

# **TRANSPORT AND THE ENVIRONMENT COMMITTEE**

Wednesday 28 February 2001  
*(Morning)*

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## TRANSPORT AND THE ENVIRONMENT COMMITTEE

6<sup>th</sup> Meeting 2001, Session 1

### CONVENER

\*Mr Andy Kerr (East Kilbride) (Lab)

### DEPUTY CONVENER

\*John Farquhar 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

### WITNESSES

Sarah Boyack (Minister for Transport)  
Mr Sam Galbraith (Minister for Environment, Sport and Culture)  
Adam Rennie (Scottish Executive Development Department)

### CLERK TO THE COMMITTEE

Shelagh McKinlay

### SENIOR ASSISTANT CLERK

Tracey Haw e

### ASSISTANT CLERK

Alastair Macfie

### LOCATION

Committee Room 2



## Scottish Parliament

### Transport and the Environment Committee

Wednesday 28 February 2001

(Morning)

[THE CONVENER opened the meeting in private at 09:34]

09:46

*Meeting continued in public.*

**The Convener (Mr Andy Kerr):** Good morning. I welcome everyone to the sixth meeting this year of the Transport and the Environment Committee. I extend a special welcome to the Minister for Environment, Sport and Culture and his officials, who are here to give evidence as part of our water inquiry. I have not received any apologies for today's meeting.

### Items in Private

**The Convener:** It is suggested that we take several items in private for reasons that are self-explanatory. I suggest that we take in private item 6 in order to review the evidence that we have taken today, item 7 to allow us to consider our approach to the budget process and item 8 on witness expenses. Do members agree to take those items in private?

**Members indicated agreement.**

**The Convener:** Thank you. I also seek the agreement of members to take in private the discussion of our forward work programme—many members are interested in that—at our meeting on 7 March. Is that agreed?

**Members indicated agreement.**

## Water Inquiry

**The Convener:** The substantive item on our agenda this morning is our inquiry into the water industry.

We read with interest, minister, some stories in *The Herald* this morning. You may want to comment on the issues that were raised. I appreciate that your office responded correctly in regard to such speculative stories. The committee has taken a sizeable amount of evidence on the structure of the water industry and the merits of having three authorities or only one. That remains a matter of importance to us and we see from various articles that you may wish to discuss it with us this morning. I invite you to make an opening statement to the committee.

**The Minister for Environment, Sport and Culture (Mr Sam Galbraith):** Thank you for inviting me back to the committee to discuss the water industry, particularly now that you have taken evidence from many others.

I begin with a word of explanation and a slight apology. I realise that, by now, the committee was expecting to have a consultation paper on the water services bill. The publication of that paper has been delayed, mainly because the scope of the consultation and the bill has been widened. We are still fixing some of the details.

I hope to be able to make amends for the absence of that paper by outlining in broad terms the ground that it will cover and how it will relate to some of the issues that have been raised by witnesses who have appeared before the committee.

Over the past few months, I have been reading with interest the evidence given by the witnesses representing the full range of the water industry's stakeholders. They have expressed a variety of opinions, reflecting the—rightly—different perspectives that they have.

What I found striking were the common themes running through everyone's evidence: the need for the industry to achieve substantial improvements in quality and standards for customers and for the environment, and to do so at broadly tolerable charge levels; and the need for the industry to respond to the challenge of competition, which is already there.

The key to addressing those two pressures was the third theme: the need for efficiency in the industry. Everyone recognises that the industry must improve efficiency markedly and as a matter of urgency. The water industry commissioner, Alan Sutherland, identified that as a priority for everyone working in the industry. He set

challenging but, I think, achievable targets for the period to April 2006.

That means, first, that we must find better ways of managing day-to-day operations and, secondly, that we need a massive investment programme, which is the only affordable way of improving standards. By improving efficiency, the industry will be placed in the best possible position to face up to the increased competition.

Many and various views on the manner and speed of achieving the objectives were given, but, having read the evidence that the committee has taken, I am encouraged by the extent of the agreement, at least on what those objectives should be. The committee's inquiry has a vital role in creating the vision of a successful public sector water industry.

The Executive remains committed to legislating this year to establish a framework for dealing effectively with increasing competition in the water industry. I can confirm that the bill will contain the provisions that are outlined in the original consultation paper, "Managing Change in the Water Industry", which Sarah Boyack, as Minister for Transport and the Environment, published last year. As she made clear, if we do not legislate to create a clear framework, we run the risk that policy will be determined in the courts. There would also be the possibility that competition will develop without any of the necessary safeguards. It would be a highly irresponsible approach to allow that to happen.

The bill will be based on three pillars. The first will be our continuing commitment to retaining the water industry in the public sector. So that there can be no doubt, let me repeat that: one of the pillars of the bill will be our continuing commitment to retaining the industry in the public sector.

Secondly, the bill will provide a new legislative framework so that competition will work in the interest of all the customers. The framework's purpose is to ensure that that competition develops without undermining public health, environmental protection or our social objectives.

Thirdly, the bill will ensure that there is no scope for cowboy or rogue operators to gain access to the public networks. It will ensure that those who are granted access are unable to cherry-pick the most attractive customers. Finally, we want to use the bill to equip the industry to compete and to allow it meet the challenges that it faces.

Some witnesses have argued that it is desirable and possible to exempt the water industry from the Competition Act 1998. Our starting point is that customers and their interests must come first. Therefore, the question is whether customers would be better off if there were no competition in the industry. My answer to that is no.

Untrammelled competition would not serve the interests of customers, or indeed the wider public interest, but that is not what we are considering. The issue is whether we should deny customers the benefits of competition, operating within a legislative framework that safeguards public health, the environment and our social objectives. Allowing customers choice will encourage the industry to become more efficient, to improve the quality of the service that it provides and to be more innovative in the delivery of services. That is the most important reason for not trying to protect the industry from the Competition Act 1998.

A second reason for not exempting the water industry from the 1998 act is that that would not achieve what those who advocate such an approach desire. As we all know, competition is there already. Many large customers have the choice to leave the networks—particularly when it comes to building their own waste water treatment works. We cannot stop that. If non-domestic customers take that choice, the remaining customers—you and I—will be left to pick up the costs of what is largely a fixed-cost system. That is a form of competition that is not subject to the 1998 act or regulation. Whatever happens to the public networks, it is vital that the authorities compete effectively.

Our policy is to welcome competition as right for customers and for the long-term health of the industry and those who work in it. Even if we could take a different approach, we would not want to. In any event, the exclusions and exemptions available under the Competition Act 1998 do not provide any means to deliver the wholesale protection of the industry that some people seek. The provisions relating to exemptions and exclusions are complex and detailed. I have studied them; if any members want to discuss them with me, I would be happy to do so.

For the moment, the point to bear in mind is that a business or industry can be excluded in its entirety only for exceptional and compelling reasons of public policy, as set out in paragraph 7 of schedule 3 to the Competition Act 1998. No one could argue that such reasons exist in respect of the water authorities in Scotland. If we took that approach, we would be open to challenge from the courts. We would run the risk—if we lost the case—of competition being allowed to develop without the safeguards offered by the bill. To have our policy decided by the courts would be the worst of all possible worlds.

