think that we would agree with that, but the point has been made that there is a risk that standards may tighten and that investment will be required to achieve higher standards. If you are proceeding on the basis that the risk does not really exist and that the same standards will have to be pursued, is there really an element of risk being transferred? How much risk is there for the contractor?

Some evidence that we have taken suggests that the risk is just the same as it is in conventional procurement—it is in the construction process. After that, everything is a bit fanciful, as you are a cash-rich body with which private contractors can see an opportunity to do business. They can transfer risk all over the place and know that you can afford to pay for it all. The amounts that are mentioned are all fanciful sums plucked from thin air. I paraphrase, but that is the essence of the evidence that we took a fortnight ago, which you probably read. How accurately can you cost and measure risk transfer? Are you sure that you are protected against consortia inflating risk?

Douglas Millican: There are two main issues to tease out. First, on the risk that has been transferred, you are absolutely right that design and construction is one of the significant risks. However, the operating performance risk, which sits with the operation and maintenance contractor, is also significant. The basic structure of our deals is that, if the operator fails to meet his obligations, there will be a deduction from the payments that are made. That deduction will flow

all the way through to the operating company. For a fairly minor failure in performance, the operating company's target profit margin could be eroded by 50 per cent. For a more significant failure, its profits will be completely wiped out and, indeed, it could make losses. There is no question but that there is a significant operating performance risk for the service company.

Secondly, it would have been unrealistic for us to expect our bidders to take the risk on changes to legislation that have not been foreseen. Our service company has taken the risk on law that exists or is in draft form. Clearly, bidders could not take the risk on any law that has not yet been envisaged. If we had asked them to do so, they would have had to include such a huge pricing premium for uncertainty that we would not have got value.

None the less, when we evaluated our bidders' proposals, one of the key things that we considered was the flexibility of the proposals to cope with changes over time. For the Almond valley and Seafeld project, we did not select the cheapest bidder. The reason why we opted for a slightly more expensive bid was that, in our view and in the view of our advisers, the ability of the winning bidder's technical proposals to cope with change over time was significantly greater than that of the other bidder. We took a whole-life view of proposals and examined the value to East of Scotland Water over the 30 years of the contract and not simply the upfront cost.

Councillor Cairns: I will amplify that response slightly. The issue was the possibility of a change in the law on the disposal of sewage sludge. Flexibility on that was a major factor in both the Almond valley and Seafeld and the Levenmouth bids. As Douglas Millican said, we accepted a slightly higher bid on Almond valley and Seafeld because it had more flexibility in the routes for sewage disposal.

Mr Tosh: My last question will be on the transparency of the process. We are taking evidence from you—and further evidence is being offered to our adviser—on basic information that might be said to be publicly sensitive. How widely and freely do you make information available about public sector comparisons in both procurement and operating costs? Do you publish your private finance initiative business cases? Are analysts able to look at what you have done? Is the water industry commissioner on behalf of the public interest absolutely in control of all the information that we need to be clear that everything is as you say it is?

Douglas Millican: When we developed our PFI projects, there was no Government requirement on us to prepare and publish a business case. The fundamental driver for those projects was the need

to meet the UWWTR requirements.

In terms of the public sector comparator, the value that we cited in our submission was made public only after the end of the bidding process. We did not make it available to our bidders during the bidding process.

The details of service contracts were open for public inspection during the period of the bond issue for the financing of the project. All our projects were financed by bonds and, under stock exchange rules, the contract details had to be open for public inspection.

We have supplied the water industry commissioner with many details in the past. Full details of the projects are available for his inspection so that he can satisfy himself that our customers are getting value for money through this process.

The Convener: Bruce Crawford will now ask questions about efficiency and structure. Again, I sound a note of caution. We will hear from several witnesses this morning and we do not want to impinge too greatly on their time, so members should keep their questions, and witnesses their responses, tight.

Bruce Crawford: Last week, we tried to address the question of having one authority rather than three, but the limited time that we had did not allow us to get as deeply into it as we would have liked to.

Obviously, on one side of the equation, a single authority model would offer economies of scale, the possibility of joint ventures and equity of prices across Scotland. On the other side, there is the aggravation that aggregation would cause. I would like to gain more of a sense of what, on balance, the best option in the longer term will be. It may be that it is not wise to move to a single model in the short term, but would it be wiser in the longer term? I would like to begin to understand the arguments a bit more deeply than has been possible so far.

Councillor Cairns: As West of Scotland Water told you, we have identified some major areas in which the three authorities can work together, such as procurement, capital developments, stores and information technology. In the run-up to Christmas, we considered those matters closely in what was called the NEW—the north, east and west—project.

The next step might be a single authority. As you hinted, the scorecard is balanced on that idea. A single authority would allow economies of scale to be made. It would be of great assistance in achieving a critical mass to beat off competition, as we discussed earlier. I think that, as was hinted at in questions on the relationships between the

three authorities, our business customers are looking for a Scotland-wide operator or for an operator on an even wider scale. The opportunities for branding Scottish water in the competitive environment are extremely important. Those are the positive points in favour of a single authority.

The other side to this matter is that there is a danger of our taking our eye off the ball, as disruption is inevitable when organisations are merged. Capital investment dipped severely when the current authorities were set up in 1996. That is the major problem. The creation of a single authority would have to be managed in such a way that best practice in the three authorities became the standard for the new authority. Taking a piece from here and a piece from there would be disastrous for the creation of a single authority, which would have to be tightly managed and quickly implemented. However, that is ultimately a political decision for the Executive and the Parliament.

10:30

Jon Hargreaves: A more fundamental issue is the sustainability of the current structure of the Scottish water industry. It is no secret that two of the water authorities have difficulties for different reasons.

If East of Scotland Water Authority continues to leak revenue, it will be more difficult to finance our functions without sending bills through the roof. Amalgamating the three authorities will mean a more sustainable balance sheet and organisation. However, the question—and the downside—is how we get from A to B. As with any business or public sector merger, any such decision should not be drawn out; it should be made quickly, with strong management providing clear direction and speed of action. From a competition point of view, size matters, as the advertisement says. We receive significant leverage from the fact that our competitors are our partners. As a result, our industrial and domestic customers would support a Scottish brand, which we could promote; although we can currently do so, that brand would be stronger if there was a single organisation. As I said, the risk area is getting from A to B, which will require a tremendous amount of thinking through and no fudging.

Douglas Millican: In the past few months, it has become apparent that our competitors are starting to take notice of some of our successes. If we had a single authority instead of three, the value of the whole would be greater than the sum of its parts and our competitors would probably think twice about trying to push so hard into the Scottish market.

Bruce Crawford: You made some interesting comments about the time scale for amalgamation. I understand your feeling that any such merger should happen quickly, even though that should be set beside the fact that the amount of turbulence that would arise might make it easier for the competition to get in. In light of that, should the Government delay competition to remove some of that turbulence and risk and to allow a period of consolidation for the creation of the single authority?

Councillor Cairns: It is not possible to limit permanently any exposure to competition. As Jon Hargreaves indicated, full common carriage competition should not be introduced north of the border earlier than south of the border. How that would relate to the time scale for the creation of a new single authority will have to be thought out.

Bruce Crawford: I am not suggesting that competition would be delayed in perpetuity; it would simply be for a period to allow for areas of turbulence and risk to be ironed out of the system before you felt that a single authority would be able to operate successfully. Whatever the views of the Government or others about whether that would be possible, would it be beneficial?

Councillor Cairns: The basic point is that competition already exists. Deals are being struck under current legislation and we cannot stop that.

Jon Hargreaves: The fact that you are asking these questions is unsettling our staff. We lost two senior managers this week, whom it will be extremely difficult to replace, because the news is out in the press and people are nervous. That leaves us with a choice. We can put the lid back on the box and say that we will keep the structure of the three water authorities and meet our efficiency targets. However, the question is not what will happen this year or next year, but what is happening in the market. Can we survive in a market that is taking the bundle services and outsourcing route for many customers? If we look at the situation over the next five years, the answer to that question is probably no. We stand a much better chance of surviving as a single body than we do as three separate ones.

Even if competition is delayed, we will hit turbulence and experience problems at some point and in the meantime we will create uncertainty. Indeed, that uncertainty already exists. The matter is simple: in view of the speed with which the market is changing, if we believe that a single authority will bring competitive efficiency and benefits that are right for Scotland—while recognising all the difficulties in doing so—we should start the process now. Things will be more difficult if we delay and try to merge when the market is more mature. That is a fine balance to strike. As I said, we can put the lid back on the box

and tell people clearly that the three water authorities will remain and collaborate. At the moment, the authorities are collaborating to an extent that has never been seen before in the Scottish water industry, which is helping—and will help—with efficiencies. However, what matters is how the market and our customers perceive us, not how we perceive ourselves.

Bruce Crawford: It will be very useful to contrast your comments with evidence that we have already received.

Is the fact that you are losing people to do with the argument about whether there should be one authority or three, or does it have anything to do with the water commissioner's efficiency targets and the driving down of costs? The joint paper from the three water authorities and your own submission contain a lot of information about how you will deal with efficiency and structural problems. As some of your fixed overheads are people, what will be the short and longer-term effects on the people you employ of driving down costs to the level expected by the commissioner? Although it is perhaps too early to give any definitive answers, it is clear that some labour will have to be shed to make those savings.

Councillor Cairns: Jon Hargreaves has already outlined why we have lost a couple of senior managers. It was nothing to do with efficiency targets; indeed, the individuals concerned would be extremely capable of coping with such targets. However, the point I want to make strongly is that we are not being unwillingly dragooned by the water commissioner, Alan Sutherland, into meeting efficiency targets.

Since the creation of the three authorities, we have achieved efficiencies of around 25 per cent and we had set ourselves a target of about 25 per cent over the next three years as opposed to the commissioner's target of 40 per cent over five years. We felt that we had to go that way for the survival of the business. Although the board has accepted the efficiency targets, it will maintain that the ultimate function of the water authority is to meet standards of public health. That said, we have agreed the targets and will make every effort to meet them. At this point, I will bring in our finance director, Iain Gardner.

