

# **TRANSPORT AND THE ENVIRONMENT COMMITTEE**

Wednesday 24 October 2001  
*(Morning)*

Session 1

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## TRANSPORT AND THE ENVIRONMENT COMMITTEE

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

### CONVENER

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

### DEPUTY CONVENER

\*Nora Radcliffe (Gordon) (LD)

### COMMITTEE MEMBERS

\*Robin Harper (Lothians) (Green)  
Mr Adam Ingram (South of Scotland) (SNP)  
\*Maureen Macmillan (Highlands and Islands) (Lab)  
\*Fiona McLeod (West of Scotland) (SNP)  
\*Des McNulty (Clydebank and Milngavie) (Lab)  
\*Bristow Muldoon (Livingston) (Lab)  
\*John Scott (Ayr) (Con)

\*attended

### THE FOLLOWING ALSO ATTENDED :

Bruce Crawford (Mid Scotland and Fife) (SNP)  
Mr Murray Tosh (South of Scotland) (Con)

### WITNESSES

Professor Alan Alexander (Chairman Designate, Scottish Water)  
Sarah Boyack (Minister for Transport and Planning)  
Jimmy Farrelly (T&G Scotland)  
Ross Finnie (Minister for Environment and Rural Development)  
Dr Jon Hargreaves (Chief Executive Designate, Scottish Water)  
Mike Neilson (Scottish Executive Environment and Rural Affairs Department)  
Michael O'Neill (Scottish Executive Finance and Central Services Department)  
Dr John Sawkins (Heriot-Watt University)  
Bob Tait (Scottish Executive Development Department)  
Dave Watson (Unison)

### CLERK TO THE COMMITTEE

Callum Thomson

### SENIOR ASSISTANT CLERK

Tracey Haw e

### ASSISTANT CLERK

Alastair Macfie

### LOCATION

Committee Room 2



## Scottish Parliament

### Transport and the Environment Committee

Wednesday 24 October 2001

(Morning)

[THE CONVENER opened the meeting at 09:19]

### Items in Private

**The Convener (Mr Andy Kerr):** I apologise for the early start, but we have a heck of a lot of business to get through.

Agenda item 1 invites us to take items 2 and 7 in private for reasons that are fairly obvious. Item 2 is consideration of possible lines of questioning for witnesses on stage 1 of the Water Industry (Scotland) Bill and on the 2002-03 budget process. Item 7 is discussion of possible advisers to our aquaculture inquiry, which clearly we must conduct in private. Do members agree to take those items in private?

**Members indicated agreement.**

**The Convener:** As members know, during the next few weeks the committee will take evidence at stage 1 of the Water Industry (Scotland) Bill. Do members agree that at those meetings we will consider our lines of questioning for witnesses in private?

**Members indicated agreement.**

09:21

*Meeting continued in private.*

09:38

*Meeting continued in public.*

### Water Industry (Scotland) Bill: Stage 1

**The Convener:** I welcome the press and public to this meeting of the Transport and the Environment Committee. I have received no apologies. Bruce Crawford has intimated that he may join us at some point.

We are beginning stage 1 consideration of the Water Industry (Scotland) Bill. Later in the meeting, we will take evidence from Dr John Sawkins of Heriot-Watt University and from trade union representatives. I welcome the chief executive designate of Scottish Water, Dr Jon Hargreaves, and the chairman designate of Scottish Water, Professor Alan Alexander. I offer them my congratulations on obtaining their positions and I thank Alan Alexander for attending today's meeting even though he has only just returned from a long journey. I understand that he got back only yesterday.

**Professor Alan Alexander (Chairman Designate, Scottish Water):** Yes.

**The Convener:** So, jet-lag and other factors may affect you. Nevertheless, I extend a very warm welcome. You have attended the committee before and I am happy to see you here again. In line with previous practice, if you wish to make an opening statement, the committee will be happy to hear it.

**Professor Alexander:** On this occasion, we will not make an opening statement. We are happy to allow the committee to take its line. We will simply answer questions as well as we can, if that is acceptable.

**The Convener:** Thank you. That is useful.

**Bristow Muldoon (Livingston) (Lab):** How will the time scale work out for the establishment of the single water authority?

**Professor Alexander:** My initial response is to bounce the question back to the member and his colleagues. Depending on the parliamentary progress of the Water Industry (Scotland) Bill, we are confident that we can meet a vesting day of 1 April 2002. Not everything will be in place in its final form, but the transition programme is well ahead on what we have described as the must-do actions—those that must be in place for vesting day. If the parliamentary progress of the bill follows the timetable and royal assent is obtained by late February or March 2002, we see no difficulty in having Scottish Water in operation on the target date.

**Bristow Muldoon:** The creation of a new authority will mean significant upheaval for the organisations that are being joined together. What issues will you have to deal with during the restructuring process to create the new organisation, which will be one of Scotland's largest employers? How do you intend to deal with the restructuring issues while delivering on the efficiency targets that you have set, meeting the deadlines from European Union directives that are being introduced and dealing with competition issues?

**Professor Alexander:** I will give a general response and Jon Hargreaves will respond on the specifics. In general, our customers should notice no change. We aim for the smoothest transition possible from the current to the new arrangements. It is particularly important that we concentrate on the fact that, as Mr Muldoon pointed out, a new organisation is being created; it is not simply a merger or three organisations being stitched together. That will be part of the continuing process of establishing Scottish Water.

We say confidently that the service will not be interrupted. The progress that we are making in improving the service and standards will not be interrupted by the change. We have had that in mind with the transition programme. We are making the change because it is in our customers' interests so it follows that our customers should not be disadvantaged by the transition process.

**Dr Jon Hargreaves (Chief Executive Designate, Scottish Water):** When a new structure is created in any business, there are winners and losers. We are trying to deal with that issue sensitively, but we must face it head on.

Our present objective is clear. The three authorities are pulling in the same direction while we establish a new structure and are in transition. This year, we are all making good progress in helping to achieve efficiencies and raise standards. That is happening at East of Scotland Water—I can speak only for that authority because I am boss there. The organisation is probably performing as well as it ever has, which is down to good managers doing their bit and following the board's line.

There are two phases to what we aim to do for 1 April. The changes that we make are designed to create minimum disruption to the bits that affect the customer. For example, although people who deal directly with the customer may have a new director, it is highly unlikely that anything underneath that will change for 1 April. Similarly, most programmes, such as the capital programme, involve a commitment from one year to the next. A programme does not just start and finish in a year. Much overlap occurs, so we are ensuring that that continues.

By 1 April, the objective is to make the sensible changes that we can make to support services such as finance, because that will help us to progress with and capture efficiencies and to continue what we are doing. By the time we get to the end of that process, it will be another 12 months before the business is restructured completely. It may take longer, but that is not a problem as long as we make progress on the targets profile and we deliver on customer service. It is right and proper that we take that at a speed that is sensible for achieving our customer service objectives.

**The Convener:** I want to raise a related point. Are you saying that there should not be any effect on investment decline issues or on private finance initiative contracts?

09:45

**Dr Hargreaves:** We are checking the legality and transfer of PFI contracts—the committee would expect us to do that. We do not anticipate any failures of the contracts because of what we are doing. We will ensure that people are in charge of looking after the contracts.

One of the interesting issues that we face is that the capital programme is broken into three chunks of business. One is about legislation, such as the bathing beaches and waste water directives, which has to be met by a certain date and is a priority. The second element of the programme is general upgrading of treatment works and other facilities. That is about future compliance—they are compliant today, but we know that they will fall over if we do not do something with them. The third element is underground assets—the pipeworks.