I know that the committee has spent some time, particularly with the water authorities, examining the various public-private partnership projects, mostly those relating to waste water. Questions have been raised about the public availability of information on those projects. I understand that for

some time the practice has been to make available the outline business case for such projects. In light of the discussions in the committee, I am persuaded that we should make more information available. I have concluded that, for all future PPP projects, the authorities must make available the full business case—subject, as ever, to any requirements of commercial confidentiality.

10:00

Another suggestion that has been made is that competition should be phased in over longer or shorter periods. I am not quite sure how that would work, but it would restrain the development of competition and would effectively rule out some customers for the time being. I do not think that that is a sensible way in which to proceed.

When we consult, we will propose a regime to regulate all competition on the public networks. That will not rule in or rule out certain types of competition; it is not our job to second-guess what can or cannot be achieved. Instead, it will ensure that the right safeguards are in place so that, however competition develops in practice, our objectives are met. However, it does not mean that there will not be plenty time for repairs.

Our aim is for the bill to achieve royal assent early next year. Once that has happened, any necessary secondary legislation will be put in place. Then the water industry commissioner, who we suggest should run the licensing system, will have to set up the system. Only then will anyone who wishes to use the public networks be able to apply to the commissioner for a licence. If the application is successful, the applicant will have to agree with the water authority the terms under which access to the networks is to be granted. There will inevitably be quite a long period—a couple of years—before competition in the public networks becomes a practical reality. That will give the authorities time to make preparations without the need for any formal staging or phasing of the competition.

The final area that I want to address is that of structural change in the industry. I would like to deal with the auction of mutualisation and the idea of moving to a single authority for the whole of Scotland. Mutualisation has undoubtedly proved a successful model in many areas of service delivery, but I do not think that it is appropriate for the water industry in Scotland. It was one of the options considered and rejected in the 1997 review, and the reasons for its rejection then remain just as valid today.

The key question that we have to answer in considering the case for a single water authority is whether it would be in the interests of the

customers. Last June, when Sarah Boyack published "Managing Change in the Water Industry: A Consultation Paper", our initial assessment was that structural change was likely to be a diversion from the challenges of developing ambitious investment programmes, improving efficiency and responding to the competition that is out there. Since then, the water authorities have done some serious work on the scope for collaboration to reduce costs and improve their customer service. That shows that, by developing many issues together rather than separately, the authorities can make very big savings for the customers.

We have had to consider the best way of ensuring that savings in areas such as asset management will be delivered. Our conclusion is that substantial change in the way in which the authorities operate will be needed, whether those opportunities are captured by collaborating within current structures or by moving to a single authority. A single authority with a single board and management is indeed a more reliable way of delivering the improvements. A single water authority would therefore be better equipped to compete and would allow us to use the managerial talent in the Scottish water industry to best effect. That is an important factor in ensuring that the industry remains in the public sector, which is one of the main reasons for creating a single authority. As an epiphenomenon, it will also be possible to address the investment needs of the north of Scotland without further large rises in charges there.

For all those reasons, I would like to signal today that it is the Scottish Executive's intention to move to a single authority—Scottish water—and that that will be included in the provisions that we will propose in the water services bill.

An important consideration in leading us to propose that course of action is the benefit that it will have for democratic accountability. Given the scale of the challenges that the industry faces, the industry is effectively a nationalised national industry. Therefore, it makes sense to hold it to account at a national level. With only one body rather than three to consider, Parliament's ability to hold that body to account will be enhanced. That is in line with the work that Angus MacKay is doing to establish a new regime for Scottish public bodies that is suitable for the devolved Administration. The partner to that national accountability is local responsiveness. I am committed to ensuring that Scottish water is responsive to local needs and concerns.

I have a final point to make on the single authority. Structural change of this nature always carries with it the risk of disruption, with some staff uncertain about the future and an absence of

strategic leadership. It is therefore essential for the process of transition to a single authority to be managed effectively. I am committed to ensuring that there is full consultation with staff and unions and that they are involved in all aspects of the process. I hope that, through this inquiry, we can build the necessary political consensus to allow a smooth transition to a single authority.

The water services bill will mark a new chapter for the water industry and its customers. It will provide a framework that allows competition to develop in the interest of customers and, by establishing Scottish water, it will ensure that the publicly owned industry can develop as a modern and efficient service provider that customers choose—and we want them to choose—to use because of the quality of service that it provides.

Thank you for your indulgence in allowing me to speak for so long, convener.

**The Convener:** Thank you, Sam. That was most interesting. Many of us share your view on the three pillars that you mentioned: public ownership, the need to focus on customers and the need to equip the industry to compete. We also share your view on preventing untrammelled competition. I also welcome the move that you have made on making information on PPPs fully available.

We have a number of structure-related questions. We will go first to Murray Tosh, who has a question on debt.

**Mr Murray Tosh (South of Scotland) (Con):** Good morning, minister. It was interesting to hear what you had to say about changing the structure to create Scottish water, which I am sure we will all know in the future as “water”. Given the extensive reorganisation, it is pertinent that we ask you about how the debt issue has been treated in the past, in case it becomes relevant again at the point of reorganisation. You were pressed on the issue last time you gave evidence, and we wish to return to it, because we have taken evidence that the water companies in England were privatised with strong balance sheets: £5 billion of debt was written off, and the companies were given the green dowry—a cash injection—of £1.5 billion. They also had extensive tax allowances against the projected 10-year investment programme of just under £25 billion.

In Scotland, at the same time, against a projected expenditure of £5 billion, the write-off of debt was less than £700 million. The water authorities were left with £1 billion of debt. That means that capital expenditure per household in Scotland requires to be much higher than was the case in England and Wales, yet apparently Scottish householders were left facing a much greater debt.

If you can, we would like you to explain what you meant last time when you said that you thought that Scotland had got a deal that was comparable to England's. In light of what you have said this morning, it is particularly important that you say whether, in the reconstruction of the industry to face the future, there is any scope—or whether the Executive has any intention—to write off or commute further debt to give the new authority a stronger balance sheet and allow it to compete effectively, while imposing appropriate charges on customers. I am sorry that the question is so long, but the issue is important.

**Mr Galbraith:** I understand. We have no plans to do that. If money did not come from anywhere, we would have had to take expenses from elsewhere. You were right about what I said last time I gave evidence to the committee. A dowry of £1.5 billion was paid to the authorities down south. Ours was £700 million, which, in relative terms, is fairly large—it is disproportionately larger than what was paid down south. The debt there was not written off; it was converted into equity.

The water authorities in Scotland do not pay tax. I think that their borrowing and investment requirements are correct. A relevant factor is the lack of investment over the years, which I do not blame on anyone overall. We are all responsible for not investing and we must correct that situation. I hope that that explains my position.

**Mr Tosh:** As I understand it, there was not a comparable dowry in Scotland, where the £700 million was written off—the proper comparison would be the £700 million in Scotland against the £5 billion and the £1.5 billion in England. The figures were broadly comparable on a Barnett basis. We are suggesting that the support that was given was inappropriate not to the population balance between the countries but to the outstanding capital work. It does not appear that the greater needs of Scotland at that point were recognised. Therefore, Scottish consumers must ultimately service the debts and the private finance initiative programme and they must face higher charges.

**Mr Galbraith:** I do not think that that is correct. The debt was not written off; it was converted into equity, which is sold to get back the money. The comparison is not correct.