Iain Gardner (East of Scotland Water): There are several points to address. The committee has already heard about the three authorities' joint efforts to meet the cost reduction targets, which is something that we can do. There is no doubt that the levels of customer service across Scotland must be maintained and improved; we cannot afford to put the core business at risk.

East of Scotland Water's labour costs are some £46 million a year, which equates to more than 40

per cent of our controlled or operating expenditure. The planning and execution process over the next five years to reduce our cost base will obviously have an impact on the size and scale of our operations and will impact on the head count as much as on the level of service and some of our activities. That needs to be carefully managed, as Jon Hargreaves has said. The uncertainty that is currently being created about the structural destination of the authorities needs to be addressed fairly quickly, to give us a clear focus as to the way forward.

Bruce Crawford: There are other questions that I would like to ask, but I am conscious of the time.

The Convener: As always, there will be the opportunity to follow up in writing areas that we are not clear about.

Bruce Crawford: Last week, representatives of West of Scotland Water told us that they think there would be substantial difficulties with shedding labour. I would like to get a better feel of what that means in reality for the people in those organisations. I am not saying that I need that information today.

The Convener: I am going to close this session in about five minutes' time, as we have to hear evidence from other witnesses. I know that Bristow Muldoon wants to pursue a specific line of questioning. We can deal with your questions in writing, Bruce.

Jon Hargreaves: We would be happy to give you a written response on that issue.

Bristow Muldoon: You have already covered some of the points that I wanted to raise, but I also want to address an area that has not yet been covered. What percentage of your commercial customer revenue do you feel is at risk from new entrants to the field? What sort of impact could that have on your revenue and what analysis has been carried out on it?

Councillor Cairns: That is probably a question for Douglas Millican.

Douglas Millican: The short answer is that all our customer revenue is at risk. There is no one customer that is safe. Having said that, we have a twin strategy of trying to maintain the business that we have and working with our existing customers to grow the value of the business that we have with each of them. Our major business customers are our top 250 customers who generate revenue in excess of £25,000 a year. We expect that, if we did nothing, we could lose a further £15 million in revenue. Our internal teams are actively working to minimise that reduction. There will be a reduction in revenue—there is no question about that—as companies become smarter in the way they use water. That will ultimately lead to good

environmental benefits but, in the short term, it gives us an income problem.

Jon Hargreaves: For domestic customers, 30 per cent churn represents perhaps another £5 million to £7 million of revenue that is at risk if the market follows that pattern, although the figure could be higher than that.

The Convener: I shall ask a final question. If there are any really pressing questions that other members want to raise before East of Scotland Water's evidence session closes, they will be able to ask them, but we must be aware of the time constraints.

What is your view on a single tariff across Scotland? That is an issue that we are all concerned about. We would also like to examine the so-called subsidy between domestic and commercial customers, so we would welcome your views on that. How do you see the urban-rural split affecting your area? I know that it may not be such a big issue for your area as it is in the north, but I would be interested in your views.

Councillor Cairns: As you say, the urban-rural split is not a huge issue for us. We have done some analysis of what we spend in Edinburgh and what we spend in the Borders. We actually spend twice as much per head in the Borders as in the more populated city areas. Historically, non-domestic business customers subsidised domestic customers. Because of competitive pressures and because of legislation, that is no longer possible. This year, such subsidies have been eliminated by the new charges scheme. The domestic and non-domestic sectors are now self-supporting.

I shall ask some of my colleagues to comment in detail on the single tariff in a minute. There are a lot of difficulties with that. From my own, slightly parochial, point of view, I think that members of my board would start to ask questions about why they are there if that important part of their activities is taken away from them. I shall ask Iain Gardner to tell you more about that.

10:45

Iain Gardner: There is little more to add on the urban-rural balance. That is a political issue rather than an economic one for the water authority. Clearly, a balance must be struck between low-density population and investment need; that triangle operates on pricing.

The committee will be aware that, five years ago, East of Scotland Water inherited the highest and the lowest mainland domestic charges, as well as an imbalance on the non-domestic front. We have successfully eliminated all that from the current year and, by working with the commissioner, we have eliminated that level of

remaining subsidy of domestic by non-domestic customers for the charging scheme starting in April 2001. That in itself is a moving target. Some of the factors that affect the subsidy are continued attrition of customer income and the mix in capital and operating expenditure between water and waste water and between domestic and non-domestic supply.

A single tariff across Scotland may well be seen as a tax, unless it comes from a single, consolidated organisation. There are certainly a large number of political questions to be answered about that in the current debate.

The Convener: I thank the witnesses for a most interesting evidence session, which has opened up some new dimensions to the debate. We have found that of great benefit to our inquiry.

Councillor Cairns: Thank you. It has been very interesting from our point of view as well.

The Convener: I welcome our next witnesses: Jim Milne and David Reid from the Dundee Anti-Poverty Forum; Sandy Snell and Andrew Gold from Marybank, Scatwell and Strathconon community council; and Ron Hughes and Seumas Macinnes from Braeside and Mannofield community council.

Good morning, folks. We hope to spend about 45 minutes hearing evidence from you this morning. We appreciate that that is not a lot of time, but we have already received your written evidence, which is most useful to us. Committee members will have some questions about that. If any of you would like to make an opening statement, we will be glad to hear it.

Ron Hughes (Braeside and Mannofield Community Council): I come to you from the north in a position similar to that of the little-known stage actor who won the leading role in "Treasure Island" as Long John Silver. The producer told him, "You've got the job. You're starting next Monday." The guy said, "Hey, I want to start tomorrow." The producer said, "No, tomorrow you get your leg off."

The point of that story is that, at the moment, domestic consumers where I come from are, on average, 31 per cent adrift from Glasgow and Edinburgh. Whatever Glasgow and Edinburgh pay, in almost a harmonised manner, the north is paying 31 per cent more. That is not acceptable. That is the point that I want to get across to you.

Having becoming aware of the water panel's survey, I wrote to the commissioner and said that, having seen the analysis, I wanted to see the questions. I received the questionnaire with a covering letter in which I was told:

"It is important to bear in mind that these questions . . . are intended to give the water commissioner a body of

information which expresses the views of members of the public in an accurate and statistically robust manner. As a consequence you will understand that it is not appropriate to invite members of the panel to choose between options for prices, investment or customer service that are not realistic."

I then asked for a copy of the analysis of the responses, but was refused on the ground of confidentiality. That worries me, as a domestic consumer.

I come to you with one or two examples of particular circumstances in Aberdeen. We invited the public to contact us to give us examples of their circumstances before I came here. One example is a lady who has lived in a high-band house all her life; she is the last surviving member of the family. She has been invited to set up a direct debit, but she cannot, because she is never sure whether she will have sufficient money on the due date to pay the water rate and sewerage rate with her council tax.

I have a near neighbour who was born into a band G house in Aberdeen. He is the last surviving member of the family. He is comfortable in the house in which he was born. He is struggling to meet this enhancement of council tax that they call water rates and sewerage rates. He pays more with a 25 per cent discount than a family in Glasgow or Edinburgh that pays 100 per cent. That is not fair.

All we are asking is for you to recognise that we in the north look to you as the guardians of the provision of fair prices, good quality water and good quality services. We will pay no more or less than other domestic householders in Scotland. We do not accept that water has left our ownership, so we need you to understand that we regard the commissioner as your employee and we regard Mr Colin Rennie as your employee. That is why we do not take them on. They are employees, and we assume that they are following a path that is approved by the Scottish Executive. We do not approve of it because it is costing us too much, and we are out on a limb piecewise.

David Reid (Dundee Anti-Poverty Forum): Dundee Anti-Poverty Forum has been at the centre of a campaign against escalating water and sewerage charges since the announcement in February 2000 of a 46.4 per cent increase in the NOSWA area. That goes against affordable water. In 1996-97, when water was in local authority control, there was a 9.5 per cent increase. When NOSWA took over in 1997-98, there was a 40.44 per cent increase. In 1998-99 there was a 30.78 per cent increase, and in 1999-2000 there was a 37.53 per cent increase. In 2000-01, the increase was 46.42 per cent.

I spoke to our MP, Ernie Ross, about this. He said, "I don't know why you are going on about the

increase. There have been increases like that since NOSWA took over." I said, "But the burden is getting worse. People can't afford it." The increase in 2001-02 is to be 17 per cent. I have added up the figures. I am not a clever man, but I have worked it out. There has been a dramatic escalation in charges. If you add the figures from 1997-98 up to the current increase for 2001-02, the total increase is 172.17 per cent. If the electricity, gas and oil companies had such increases, nobody would be able to afford their products. It is ridiculous.

People in Dundee, Aberdeen and other places in the north of Scotland have a choice to make. What do we do? Do we pay our water and sewerage, which is about £5, or buy food for our children, or buy a power card? Most of the people who are in poverty have power cards, and if they do not buy one, their electricity will be cut off and they will have no heating. Poverty in this country is rife. Dundee has one of the highest council taxes in the country. We are paying through the nose.

The council backed us on printing the 46.42 per cent increase in council tax books. The council is against NOSWA's increases. We have been fighting against it. I have been at meetings, as has Jim Milne. It is horrendous. We have a report, which we will give you later. People are suffering. I joined the anti-poverty forum to fight poverty in Scotland, because I see how bad it is. Like Sam Beckett in the television programme "Quantum Leap", I want to change things. I hope that the gentlemen who are here today will do that. Thank you for listening.

The Convener: Robin Harper will lead our questioning and other members will contribute as we go along. As you will have seen from the previous session, we try to keep questioning as light and informal as we can, but we need to get to the core of some of the issues that you addressed in your opening remarks.

Robin Harper (Lothians) (Green): Your submission is detailed and argued with some passion, and one can understand that. The basis of your submission is that you have the highest water charges in Scotland and that they bear unfairly on the poorest people in our community. My questions will tease out those issues a bit more. Mr Hughes, you indicated in your written submission that the Executive's proposals for transitional relief for low-income water customers do not go far enough. What are your proposals? Do the other witnesses have any?