It is clear that it will take time to start meeting the water industry commissioner's targets on capital efficiency. It may make sense to delay some of the work in the non-essential programme so that we get maximum efficiencies. How we let and bundle contracts will take at least 12 months to put in place.

The objective at the moment is to make absolutely sure that the programme outputs—as opposed to the spend that we are committed to under the various acts—are met. We may see a different profiling of finances from those that the three authorities have put forward in the past. That is about gaining maximum efficiency for customer benefit.

**Bristow Muldoon:** One of the areas that the committee considered extensively in the water inquiry that it undertook earlier in the year was whether the way in which the water industry is evolving in Scotland is consistent and fair compared with how it was restructured in England

and Wales—particularly on the question of debt. The committee did not find clear evidence that there had been distinct unfairness, particularly in terms of the impact on the water charge payer, but it was difficult to judge, partly because the water industry in England and Wales is privatised; the water industry in Scotland remains and will remain in the public sector. What is your view on inherited debt? Has a strong case been made that there should be a review of that before Scottish Water is established?

**Dr Hargreaves:** My answer to that has not changed since I appeared before the committee last October. It is difficult to compare the level of indebtedness of the public limited companies because they do other business, but there does not seem to be a significant disadvantage to the Scottish water authorities at the moment, nor will there be to Scottish Water in the future. The debt will increase as we spend nearly £2 billion over the next four years; it is not going to decrease. We have the advantage of getting good market rates because we borrow via the Government. There are indications that the cost of PLC debt is increasing because of the previous regulatory review. Our cost of debt is fairly stable and, for various reasons, is probably at the best level of all time.

There is no issue with that. If it can meet its efficiency targets, Scottish Water will have the capacity to manage the debt sensibly with regard to customer charges. The issue for the Government in Scotland to consider is who else will suffer if it writes the debt off. As a priority, Scottish Water should be capable of carrying the debt; it is not disadvantaged by it.

**Des McNulty (Clydebank and Milngavie) (Lab):** As part of the evidence that the water companies gave us during the water inquiry, you indicated that the process of letting PFI contracts was essentially at an end because the requirement for that kind of arrangement had been met and, in future, investment needs would be met from increased borrowing. Does the amalgamation of the three authorities have any advantages or disadvantages for the process by which you accumulate debt? With the amalgamation, will you still finance further investment through borrowing rather than through other means such as PFI?

**Dr Hargreaves:** At the moment, we have neither ruled in nor ruled out PFI. If it makes sense to go down that route, we will do so. The fact that the cost of money is very low in the markets and that there is a real appetite for that sort of project in other sectors means that it should provide good value for money. However, it is difficult to achieve best value for money from PFI unless the contracts are sizeable. At the moment, we do not have such contracts, not because we are

particularly for or against PFI, but because we do not think that it is appropriate. That situation may change; we review it constantly.

With regard to indebtedness, the amalgamation of the three authorities will have no significant advantages or disadvantages. We basically add up three numbers. As we all raised debt through the same Government facility, the percentage cost of debt for the three authorities will be similar. Although there will be opportunities to refinance certain elements of our debt portfolio, that is a job for the new finance director and will come further down the line.

**Des McNulty:** But, in essence, amalgamation might improve your credit worthiness.

**Dr Hargreaves:** It could do.

**Professor Alexander:** It is worth adding that, as Dr Hargreaves says, the change in the industry's debt will be broadly neutral. However, besides the fact that a bigger organisation might have the kind of advantage that has just been referred to, it will give us a greater opportunity to examine the efficiency of the capital programme across Scotland. That is an important element of the change.

**Des McNulty:** At the time of disaggregation of local government and the creation of local authorities, some functions such as the testing of drinking water did not transfer with the water authorities. Will any such issues arise from amalgamation? I know that it was quite complex and expensive to set up new arrangements to deal with those necessary functions. Furthermore, how are you handling the staff issues associated with the amalgamation?

**The Convener:** Those questions were not strictly supplementaries to Des McNulty's initial question, but we will take them.

**Professor Alexander:** We have already set up a partnership arrangement between the shadow form of Scottish Water and the trade unions in which we will discuss all staff issues that arise from the creation of Scottish Water and the running-down of the three existing water authorities. The first meeting was about three weeks ago and there will be another meeting, which I will attend, on 8 November. Our intention is to make everything available on a planned and timetabled basis throughout the process of transition. On our visits to the three existing authorities, Dr Hargreaves and I have committed ourselves to being as open, candid and clear as possible with the staff and to being available for discussions at all stages.

**Dr Hargreaves:** Every week, the transition team issues a briefing note. Although we are trying to keep people busy, so they do not have time to

think about such issues, we are also doing our best to keep them informed. Part of the problem is that because there is not a lot we can say at certain times—there is no constant stream of good news—people imagine that something is going on when it is not. We are being very honest with the staff. Last week, we announced the headline structure of the business and we have made it clear how we will recruit managers. We are dealing with the issues as openly, transparently and quickly as we can. Other issues on people's minds, such as the location of the headquarters, will be addressed in good time. We do not want to rush such decisions, so we are trying to keep the lid on them.

On the first question, I cannot think of any functions that the new organisation will have that we do not already perform. Although not all the authorities have the same capacity, within the three authorities we have the capacity to do what we need to do.

**Des McNulty:** Are there opportunities for consolidation in some areas?

**Dr Hargreaves:** Absolutely. There are many opportunities for consolidation.

**Fiona McLeod (West of Scotland) (SNP):** I am surprised that, as chief executive designate of a new company, you are saying that you can cope with the debt. I would have thought that this is an exciting opportunity to write off the debt. It has been indicated to us that to 2005 the three authorities will face a total of £150 million in interest charges. If you did not have to meet those charges, what more could you invest in?

**Dr Hargreaves:** I suppose that Christmas comes only once a year, and it is not here yet.

**Fiona McLeod:** You can always ask Santa.

**Dr Hargreaves:** The member is right: it would be delightful to have the debt written off. However, the realist in me tells me that a business has to carry debt and the service has to fund that debt. It is not for me to decide what the Government spends its money on. If Santa landed tomorrow and said that he would write off all our debt, that would be great. The money could be used for investment and we would not have to borrow as much in the short term. However, after a while the debt would be back up at a big figure. Over the next four years we will spend £2 billion, a large chunk of which will come from borrowing. We would not stay debt-free, unless the Government continuously wrote off our debt. There is no free lunch. If the debt were written off, the Government or someone else would have to pay the interest on it. It would not disappear; it would simply move from one pot to another.

It is right and proper that the infrastructure that

we build and use to supply our customers—which requires significant improvements—should be paid for from the service. We provide a water service, not something else, and will continue to do so until a political decision is made to change that. If the debt burden were to become too heavy and we were unable to meet our financial ratios, I would take a different view, but at the moment the financial ratios are satisfactory. Everything is predicated on our running the business in a different way and on our meeting some pretty tough targets. If the business does not respond to that challenge—and I am confident that it will—we may have a problem further down the line, but that would be a problem not of debt, but of management. We seek to ensure proper management.

**Fiona McLeod:** I am conscious that you worked in the private water industry in England. Was that at the time when the debt was written off? What advantage did that give the private water companies?

**Dr Hargreaves:** My career in the water industry was first in the public sector, then in the private sector and now in the public sector again. I have been in and out, as they say.