**Mr Tosh:** I am sure that we will return to you if we are not completely satisfied about that issue.

**The Convener:** There are continuing questions about what happens to the debt once it is converted into equity, but we may revisit that in more detail through questions in correspondence with the minister, if he does not mind.

**Maureen Macmillan (Highlands and Islands) (Lab):** I am happy to hear the minister's



commitment to a single authority, which will be of great benefit to the north. What time scale do you envisage for that? The North of Scotland Water Authority has said that, in the next couple of years, consumers in its area will pay the highest charges in the UK. Could a single tariff be introduced in advance of merging the three authorities?

**Mr Galbraith:** I hope that we can introduce that as soon as possible, but the time scale depends on the parliamentary process. We cannot introduce anything before that is followed through. It is fair to say that the prices and some of the large increases are reaching their peak and should begin to level off. The future is brighter.

Maureen Macmillan is correct to point out an interesting epiphenomenon of moving to one authority, which will be assistance. However, that is not the reason for the change. The reason is to become more efficient, to retain the service in the public sector and to allow it to stand up to competition. We will introduce a single tariff as soon as possible, commensurate with the parliamentary process.

**Maureen Macmillan:** Is there no way of equalising tariffs before that process starts?

**Mr Galbraith:** No.

**Maureen Macmillan:** I will continue on the theme of the high charges, particularly in the NOSWA area. I have some statistics to relate. Between 1996 and 2000, the retail prices index rose by 11.5 per cent. During that period, band D water and waste water charges rose by 142.6 per cent in the west, 187 per cent in the east and 200.1 per cent—sorry, 200.1 per cent, although it sometimes seems like 2001 per cent—in the north. From 2001 to 2006, significant price increases will be inevitable at a rate that is much higher than the RPI. That will affect all members of the community, but particularly the less well off. What is the Executive's response to the evidence that the committee heard that the proposals for a transitional scheme are inadequate, given the level of the increases?

**Mr Galbraith:** What you say about the huge increases is correct. As I said to Murray Tosh, they simply reflect the fact that we have not invested in our water industry in the past century. The industry has been in a poor state of repair, so we have been forced to implement those increases. That has been compounded by the requirements of European Union regulations on water quality standards and the waste water treatment directives, which we have no choice but to implement. Their effects have varied among the water authorities.

Charges are balanced against a person's ability to pay and are dependent on their council tax band. A person in band A pays a third of what

someone in the highest band pays. There is therefore a built-in mechanism to control affordability. Because of the significant rises in charges, we were keen to set up a system that would deal with the people who faced the biggest increases. We decided to give assistance to those who are on council tax benefit—85 per cent of people in bands A and B—and to those who are suffering the biggest increases. We thought that that was the best way in which to implement the scheme, rather than to spread the assistance widely and make the amounts smaller.

10:15

We decided to set a cap at £180, so that no one would pay more than that. That allowed us to deal with everyone who is in band A and on council tax benefit in the north, where there were the biggest increases. Less assistance was made available to people in band A in the east and west, because they were not paying nearly as much as that and never reached that cap. It was a process of equalisation, in which we tried to equalise the charges throughout Scotland. The scheme therefore not only deals with those who are least able to pay, but enhances the banding mechanism and addresses the situation of those who face the biggest increases—those are the people who will benefit the most.

**Des McNulty (Clydebank and Milngavie) (Lab):** We have heard from people in Dundee about the implications of the increases in water charges, and I have much sympathy for the views that they expressed. If there is a process towards the equalisation of charges, that will benefit the people of Dundee; it could also be good news for rural Scotland. Have the implications been costed of its impact on my constituents or people in other parts of Scotland?

**Mr Galbraith:** The implications of changing from three water authorities to one?

**Des McNulty:** Yes.

**Mr Galbraith:** It is difficult to make such costings, because of the unknown factors, such as future charges, the loss of non-domestic customers, improvements to efficiency and the management of capital. The water commissioners are managing only the operational side and the revenue, but what about capital? What investment option will we choose? We are also consulting on quality and standards. It is therefore difficult to make predictions. What we can say is that the scheme will not impose additional costs on people in the east and west, because of the efficiency savings that we will make.

**Des McNulty:** I would like to see some figures.

**Mr Galbraith:** I invite your adviser to discuss

that and some of our models with my officials. However, we should be able to equalise the tariffs at no extra cost to the east and west.

**The Convener:** That would be useful.

**Bruce Crawford (Mid Scotland and Fife) (SNP):** I have a simple question that follows on from what you have just said. Are you saying that there is to be a single body with a single tariff and that there will be no future cross-subsidy by one part of Scotland—for example, the central belt—of the former NOSWA area? That was what Des McNulty was asking. Will there be an element of cross-subsidy to achieve tariff equalisation?

**Mr Galbraith:** There are always cross-subsidies in the water industry, as in any national industry. Within water authorities, customers in higher bands cross-subsidise those in the lower bands and non-domestic users cross-subsidise domestic users. There are huge cross-subsidies. I am saying that we can equalise the tariffs as a result of the substantial efficiency savings that we will make and that we should be able to do that without penalising areas.

**Maureen Macmillan:** The voluntary sector will now have to pay water charges—it has hitherto been exempt. The figure of £97 million over three years has been quoted. Is there no way that the cost to the sector could be mitigated? Some charities use very little water and it has been suggested that they could install meters. However, meters are expensive to install. Victim Support Scotland in Inverness, for example, uses hardly any water and reported that it would cost £600 to install a meter. It could not afford that.

**Mr Galbraith:** There is a way to mitigate that—the water authorities will insert the meter free of charge. The Local Government etc (Scotland) Act 1994 places a duty on authorities not to favour any particular customer. That applies to charities. The granting of charity relief—which, because of the various procedures and regulations that had been in place among different local authorities, was a bit of a hotch-potch—has been getting phased out over the years. Last year, after a delay of one year, the relief on charges was withdrawn from charity shops, offices and depots. A year ago, we also started to discuss the possibility of phasing it out for churches and so on—that phasing out is now under way.

I again asked local authorities this year to consider whether it was possible to ring-fence any particular group. They said that it was not. I was interested to note that Martin Sime of the Scottish Council for Voluntary Organisations said:

“It is very difficult to discriminate between one type of organisation and another—I would not commend that approach.”—[*Official Report, Transport and the Environment Committee*, 19 December 2000; c 1425.]

When we start giving out relief to charities, where do we stop? Is Fettes College to get charitable relief? Are private nursing homes to get charitable relief? If not, we have to start drawing boundaries. The way forward for voluntary organisations is to get a meter, which the water authorities will install free of charge.

**Mr Tosh:** I would like clarification on that point. Which criteria will you apply in deciding who gets free installation of meters and metering without charge?

**Mr Galbraith:** Charities.

**Mr Tosh:** Registered charities?

**Mr Galbraith:** Of charitable status, yes.

**Bruce Crawford:** Does that include Fettes, if it applies to have a free meter put in?

**Mr Galbraith:** You have highlighted the problem.

**Bruce Crawford:** There are many voluntary sector organisations that are trying to help the Government to deliver its policies, particularly on issues of social inclusion. People who are on a standstill budget—particularly on budgets from local authorities—will, if they face any extra costs, find their overheads difficult to absorb. That applies even if the charges are metered, because the cost will still be an extra one. I—like, I hope, the rest of the committee—would like you to consider that matter again, particularly for the sake of the voluntary organisations that are involved in the support of the disabled and in other areas of social inclusion in the community. It is imperative that we find some way round that problem.