Ron Hughes: A feature of council tax benefit is that benefit cannot be awarded beyond band E. That will still leave a savage bill for the two examples that I gave earlier. In addition, there are anomalies because we are tied into council tax regulations. For example, an 18-year-old parent

pays water rates, but a 17-year-old does not, because regulations determine the age at which you start paying council tax. Most private owners need a small amount of money to pay the painter, plumber, pointer and plasterer. If a person has more than £3,000, there is an assumed weekly income from each additional £250 or part thereof, so if they have £3,025, the £25 attracts a notional additional income of £1 a week. There is no bank that pays 20 per cent interest net, unless you deal with the Mafia.

Worse than that, we are dealing with a user pays philosophy. The transitional relief for band A in Glasgow will not have any effect. If the legislation says that you must pay £200, band A in Glasgow, at £177, will be below that and band B will benefit by £7. In the north, band A will benefit by £33.47. That is only for three years and it is an escalating price. The proposal is that this year you will get council tax benefit relief, but next year the £200 ceiling will be raised. In band B in the north, the customer will benefit by £111 and in band B in Glasgow they will benefit by £7.

I have to tell the committee that, of 104,000 liable persons in Aberdeen, only 17,500 are on council tax benefit; 75 per cent of those live in band A and B properties. This is not a solution to the problem. It does not address the many cases that are represented by the two examples that I gave to the committee.

The Convener: I say to Andrew Gold and Sandy Snell that we will come to questions addressed to their contribution later, so we will take David Reid and Jim Milne now.

11:00

Jim Milne (Dundee Anti-Poverty Forum): It is fair to say that when the transitional relief was announced it was welcomed, especially in the North of Scotland Water Authority area, where the vast majority of people who will benefit from the scheme reside. The reality is that it is a policy of equal suffering, because people who are on benefits throughout the country and have to pay a lower amount than £180 to £200 will still have to pay their bills in full. All that you are doing is capping the north of Scotland at the same level, so people will still have to pay that same amount.

People do not have the disposable income to meet these bills. That is why the "Affordability of Water and Sewerage Charges" report was flawed when it said that it was just a matter of adapting to steep increases over the past few years. In our analysis of incomes in the Dundee area, where a high level of households live on state benefits, we cannot find families—of different categories and sizes—who have a sizeable disposable income to meet these charges. Therefore, people are not

going to be able to get used to the increases of 30 per cent, 40 per cent or 50 per cent that there have been over the past few years.

We met the water commissioner when he visited Dundee in December; he indicated to us that the investment programme over the next few years will mean that high levels of increase will have to be maintained to meet the required investment levels. As I said, transitional relief was welcome, but if you consider that about 1.3 million to 1.4 million households in Scotland are in council tax bands A, B and C, the vast majority—apart from a few hundred thousand—will not qualify for a penny of transitional relief.

Des McNulty: Do you feel that you might be shooting at the wrong targets? One of the arguments that could be put in contrast to your point of view is that, historically, water charges in Scotland had been lower than elsewhere because of the lack of investment. Now that the proper amount of investment is being put in, the water charges are being brought up to a market level. The real issue in Dundee is the other element of the bill—the high level of council tax—rather than water charges.

Jim Milne: The problems that Dundee has with the council tax, in relation to the removal of certain geographical areas on the fringe of the city to other authorities, have been well publicised. The council has made that point to the Executive on several occasions. It feels that it is disadvantaged by that in several ways and that the people are paying the price for it. The problem is compounded by the water rates. If we had a high council tax and low water rates, it could be argued that there was a levelling out process, but that is not the case.

David Reid has indicated the enormous levels of increase over the past five years. Whether we like it or not, state benefits have not kept pace with those increases. State benefits have gone up over that period by a maximum of about 3.5 per cent and at the lowest by about 1.2 or 1.3 per cent, so there has not been compensation for the people who have had to meet the bills.

Des McNulty: So your argument is that people are being hit both ways.

Jim Milne: That is right.

Robin Harper: One of your submissions identifies a trend in Aberdeen that those on benefits are paying less and less of their council tax and water bills. Are collection rates for water charges falling in Dundee too? Is that problem greatest in NOSWA's area?

Jim Milne: I do not know, but it is a fear for the local authority. As was mentioned earlier, the council took an unprecedented step last year by

writing on the council tax book, in red letters, that the water rate increase was not one that it was implementing; it was implemented by NOSWA and the council was just the collection agent for the water rate. The council was frightened that people would not see the difference, so it would get the flak for the massive increase that was announced and implemented last year.

It may be the case that there is an increase in council tax arrears and people going into debt because they do not see the difference, so they do not pay the bill.

David Reid: I spoke with the council's finance department umpteen times. It said that the problems it has with collecting council tax could probably be put down to water and sewerage charges. If someone is on benefit, they are exempt from council tax, but they are not exempt from water and sewerage charges. In Scotland, we should be helping people who are in poverty. We help other countries, because Britain is a capitalist country and we say that we will help people outside, but we should be helping our own people; we are trying to help them to get jobs.

Consider the example of a person who works 37 hours a week for a wage of £3.70 an hour. He goes to his job and, after his tax is taken off and he has paid his water and sewerage bill and council tax, and he ended up paying £46 rent, it was not worth him going to work because he was worse off.

Tony Blair and that are saying, "Go out and get a job; you will be better off." I have not worked for 11 years—I got an injury at work—but at that time I was getting £135 in my hand. Someone is lucky if they come out with £135 these days. We should be helping our poor. The Government has taken so much money out of the country through regressive taxation, such as VAT. It should be putting money in to help on water and sewerage; it should be doing something.

The Convener: You have raised some broader issues, which we can reflect on but we are here to focus on the water charge.

Robin Harper: The view that David Reid has expressed leads into the next question. It has been estimated that £2 billion of investment is needed to get the Scottish water infrastructure up to scratch. Do you accept that consumers should play their part in raising that money so that services can be improved?

Jim Milne: We must ask why we are in this situation. Clearly, we have had years of underinvestment and neglect. It might be okay to say that people were getting water on the cheap and that we have not put the money in to upgrade the system, but that is not the consumers' fault. It is the fault of the people who run the water

industry and the politicians, not of Joe Bloggs and Mrs Smith who have to meet the escalating water charges. People want a clean, efficient water and sewerage system and they are prepared to pay for it. I do not think that it is a price worth paying, as Sam Galbraith said in the "Affordability of Water and Sewerage Charges", because for many the price is far too high. If you can afford to pay more, you should pay more, but our contention is that people who are at the sharp end of society cannot afford to pay. That is what we ask the committee to consider.

Robin Harper: Will increased competition drive down prices for customers? Do you feel that a single water authority could reduce overall costs, or would it be enough for water charges to be the same across the country?

Jim Milne: It was interesting to listen to the previous group's evidence. Dundee Anti-Poverty Forum feels that a single water authority in Scotland—with economies of scale and more robust management of the system—could be of benefit to all people in Scotland. I was not sure whether the three authorities shared that view. We think that that is probably the way to go because, whether we like it or not, competition is on the doorstep—Alan Sutherland made that point to us in December.

We have fears about that, as the issue is not only competition, but methods of collection. Up until now, we have not had a metering system in Scotland based on the amount of water that people use. We consider that the introduction of any form of metering system for households in the Scottish water industry would be a retrograde step. The chairman of the North of Scotland Water Authority board has indicated to us that he is loth to go down that path. He shares our view that the problems for people on a low income must be considered. We welcome those comments. Competition is fine if it drives down prices, but not if it results in harsh collection methods for the people who can least afford to pay.

The Convener: We are now on issues of ability to pay and poverty—Andrew Gold and Sandy Snell are here to discuss issues of supply. I am happy for members to raise issues to do with poverty, so they should indicate to me if they want to come in.

Robin Harper: We have representatives of NOSWA here. What is your relationship with that authority? Do you have a useful dialogue with NOSWA with regard to low-income households? Have you managed to feed into the customer consultative committees? Do you think that those committees are effective?

The Convener: We will give Jim Milne a wee break and go to Ron Hughes or Seumas Macinnes

on that one.

Ron Hughes: Funnily enough, in my discussion with the water commissioner's office, I raised the need to see the water authorities' analysis, especially NOSWA's. Consumers may not have a great deal of confidence in the consultative committees, because members are appointed by the water commissioner. The guidance from ministers makes it clear that the commissioner does not wish to argue with the committees—he wants them to come along with him on issues that he feels are worth pursuing.

As I said earlier, our community council regards the North of Scotland Water Authority and the commission as employees of the Executive. We take our concerns to the Executive and have done for a considerable period.

The Convener: Would Jim Milne or David Reid like to give Dundee's perspective?

Jim Milne: We feel that we have had a healthy dialogue with the NOSWA board and its chief executive and chair. We realise the problems that they have in relation to the size of the NOSWA area, which demands high levels of investment that it must claim back from its customers. We sympathise with that. I am quite sure that they sympathise with the plight of the people that we seek to represent: the low-paid and people in poverty. A healthy dialogue has been going on for the past year. I hope that it will continue in future.

The Convener: Do Andrew Gold and Sandy Snell want to comment on the relationship with NOSWA?

Andrew Gold (Marybank, Scatwell and Strathconon Community Council): We do not have a relationship with NOSWA because we are not customers of any supply authority. We will speak about the impact of private water supplies and our hope that someone will help us to improve the situation.

The Convener: Fair enough. Is there anything else?

Maureen Macmillan (Highlands and Islands) (Lab): Will Sandy Snell and Andrew Gold begin by telling us exactly where Marybank, Scatwell and Strathconon are? How many people in your community council area do not have access to public water? What regime is currently in place for people to access clean water?

Sandy Snell (Marybank, Scatwell and Strathconon Community Council): I brought a map for the committee to see where we are. About 120 people are on a private supply.

Maureen Macmillan: The point I wanted to make is that you are not far from Inverness—it is not as if you are away in the wilds.