In England and Wales the private water companies had to be floated—it was not just a case of writing off the debt and sending them off into the sunset. The companies had to be able to pay a dividend. The system was structured to enable them to float, because if they did not float we could not have raised the £40 billion-odd that the water industry in England and Wales has spent in the 11 years since privatisation.

A judgment had to be made at the time of privatisation. In retrospect, I think that the water companies could have floated with more debt than they were given. However, if we were to look at their balance sheets now, we would find that most of them have an indebtedness rate of well over 50 per cent and that will continue to be the case. All the indications are that the framework directive will not stop the industry spending money. A debt capacity is needed.

My previous company could not have floated without a debt write-off. It was so debt-laden that its revenues were just about covering interest charges. Its finances were totally out of balance. Scottish Water is not in that position.

**John Scott (Ayr) (Con):** I want to ask about acceptable gearings and levels of debt. At what figure do you intend to set the company's market capitalisation and its net worth as a business?

**Dr Hargreaves:** That is still being discussed and debated, for a number of reasons. One of the issues is whether it is a straightforward transfer of the current asset value of those companies. It is



clear that a number of people, not least the Inland Revenue, have an interest in that. Some pretty detailed discussions are going on about that so I cannot give you an answer.

**John Scott:** How can you talk about acceptable levels of gearing if you do not know what the market capitalisation is?

**Dr Hargreaves:** At the moment, we are assuming that the market capitalisation will be as it is today, but the detailed discussions will take several months to resolve.

**John Scott:** Would not the synergies that would be involved in joining the companies be expected to increase the net worth of the company?

10:00

**Dr Hargreaves:** A lot of this is to do with how the companies were valued when they were set up in 1996. If that was a correct valuation, the market capitalisation will simply be the net worth of each company added together. There were some differences in the way in which the three authorities were valued. That is taking some time to unravel. We do not want to have to revalue all the assets, as that would take a long time.

As the three authorities come together, some of those assets will be worth less because we will be able to rationalise some of them and may not need them. We are examining that at the moment. There will be a change, but it is not likely to be significant enough to affect market value.

**Bristow Muldoon:** The Ofwat submission that the Executive received states:

"For England and Wales, the comparative data does not show any clear correlation between the size of the company and efficiency; economies of scale in larger companies may be offset by the difficulty of managing more complex entities."

As is obvious, we are expecting efficiencies to be gained through the establishment of Scottish Water. In what way will Scottish Water be in a position to gain from economies of scale without suffering any disadvantages due to the complexity of managing a large organisation?

**Dr Hargreaves:** It is interesting that that comment has been made. When I gave a paper at *The Economist* conference in London last week, almost every chairman and chief executive in the water industry stood up and argued for amalgamation of the companies in the interests of efficiency. Bigger does not have to mean more complex. There is a keen desire south of the border for mergers to take place, not just for shareholder value but because some of the companies are so small that they are as efficient as they can be. Simple factors such as buying power are important in this regard. Scottish Water

would be able to go to the market with £200 million of buying power every year and so would get better deals than if it went with smaller amounts.

When we last gave evidence, and all three of the authorities were independent, we were trying to work out how we would be able to meet the tough efficiency targets. The three authorities had varying degrees of confidence about their ability to do that. I believe that the formation of Scottish Water will allow us to take advantage of scale. It is clearly demonstrable in the market that it is easier to get good prices and guarantee deliveries with a bigger investment programme, which is also cheaper to manage. That is not to say that everything will run smoothly—nothing ever does—but scale generates efficiencies.

In every public statement that we have made, we have made it clear that Scottish Water will not succeed if we end up with a monster-sized headquarters with 1,000 people in it. We are talking about a devolved business that operates close to the customers and the assets. For reasons of economy, we have to have certain facilities and people situated in one place, but the jobs of the vast majority of operational people will not change one jot as those people will still be needed to run the treatment plants and so on. The people running the networks will still be doing that.

We quickly developed the concept that a small headquarters dealing with strategy and policy and comprising about 50 people was all that we needed to manage the business in a devolved way. That means managers getting off their—getting away from their desks—and going where they should be, with customers and employees, not sitting in some ivory tower having great ideas. That is a management style issue, and we are clear about how we will run that.

The business is no more complex—it is just bigger. That simply means that better processes need to be in place to capture financial data, which is one of the early must-dos. A big team of people is working on that today, to ensure that we can add up the numbers on 1 April and can pay people and receive money.

**Professor Alexander:** What we are about is dominated to an extent by questions of efficiency, particularly given the targets that were being set by the commissioner. Jon Hargreaves and I have concluded that, when we are opened up, people will find efficiency targets inscribed on our hearts—rather like Calais on the heart of Mary Tudor. This is also about the effectiveness of the Scottish water industry, particularly in the increasingly competitive climate that it will have to face. Our capacity to do what I think the committee, the Executive and the Parliament would like us to do—produce an efficient and effective public sector water industry in Scotland—

is enormously enhanced, in my judgment, by the scale that the single Scottish Water body will give us. It is important to think not only about the way in which we do things, but about the effectiveness of what we do.

**The Convener:** We need to move on, although I found it interesting to hear about how you envisage the culture of the organisation forming and developing. I would endorse what you were saying about that.

**Nora Radcliffe (Gordon) (LD):** Two of the three questions that I was going to ask have been dealt with, but I will ask a hypothetical question. Can you envisage a situation in which Scottish ministers would have cause to use their powers as provided for in the bill to take any excessive funds that you may hold or that you are not investing suitably?

**Professor Alexander:** "Chance would be a fine thing" is the reply that springs to mind.

**Dr Hargreaves:** That would be a good day.

**Professor Alexander:** The short answer, applying to the short-to-medium term, is no, but one can understand why such a power would have to be included in the act. Looking forward to the horizons that we have in mind, which is to 2005-06 and the strategic period following that, I think that such a scenario would be very unlikely.

**Dr Hargreaves:** If we can build an economically stronger business, two things should happen come the next periodic review. One is that charges will be kept to a minimum. Secondly, the reliance on borrowing from the public sector borrowing requirement should decrease over time. That depends, because one never knows what European directive is lurking round the corner. The water framework directive quotes numbers ranging from £1 billion, a big number, to £9 billion, an even bigger number. Nobody is yet sure what the directive will effectively mean.

Expenditure, however, will fall as we reach the next periodic review. The money that we are spending over the next four years on upgrading our assets will cover 4 or 5 per cent of them; we still have a huge amount of money to spend on that, but we can spend it at a rate that is commensurate with what the market can afford and with what customers are prepared to pay. It is not a one-way discussion, in that customers have a big say.

**The Convener:** We will now move on to the subject of other ventures undertaken by Scottish Water.

**John Scott:** Scottish Water's focus is to maintain and manage its core functions. What criteria will it use to evaluate opportunities to become involved in other ventures, in other words

to become a diversified water company?

**Professor Alexander:** In a sense, Mr Scott has answered his own question. The criterion that I would apply is the question, "Does anything else that we do contribute to our capacity to deliver core functions efficiently, effectively and economically?" That is the test that I would apply across the board.

**John Scott:** Have you earmarked any areas in which you might be able to bring in extra funding to help you deliver a cheaper water service?

**Professor Alexander:** Not in any specific sense at the minute, but if you look at the way in which the industry is developing, the possibility of delivering other things on the back of our relationship with our customers in our core business is something that we will have to look at, but I would still apply the same test, which would be, how does that enhance our capacity to do what we are set up to do?