**The Convener:** That is something that we could follow up. We have had a number of exchanges on that subject and it might be interesting to pursue some of the more detailed issues with you through correspondence, minister, taking cognisance of what the water authorities and the voluntary sector are saying—unless you want to comment further on the matter now.

**Mr Galbraith:** It was Martin Sime who said that it was difficult to draw a boundary. That is the problem. Charitable bodies include Fettes College and private nursing homes, which are profitable organisations. We have to be careful. Drawing such a boundary is against the 1994 act, but we could change the act. Legislation is not infinite.

Maureen Macmillan mentioned the cost of £97 million a year. What exactly did you say, Maureen?

**Maureen Macmillan:** The sum of £97 million over three years has been mentioned.

**Mr Galbraith:** No—it will not cost that. The charges to be levied on the voluntary sector are

being phased in over five years. The water authorities calculate that the cost to voluntary sector organisations will be £19 million a year. That does not reach £97 over three years. For the year coming, the figure is £4 million. The figures that have been put out are utterly wrong.

**Bristow Muldoon (Livingston) (Lab):** I want to ask about the effects of the proposed structural change. Some of my questions on the phasing in of the pricing systems have already been covered by Maureen Macmillan. You said that you believe that the efficiency savings from the move to a single water authority will be sufficient to ensure that no additional charges will be borne by people in the East of Scotland Water and West of Scotland Water areas. Do you have any figures for the efficiency savings that may be expected? The water commissioner expects substantial efficiency savings from the existing system.

**Mr Galbraith:** The efficiency targets that we want to set will not be possible to achieve without the move from three authorities to one authority. We are talking about large sums of money—more than £100 million a year.

**Bristow Muldoon:** Has an assessment been made of the likely impact on the number of people employed in the water industry and of the areas in which the move to one authority will lead to efficiencies?

**Mr Galbraith:** I would like to talk about employment, because it is important. As I have often said, none of us is here to have people losing their jobs. Let me repeat what I said in my statement: I intend that the change will be made in full consultation with all staff and with their full involvement. The water industry has introduced tremendous efficiencies since the three authorities were set up. The staff have co-operated extremely well and have done great things. I am grateful to them for that and I want them to be involved in this process.

I think that the change will be a way of ensuring the retention of jobs. A fit, lean, single, public sector water authority will be able to take on the competition and look for other business and provide other services. I have heard in discussions that the water authorities are looking to do other things; they will be able to do so after the move. They will be able to keep things in house. Three authorities together could certainly handle billing by themselves, rather than having to contract it out. That would be more effective than the individual authorities doing it.

We want the unions to be involved and we want to handle change as sensitively as we can. In the long term, the process will be a way of helping people to retain their jobs. We have not considered any particular scenarios for jobs, but

some of the numbers that have been given have just been wild.

**Bristow Muldoon:** You said that you believed that democratic accountability would be more effective with a single authority being accountable to the Executive and Parliament. What structure should the board of that authority have? What range of backgrounds and interests should be brought to it?

**Mr Galbraith:** I would be grateful to hear the committee's views on that. Boards should comprise people who bring something to the industry concerned. Those people should not come to represent a particular interest, but should have the skills that allow them to make a contribution. The board will be accountable to Parliament. As I said, we are talking about a national, nationalised industry; it ought to be accountable to us. The industry must also be responsive locally; the water commissioner's local committees will play an important role in that. There are therefore two things to be considered when dealing with the existing democratic deficit.

**Des McNulty:** I very much support the idea of a strong and robust water industry in Scotland—there must be a framework to sustain and develop that. I am absolutely at one with you on your vision for the industry.

We have heard from the various water authorities about the ways in which they may take forward their business plans on, for example, diversification. They spoke about their need to put equity into ventures. Do you propose to give them any new powers so that they can do that?

On the competition procedures, how might common carriage be dealt with? Is it proposed to extend common carriage in relation to the way in which competition regulations might be applied to the water industry?

10:30

**Mr Galbraith:** To a limited extent, water authorities can move into other areas. However, you are right. In the regulations under which the water authorities operate, the powers—what the authorities can and cannot do—are expressed in a restrictive way. We would certainly wish to consider giving the authorities a more general power to pursue other commercial interests, under the control and approval of ministers. That is important. However, there is no evidence to suggest that the authorities are missing out on opportunities to any great extent, although opportunities exist. That was the point that I was making in response to Bristow Muldoon.

There is going to be competition—we cannot stop that. In fact, competition exists already. We

are losing already and we need a fit, lean public body to take on our competitors. Such a body will be able to go into the market, take on other commercial interests and enhance jobs in the industry.

We must have a strict regime on common carriage in order to ensure that cowboys are not involved and that everyone adheres to the various and important safety, social and environmental standards. I do not want there to be cherry-picking. One can just imagine that, without the council tax band system of altering charges, new suppliers will cherry-pick the high band areas. We intend to insert provisions in the regulatory regime that will not permit such cherry-picking—in other words, charges will have to reflect the council tax bands. That will prevent new suppliers from simply lowering the charges and cherry-picking.

We are considering those areas. New suppliers will also have to pay the full costs—not just those of their wee bit, but those of maintaining the whole system. While I hope that our system can beat off the competition, even if a new supplier were to get in, it would still pay the charges for the system. It would be a disaster if such people got off paying charges, as we would lose everything but still be left paying for the maintenance of the system. That is the danger—we would lose income but the system would still have the same costs.

**Bruce Crawford:** I am glad to hear the minister talk about a fit, lean public body and full consultation. On efficiency costs and the scale of the economies that will be achieved by establishing one organisation, we have heard from a number of authorities that they expect a number of job losses. I heard what the minister said about full consultation and wanting to do what he can, but one of the problems that local authorities faced during reorganisation was that there was no support from Government to help them with redundancy costs and all such costs were passed on to the taxpayer. Would it be possible for central Government to provide help with redundancy costs? There will be substantial job losses and support would allow employees to leave with a bit of dignity and with a satisfactory package, as it might not be easy for them to pick up other work. If support is not available, the costs may be passed on to the consumer. Will the Executive consider providing support, in order to help the authorities through that period of transition, change and turbulence?

**Mr Galbraith:** A spend-to-save element is built into the standards and consultation document "Water Quality and Standards", part of which deals with the exact problem that you describe. It is necessary to make that spend in order to save. I like the word "dignity", and I hope that the authorities will be able to keep redundancies to a

minimum by winning other business, for example. The unions have done well in the past and I hope that they will continue in that vein. I repeat: a spend-to-save element is built into the projections in the quality and standards document.

**Bruce Crawford:** Thank you—that was useful.

**The Convener:** We now move on to the subject of competition.

**Bruce Crawford:** I listened carefully to the minister's comments on delays and the exemption of the water industry from competition. One of the thoughts going through my mind is that reorganising the authorities into a single authority will create turbulence. Inevitably, when pulling together three organisations into one on that scale, there will be a lot of introspection and internal examination. I have been through that process as a council leader, so I know how difficult it is. It certainly takes a lot longer than two years to begin to change the culture of the organisation to make it go in the new direction that you want for the future.