Sandy Snell: It is thirty-odd miles—

Maureen Macmillan: From Inverness.

Sandy Snell: Yes.

According to NOSWA, it

“is investing £720,000 in the project”—

the project being in the Sauchen, Millbank, Comers and Midmar areas—

“which involves laying nearly 12 miles . . . of water mains and fittings. The work is part of a £400 million investment by the Authority over the next six years to improve public water supplies.”

On 28 June 2000, Mr Quentin Tweedie, NOSWA's investment programme manager for Grampian, said:

“Some people might think it strange that we're in the 21st century and yet some areas do not yet have a public mains water supply.

We would like to be able to say that everyone who wants the opportunity of connecting to a mains supply in the north of Scotland can do so, but that is not the case. There are still areas with no access to a public water main, and other areas, particularly in rural areas, where tap water doesn't meet the standards most of us can take for granted.

It is to address these that we need to spend so much on improving the public supply over the next few years.”

11:15

Andrew Gold: I will add some theatrics: the bottle I have here contains water from our supply. It is ironic that we are drinking nice, clean bottled water in the committee. The water I have here came from the tap in my bathroom. We like the peat to be in the whisky, not in the water.

Maureen Macmillan: Will you tell us about the various kinds of water supply that you have and what the problems are? Does the time of year—summer drought or winter frost—affect the supply? Do you ever run out of water?

Sandy Snell: I have lived in Strathconon for 27 years and this is the first year that I have been without water from the hill. The supply was frozen and my neighbour and I had to go out with a sledgehammer and break the ice. It is the same for quite a few people in Strathconon. There are also problems in summertime when the supply dries up. Some people are happy with their water supply. It depends on the type of supply. There can be up to 20 different private water supplies.

There is an anomaly. The Scottish Environment Protection Agency charges us £70 a time to test our water, then tells us that it is contaminated and that we should not drink it. We say, “Fine. What's the alternative?” It shrugs its shoulders and walks away. What are we supposed to do? The school has been drinking bottled water since August—kids are going to school and being told to drink

bottled water, then going home, possibly to drink contaminated water. People in Strathconon neither desire nor expect mains—they realise that there would be horrendous costs in putting mains up there. However, there are alternatives.

Maureen Macmillan: Supposing you eventually get mains water, is there any reason why you would not want it, or is it just that you have assumed that it would be far too expensive?

Sandy Snell: I have spoken to a lot of people in Strathconon. Their main concern about taking mains water is that it would be full of chloride. They would prefer their hill water to that. There is no reason under law that they should take mains water. If someone were to go to the horrendous cost of putting mains up there, and 90 per cent of people were to decide that they did not want it, it would be a white elephant.

Maureen Macmillan: You would need to have some sort of scheme to ensure that the water that you got from the hill was clean. Does Andrew Gold want to talk about that?

Andrew Gold: Yes. It seems to us that a huge infrastructure would be completely inappropriate in a place such as Strathconon, where about 120 people are scattered along a 17-mile glen. However, there are other sources: wells, boreholes and springs. Even the hill water can be collected and treated. What might be appropriate is a feasibility study that would identify local sources of supply that could be treated in a low-tech, sustainable way and distributed locally to the groups of houses.

Where I live, five houses are supplied by two separate hill supplies. Further along the glen, in Strathconon village, there is another group of houses. We believe that it would be better to sink either boreholes or wells or to make larger catchments for distribution after treatment than to lay a mains all the way from the nearest point, which is Marybank, 17 miles away.

Sandy Snell: Boreholes have been sunk in Strathconon, by the estate. That was done privately. The advantage of boreholes is that the water from them is clean. From what I can gather, the problem is that contaminated water is running across the surface and picking up faeces and anything else that happens to be lying there. Borehole water comes from further down and is cleaner; there is less chance of it freezing up and less chance of contaminants getting into it. A borehole might cost £1,000 or £2,000 and could supply six houses. I do not know whether grants would be available, but a lot of people would be interested in that idea.

The Convener: I asked about your relationship with NOSWA. Have you said to it that you do not want a 17-mile pipe, but that it could perhaps give

you a hand by sinking boreholes or providing other clean water systems? Have you discussed those options with NOSWA? What views have been expressed to you?

Sandy Snell: I have not been involved personally in such discussions. I draw the committee's attention to this public relations handout from NOSWA, which I have not had the chance to make available to committee members. NOSWA sank two big boreholes in Garve, between Dingwall and Ullapool, which seem to have been successful. It has experience of such measures.

The Convener: So, the potential is there if the resources were made available.

Andrew Gold: Letters are being exchanged. We are trying to get past the notion that there has to be an all-singing, all-dancing solution, which will carry with it all the disadvantages that the community does not want—such as the things in the water that the community would rather not have. It is difficult to get past the organisational structure of a body such as NOSWA, which is bound to have laid on it all the regulation and legislation from Europe, which is anomalous for us.

It is a big problem for us that, out of the blue and for reasons of which we are unaware, someone can turn up and take a water sample—not even from a person's tap, which strikes me as strange, but from where the water arrives at the tank—and declare the water unsafe. They have then done their bit and can walk away. Somebody else then comes along and says that they can give the person a grant under the house improvement grant scheme. However, it may be that the person cannot get the money, because their house has been improved in the past two years without a grant. People end up going round in circles.

We would very much like the expertise that organisations such as NOSWA have at their disposal to be used to examine our situation, to identify where there might be sustainable supplies of water and to advise us on how best to manage those supplies. If it is possible, we would like somebody to point us in the direction of a source of funding—whether it is European funding or money from the Executive—to help us to do that. As Sandy Snell says, we are not expecting—and do not want—somebody to fix things for us by giving us £10 million. That is unrealistic.

Robin Harper: Are you considering taking the issue a bit further and setting up your own Strathconon water company in partnership with NOSWA? Would not that be the logical extension of your current thinking?

Sandy Snell: We are waiting for answers. If somebody offers us alternatives, that is fine. We

will wait for guidance.

A couple of years ago, my water supply was disrupted by tree-felling exercises. I phoned NOSWA and said, "I do not have any water. How can you help me out?" I was told that, if I got a Land Rover, a trailer and a bowser—from where, I do not know—and travelled 17 miles to Muir of Ord over the weekend, NOSWA would fill the bowser for me and charge me £53 for the privilege. I am able-bodied, so I might be able to do that, but I do not know how a pensioner or a single mother could be expected to get those things together and travel 17 miles. It did not make sense.

The Convener: We will have the opportunity to examine such issues soon.

Bruce Crawford: I am a bit frustrated. We hear about these problems and SEPA tells us that there is a specific problem. The water has been pouring out of the hills—for those who can get it—for a long time. How many people have become ill? Has anybody compiled statistics on what is happening?

Sandy Snell: I am glad that you brought that up. There are quite a few octogenarians in the area, and some people who are older, who have been drinking the water all that time. There have not always been people coming along and asking for £70 for testing the water, then telling people that they cannot drink it because it is not good for them.

Bruce Crawford: It seems that there is a problem with bureaucracy. We all understand the need for clean water—the drive towards that comes from Europe. However, if the matter were dealt with sensitively by a Government agency, a practical solution could be reached. The people who live in the area have built up immunity to the contaminants over a long time and have no real difficulty with the water. Why the heck are we stopping them from drinking it?

Andrew Gold: The situation is not quite as straightforward as that. You raise the issue of bacterial safety and the fact that because people have not died, it is not a problem. However, there are other issues. The water off the hill is very aggressive, because it is acidic. That does in a person's heating system and their washing machine and it ruins their clothes, which become stained. It takes copper out of people's pipes and tanks and puts it inside them. There are limits to how much of that a person can cope with.

If people want to deal with the bacterial issue themselves—and they can, by using ultraviolet filters—they must first take the peat out of the water, because the bacteria can sneak through on the bits of peat. Even if the bacteria are not a problem, bits of peat still come through the system, gumming up the works and spoiling

machinery and clothes. It is not good enough simply to say that, because nobody is sick, there is no problem.

The Convener: Was that a white shirt that you were wearing, before you came down, Andrew? *[Laughter.]*

Nora Radcliffe (Gordon) (LD): The witnesses say that they do not want chlorine in the water, such as there is in the public water supply.

Sandy Snell: I personally am not saying that.

Nora Radcliffe: But some people might not want it.

Sandy Snell: Yes.

Nora Radcliffe: Do you acknowledge the bind that any official body that provides water is in? A statutory body cannot supply water that does not meet the statutory water quality standard. You cannot opt into the system partially.

Sandy Snell: The water from the boreholes that has been tested is perfectly okay—it passes the tests. Nothing would have to be added to the water; it would be fine. It is just a matter of sinking boreholes below 100ft, as has been done on three occasions in the glen. One of those boreholes is supplying about 10 houses at a fraction of the cost of a mains. I think that that would be the best way forward.

Des McNulty: Why do you not just do that then? Why do not the six houses club together and get a borehole dug for £2,000?

Sandy Snell: It is not that easy. There is too much paperwork to circulate to committee members, but I have the results of the different places and sources to show you. There are up to 20 different sources, as some houses are isolated and well away from other houses. We are open-minded. If NOSWA said that it could sink three big boreholes and supply everybody, that would be fine.

The Convener: Perhaps you could copy that information to committee members.

Sandy Snell: Sure.

Ron Hughes: The community council has documents from July 1999 in which Alastair Findlay, the chief executive of NOSWA says that

"the Authority's Annual Water Quality Report for . . . 1998 has been published."

He means NOSWA's report. He continues:

"This report confirms that vast majority of public water supplies . . . continue to be of good quality, with mainly very high levels of compliance with the prescribed standards."

A December 2000 article on the drinking water inspectorate said that tests conducted by the inspectorate in 1999

"showed 99.82 per cent of samples met European Union health guidelines."

In December 2000, Katharine Bryan said in evidence to the Transport and the Environment Committee:

"It gives me no pleasure to say that NOSWA's drinking water is the worst in the UK." —[*Official Report, Transport and the Environment Committee*, 12 December 2000; c 1359.]