**Dr Hargreaves:** In some areas we have assets that other people are interested in. For example, we have pipes. The technology to stick cables in pipes is now available. If we can raise revenue by allowing other people to stick a thin cable to the top of one of our sewage pipes, we should consider that. We have the power to do that under the Water Industry (Scotland) Bill, which is right, because the benefits will flow back to customers. In other areas, we have waste water treatment plants with spare capacity. It is sensible to utilise that to the benefit of our customers.

We have argued strongly for commercial powers, not so that we can try to buy companies in England or Africa or anywhere else, but so that we can do two things, both of which are about the same issue. One is the efficiency of the business, the other is the effectiveness of how we deliver the service to customers, which is to our customers' benefit. It is clear that there are other ways that we can explore that.

If we do not have commercial powers, we will be inhibited, which will inhibit our ability to compete. It is not in our minds or the minds of our owners to become a water plc. We are not setting out to take part in the sort of activities that we saw south of the border, where people were losing and making money by buying and selling companies. We need to compete to retain customers and improve the efficiency and effectiveness of the way we deliver the service. That may require us to do different things with our assets and the way we provide the service.

**John Scott:** Given that you will be competing with diversified water companies south of the border to supply water to Scottish consumers—companies that have found it necessary to diversify to make themselves more efficient and

use their assets fully—how can you take a strategic view at this point that you will not follow the same route?

**Dr Hargreaves:** We are following the same route, which is to use those commercial powers to utilise our assets. I do not perceive it happening in the short term, but in the longer term, such as in five years' time, if the new model that we are trying to build is as successful as we all believe it can be, I guarantee that there will be a flood of people from overseas who will want us to help them. I have spent six years of my life trying to sell the privatisation model around the world, because it is missing in the world, but that is for another day, it is not for tomorrow. The temptation may be to start telling other people about the model, but we have not proved it yet. We have to prove it here. Utilisation of assets is what I am talking about, and it is what the plcs have done. Most of the diversification that has succeeded has been diversification overseas, which in this case includes Scotland, in the sense that the plcs have bid for and won PFI contracts.

The lesson that I learned—and I spent 10 years in one of the plcs—is that while significant, but not substantial, shareholder value was created, the benefits came from the commercial acumen that you get when you behave like that and deliver for your existing customers. That is what we can create, what we need to create, and what we will create. If that requires us to go into partnership with private companies, we will do that. If that takes us south of the border because one of our customers wants us to go there to provide the service that we provide in Scotland, we will do that, but we will not buy a construction company to help us do that.

**John Scott:** Do you see yourselves providing electricity or gas or anything like that?

**Dr Hargreaves:** No, not as a supplier. We are examining whether it makes sense to find a way of giving our customers choice, but that choice will come through a partnership, not directly through ourselves. We will not end up owning wires and gas pipes. We may end up having customers who buy water with gas, electricity and telecoms, but that will be done as a retailer with other partners, not by ourselves.

**The Convener:** I need to caution members that we must make progress.

**Bruce Crawford (Mid Scotland and Fife) (SNP):** It is good to hear from Jon Hargreaves that you are not intent on becoming Scottish Water plc, which is what the minister has been telling us all along. I understand what you are saying about how you would use the powers and that you cannot envisage becoming a plc at this stage, but the general powers under the bill would allow the

new organisation to form or promote companies under the full range of the Companies Act 1985 and it could therefore become a public limited company without the permission of Parliament. If that is not the case, can you tell me why?

10:15

**Professor Alexander:** That is not my reading of the bill. As far as I understand it, what is being established is a public corporation, to be called Scottish Water, which could be privatised only by a further piece of primary legislation. I read the general powers to act commercially—if I can use that phrase—as supporting that general policy objective. That is how Jon Hargreaves and I have interpreted it. As we said when we came before the committee previously, we believe that to achieve a working, viable and internationally marketable public sector water industry model we need to have as many ways of doing business as possible. In my view, that does not change the nature of Scottish Water as a public corporation.

I go back to the answer that I gave to Mr Scott. The test is how acting in one way or another supports us in the delivery of our core functions. Hitherto, our capacity to respond in that way has been constrained by the need continuously to seek consent to do things differently. That is what the change will be. It is about the way in which we do things rather than the things that we do.

**Nora Radcliffe:** That is fine as far as it goes and under the direction of the people who are currently in charge, but if the people at the top change and the underlying philosophy changes, could people interpret the legislation differently?

**Professor Alexander:** Not as I read the bill. If the bill in its present form becomes an act, Parliament will have to act again to change the nature of the institution that Scottish Water will be. It would be nonsensical not to concede that the interpretation of the way powers can be used will vary over time. All that I can do is repeat that we will interpret the bill as a way of enabling us to deliver the core responsibilities of Scottish Water and that we need as broad a range of tools as possible, given the climate in which we must work.

**Dr Hargreaves:** At the end of the day, we cannot do anything without ministerial permission. There will be a memorandum that will be quite specific about what we can and cannot do. We do not have access to banks to borrow money willy nilly—we have to do that through our shareholder. The shareholder is accountable to Parliament. It is like any other plc. There is an idea that plcs can just wander off and do things, but there is a whole pile of procedures that they have to go through first. That is absolutely right, because as Nora Radcliffe said, management can change and people can do silly things.

I cannot conceive of any way in which those powers could be misused without Parliament agreeing. Making such a change would require the permission of the Scottish ministers. If the memorandum is not strong enough and Parliament believes that the organisation is misusing those powers, all it need do is rewrite the memorandum and rein us in. However, if we do not have those powers, sensible actions such as sticking wires down our sewers, which could earn us many hundreds of thousands of pounds at no risk to our pipes or our customers, are constantly frustrated. At the moment, we cannot take such action.

**Professor Alexander:** We could not do it without specific consent. At that point the person who wants us to carry out the service with them walks out because they cannot afford to wait six months—they go to someone else.

**The Convener:** The minister has said several times that privatising the industry would require another piece of primary legislation. The situation is absolutely clear in terms of the powers of the bill and any subsequent actions that might be taken.

I worked in the public sector for many years and I know that the power to act commercially is something positive—at the end of the day it is about customers and service. There is also an advantage for the people involved in the service—pride in the service and the fact that they deliver a high quality service that is value for money.

Acting commercially is not bad—it is good. We strive for that. We are aiming for the new public sector model, which I hope will, in 10 years' time, be taken around the world as an example of how to run a water industry in the public sector. That is really the objective of the bill. We have hammered the issue fairly heavily.

Fiona McLeod has a particular interest in regulation issues, which we now move on to.

**Fiona McLeod:** Dr Hargreaves, I was pleased that you said in your submission that you regard the drinking water quality regulator as a positive addition to the regulatory framework. I would like to explore why that is a positive addition to what we currently have. What will the difference be between working with a department in the Scottish Executive and working with the drinking water quality regulator?

**Dr Hargreaves:** It is just a matter of clarity. The present role is carried out in a sensible way. I was pleasantly surprised when I commenced my current job 15 months ago. Elsewhere, the drinking water quality regulator has started to become not intrusive—that is not the correct word—but paranoid about his position in the press and so on, to the extent that he has begun to take some silly decisions.

**Fiona McLeod:** Sorry, is that south of the border?

**Dr Hargreaves:** Yes. The drinking water quality regulator in Scotland will give the customer—the public—absolute clarity of mind. He will protect the quality and safety of drinking water in Scotland on behalf of the Scottish Parliament and the Executive, whether Scottish Water supplies the water or some other provider supplies it. That action is possible at the moment—the existing organisation can do that. The proposed change will just provide absolute clarity. I have learnt that the clearer regulation is, the better it works. When regulation is fuzzy, it tends to fail.