I wonder whether two years will be sufficient to allow the organisations to deal with a massive change to the way in which they conduct their business, changing their personnel systems, merging budgets and handling redundancy. I wonder whether it might be wise to consider a process of delaying the competition to allow that turbulence to get out of the system so that, when the organisations have become fit, lean and fresh without the interference of competition, they can start to move forward. There are real dangers for the industry in that process, particularly if it is to remain in the public sector. I share your view that it should stay in the public sector, but I think that a delay may help us to achieve our goals for the industry. Would you be prepared to reconsider that?

**Mr Galbraith:** You make a valid point. We all realise that there will be some turbulence, and I hope that we can manage that. I hope that we can build consensus to help to shape that process. You have raised the point, as others have, about what happens in relation to the Competition Act 1998. I do not think that it is necessary to put a time scale on that, and I am grateful that you have made it clear that your point is not about the act but about whether we should build in a time scale—

**Bruce Crawford:** I did not say that.

**Mr Galbraith:** I thought that that was your position.

**Bruce Crawford:** I was recognising your position.

**Mr Galbraith:** I thought that that was also your position. However, if it is not, I am happy to

withdraw that comment. I thought that I had heard Richard Lochhead saying that he was happy that the situation would apply for just three years. However, if that is not your party's position—

**Bruce Crawford:** I am being neutral.

**Mr Galbraith:** Oh, you are being neutral. Thank you very much indeed. That must be very unusual for you, but I am grateful for it. I apologise for putting words into your mouth.

I do not think that it is necessary to put a time scale on the process. It will all take time as we move along. We will need secondary legislation as we set up the system and as applications get approval. I therefore would not like to set a time scale. However, dates of commencement are built into any bill, so we shall certainly want to look at that aspect of the process in the light of what is happening with the Competition Act 1998 in England. That is the best assurance that I can give. Of course we do not want to do anything silly.

**Bruce Crawford:** Is that a guarantee that the act will not apply in Scotland before it applies down south?

**Mr Galbraith:** I am not saying that, but we will want to look at what is happening, what stage we are at and what the possibilities are. We do not know what will happen down south, so we must not commit ourselves to being, dare I say, London led on this matter. We do not want our legislation to be predetermined by London, but we certainly want to take account of what is happening in England so that we are not too far out of step. Because all bills have commencement dates written into them, we would want to assess the territory and the geography in that respect.

**Bruce Crawford:** I think that it is worth teasing that out a bit further. Obviously, the issue of common carriage and when different bits of the country come into the process is crucial. The convener was talking about guarantees. Are you giving a guarantee that Scottish authorities will not have to face common carriage before English ones do?

**Mr Galbraith:** My understanding is that English authorities can go for common carriage at the moment. The Office of Water Services' current view is that common carriage can be taken in England as things stand. Technically and legally, that is not a problem, as it is already possible. However, you are asking me when the Competition Act 1998 will be applied in England, and we will not know that until after the general election. That would certainly be a material consideration that we would want to take into account when deciding on commencement dates. I do not want our legislation in this area to be predetermined by what goes on at Westminster,

but that is a material consideration that we must take into account.

**Bruce Crawford:** One of the witnesses said that, if the Competition Act 1998 applies in Scotland before it does in England, we will become the focus for all competition, which is dangerous.

**Mr Galbraith:** It will not apply here before it does in England. Ofwat's view is that common carriage is allowed down south as things stand; the regulations are not in place in England in quite the same way, so we would not be the focus. However, the English situation is an important point that we would have to consider when deciding on commencement dates. That is why I do not think that we should put a date on this, although we should make sure that it is a material consideration.

**The Convener:** If there are no other questions on competition, we will move to the subject of capital investment.

**Mr Tosh:** Minister, would you clarify the role of the Executive in relation to PFI and PPP proposals? We have taken a lot of evidence from the water companies. What is your role in ensuring that all the deals give value for money, that the risks are appropriately calculated and allocated and that the concessionary periods are appropriate? How does the Executive satisfy itself about overall value for money?

**Mr Galbraith:** We give the water authorities central guidance on those matters. Proposals must compare with the public sector comparator and be value for money—there are various guidelines on that. The board takes the responsibility for making that decision in the end.

**Mr Tosh:** So there is no final ministerial approval, as long as the water authorities apply the public sector comparator. Do you see that in all cases?

**Mr Galbraith:** We do usually.

**Mr Tosh:** Usually, but not invariably?

**Mr Galbraith:** Invariably.

**Mr Tosh:** That is an important point, because you made a welcome concession, although perhaps that is not the right way to put it.

**Mr Galbraith:** It is correct that you should not use that term.

**Mr Tosh:** Indeed, I am sure that you have never made a concession in your life.

**Mr Galbraith:** I might concede—what you say might not be true.

**Mr Tosh:** I will say rather that you have never made a concession in your public life.

At the beginning of the meeting, you announced that, henceforth, PPP business cases will be revealed. We are not entirely certain that that is a huge concession, because the evidence that we have taken from the water companies suggests that most of the big contracts have already been allocated—there would be further PPPs only if the companies found ways of bundling relatively small-scale schemes and went through the PPP procurement method. In principle, what you have announced is an important departure, but we do not have public sector comparators for the existing PPPs. Does your change in policy extend to divulging that information to the public, so that we can see what has happened in the eight or nine PPPs that have gone through so far?

**Mr Galbraith:** The authorities can certainly make that information available to you. The reason why I referred only to the future was that, if the water authorities are faced with the turmoil of going from three into one, I want them to concentrate on that—I had no sinister reason. We went through the same process in the health service. That is why I am committed to the policy, as I was responsible then for making information publicly available. Mind you, the business cases generally come in crates on wheelbarrows, so members should not think that they can go along to the library and carry them off under their arm. When I saw one, I thought, “Oh, thanks very much” and left. They are big documents, but I made them available. To go back over stuff and clear out the confidential information took a long time. That is why I am reluctant to throw us back—I want us to keep looking forward. We can make the information available.

**Bristow Muldoon:** On the direct comparability of PFIs and PPPs with the public sector model, in evidence we learned that when one of the water authorities was considering the value for money of a PPP, it used a PPP model that was based on a different lifespan from that of the public sector comparator and that was on a different scale from that of the public sector comparator. Would it be appropriate to issue guidance to authorities to ensure that the comparison that is made between the different models is valid?

**Mr Galbraith:** We issue guidance on how these things should be done. I cannot comment on the specific case to which you refer. One has to compare like with like—that is part of the public sector comparison and value for money analysis. I would be surprised if the water authorities did not compare like with like.

**Des McNulty:** Are you happy with the basis on which the commissioner set his efficiency targets? Were you consulted on them? Do you have any information about the job implications of reaching those targets?

**Mr Galbraith:** The efficiency targets are used by the commissioner. He is a one-person quango—those things that we do not like—and has some autonomy. He talks to us and discusses what is likely to happen.

We do not have any scenarios for the job implications. Various suggestions have been made, and the position varies. The effects on jobs with water authorities down south, for example, have been varied. I think that everyone would agree that fewer people will be employed. I do not know what the figure will be. We will have to balance that against other employment opportunities, about which I talked to Bristow Muldoon. It is difficult to construct any definite figures at this stage.