As a consumer, I am concerned about employees who spin their way towards the £400 million investment that the water authorities require to address some of their problems. I am simply pointing out the contrast between what professional people say about NOSWA's water.

The Convener: Perhaps we could raise that later this morning.

Nora Radcliffe: Perhaps we should ask NOSWA to clarify those figures. Does that figure of 98 per cent—or whatever—compliance refer only to public water supplies? Does it include private water supplies? I suspect that it does not. I see the witnesses from NOSWA shaking their heads.

The Convener: We will deal with those questions later, as they would be answered more appropriately by—

Ron Hughes: The other two examples were to do with the NOSWA area. Katharine Bryan replaced Alastair Findlay and two very contrasting comments were made—

The Convener: You have made your point—we will deal with those matters when we put questions to the witnesses from NOSWA.

Thank you for coming along. We failed when we tried to get to you, but you managed to get to us—today is a much better day than the day on which we had planned to travel to Aberdeen. We appreciate the effort that you have made to come down to Edinburgh.

If you have further evidence or advice that you would like to pass on to us, the clerk would be happy to receive it. Thank you for your written evidence, which we have read, and for your oral evidence.

We will have a short break of no longer than three or four minutes.

11:31

Meeting adjourned.

11:38

On resuming—

The Convener: I thank the witnesses from the

North of Scotland Water Authority for joining us again. I apologise for not being able to meet them in Aberdeen, where we would have had an interesting meeting, particularly given some of the sites that we were to visit. Unfortunately, that was not possible. Is Ron McAulay going to join us?

Katharine Bryan (North of Scotland Water Authority): I am sure that he will be here shortly.

The Convener: That is fine. Katharine, do you wish to make any introductory remarks? If so, please take this opportunity to do so.

Katharine Bryan: I will say a few words before Ron McAulay arrives. Thank you for giving us the opportunity to meet the committee again. We are particularly grateful for the opportunity to meet the new members of the committee. Like you, convener, we were disappointed that you could not come to Aberdeen, but we hope to be able to rearrange the visit for some committee members.

We have been following the inquiry closely and with great interest. It was particularly valuable to hear the evidence of the previous witnesses about the problems for those on low incomes of paying NOSWA charges and about some of the problems of private water supplies. We are no strangers to some of the comments that were made, but it is good to hear at first hand the concerns about those situations.

NOSWA has always known that it had the most difficult task of any of the water and sewerage providers—not just in Scotland, but in the UK. Since day one, we have concentrated on three main goals: improving our customer service; delivering efficiencies; and improving our operational performance. My point is that the high charges that we have heard about do not equate to inefficiency.

I am conscious that, as the inquiry progresses, the questions are becoming more technical and more detailed financially. I hope that our team today will be able to answer the committee's questions. I am pleased to introduce my colleagues Doug Sutherland, our director of finance, and Ron McAulay, director of operations for the Highlands and Islands.

Des McNulty: I will ask the witnesses about the public sector model, to which the authorities are collectively subscribing and about which I also asked the witnesses from ESW. What would more room for manoeuvre to achieve the outcomes that are set by Government mean to NOSWA? What are the issues for NOSWA in developing scope for market and product mix?

Katharine Bryan: It is clear to everyone that we cannot remain as we are—we cannot just stick to our knitting, so to speak. We must develop a strategy for competition that gives added-value

services to people. We must agree funding mechanisms and guidelines on how to operate flexibly and, sometimes, quickly to the advantage of our customers.

We uphold the conclusions that have been proposed in the joint paper, but there will be slight differences of emphasis from NOSWA, ESW and WSW. Today, we heard from ESW that it is losing a lot of its customers, but competition is with us all. We commend the document to the committee. It talks about an evolution from where we have been—from the public sector model that was set up in 1996. We want to move with the Scottish Executive towards a system in which we can develop our scope in relation to both market and product mix in order to invest incrementally towards a stronger position in the competitive market.

I will hand over to Doug Sutherland, in case he wishes to add to my response.

Des McNulty: Before you do so, I would like to highlight the fact that NOSWA is in a special position in comparison with the other two Scottish authorities, in that it has the highest investment targets relative to its customer-charge base. I am particularly interested that NOSWA is taking a line that might seem more reasonable in a different context. How do NOSWA's specific circumstances relate to incremental investment?

Doug Sutherland (North of Scotland Water Authority): We listened to ESW's evidence and agree with all the key strands of how competition will develop in the industry and with the fact that competition already exists. If we are to have a publicly owned and sustainable water industry, to which we are all committed, we must respond to developments in the market.

NOSWA faces some disadvantages in comparison with ESW, but it also has some advantages. For example, the NOSWA area has a different spread of industry. We do not have a concentration of high volume water users; we have a lot of medium-sized water users. While we feel the impact of competition and are responding accordingly, we do not feel it in the same way as ESW will feel it. However, as Jon Hargreaves, the chief executive of ESW, said, competition is here and the market is developing. It is highly likely that, in a few years' time, water services will be bundled up and sold with electricity and gas. If we are to have a publicly owned and sustainable industry, we must find a way of responding to that challenge.

We like to think that we are experts in water and waste water and that those are the things that we are going to stick to. For example, in addressing our product mix in areas of Aberdeen where industries have been particularly hard hit or in

some other industries, we have always focused on water and waste water. All three authorities in Scotland are bidding for the Ministry of Defence deal called Project Aquatrane, which involves the MOD's putting out to tender the provision of its water and waste water services across the UK. We are competing hard for the Scottish part of that project, which is exactly what we would be expected to do, as the project is about water and waste water services in our area. In such ways, we are developing our market mix.

11:45

Katharine Bryan: Concerns were expressed this morning about incremental investment and the amount of money that we may or may not be able to invest to compete in the way that we need to if we are to survive and thrive. We want to talk to the Scottish Executive about that, particularly because, as was highlighted, we have a high capital investment programme and the lowest customer base of all the UK water and sewerage companies. We need to select our opportunities carefully against the background of a strategy that looks for added value and market niches.

To minimise risk, we have to develop mechanisms that ring-fence our new business from our core business and find ways in which we can balance the successful projects with the less successful ones across the pool of finance. The incremental investment should reflect the situation that we are in. Unlike Thames Water or Vivendi, we are not in the big league; we have to work carefully, if adventurously, towards a situation in which we can develop our market niche and compete with other companies and organisations.

Des McNulty: Customers are aware that they are paying for you to meet the environment targets. How will you go about persuading them that they should pay more to allow you to invest incrementally?

Doug Sutherland: The issue is not about getting customers to pay more. Losing customers is the worst thing that can happen to the Scottish water industry. Ninety per cent of the industry's costs are fixed. If we lose even 10 per cent of our customers, we will have a significant financial problem. Competing hard to keep customers, particularly the large ones, is in the interests of all customers, especially domestic customers—domestic charges will be lower if we have a high number of large customers, given that we are a fixed-cost industry. I know that people can argue that the charges are higher than they want them to be, but I stress that the worst thing that can happen is that we start to lose customers.

Des McNulty: Is the incremental investment that you are talking about mainly geared towards

keeping your larger customers or do you believe that it has a broader spread?

Doug Sutherland: That depends on how competition develops. Clearly, the customers who have an option at the moment tend to be the larger ones, and incremental investment tends to be geared towards them.

Incremental investment will not involve a lot of money. This morning, a sum of several million was mentioned, not tens of millions. We agree with that figure, which is not a significant sum in the context of, for example, NOSWA's overall funding in the next five years.

Des McNulty: Is there a possibility that the traditional pattern, in which non-domestic customers to some extent subsidise domestic customers, might be altered or reversed if you take the route that you describe?

Doug Sutherland: Our policy has always been to ensure that all customers pay on a cost-reflective basis. As is well known, the industry in Scotland inherited a situation in which domestic customers were subsidised by non-domestic ones. Over the past five years, we have worked hard to sort out that situation and we will try to maintain the balance that we have struck.

Mr Tosh: I would like to clarify that point. This morning, ESW told us that it has eliminated the non-domestic subsidy of domestic consumers. Are you saying that you are now also in that position?

Doug Sutherland: We are largely in that position, but we have chosen to strike a balance on waste water on an incremental basis over the next few years. For its own reasons, ESW chose to move to that point in one fell swoop.

Mr Tosh: So your customers pay for that through the sewerage charge.

Doug Sutherland: Yes. The factor is not particularly significant; we could balance the waste water arrangement in one year, but we have chosen not to.

The Convener: We will move on to deal with capital investment.

Mr Tosh: I want to clarify a couple of points in the paper that we were given on the public-private partnership costs. The comparison of costs has been a running theme for us with the other water authorities. NOSWA has given us perhaps the least information on the subject, so I thought that it would be useful to ask you how you carried out the benchmarking exercise to compare the net present value analysis of the PPP against a conventional model.

Doug Sutherland: As deals have been done, we have published business cases. I believe that the committee has copies of the business cases

for the Tay deal and for the Aberdeen deal. I will talk you through the Tay deal.

We inherited a position in which the public sector comparator in Dundee was going to be the building of five waste water treatment plants strung out like a row of pearls along the Tay—three plants would be built in Dundee, one plant in Arbroath and one in Carnoustie. When we decided to use the private finance initiative option, we had the scheme costed and found out what the private sector thought would be a suitable alternative. The scheme that was chosen, and which will ensure a high degree of value for money, was the building of one superplant at Hatton, which is 10 or 15 miles east of Dundee. That will avoid the capital cost of building five plants.

The cost of building the plant the traditional way, through the public sector, was prepared by external advisers and checked over by our financial advisers. It came to £153 million, in today's money. That figure is made up of £120 million, which is the capital cost, and—also in today's money—the operating costs for the five plants over the next 30 years, which are about £33 million, or roughly between £4 million and £4.5 million a year.

Mr Tosh: How can you be that precise about the capital costs? Obviously, the construction would be put out to tender.