**Professor Alexander:** I agree with that. It is important that a regulator is seen to be independent of the other stakeholders. The bill tidies the matter up and establishes that independence.

**Fiona McLeod:** You welcome the establishment of a drinking water quality regulator with open arms because you think it gives clarity. One of my concerns is that we have already a water quality regulator in the Scottish Environment Protection Agency. Should SEPA be responsible for drinking water quality also? Would that give more clarity? You will have to work with two organisations. Would it be easier to work with one?

**Dr Hargreaves:** I do not think so. Again we go back to clarity of role and purpose. I am not saying that, technically, SEPA could not recruit people and fulfil that role. The point is that if you put drinking water regulation under SEPA, it would always have a dilemma about whether to try to protect a river or drinking water. We had that problem in England, pre-privatisation. The water authorities were effectively policemen as well as gamekeepers. It did not work well. There was always a slight dilemma, for example, when someone was trying to do something with a river for fishing and someone wanted to extract water upstream.

It is better that the way the system is set up separates the drinking water and the customer end from environmental management and resource management. The proposed model certainly does not give us a problem and it has worked well in England, is being copied around the world and was set up in Scotland a few years ago. All we are doing is reinforcing that clarity. I would not merge SEPA's responsibilities.

**Fiona McLeod:** You talked about the possibility of customers in Scotland asking you to go down south to provide their bases there with the services that you have provided here. You said that there are slight problems with the drinking water inspectorate. How will Scottish Water fit into the UK devolved regulatory system? It may

provide services in England under the drinking water inspectorate or go into partnership with non-Scottish bodies in Scotland that are currently regulated by the inspectorate rather than the regulator.

**Dr Hargreaves:** The matter is made simpler by the fact that, fortunately, we are all working to the same European legislation. Parts per million are the same. The ground rules are the same. Prosecution and how the law is enforced is different in Scotland because laws are different—that is the only difference.

The drinking water inspectorate in England is a more mature organisation in that it was set up at privatisation and has developed. However, it works on the same basis. Companies provide it with information and it carries out audits. Over recent years, the inspectorate has learned a lot from prosecutions that it has taken. The way in which evidence must be collected for prosecutions has led it to make decisions that are not terribly sensible in respect of customers' interests, although it prosecutes those who fail to comply. In Scotland, because of the way in which things are set up and how the law works—which is better—things will be different.

I cannot see a problem. Most customers south of the border will want us to save water. We work for customers south of the border and they ask us to help them not to use water. We do not buy water from somewhere else. We intend to minimise waste, we do efficiency studies for them and help them to manage their assets. That may end up with us managing on an industrial site.

**Des McNulty:** One of the spurs to change that you and the Executive have mentioned is the need to avoid the cherry-picking of the most lucrative commercial customers. In previous evidence, I noticed that East of Scotland Water and West of Scotland Water seemed to adopt slightly different strategies for dealing with cherry-picking. What strategies should Scottish Water adopt? What do you think of the powers in the bill? Would they help you to prevent cherry-picking?

**Professor Alexander:** You will find less distance between East of Scotland Water and West of Scotland Water now than a year ago simply because we are responding to the same market pressures. Both authorities and, to a slightly lesser extent, the North of Scotland Water Authority have approached the issue of retaining major commercial customers, which is a key part of what we have to do.

As I think I said when I was before the committee previously, if we lose high volume/high value commercial customers, there will be an immediate knock-on to the charges that will be levied on domestic customers as we must still

manage assets that we would not be utilising to the same extent. We have approached that by a well designed and targeted key account management process whereby we have a continuing, close relationship with our major commercial customers.

Since Jon Hargreaves and I were previously at the committee, there has been evidence that we have stemmed the flow—I touch wood in saying that. We are retaining more customers because we are giving them the service that they want and are guaranteeing that service over time.

My strategic approach in respect of Scottish Water would be the same. We must be customer-oriented across the board. The immediate competitive threat is on the commercial side and we need to remain sharp in managing accounts and having good market intelligence. I do not want to go into detail about that, but we know much more about the market in which we are working than we did a year ago and that helps us to retain customers.

Our capacity to avoid cherry-picking across the board will depend on what Parliament does in the second bill in respect of how access is organised. We need to ensure a level playing field. That means that we have to find ways of ensuring that our allowing any incomer to attempt to penetrate the market is predicated on their paying a fair price for access to assets that we have created. That is the sort of thing that we have to get right in the second stage of the process of change in the industry.

**Des McNulty:** How do you think that the board composition of Scottish Water will take account of those two aspects—protecting the publicly owned nature of the industry and ensuring commercial competence and confidence?

10:30

**Professor Alexander:** First, if we are to have what we might call a two-tier board of executive and non-executive directors, which I think is what is intended, it is important for the defence of the public interest that the non-executive directors are in a majority on the board. Secondly, we need a board that is based on the kind of competencies that will allow that defence of the public interest to be real at board level. We need people who can ask hard, sharp, searching questions of the executive directors and of the other directors, who will not necessarily be on the board.

The process of appointment is, of course, a ministerial one. I have emphasised from the outset that having competencies at board level in such areas as asset management, finance, human resources and customer care is absolutely key. That is much more important than any

representative element.

We need to ensure that we are accountable at many levels in Scotland, and the board will be only one level. I am sure that we will continue to be accountable in the Scottish Parliament—you may have to issue us with a season ticket over the next couple of years. We are happy with that. We will continue to be accountable to the Scottish Executive, but to make that accountability real we need to be sure that the right kind of tough, continuing scrutiny is going on at board level. Those are the criteria that I hope will be applied, and the list of preferred competencies that appeared in the advertisement that the Scottish Executive placed makes that point.

**Robin Harper (Lothians) (Green):** Do you have a view on the retention of the link between council tax bands and domestic water bills?

**Professor Alexander:** Yes, but we have to distinguish between how the charge is assessed and how it is collected. There is a strong case for assessing the charge on a basis that is related to council tax banding, because that is—admittedly in a rough and ready way—related both to usage and to ability to pay. There are other related issues that we could discuss in another context.

I have to make it clear that I doubt whether, in the medium to long term, we can continue to have the arm's-length, intermediated relationship with our customers that collecting water charges with council tax creates. The last time that I gave evidence to the committee, I said that I did not know of any other business that had direct contact with its customers only once a year and in somebody else's envelope. I do not think that we can continue with that.

The difficulties that we have had with charge collection, particularly in the west, point us in the direction of a new way of collecting water charges. It is important to separate how much we want from customers from the question of how we get it from them. I would be perfectly happy to continue with a charging process that is related to council tax bands, as has happened elsewhere, but collecting would be done directly over the next few years.

**Robin Harper:** Would you collect the charges?

**Professor Alexander:** They would be collected in a way that gives us a direct relationship with our customers. I am choosing my words carefully, because the board will have to consider whether that is done directly by us or as part of some sort of joint venture. We need to communicate with our customers continuously rather than once a year. If we do not, it will become difficult if not impossible to provide the kind of customer service that will create a viable public sector model.

**Robin Harper:** What are the financial

considerations of moving to a different method of collection?

**Professor Alexander:** There are ups and downs. If we had a direct customer-management relationship with our domestic customers such as we have with our commercial customers, we would be more likely to achieve the levels of collection that we need. If it cost us more to set up that process, that would be compensated for by the income that we would receive. However, the board of Scottish Water will have to make a decision about how quickly it wants to set up such a process. If we want to do it quickly, a joint venture may be the best option for the simple reason that, if we did it ourselves, it would take three to five years to cleanse the data to a level that would enable us to have confidence in using them. We must deal with the issue in a balanced way.