10:45

**Des McNulty:** You made a strong point about the need for accountability in the system's management. In reality, the commissioner drives the water industry by setting his efficiency targets, which set the parameters within which the authorities must operate. Are you, as a minister, involved in setting those targets? Do you agree with the basis on which they are set?

**Mr Galbraith:** We own the industry, but we do not manage it. That is important. I am not saying anything against civil servants, but it is not a good idea for the Government to manage industries. That is why others manage the water industry.

As the committee will have seen from our water quality and standards document, we are responsible for consulting on such issues as investment options. We make big decisions about such issues. The commissioner is the customer's champion and considers the customer's interests. He represents the customer. He takes the customer's perspective and says that the industry must become more efficient, in the interests of the customer, to use our money better. That independent role is the commissioner's job and is appropriate.

**Des McNulty:** I am not sure whether the commissioner considers it his role purely to be the customer's champion. He sees his role as including being an economic regulator and other aspects. Who sets the objective for the industry? Will it be the minister, the board of the proposed single water company or the regulator through target setting?

**Mr Galbraith:** We are all involved and all have different roles. The commissioner's role is to secure the long-term interest of the customer. He must consider not just efficiency targets, but targets for the long-term economic future. That is the commissioner's job. Ministers have a role in considering investment and the level of borrowing

that we will make available. Boards consider operational matters, such as how to deliver the service and what to invest in. We give boards an overall amount. The process involves an interplay of all three bodies.

**Bruce Crawford:** Des McNulty asked interesting questions. I would like to understand a bit more about the lines of responsibility. To whom in the Government does the commissioner report? What remit does that minister have with regard to the commissioner?

**Mr Galbraith:** Everyone is ultimately responsible to the minister. We own the organisation and are ultimately responsible for it. However, some responsibilities are devolved to those in the organisation, in the interests of the customer. We take the strategic view. We decide how much investment will be available, based on various factors. We make that borrowing available. The day-to-day operational management is up to the boards. They are answerable for that to ministers. The commissioner is appointed independently. His job is to represent the customer and consider what they are getting. Therefore, he takes a long-term strategic view of what the authorities should achieve. That system works well and represents all the stakeholders.

**Bruce Crawford:** I understand that. However, I do not know whether you can issue instructions or guidance to the commissioner.

**Mr Galbraith:** I can.

**Bruce Crawford:** It would be useful for us to get an exact description in writing of the relationship between the minister and the commissioner, so that we can understand in greater depth that relationship and what specific targets can be set for the commissioner by a minister.

**Mr Galbraith:** We will send you a copy of this document—"Water Industry Commissioner for Scotland: Guidance from Ministers". The answer to your questions is yes. There they are.

**The Convener:** Thanks very much for that unequivocal answer, Sam.

Fiona, do you want to ask a question on the subject of mutualisation?

**Fiona McLeod (West of Scotland) (SNP):** Yes, but before I do so I shall pick up on a recurring theme. In answer to a number of questions, the minister has kept referring to the authorities' going out and doing other work. Can you explain what you mean by that, minister?

**Mr Galbraith:** A host of management services are involved. Authorities could manage the services within the system, regulate water cutback in the water supply and determine how waste is handled and water is recycled in the plants. All

those services are delivered by outside contractors, which has a huge knock-on effect because it reduces the amount of water that is delivered and has an effect on water charges. If the authorities could be helped to recycle their water, cut down their water usage, deal with their waste and reduce their management of other waste, that would be useful.

**Fiona McLeod:** Okay. I just wanted to ensure that you were still talking about the core service of providing a water supply.

**Mr Galbraith:** I was not talking about selling insurance.

**Fiona McLeod:** We have discussed the idea of mutualisation with several witnesses but, in your opening statement, you dismissed that out of hand. You said that it had been rejected in 1997 and that that rejection was still valid. I would like to explore that further with you.

In talking about mutualisation, the committee has always been careful to ensure that our witnesses understand that we are not talking about the English model that has been adopted by a couple of companies down south. What we are considering is a more co-operative model of mutualisation that would give the organisation a mandate to serve its community or customers. That mandate would ensure that it stayed a servant of the public, providing a public service, while still being able to acquire capital outwith the public sector borrowing requirement.

That idea fits in well with your announcement today about the proposed single water authority, which you talked about securing as a public service authority. Will you elaborate on your earlier remarks about why you believe that mutualisation should be rejected as a financial model?

**Mr Galbraith:** What model are you thinking of? There is no English model; there is a Welsh model.

**Fiona McLeod:** Northumbrian Water.

**Mr Galbraith:** No. There is no English model. The problem is that people are vague when they enter this debate. They do not understand it. What model are you talking about? In the Welsh model, it is proposed that the assets are held centrally, by one body, while all the services—which is where 90 per cent of the staff are employed—are put out to competition for contractors to deliver. Is that the model? Do you mean the Welsh model? There is no English model.

**Fiona McLeod:** I understood from evidence that Northumbrian Water was going down the line of mutualisation.

**Mr Galbraith:** No, it is owned by a French company.

**Fiona McLeod:** We were talking about pursuing a co-operative model that would ensure that the organisation would remain a public body, although it would be able to raise money outwith the public sector borrowing requirement.

**Mr Galbraith:** What you mean is one whole body that would cover all of it.

**Fiona McLeod:** Yes. That would be a way of raising money.

**Mr Galbraith:** A number of suggestions have been put forward. The general opinion is that a body of that form would not be the most efficient or effective. That is why the Welsh have opted for the other model. You are putting forward the argument that the body could borrow money outwith the public sector borrowing requirement. It could, but that would cost much more. The Government either guarantees borrowing or does not guarantee it. If it guarantees borrowing, that is part of the public sector borrowing requirement. If it does not, the money is not lent at the preferential rate at which it is lent in the public sector borrowing requirement.

**Fiona McLeod:** Some of the evidence that we have received suggests that that is not the case.

**Mr Galbraith:** It is bollocks, then, the evidence that you have got. That is just the reality of it. It is one way or the other. It is either on the public sector borrowing requirement or it is not. If it is on the PSBR you get preferential rates, if it is not you do not, and there is no way round that.

**The Convener:** Is the word you used a technical term that is used in the water industry on a frequent basis?

**Mr Galbraith:** Sorry about that.

**Mr Tosh:** I am sure that we could pass that on to Cathy Jamieson, who suggested the model to the committee.

**The Convener:** To be fair, two things are happening here. First, we are projecting a model that we have not fully considered, because we have not concluded how to deal with the evidence that we have received. Secondly, the minister is responding based upon that projection. This is an issue that we need to pursue at a later date, so we will lay down a marker to do that once we have taken and reviewed all our evidence.

I understand that a couple of members have questions. I wish to address an area that we went over too lightly. East of Scotland Water mentioned an innovative way of getting equity into the company, and that was the Rolls-Royce model, whereby the Government has taken an equity share in a project. Des McNulty raised this issue with you. We need to be more creative in developing the public sector model so that it is

strong, can compete and can win. Are you going to examine ways in which to develop equity?