Doug Sutherland: It would be, yes. When NOSWA took over, we inherited a number of schemes that had been devised by Tayside Regional Council and would have been carried out if there had not been a reorganisation in the water industry in 1995-96. We gave the numbers to our external advisers, telling them to decide whether the figures gave a good and fair benchmark against a private sector alternative.

As I was saying, the public sector comparator is £153 million. The private sector cost is £144 million. That is made up of £140 million, which is the cost that we will pay over the next 30 years, on a purely volumetric basis such as the one that Douglas Millican mentioned, and between £3 million and £4 million, which is the cost of putting the project together using technical and financial advisers. Those are the nuts and bolts of the calculation. At that level, PFI is a simple concept.

Mr Tosh: I want to pursue that point, once more referring to evidence that was given by ESW. The variation on its Almond valley and Seafield project was much more substantial than what you have achieved on the Tay—although you have achieved a slightly wider margin on the Aberdeen project. Was there anything different in ESW's description of the way in which it had handled the tender or are all the differences between its saving and yours explicable purely in terms of population

dispersal and the volume of material going through? Did you feel that ESW did a better job in some respects—keeping the tenderers hanging on to the last?

Doug Sutherland: Wearing my NOSWA hat, I could give you a very competitive figure—NOSWA did a good deal. The two deals were similar; they were both funded through bond finance. The ESW deal was larger and, under PFI, the larger the deal, the more scope one has for cutting costs. However, like most finance figures, these were not calculated on a comparable basis: the ESW figure makes an allowance for risk transfer, whereas the figures for the Tay project—£153 million against £144 million—make no allowance for risk transfer. Risk transfer is difficult to cost under PFI, but is worth many millions of pounds. If we were to estimate the risk to be included in our figures, the gap would be much bigger. I cannot say how big the gap would be, although it would certainly be much larger than it is without the risk element.

Mr Tosh: In the paper, you commented that you have made a significant saving in whole-life costs because of the way in which the concessionaire has dealt with demand risk, construction risk, design risk and operational management. Could you expand on that and explain where the savings in risk transfer are to be found? As we suggested to the other authorities, there is some argument about how genuine the risk calculations are.

Doug Sutherland: The original design for the Tay project was to have five waste water treatment plants strung out along the Tay. The design that was picked and is almost fully built involves one superplant to the east of Dundee. That project was fairly risky and technically complex; it involved tunnelling under Dundee and pumping sewage for 15 years. The technical guys could tell you more about that project than I could. A significant risk was associated with it.

The concession company has put together project finance for the next 30 years—it has built the plant and must run it for 30 years. That is a risk that we do not have to carry—our risk is capped. If—God forbid—the plant went wrong, we would be faced with a significant public relations issue, but the financial consequences would impact not on us, but on the concessionaire. In order to evaluate that risk, one has to consider what might go wrong in the next 30 years. Given the extent to which society has developed over the past 30 years, it is clear that there is considerable scope for things to happen.

Mr Tosh: We politicians are simple people and it is difficult for us to quantify that, put a price on it or see how one can make those comparisons realistically.

Doug Sutherland: Exactly. That is why our

benchmark has always been that, although we know that risk is worth a lot of money, before we will sign up to a PFI scheme, we must see that the scheme shows a saving excluding the risk calculation. I can give you an example of that. We tendered a PFI scheme to build a smaller plant in Montrose, costing some £20 million. After it came back from the market, we sat down and considered the numbers and concluded that, in that case, PFI was not value for money. Therefore, we ditched the PFI and decided to build the scheme ourselves. We have to have a saving before the risk element is included.

Mr Tosh: So your savings are real, whereas ESW's are partly real and partly imagined or theoretical.

Katharine Bryan: I could not comment on that.

Mr Tosh: I see.

You have already dealt with the transparency issue.

Katharine Bryan: The transparency issue is important. We were rather disturbed by the comments made last week by witnesses who were implying that the water authorities had hidden information. We have publicised ours in newspapers and libraries. It is important that committee members realise that.

The Convener: Perhaps what was said was fair comment on the quality of information available. I believe that Ian Jones has a meeting with you this afternoon to go through some of the more detailed aspects.

Katharine Bryan: That is right.

The Convener: The detail in the information that we received from the other water authorities was greater than in the information that we received from NOSWA. However, Ian Jones will deal with that later.

Katharine Bryan: We will supply you with that information.

Des McNulty: I would like to push you on the extent to which your calculations are based on volumetric assumptions. Given the 30-year timeframe, how robust can those be? If we went back to examine the volumes of projects that were funded 30 years ago, could any projections that were made at that time give you a decent handle on the costs so far ahead? Is that a wee bit fanciful, given that there is an element of unreliability? I presume that the contractor gets paid according to the volume that is dealt with.

12:00

Doug Sutherland: Projecting volumes over the next 30 years is a complicated exercise. Inside

NOSWA, I have a reputation for creating something of a stink about volume and the ability of engineers to predict volume. The industry is beginning to learn how to carry out such calculations and how to project volume over the next 30 years. However, one of the characteristics of the water industry is its stability—it is not particularly exposed to technological risk and is a basic service that has been required since Adam and Eve.

Dundee has a fairly stable population base and, apart from changes in industry, the numbers will not change significantly during the next 20 or 30 years. However, we built that factor into the PFI deal in Dundee. If the population of Dundee doubled overnight and the volumes of wastewater that the PFI concessionaire was treating doubled, the concessionaire would make significant returns. We have always felt that that was unacceptable, so all our deals include a profit-share mechanism to allow us to recoup excess profits from those guys, if the volumes prove to be larger than anticipated. That means that we get value for money, which we use to keep down charges to our customers.

Des McNulty: Rather than projecting a precise figure that is based on one volume calculation, would it be more realistic to project a range of costs depending on different volume calculations?

The Convener: Before you answer that, can I ask what happens if the projected volumes drop?

Doug Sutherland: If the projected volumes drop, the PFI concession company will have a problem—that is its risk.

The Convener: There is no mirroring of the profit-share mechanism?

Doug Sutherland: No.

The Convener: That is fine.

Doug Sutherland: The concession company might not be entirely happy about it, but that is the game of life.

Mr Tosh: Does that mean that the Competition Act 1998 is a greater threat to the concession company than it is to you?

Doug Sutherland: No. The matter relates to the supply of water, rather than waste water.

Des McNulty: I asked about the range.

Doug Sutherland: Yes. When the initial deals were costed, several ranges were calculated; a middle range, a high range and a low range. The difference between the high range and the middle range, and between the middle range and the low range, is about 10 per cent or 12 per cent. However, it is difficult to replicate those satisfactorily in a pricing mechanism to which the

banks will sign up, so we usually end up with a simple volumetric formula.

The Convener: Thank you. I want to move on to issues of efficiency and structure. We will write to you on two matters that have been raised: benchmarking methodology in respect of efficiency savings; and the achievement of efficiency targets in relation to resources, particularly staffing.

We have other issues to discuss, but we want especially to ask about the issue of having a single water authority. You have heard what the witnesses from ESW said about that. We would like to hear your views on savings, financial benefits, restructuring, the composition of boards and all the other questions that are connected with a single authority.

Katharine Bryan: I mentioned NOSWA's obsession with efficiency and giving best value to our customers. In pursuing those aims, we have been considering, as Bob Cairns mentioned, a project called the NEW project—the north, east and west project—which would involve collaboration between the three water authorities. We are delighted with the progress that has been made over the past few months. The organisations have been talking to one another and finding ways of making savings. There are some big savings to be made, although that might depend on whether best practice is taken to the point of instigating structural change. However, the remit of the project is to consider not structural change, but ways of working together and sharing ideas.

For reasons that committee members are well aware of, even if NOSWA meets the efficiency targets that the water industry commissioner has set for us, and even if we take the full value of the collaborative savings, we will still not be able to close the differential between our charges and those of ESW and WSW. We will still face the prospect of having the highest charges in the UK in the not-too-distant future. A change to one authority would certainly offer benefits to the customers of NOSWA and, I believe, to the customers of ESW and WSW, although perhaps for slightly different reasons.

Any change offers the opportunity for change for the better. One such change would be greater competitive strength—I think that the witnesses from ESW mentioned that. A new business strategy that was shared among the three companies—perhaps enhanced by a Scottish Water brand—would enable us to retain customers and, in active competing mode, to fend off competition from further south or abroad. It would enhance our ability to get involved in partnerships with other organisations, with the aims of delivering better customer services and reducing charges, because we would be a better organisation to deal with. It would enable us to

achieve our efficiency savings and our collaborative savings earlier and more easily.

The change would also—this point has not been mentioned—provide us with the opportunity to attract high calibre managers to a new organisation and to enable the public sector model really to demonstrate its strengths against the private sector model. ESW witnesses spoke about managers leaving, perhaps because of uncertainty. A senior post in our organisation was recently advertised externally and we received only four applications. That gives us a message.

There could be advantages to the customers of all three authorities in structural change, but there would obviously be risks that we would need to manage if that option were taken. For example, there could be a risk to the capital programme and to delivery on agreed dates. That risk would not be insuperable with careful and strong management.

The Convener: What would you feel about the diversion from the real world of competition if there was a restructuring exercise?

Katharine Bryan: I am sorry—the diversion?

The Convener: I was wondering about the diversion of management resources and about people's uncertainty over their future if there was a single water authority. You need to compete yesterday—never mind tomorrow.

Katharine Bryan: It was said that the sooner the position is clarified on whether we stay as three authorities or become one authority—or on whether there is some other solution—the better. However, in the intervening period, while a decision is being made, I assure members that there will be a very strong commitment to delivering our targets. We are producing business plans and we are setting goals for our staff; those are public goals. I will report to my board and to the Scottish Executive on the goals. We need to focus on the goals that matter for the north of Scotland.

Des McNulty: In the event of a move towards a single authority, could investments in your area be crowded out by investments in other areas, or vice versa? What criteria might a new single water authority bring in that might be different from NOSWA's criteria for investment priorities?