**Dr Hargreaves:** The water industry commissioner has assumed that, within the efficiency targets, we will considerably improve debt collection, which is far worse in Scotland than it is south of the border. A lot of bad debt is sitting out there, which we must do something about. At the moment we are struggling to improve our position. I note that that is highlighted in the committee's recommendations as something that needs to be targeted. It is. It is part of the WIC efficiency target, and it is clear what we must achieve. However, we are not going to be able to achieve that under the current system.

I return to your question about council tax banding. In England and Wales, probably millions of pounds have been spent in searching for an alternative. However, except where someone has a meter, the equivalent is still used, as size seems to have a rough link. The system is not perfect in that respect, but no system is, except where the customer pays for what goes through a meter.

**Robin Harper:** You have partly answered my next question, which is whether you feel the need for greater efficiency in the collection of the charges. How would you achieve greater efficiency in collecting charges?

**Dr Hargreaves:** Professor Alexander alluded to one of the problems that we face: data quality. The three water authorities bill their commercial customers. The quality of the information that we use to send out those bills—we inherited that information—is poor. In the east, we are conducting what we call a book-to-physical: we are visiting every customer to check that our records are correct. If we sent out a bill according to a record that was incorrect, that would be an invitation to the customer not to pay the bill. It is no surprise that there is mounting debt. We will therefore reassess the record of every property in our region over the next few months.

Once the data are cleansed, we will be able to send the bills out. We will then face the more obvious collection issues with which anyone who issues bills will be familiar. Some customers pay willingly; others do not pay. Public sector organisations are often regarded as the last to be paid, if at all, and we must change that perception by being tougher. We are now being much tougher in situations in which the bills are clean but people are not paying because they do not want to pay. We are cutting those people off. I am talking about commercial, not domestic, customers. We have to go through the whole rigmarole of sending letters but, at the end of that, we take firm action. We only have to cut off one or two customers before the word spreads and people start paying their bills. Non-payers are effectively asking everyone else to subsidise their business, which is not fair, right or proper.

One of the problems that the Scottish water industry has encountered—it is not alone in this—is that it is difficult to get billing right, as billing is not a financial system but a customer management issue. A lot of companies have spent millions of pounds on installing supercomputer systems only to find that they have failed completely. We must get the billing system right and recognise that it is a customer management issue.

**The Convener:** I advise Robin Harper that questions must be short and focused. We need to move on. Perhaps the other issue that he wants to raise can be dealt with in correspondence. Maureen Macmillan will continue on the theme of customers, which is an area that needs to be examined.

**Maureen Macmillan (Highlands and Islands) (Lab):** Although the company will be a public sector company, some of those who have produced submissions—particularly the trade unions—are worried about its lack of democratic accountability. I presume that the customer panels that will be set up will go some way towards alleviating such fears. How much power will the customer panels have over Scottish Water's policy? Will the customer panels be concerned only about service delivery or will they have an input into the company's other ventures? How will the panels interact with the industry?

**Professor Alexander:** First, let me say that it does not feel as if we are not democratically accountable—and I do not mean just at the moment. We know that we will be accountable to the Transport and the Environment Committee. We know that we must keep our owner happy, because the Scottish Executive needs to know that we are doing things right. We feel pretty accountable.

There are issues concerning how we relate to

our customers. An important point is that the customer consultative panels are on the regulatory side rather than on the business side. Both Jon Hargreaves and I believe that the board will have to consider whether another more direct way of involving customers in the planning of the business may be required. However, there is an important distinction between taking seriously what customers say—listening carefully to them and being influenced by them—and the board's statutory and fiduciary duty to manage the business. The board must make well-informed decisions in the knowledge that it takes responsibility for those decisions.

Given the history of the water industry in Scotland—it was first controlled by local government, then control was given to regionalised authorities and now it will be under a single authority—it has become progressively more difficult to be accountable by piggybacking on local representative institutions. To be frank, I have never felt particularly accountable via the 13 local authorities in the west of Scotland. We stay in close touch with those local authorities, but customer contact and contact from the commissioner are much more likely to influence the board. Ways must be found of ensuring that the right kind of representations can be made to the board. However, ultimately the board will be responsible for delivering on the targets that are set.

**Maureen Macmillan:** How do you propose to have the right kind of representation on the committees? How will that work?

**Professor Alexander:** The WIC committees will not be ours but will be set up independently as part of the regulatory process. Jon Hargreaves and I both strongly believe that Scottish Water should be a customer-oriented and customer-facing business, so we may need to find ways of consulting with our customers in ways that will influence the board's decisions. We have not gone further than that at the moment, but we both believe that that will need to be considered.

**The Convener:** Bruce Crawford has a supplementary question on that issue.

**Bruce Crawford:** My question concerns a different issue, so I will ask it later.

**Fiona McLeod:** I was interested in Professor Alexander's enthusiasm to involve the customers in the business side. Is there a way of looking at the make-up of the board? Should the bill require the board to be open to the public and the minutes of its meetings to be publicly available?

**Professor Alexander:** Let me deal with both those questions fairly quickly. Given the numbers that are envisaged for the board and the small numbers that a board requires to be effective, the

difficulty is that making the board representative may cut across the need for the board to be absolutely sharp and competent. Openness is also difficult. We will be a public organisation, so we must be accountable. However, I must keep emphasising that Scottish Water will have to work in an increasingly competitive environment. If we are to build the effective model that we want, any arrangements that we make for openness and accountability must be qualified by the need to avoid becoming less competitive than necessary. That will be a difficult task.

10:45

**Dr Hargreaves:** Perhaps I can help on this question. South of the border, customers were involved as board members. Within two board meetings, those people discovered a problem: board members have absolute and clear fiduciary duties and responsibilities, which will soon include the possibility of manslaughter charges, should the business do something wrong. Customers are not on the board to represent customers; they are there to say, "If you do it right for customers, this is what will happen." They quickly become like every other board member—they have to become just as interested in the finances and the capital programme, as they have real legal responsibilities.

Other mechanisms are required that will allow the board to be properly informed about how customers feel about the services. We must consider carefully how to do that, because we do not want a mechanism that looks good but does not deliver. The best way would be to have everyone in the business focused on customers, as that would produce feedback. I get letters and irate phone calls, and that is the best way of ensuring customer involvement, because those problems get sorted, believe me.

**Maureen Macmillan:** I live in NOSWA's area and so I am aware of the high charges in that area. One of the results of amalgamating the authorities is that the charges will be levelled out. People who live in the north of Scotland are obviously delighted about that. Can you reassure me that significant additional burdens will not be placed on ESW and WSW customers?

**Professor Alexander:** I think that we can reassure you on that point. Although there is no doubt that charges will increase throughout Scotland—the size of the investment programme will ensure that that happens—the increase would be greater if we did not establish Scottish Water. The possibility of geographical cross-subsidy—to use the shorthand term—will be largely eliminated by the efficiencies that will come from the creation of Scottish Water. That is how harmonisation will be achieved. It is misleading to suggest that there

will be geographical cross-subsidy and that people who live in the east and the west of Scotland will bail out those who live in the north. That is not what this is about. If we operate the water industry across Scotland, we will be able to take the inefficiencies out of the business and harmonise charges equitably. If the three authorities had remained, the trajectory of charges would have remained anything but equitable over the next five to 10 years.