**Mr Galbraith:** We have not ruled that out. The situation is a bit too restrictive at the moment. We need to look at the powers that we might give the authority, subject to our final approval. These might be areas that we want to look at.

**Des McNulty:** Do you have any information on the effect on employment in the industry of the efficiency measures that the regulator is putting in place and of the process of shifting from three authorities to one? How will they affect the numbers of people who are employed, or the balance between management and operational workers?

**Mr Galbraith:** I am afraid that we do not have that information yet. We all realise that fewer people will be employed, but some of the wilder figures out there are not true. We need to sit down with the unions and discuss the implications with them.

**Maureen Macmillan:** I think that it was NOSWA that raised a concern about the time that it might take to restructure the industry. It said that because there were rumours about the restructuring, it was already having difficulty recruiting management staff. How can that problem be overcome if it is going to take two years for the structure to be changed?

**Mr Galbraith:** You are absolutely right. My officials are meeting the chief executives of the water authorities this afternoon, and I have arranged to meet the chairmen soon to discuss the issue. I hope that we can build a consensus. There are systems for putting the structure in place, but we have to move fast. We cannot pre-empt legislation and the will of the Parliament in these matters, but I hope that we can do things to reassure everyone and put in place systems so that, should Parliament so wish, we will be in a position to move forward quickly.

There are terrific people working in the water industry—terrific managers, and the rest of the workers are terrific—and we need to retain them and not lose them. That is one of the important things that I have to do, and it will be started this afternoon.

**The Convener:** There are no other requests to ask questions, so I thank the minister for an informative and, on occasion, entertaining session this morning. We will come back to you in writing on a number of matters.

**Mr Galbraith:** I am sure that you will.

**The Convener:** Once again, thank you for your attendance this morning.



That was the final evidence session of our water inquiry. I thank all the witnesses who have taken part and given evidence. Their contributions have been extremely useful.

Agenda item 4 is subordinate legislation. We will wait for the Minister for Transport to join us. We will have a short adjournment for those who need a natural break.

10:58

*Meeting adjourned.*

11:04

*On resuming—*

## Subordinate Legislation

**The Convener:** I welcome the Minister for Transport and her officials, who are here to discuss the Scotland Act 1998 (Transfer of Functions to the Scottish Ministers etc) Order 2001, which, along with the covering note, has been circulated to members.

We will follow the standard procedure that we have used in the past with regard to handling affirmative Scottish statutory instruments. We can allow some time for members to ask the minister and the officials questions about the instrument, for the purposes of general discussion. The minister will then move motion S1M-1632, which may then be formally debated prior to coming to a decision.

I remind all members that Executive officials may not contribute to any formal part of the debate; in other words, after the minister has moved the motion, only MSPs can take part. That will last no longer than 90 minutes, as per the usual rules. I ask the minister to make some introductory remarks.

**The Minister for Transport (Sarah Boyack):** I will make most of my remarks now, so that if members wish to raise issues, those can be put on the agenda. I will describe briefly the purpose of this type of instrument. The order is made under section 63 of the Scotland Act 1998, and comes into force after it is made in council.

Section 63 enables the Scottish ministers to exercise executive powers in areas where primary legislation continues to be a matter for Westminster. This type of order provides a mechanism for functions in reserved areas to be transferred to the Scottish ministers, so that we can exercise the powers in or as regards Scotland. That is, in essence, executive devolution. The transferred function that we are debating this morning can be exercised by the Scottish ministers concurrently with the UK minister.

The purpose of this section 63 order is to give the Scottish ministers the power to provide grants to the Strategic Rail Authority in respect of passenger rail services provided under the Scottish franchise. The order delivers another significant element of the McLeish settlement to Scotland.

The Scottish ministers currently fund those elements of the ScotRail franchise that are operated on behalf of the Strathclyde Passenger Transport Authority. When the order is made,

Scottish ministers will take on responsibility for funding the entire franchise, through our payments to the SPTA and to the Strategic Rail Authority, which, in turn, pays the franchisee.

I hope that members have been able to see the note that was prepared by the Executive. It explains in detail the content of the order and shows that it transfers one of the powers that is given to the Secretary of State for the Environment, Transport and the Regions in the Transport Act 2000. That power is contained in paragraph 7 of schedule 14 to the 2000 act. That paragraph provides that the UK

"Secretary of State may make to the Authority grants of such amounts, on such terms, as he may determine."

The order lists the precise functions that can be exercised by the Scottish ministers. They are the making of grants for funding passenger rail services that start and end in Scotland and that are provided under a franchise agreement, and for services that either start or end in Scotland and are provided under a franchise agreement by a person who also provides services under a franchise agreement that starts and ends in Scotland.

That may sound complex but, in practice, it refers to the services that are currently provided under the ScotRail franchise, including the Scottish sleeper services and the small number of other cross-border services that are operated by ScotRail. Apart from the cross-border services, those are the same services for which Scottish ministers can give directions and guidance to the SRA under the terms of section 208 of the UK Transport Act 2000.

The order includes the power to fund services under that franchise, should it become necessary for the SRA to fulfil its duty under section 30 of the Railways Act 1993 to act as the operator of last resort. In the event that the franchise is terminated prematurely or comes to an end without any further franchise agreement being made, the authority will provide or secure provision of services until a new franchise agreement is made.

Members will have noted that the powers under the order will be exercised concurrently with the secretary of state, who will therefore retain the power to make payments in respect of the Scottish franchise should the need arise. That could be done through projects that are incorporated into the Scottish franchise while being funded from additional sources.

The Scottish ministers' powers to issue sole directions and guidance to the SRA in respect of the Scottish franchise, and to issue advice in relation to other operators' services that serve Scotland, will not be affected by the secretary of state's retention of the funding power.

The order is not concerned with the actual level of funding for the Scottish rail franchise, but members may want some details on that. The transfer of public expenditure provision from the DETR to the Executive has been agreed. The sum transferred and grants provided to the SRA will meet all the commitments relating to the current franchise up to the financial year 2003-04.

The contractual payments for all the current franchises are already determined, and the transfer of provision to cover the contractual payments for the Scottish franchise has been agreed between the DETR and the Scottish Executive. The payments to ScotRail for 2001-02 amount to £111 million; provision for that is included in the Budget (Scotland) (No 2) Bill. Performance regime impacts and any changes resulting from the regulator's review of Railtrack's charging framework will be addressed subsequently. My officials are making the necessary arrangements so that grants to the SRA will begin from April this year.

From 2004-05 onwards, provision from the Scottish rail franchise will be made in the context of the Executive's own future spending plans. Scotland's railways will then be funded from the Scottish assigned budget in the normal way. Today's order marks a milestone for us in the devolution of railways in the overall GB framework. Combined with the other elements of the McLeish settlement that we have already implemented, it will underpin the Executive's role in determining the future direction of passenger rail services in Scotland.

**Bruce Crawford:** It is a difficult area to understand, but you did a good job of explaining it.

I understand the issue about transfer of the powers to be able to provide the grants to the SRA—that is important. I want to tease out what the transfer of provisions means. I am aware, from your answer to my parliamentary question with regard to the rail modernisation fund—which is about £7 billion—that none of the fund is finding its way into the Scottish assigned budget via the Barnett formula. In those circumstances, how will the Scottish franchise best benefit from that £7 billion rail modernisation fund? How will the franchisees and the SRA get hold of the money if it cannot come through you?