Katharine Bryan: Much of our investment is dictated by statutory deadlines or European directives—we have no choice. We must all deliver to those deadlines or directives. We must then consider issues such as quality and standards and ask how much money is available for, for example, repairing and renewing the infrastructure, making new connections and extending the system. Such matters are decided on the basis of need and importance and are

dependent on the amount of money that is available.

Ron McAulay (North of Scotland Water Authority): I hope that the criteria that we use to determine which water mains we will replace are similar to the criteria that are used by ESW and WSW, so I hope that there would be no great shift.

Des McNulty: One of the key arguments that ESW—and, to some extent, NOSWA—has put forward has been on the ways in which to deal with competition. We have heard about incremental investment that is geared towards that. However, if that is the goal and focus of moving in that direction, how does it sit with the public service ethos of extending the network or improving particular elements of the infrastructure, such as piping? There must be a trade-off.

Katharine Bryan: I will set the context for the answer and my colleagues will give more detail. It is extremely important that everybody realises that all three water authorities will focus on the core business. We are public sector water authorities—our prime concern must be public health, the health and safety of our employees and delivering on the goals to which we are publicly committed. This is not a case of either/or. It is not a case of, "Would you like to devote more of your attention to competition, but less to other things?"

I am sorry if I misunderstood the question but, as members can probably tell, I feel passionately about this issue. We must do two things: we must maintain, deliver and improve our core services; and we must develop a new strategy on competition, which I hope will be done across the three authorities. I can see from Des McNulty's expression that I have still not answered his question. I apologise. I will let him ask it again a bit more clearly, so that I can perhaps understand it.

Des McNulty: There are two aspects. First, what is the balance of investment priorities? You have to protect the business—for very good reasons, such as keeping commercial customers happy—and you have to consider maintenance, extension and improvement of the domestic supply. Secondly, how do you decide between different projects that are geared towards the same goal, which might be public health or environmental standards or whatever? I presume—this is what happened when I was involved in Strathclyde Regional Council—that the industry must habitually make judgments, not between apples and pears, but between different kinds of apples, based on some kind of utility criteria. I wonder how those kinds of criteria might be affected—if at all—by a move to a single water authority.

Doug Sutherland: I will have a go at the first half of that question and Ron McAulay will pick up

on the second half.

The balance, or trade-off, between competitive investment and extending the network will exist irrespective of whether there is one, two or three water authorities or, indeed, of whether there is any other conceivable organisational split. We deal with that balance day in and day out—we must do both things. Fighting off competition is critical to the network's sustainability. That generates cash, because it keeps customers, which funds new investment. It is a classic economic cycle, and we will have that irrespective of the debate about whether to have only one water authority.

Ron McAulay: Many requirements, including the requirement to improve levels of treatment for water or for waste water services, are usually dictated to us by legislation. Deadlines tend, therefore, to be set by such criteria. Many investment decisions on the replacement of water mains that keep bursting or on collapsing sewers will be based on such criteria as the number of interruptions to supply that people have experienced.

Other issues are of help in tackling competition. If we replace sections of main that keep bursting and that cost us money to maintain, we can start to save money. It is almost a spend-to-save situation. I imagine—in fact, I am fairly certain—that, across the three authorities, we all use similar criteria to establish where we want to invest. If we were to become one authority, I do not think that there would be a great change to that.

I can illustrate to members how our performance is measured. We now have common guaranteed standards of service for the three authorities. That, in effect, allows us to measure our performance in relation to the customer service that we provide. That includes standards that relate to interruptions to service and so on.

12:15

Des McNulty: Let me put a scenario to the witnesses. I am not suggesting that this situation necessarily exists in the Scottish water industry, but let us suppose that one of the three authorities is significantly in advance of the other two in meeting its environmental targets and so on. A single water authority is then formed, which presumably will work towards one set of criteria. Will that mean that the investment is skewed towards making up the deficiencies across the whole territory and that, as a result, there is a diversion of investment to different areas of the country to meet environmental targets? That might be a practical consequence of bringing the authorities together.

Ron McAulay: If one authority was that far

advanced, I suggest that the amounts of money that were being invested would be skewed. That authority would not need to invest as much as those that were behind it.

Lewis Macdonald (Aberdeen Central) (Lab): I was looking forward to welcoming the committee to Aberdeen a few days ago, so I am glad to have the opportunity to join its meeting today and to ask a few questions.

First, I want to explore the statutory framework for charging schemes. The unit cost of supplying water to households in my constituency—Aberdeen Central—will be significantly less than the unit cost of supplying water to crofting communities in Wester Ross, for example. Can you confirm that you are able to apply the statutory provision that governs the charging scheme to that difference in cost? In other words, is there no option for you to reflect that difference in cost in your charges? Is that a different position to that which exists between the three water authorities? Supply to an urban area, such as that which I represent, might cost less than supply to a rural community in Dumfries and Galloway, but it might also carry a higher customer charge because of the statutory basis of charging.

Doug Sutherland: Since day one, all three authorities have adopted policies of harmonising charges, particularly domestic charges—their charges are now harmonised. Cross-subsidy between people living in a city and people living in rural areas is a feature of the utility business, irrespective of whether the utility is water, gas, electricity or telecommunications. It is an accepted and, to be honest, fair method of cost-reflective pricing.

The Convener: If I am correct, Lewis Macdonald was asking whether that is a matter of good practice or is statutorily underpinned? Do you have statutory responsibility to harmonise?

Doug Sutherland: The commitment that was given, when the legislation that set up the water authorities was passed by the House of Commons, was that we would seek to have harmonised charges in Scotland, particularly in the domestic sector.

Lewis Macdonald: Is the position that was created by that one of harmony within each of the three areas, but not between them? I notice that the Executive's consultation did not contain detailed projections of likely levels of charges, but it did project the differences that might arise. Those seem to be substantial, and are expected to grow over the next four years. Can you add anything—that relates to your projection of those differences—to the case for maintaining a structure of three separate authorities?

Katharine Bryan: It is clear that prices will not

come down in the next few years. We are able to raise the money to pay for the environmental clean-up that NOSWA is undertaking only from our customer charges. Given that, our charges will presently become the highest in England, Wales and Scotland.

Lewis Macdonald: Will the differential between you and the rest of Scotland grow if that position remains?

Katharine Bryan: Yes, I think so.

Lewis Macdonald: Have you anything encouraging to say about any benefit that an amalgamation of the three Scottish water authorities might bring to customers—including enhancement to customer services—in the ESW and WSW areas? Are there areas in which your customer service leads the field? Would amalgamation bring benefits to customers throughout Scotland?

The Convener: In other words, what are you bringing to the party?

Ron McAulay: We would be quite happy to roll out our best practice to the ESW and WSW areas. The water industry commissioner carries out audits of our performance against guaranteed standards and a range of factors that relate to customer service. I am pleased to say that NOSWA has come out on top of the league in each of the audits that have been carried out so far. We are always looking for ways to improve our customer service. We use the feedback from the audits to try to find ways of improving our service. It is a matter of course in the industry to consider such things.

Lewis Macdonald: Thank you—that was very helpful.

Robin Harper: My question might be significant with regard to the proposition that there should be a unitary water authority for Scotland. Is it the case, and have you received advice to the effect that, when competition rules become fully applied, your ability to co-operate with the other water authorities as you do now might be affected?

Katharine Bryan: I will give a general answer to that. I hope that my colleagues can help me, because that was a rather difficult question. We have had meetings with the other two authorities to find ways to collaborate in competition. It seemed to everybody that it is not in the interests of Scotland, and that it is possibly wasteful of staff, time and money, to have competition between organisations that work for the same owner.

Although deals are currently being discussed, sought and struck, we are seeking not to damage the interests of Scotland as a whole. That is a rather a bland statement, but I hope that it gives an idea of the context in which we work.

Doug Sutherland: It is a sensitive situation to have three independent water authorities, to have competition legislation and to have demanding customers in a competitive environment. There are certain things that we can do and certain things that we cannot do. As a public body, we must follow all the legal requirements.

In many ways, competition is driven by customer demands. The customers push the authorities. Companies such as Marks and Spencer and BHS, which have branches throughout Scotland and the UK, as well as many manufacturers, do not get hung up about whether there is one, two or three water authorities—they want a single deal. That avoids problems for them and it is up to us in the Scottish water industry to find out how to handle that wish.

It would, for example, be crazy if East of Scotland Water, having won the Marks and Spencer account for Scotland, duplicated our network in part of our area. ESW would therefore do a deal with us and agree a price for the provision of water and of waste water services. East of Scotland Water would get a cut of the action, as would the North of Scotland Water Authority, thereby benefiting the Scottish water industry. There are ways of handling such situations.

The Convener: Bristow Muldoon will ask a question on competition. I have set myself a performance target of finishing this part of the meeting by 12.35. Perhaps we should meet and exceed that target. We should also address the matter of a single tariff at this point. We can pursue other questions to the witnesses in writing.

Bristow Muldoon: It is generally accepted that the water industry is already subject to competition—competition is inevitable. Is there an argument for providing protection against full implementation of competition until the Scottish water industry has closed the gap in investment or, if the decision is made to move towards a single authority, until it has got through the transitional phase?

Doug Sutherland: In a perfect world, we would not have competition, we would spend two or three years establishing a Scottish water authority and getting together a first-class management team and then we would fling our doors open, ready for business. The fact is that competition exists and large customers are considering alternatives. If we pursue the idea of establishing a single water authority over the next two or three years, we will have to handle competition. We will give it our best shot and will succeed—we have no problems in that area.

We would like the legal introduction of competition to be phased over the next two or

three years, to give the industry a chance to adjust. We hope that that will be facilitated through the proposed water services bill. A level playing field could be created for large, non-domestic customers first, for smaller non-domestic customers second and then for domestic customers third. I suspect that most people in the competitive world—whether they are on our side or in the private sector—would welcome that kind of phased approach.

Bristow Muldoon: You say that you are not under the same pressures as East of Scotland Water, as your commercial customers are not targeted by competitors. What analysis have you conducted of the degree to which your commercial customers may be targeted by competitors? What proportion of your income would be threatened?