**Dr Hargreaves:** Comparable levels of service for all customers are equally important, but that comparison cannot be made at present. The quality of water and the standards of service are different in different areas. One of the clear objectives of Scottish Water is to put in place the same level of service throughout Scotland. That is a tall order, but it is what we are setting out to achieve. That will take time; we do not promise to do it tomorrow because we will not be able to. However, it is just as important as some of the other factors, although it is often missed.

**Bruce Crawford:** Charges are one of the most important issues for customers. However, I guess that most customers are also interested in levels of investment. I am sure that, once the water industry becomes more customer-oriented and can bill customers directly, a lot more questions will be asked about how those bills are made up. The correlation between charges and the investment programme will become much clearer.

I am trying to get my head round the amount of capital finance from revenue. A customer might ask you the amount of capital finance from revenue as a percentage of the overall capital programme. Have you any idea what the current value of that is? If it is calculated on a year-on-year basis, it must have quite a large impact on the level of charges.

**Professor Alexander:** Customers should know where their money is going. Last year, at West of Scotland Water, we customised our one annual communication, which meant that people in Dumfries and Galloway, south Lanarkshire or wherever received a leaflet that told them what we were doing in their area. That represented just a small attempt to communicate in that way. Scottish Water will have to tell people what they are paying, where their money is going and how decisions are taken. If I may, I will answer your other question by correspondence.

**The Convener:** Sure.

Unless there are any other pressing matters, I will draw this interesting session to a close. We remain confident that the public sector model will work for Scotland and will become a beacon example to other parts of the country of how to run a service. You have given us an interesting insight



into the new culture that you intend to introduce. There is a long way to go, and we will keep in touch. Your application for a season ticket has been accepted.

**Professor Alexander:** Is the ticket in the post?

**The Convener:** You will receive it in due course. However, you do not get a discount. Thank you for coming along this morning.

The next witness is Dr John Sawkins, who is also no stranger to the committee. We were hoping to hear from our water adviser, Ian Jones, but unfortunately he is unwell. We wish him a speedy recovery. He will join us at a later date, to be arranged.

We will go straight to questions. As we are still pressed for time and have a busy agenda ahead of us, it would be a help if questions and answers could be kept tight.

**Bristow Muldoon:** My first question is about licensing, which the bill does not cover even though it was mentioned in the initial proposals for legislation. That might be so that the bill can be tied into English legislation. What impact will that decision have on the restructuring of the water industry?

**Dr John Sawkins (Heriot-Watt University):** Are you talking about giving licences to firms that want to operate within Scottish Water?

**Bristow Muldoon:** Yes.

**Dr Sawkins:** It is essential that licensing is introduced as soon as possible. It would not create a level playing field if we placed a huge burden on Scottish Water to jump through all these hoops in order to meet certain standards and then allowed any Tom, Dick or Harry to poach or cherry-pick services without being openly and transparently licensed.

**Bristow Muldoon:** I do not know whether you heard any of the evidence from the previous witnesses. As I said to them, in its submission on the Executive's proposals, Ofwat made the surprising observation that it had not found a correlation between the size of companies in England and Wales and their efficiency and that some economies of scale in the large companies might have been offset by some of the complexities of the organisation. What is your view on that point as far as Scottish Water is concerned?

**Dr Sawkins:** I certainly wrote down that observation. Last time I gave evidence to the committee, I was asked at the start of the session whether I was in favour of amalgamating the three authorities; I replied that the three water authorities should be retained. I am pleased to say that some of Ofwat's evidence suggests that that

idea is not as completely mad as it might have sounded at the time.

As some of the small water supply companies south of the border show, it is not necessarily the case that bigger is better. Many of those small firms have worked well for years and are very close to the people whom they serve. That was the spirit of Dr Hargreaves's response to your earlier question. One of Scottish Water's aims is to get in touch with the people and not, as Professor Alexander pointed out, simply to be in contact once a year through the post. That is what the small firms did well. They were responsive to what the people who turn the tap on wanted. A big firm can sometimes lose sight of that.

South of the border, Ofwat has been successful in focusing big firms' minds on the end user. It has been good at getting those firms to turn themselves round and say, "This is what our job is and this is what we must do well." I was pleased to hear that some of the work that Ofwat has done is in tune with what I said in my previous visit to the committee. Bigger is not necessarily better.

**Bristow Muldoon:** The efficiencies that might be obtained through bringing the three existing organisations into one are part of the justification for the move to Scottish Water. From what you have seen of the way in which the industry is to be structured, do you believe that those efficiencies are feasible?

**Dr Sawkins:** Yes. That is the short answer to your question. Compared with the industry south of the border, the Scottish industry has a long way to go on many issues—a lot of slack must be wrung out of the system as it stands. There have been base cost reductions since the three water authorities were set up in 1996. Those reductions have been large compared to the cost levels that existed under the old set-up. It will be a good thing if the move to a single water authority gives us more chance to wring further inefficiencies out of the system. All the signs that I see or read from the chief executive to be—when MSPs have passed the bill, of course—are good.

**Bristow Muldoon:** I want to consider again the structure and the potential competition from new entrants. Do you think that the structure proposed in the bill is flexible enough to allow Scottish Water to compete effectively?

**Dr Sawkins:** Yes. The flexibility is marked. I was interested to hear what Professor Alexander and Dr Hargreaves said about that. They do not contemplate Scottish Water becoming a public limited company and doing what such a company does. However, as I understand the bill, if they wanted Scottish Water to become a public limited company, it could become one. That is the bottom line. If the chief executive and chairman change,

the new people will be able to do anything they want.

Another concern is that, under the bill, ministers will have an iron grip on Scottish Water. It will be hard for Scottish Water to work at arm's length because, as soon as it makes money, that money will be clawed back; as soon as it decides to invest in something that Scottish ministers do not want it to, the ministers will tell the authority to stop; and when the WIC offers his advice, Scottish ministers can refuse to accept it. Questions about the WIC stand out. What will the powers of the WIC be and what will he do? What is the point of the post? The WIC will be funded by a levy on Scottish Water, which is strange, as he will also be in the pocket of the Scottish ministers. Neither the WIC nor Scottish Water will have freedom to work at arm's length. Perhaps I have offered more than the question asked for.

**Bristow Muldoon:** Your answer was interesting and we must return to the issues that you raise and explore them with ministers in due course.

The final matter that I want to touch on is one of the concerns of staff working in the industry: the impact that restructuring will have on the number of staff employed and the uncertainty of the next period. How do you think the restructuring will affect staff levels in the industry?

**Dr Sawkins:** The short answer is that I anticipate that staffing levels will fall quickly. They should fall fast if we are gain the efficiencies that we have talked about. If one considers the data, the number of employees working in the Scottish water industry when it was under local government control from 1975 to 1996 was pretty steady. In other parts of the UK, south of the border and in Northern Ireland—where the water supply industry is controlled by central Government—the number of people employed in the industry fell. When the English and Welsh water supply industries were privatised in 1989, there was a rapid fall in the number of people employed in them.

11:00

From 1975 to 1986, the Scottish water industry operated under the protective umbrella of local government. Local government was not very good at investing in or at wringing the inefficiencies out of the system. Although that is a plain and bald thing to say, that is how it looked from the outside and I take that view. There is a lot of slack to be wrung out of the system and the numbers of people employed are going to fall quite fast. They need to fall fast if we are to have the efficient, lean Scottish Water about which Jon Hargreaves and Alan Alexander spoke.

**Bristow Muldoon:** Various figures have been thrown around about how many people might be

employed by the industry in future. Can you give us an estimate?