**Sarah Boyack:** We will bid into the funds at a UK level. If we think that there are projects in the ScotRail franchise that should be supported by those funds, we will discuss that with UK ministers. Do you want to add anything, Adam?

**Adam Rennie (Scottish Executive Development Department):** The significance of the UK minister retaining the concurrent powers is precisely to enable the sort of transaction to take

place in which the central GB funding ultimately finishes up as part of a franchise. Central GB funding does not always have to come into Scotland through that route, but it might on occasion do so. The way that the order is drafted enables either avenue to be taken. The Scottish ministers will have transferred to them, to take effect from 1 April, the entire amount that is necessary to pay for the current ScotRail franchise up to its termination in 2004.

**Bruce Crawford:** In regard to the existing contract, I understand that the money will be in the assigned budget and will be dealt with in the normal way. Do I hear it correctly that the Executive will be able to bid directly into the rail modernisation fund at a UK level, if required?

**Sarah Boyack:** We work through the Strategic Rail Authority. There are a variety of funds, and the SRA may set up different funds in future. The rail modernisation fund and the rail passenger partnership scheme are the funds that we are thinking of in the context of the ScotRail franchise.

**Bruce Crawford:** But the specific fund that I am talking about is the rail modernisation fund, which was a £7 billion fund held by the DETR.

**Sarah Boyack:** The point that I am making is that all those funds are distributed on a UK basis. We have to put in projects that meet the overall criteria, which is why we are in discussion with the SRA about its criteria and what we think the priorities are in Scotland.

**Mr Tosh:** Returning to the transfer of functions order, I want to ask the minister about the issue of exercising functions concurrently with the Secretary of State. As I understand it from what you have said, minister, the size of the payment is already agreed between your department and the DETR until 2003-04. What happens after that? Does the determination of the annual payment to the franchisee become a matter for the discretion of the Scottish Executive within its assigned budget, or is it still necessary thereafter for the sum to be agreed concurrently with the DETR?

Given that, over a potential franchise period of 15 to 20 years, many changes might be made to the levels of service and financial input, how will variations to the level of specification be dealt with? Will decisions about variations fall within the discretion of the Scottish Executive, or will they have to be negotiated with the DETR? Will those allocations take place on the basis of concurrent use of power?

**Sarah Boyack:** We envisage that the franchises will be paid out of the assigned budget, and therefore our responsibility will be to set the instructions and guidance for the SRA. We will have to work out what we can pay for the ScotRail franchise. I was asked previously about other

funds that might come into play, and it is at that point that they may become relevant.

However, through the Scottish assigned budget, we will be responsible for paying for the franchise and, given the fact that the time frame is long, we will have to determine the pattern of investment over that lengthy period. We will also have to determine the extent to which we believe that other parts of the UK rail fund come into the picture.

11:15

**Mr Tosh:** In theory, if the Scottish Executive were to decide to make a radical change to its pattern of payments—perhaps to support more rural services or whatever—would it be entirely for the Executive to determine how to use the resources from within its own budget? I presume that there would be no necessity to negotiate or operate concurrently with the DETR on any aspect of that budget.

**Sarah Boyack:** This is about our priorities.

**Maureen Macmillan:** Can the minister give us an idea of the kind of projects that the Executive could bid for from the UK fund, as opposed to what is done by ScotRail through the SRA?

**Sarah Boyack:** We have two fairly recent examples, the first of which was the SRA's decision to help fund the reopening of Beaulieu station. The second example is the crossrail project in Edinburgh. The Executive is putting substantial amounts of money into the public transport fund and the SRA is also making a contribution, which means that there is a partnership package to fund that development. Those are practical examples of investment that has come through to Scotland.

**The Convener:** As there are no further questions, we move to the formal part of our agenda. I thank the minister and her officials for their comments and invite the minister to move the motion.

*Motion moved,*

That the Transport and the Environment Committee recommends that the draft Scotland Act 1998 (Transfer of Functions to the Scottish Ministers etc.) Order 2001 be approved.—[*Sarah Boyack.*]

**The Convener:** The question is, that motion S1M-1632, in the name of Sarah Boyack, be agreed to.

*Motion agreed to.*

**The Convener:** I thank the minister for attending today. The committee must report on the order by 12 March and will agree a short report to the Parliament setting out our recommendation.

## Ferry Services (Highlands and Islands)

**The Convener:** We move on to item 5 of our agenda, which is on ferry services in the Highlands and Islands. Members will have received a covering note on possible action by the committee and a note from the Scottish Executive on the next steps was circulated by e-mail.

The Minister for Transport has announced details of the Executive's proposals for the future of Caledonian MacBrayne's ferry service network, given that, under European Community law, the services are to be put out to tender. The Executive is required to consult the Commission on the proposals and therefore they are provisional at this stage and subject to the Commission's further approval and investigations.

Members are asked to consider whether and how the committee might wish to examine the Executive's proposals and the future of the Highlands and Islands ferry service network. I remind members of the option to appoint a reporter or reporters to consider the issue and to report back to the committee, given the full agenda of work that faces the committee at its formal meetings. I seek members' views on those issues.

**Mr Tosh:** It would be appropriate for us to consider the matter quite closely. I suggest that we appoint a reporter or reporters. There was an indication that Des McNulty and Robin Harper were interested in pursuing in detail progress in this area. If they are happy to be nominated, I would be happy to nominate them.

**Bruce Crawford:** The issue is important and I agree that we should go ahead and appoint a reporter. As I am a reporter on the trunk roads inquiry, it would not be appropriate for me to become a reporter on this issue. I do not want to volunteer members at this stage, but I would have no problem if the members suggested by Murray Tosh wish to take the matter forward, unless other members were interested.

When would we consider the remit for the reporter? The issue is important, because it covers not only the competitive tendering process but EC regulations. Detailed arguments are being made, particularly by the unions, about the requirement for a tendering process and the potential for the new vessel-owning company to become a Trojan horse. We must ensure that we get the reporter's remit right.

**Mr Tosh:** Would it be appropriate for the reporter to report quickly on a remit for the committee's approval?

**The Convener:** The first task for the reporter or

reporters would be to develop a remit with the committee clerk, and to circulate it to the committee for our approval.

I understand that Maureen Macmillan is also interested in this issue.

**Maureen Macmillan:** That is correct, convener. I am one of the MSPs for the Highlands and Islands region and I believe that the issue of Caledonian MacBrayne services is important for that region and for John Farquhar Munro's constituency, although I have an overview because I represent the whole region. It is important to focus on exactly what we want to do. There is so much that we could examine, but we should focus on specific areas.

**Mr Tosh:** I am happy to extend my nominations to include a third member.

**The Convener:** The committee clerk advises me that Robin Harper would be happy to stand aside if sufficient members were interested in becoming reporters. Des McNulty and Maureen Macmillan could become our reporters, plus or minus Robin depending on what he decides. He has had to leave the meeting because of another appointment. We could agree that all three could become reporters, but give Robin the right to withdraw if he feels that that would be appropriate. Are we agreed?

**Members indicated agreement.**

**The Convener:** Thank you.

We now move into private session for the final three items on today's agenda. I thank members of the press and the public for joining us today.

11:21

*Meeting continued in private until 11:58.*

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