Doug Sutherland: I would not like you to think that we do not face competition. We do, but East of Scotland Water faces excessive competition. Analysis from the past two or three years shows that between £5 million—about 2.5 per cent of our turnover—and £20 million could be threatened by competition. That income would come from large customers.

The Convener: Let us finish our questioning on the issue of the single tariff. What are your views on a single tariff throughout Scotland? We asked the representatives of East of Scotland Water for their views. There is also the question of subsidy between business and domestic users, which you covered in some ways, but which I would like you to address specifically. I would also like to know your views on the balance between urban and rural areas of any subsidy.

If any committee member has a pressing question to ask, we will have time for it.

Doug Sutherland: If there were a single Scottish water authority, there would have to be a single tariff throughout Scotland. You might expect to hear that view from people from the north, as they might benefit more than others. Single tariffs are common in the utility industry and are best practice. A single tariff is best practice in any industry—for example, baked beans in Tesco tend to be priced roughly the same throughout the UK.

Given that we have all sought to harmonise charges and establish a fair balance between domestic and non-domestic rates, that principle should continue if there is a single Scottish water authority. The only way in which competition can be fought is by ensuring that cost-effective charging is in place.

Ron McAulay will reply to the urban-rural question.

Ron McAulay: North of Scotland Water Authority faces the biggest challenge in relation to

the urban-rural split. Our area includes some of the remotest parts of Europe, in the Highland and Islands. Within the Highland region alone, we have around 150 sources and 150 water treatment works serving a population of just over 200,000. The same size of population is served by one source and two treatment works in Dundee. Serving a widespread community can be quite a challenge and requires much more investment, as 150 locations will need to be upgraded.

12:30

The Convener: You sat through what the people from Strathconon had to say. What is your response to their questions regarding their situation? How can you help?

Ron McAulay: Unfortunately, the problem that people in Strathconon suffer is not uncommon in the Highland region. I am sorry that I did not bring along a sample of water from one of our public supplies. The quality of many of our supplies is far worse than the quality of the sample passed around the table. We must concentrate on upgrading those supplies.

I am happy to meet the people from Strathconon to discuss what we might do to help them out. Trying to cover about 60 properties—I am assuming 120 people—over 17 miles is difficult. It would be very expensive to sink 20 different boreholes. We have sunk boreholes at Garve, as has been mentioned, but we have also built a treatment works to treat the water that comes out of the boreholes. The cost is not £1,000 or £2,000, but hundreds of thousands of pounds.

The Convener: I have opened the stable door and the horses have bolted, in the shape of Fiona McLeod, Maureen Macmillan and Lewis Macdonald. Although their questions may not be linked, I propose that we take them all together. Nora Radcliffe has now also indicated that she would like to ask a question—a further horse has bolted.

Fiona McLeod (West of Scotland) (SNP): Ron McAulay said that he would meet the folk of Strathconon to discuss what could be done to help them out. In the atmosphere of competition that we are all in, and considering the efficiency savings that must be made, how much public responsibility does NOSWA have to areas such as Strathconon? It would cost a fortune to sink the boreholes, but NOSWA is a public company. Does it have a duty to provide proper supplies of water to everybody in Scotland?

Maureen Macmillan: I wondered about the practicability of the kinds of schemes that NOSWA provides. Once a scheme has been established, does NOSWA have to provide a Rolls-Royce service? How flexible can NOSWA be in delivering

something for the people of Strathconon?

I also want to nail the question of whether there is good water in the NOSWA area. Ron Hughes picked up on contradictory statements.

Lewis Macdonald: I was pleased to hear Fiona McLeod's point, which I reiterate, about the public responsibility to support and supply areas such as the Highlands and Islands. Do you accept that the present urban-rural balance is subsidised by two cities—Aberdeen and Dundee? Could not public support be spread across the whole of urban Scotland only by establishing a single tariff?

Nora Radcliffe: My question relates to the thrust of the previous questions. We have talked about private water supplies in the Highlands and Islands. However, in the north-east, there is a farming community with a thinly spread population and the highest number of private water supplies per square mile anywhere. What imperative is there on NOSWA to be concerned with private water supplies or to bring them into the public arena?

The Convener: The first question concerns NOSWA's public service obligation. The second concerns whether the services to remote communities have to be Rolls-Royce services and addresses the statements of previous witnesses, regarding quotes about the quality of water in the NOSWA area. The third question concerns the urban-rural balance, specifically in relation to Aberdeen and Dundee. The fourth question is about private supplies. Perhaps the witnesses can orchestrate a response to all four questions.

Katharine Bryan: With pleasure. I shall address the question relating to the concerns of the previous witness about the various ways of recording the quality of water supplies. Ron McAulay will deal with the other issues.

The Convener: Hard lines, Ron.

Katharine Bryan: It is worth making the distinction between private and public water supplies. The figures that were quoted by the previous witness were for the public water supply provided by NOSWA. We do not measure, or have responsibility for, private supplies. The figures quoted were from the Scottish Executive's audit of samples, which showed 98.5 per cent compliance, or something of that ilk. On the face of it, that figure sounds good but, regrettably, it leaves NOSWA with the worst supply in the country. That is partly because that percentage of compliance includes relaxations of, for example, some of the parameters that are not of huge health significance, such as colour and trihalomethanes. It was assumed that, within a certain period of time, our investment programme would allow us to meet the standards for colour and trihalomethanes, therefore the percentage does

not give the full picture. We need the investment programme in order to meet the standards fully without those relaxations. We must also get up beyond 98.5 per cent to more than 99 per cent, which the authorities in England and Wales have enjoyed for many years.

Ron McAulay: The question was whether we have a public responsibility for private supplies. We have no set responsibility for the maintenance of private supplies, but we take our overall public responsibility seriously. We try to help people who come to us with problems with private supplies. I was disappointed to hear what one of the earlier witnesses said and can give other examples where we have delivered water to people who have experienced problems with private supplies, to try to help them out.

Fiona McLeod: Do you think that you have a responsibility to supply water to all members of the public?

Ron McAulay: The legislation makes us responsible for providing water within our area, provided that that can be done within what is called "reasonable cost". That is where the stumbling block is. In places such as Strathconan, the cost would fall well outwith anything that could be classed as reasonable.

We were asked whether our solutions are flexible and whether they needed to be Rolls-Royce solutions. I assure members that we do not put in Rolls-Royce solutions. I noticed that previous evidence referred to Mini, Mondeo and Rolls-Royce solutions. I would change that around—the solutions are Mondeos, Minis and push-bikes. We are looking for solutions that will do the job of delivering the standards. Unfortunately, there is no flexibility when we consider whether the standards have been met, as we cannot provide a solution that fails to meet the standards.

We were also asked whether rural supply is supported by consumers in Dundee and Aberdeen. I would add a third city—Inverness. It is correct to say that large urban areas help to support the cost of providing supplies to remote communities such as Applecross, on the west coast. The cost per head of population of providing a supply to a small community such as that is far greater than in places such as Aberdeen.

I am trying to remember the question about private supplies in the north-east.

Nora Radcliffe: Is there some sort of imperative on you to start including people with private supplies in public water supplies?

Ron McAulay: Because of the amount of investment that requires to be made over the next few years, we foresee that we will not have a huge

amount of money each year to allow us to extend supplies to first-time communities. The figure will be about £1 million each year, which is not a great deal of money when one considers that supplying the 60 properties or 120 people in Strathconan would probably cost more than £1 million. When we have the funds, we will consider what we can do to help.

When I nipped out—I apologise for coming back in late—I had a quick word with the witness who gave evidence earlier and arranged to meet him. I am not sure that I have much to offer him, but I am happy to sit down and talk to him about what might be done and to give him advice. He asked earlier for access to our expertise—we have no problem with giving him that access.

Nora Radcliffe: So, for us the question is probably a political one about the existing structure of the water authorities. There is nothing for people who are in a similar situation to the residents of Strathconan or for farmers in the north-east.

Ron McAulay: The committee must address the issue of funding.

Nora Radcliffe: But you cannot provide public water supplies to those communities under the current set-up.

Ron McAulay: No.

Nora Radcliffe: There is no imperative on you to do so. If we want to sort the situation out, we may have to look for a different political solution.

Katharine Bryan: I think so. I have here the quality and standards consultation document, which refers to the Mondeo, Mini and push-bike solutions, although the push-bike solution includes there being no money at all for those sorts of problems.

The Convener: I draw the session to a close and thank the witnesses for coming along. I also thank them for the written submissions that they provided. We will write to them with requests for further information. We appreciate their co-operation with our inquiry, which I think is a good one. I also thank members for their patience.

Committee Effectiveness

The Convener: We move on to agenda item 4.

The paper on committees was discussed and agreed at the conveners group and deals with a number of working practices that we believe may increase the effectiveness of committees. The paper will go before all the Parliament's committees and we are invited to consider its contents. Do members have any views, or are they happy simply to note the paper? Murray Tosh is exceedingly happy to note the paper.

Des McNulty: We must make more effort in organising the dates of our meetings. I note that the paper says that the pattern of meetings will move to a fortnightly one, but I believe that there are better ways of organising the dates of meetings than we operate at present. There are regular clashes of meetings for some members.

The Convener: I have made the clerking team aware of those clashes. Unfortunately, that takes us into difficult territory, as there is little scope for altering the dates of meetings. We will continue to raise the issue, as some members are on more than one committee and sometimes clashes arise. Des McNulty suffers from that frequently.

Nora Radcliffe: The paper says a lot of good things, but I am concerned that it refers to our work being "supported by clerking staff". We must examine closely the strain that we put on the clerking staff. While they can, and do, undertake a lot of work, sometimes we spread the clerking resources thinly. We should consider augmenting the number of clerking staff.

The Convener: Your point is well made, Nora, and will form part of our response—I see Shelagh McKinlay nodding vigorously. I will ensure that members' views are reported back to the conveners group.

As there are no further points, we move into private session to discuss who sent whom a Valentine's card. I am kidding.

12:41

Meeting continued in private until 13:10.

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