**Dr Sawkins:** No. That is the one thing that we are not good at doing. I can say that the numbers are going to fall and that they should fall fast but I cannot say how far they will fall. They might not fall to the levels per head of population served that exist south of the border, because some of the plant must be replaced. More people might be needed to maintain and run older plant. As plant is replaced, we expect that fewer people would have to be employed to run new plant.

That does not mean that Jon Hargreaves or Alan Alexander is going to come in with an axe and sack people left, right and centre. I was interested to hear about the care with which they want to manage the whole process. However, I do not envisage that the same number of people will be working in Scottish Water in a year—or two or three years—as currently work for the three water authorities.

**The Convener:** We now move on to other ventures. John Scott will lead the questioning.

**John Scott:** I have a supplementary to the last questions. Given all the different groups and interests to which the board must answer, do you think that the model is workable? You seem to have expressed doubt that the model can work.

**Dr Sawkins:** Yes, as a whole, the model could work. A little more work must go into the checks and balances of the system—such as checking on what Scottish Water does and keeping control over the prices it will charge and the level of service that it provides. However, there is no reason why the model as a whole cannot work.

We had a very interesting discussion about levels of debt compared with what will happen south of the border. As Jon Hargreaves said, English and Welsh private water companies are finding it more difficult to raise capital since the last price review. Rates of return have fallen. Ofwat has driven down the cost of capital. Scottish Water is well placed to be able to borrow at lower rates than its counterparts south of the border. For all those reasons, I think it can work.

**John Scott:** Is it plausible that Scottish Water would enter the water and sewerage market outwith Scotland, given the investment priorities in Scotland and the fact that the privatised market south of the border has been in development for 12 years?

**Dr Sawkins:** The short answer is yes, I think it could. In some circumstances, I think that it should. If Scottish Water has the expertise and spare capacity in its system, why should it restrict its work to north of the border?

**John Scott:** This question might already have

been answered, but is there scope in the bill for the Government to invest in Scottish Water's commercial ventures, for example based on the recent equity stakes that the Government has taken in Rolls-Royce? Could it take the form of state aid? Is that a likely development, where the aim is to help the general economic interest, for instance by helping to meet European environmental standards?

**Dr Sawkins:** It is open to the Scottish Executive at any time to inject money into Scottish Water, just as it can take money away if there is a surplus. My reading of the Water Industry (Scotland) Bill is that the Executive could do what you suggest. I am afraid that I am unable to give a more detailed answer than that, because I have not got to grips with the ins and outs of that part of the bill.

**The Convener:** We move now to Fiona McLeod, on the very interesting subject of the water industry commissioner.

**Fiona McLeod:** You have already set us on the trail, Dr Sawkins. It is clear from my reading that Ofwat and the water industry commissioner do not have the same powers. You have made it clear that I am right. Do you think that they should have the same powers?

**Dr Sawkins:** First, I say that yes, they do not have the same powers. Ofwat has been very successful in driving down the charge level south of the border and in wringing out the inefficiencies from the system, and it has benefited in that from being set up by statute and from being at arm's length from the Government. If the companies do not like the price caps that are set for them, they get back to Ofwat and say, "We don't like the price cuts" and Ofwat says, "Well, that's tough." The companies cannot then appeal to central Government ministers: they must appeal to the successor to the Monopolies and Mergers Commission, which is the Competition Commission.

Here, the WIC will be second-guessed every time. Why bother having a WIC? If I were a chief executive, why would I go through all the fuss? I would simply go to the Scottish minister who will make the final decision at the end of the day and ask him or her, "What are my prices going to be, and will you accept the advice of the WIC, yes or no?" I am not sure—perhaps because I missed it in the bill—whether Scottish ministers must ask for advice from the WIC. It is the responsibility of the WIC to give advice, but must Scottish ministers ask for that advice? They do not have to take it.

When the last round of prices was given out, the WIC had a very tight time scale and did a fantastic job—he has done good work in difficult circumstances. I think that I am right in saying that

on the same day that he gave his advice, the Government turned round and said, "No, we are not going to accept your advice", in a one-page letter. That does not give the impression that the Government will listen. It does not give the impression that the Government will take advice and act on it. My concern is that the WIC must be given more teeth in the Water Industry (Scotland) Bill. Otherwise, why bother?

The way that the levy will be applied to Scottish Water means that it will have to pay to have all its plans and figures checked by the WIC. If I were on the board of Scottish Water, I would moan to the Scottish minister. I would say, "Look, I am paying too much for this guy, with all his staff doing this work, which is basically second-guessing me. Let's cut him out, and I'll give you the facts."

**Fiona McLeod:** "We will just deal direct."

**Dr Sawkins:** Yes.

**Fiona McLeod:** In some ways, you could ask why not just deal directly? However, according to section 1(2) of the Water Industry (Scotland) Bill,

"The Commissioner has the general function of promoting the interests of customers of Scottish Water."

Are you saying that if we do not have a strong and independent water industry commissioner, it will be the customer who ends up without a champion?

**Dr Sawkins:** Yes.

**Fiona McLeod:** And would everything that happened to the customer be almost finance-driven?

**Dr Sawkins:** I would not go that far, but if there is no strong WIC—in the way that there is a strong Ofwat south of the border—the consumer, about whom we should be most concerned, will suffer.

**Fiona McLeod:** Could you give us more ideas in writing on how we could strengthen the WIC through the legislation?

**Dr Sawkins:** I can certainly do that.

**The Convener:** I think that John Sawkins is giving us an appetite for our meeting with Ross Finnie when he comes to discuss the issue. We need to examine that matter in some detail, but we shall pursue it in correspondence with Dr Sawkins.

**Maureen Macmillan:** Dr Sawkins, we have heard that you do not think that the WIC has enough powers, and that you believe that Scottish Water needs to stay close to its customers. Do you believe that the proposed water customer consultation panels will be more independent than the current consultative committees?

**Dr Sawkins:** Yes. The proposed water customer consultation panels certainly should be more

independent than the consultation panels as they are currently constituted, because the WIC chairs the present panels. Customer representation should not be in the pocket of Scottish Water, nor in the pocket of the WIC, who will also have an axe to grind. Neither should it be in the pocket of any other body; the Scottish Environment Protection Agency springs to mind, as one of the other options is to attach the panels to SEPA, but it also has its own line to pursue. It is a hard problem to solve. I do not see any simple solution for getting real protection for the individual consumer. However, what the bill proposes is certainly better than what is currently happening.

**Maureen Macmillan:** Do you have no ideas about how the panels should be constituted or elected?

**Dr Sawkins:** I am afraid not.

**The Convener:** You talked about who funds and controls the lines of communication. If the water industry does not fund that, does the Executive fund it? We might need to discuss those possibilities with you through correspondence. I accept your point but, at the end of the day, somebody has to fund, organise and make the system accountable.

**Dr Sawkins:** Absolutely.

**The Convener:** We need to consider the routes by which that can be achieved without a diminution of democratic responsibility. We have opened up an interesting area, which we will have to examine further with you.

**Maureen Macmillan:** Will the panels make Scottish Water close to the public? That is what they are meant to do. Will they be sufficient?

**Dr Sawkins:** They will certainly help. It is better to have those bodies in place than not to have them. However, I do not think that we can get it completely right. If people turn on the tap and good water comes out day in, day out without any trouble, they will not complain or take much of a view on how the water industry as a whole is run. People just want water to be there and to work. If we want to get people enthused, switched on and engaged in the process of bringing Scottish Water to account, we must struggle with that.

**John Scott:** Are you saying that the panels are just window dressing, as the cost of water to the consumer will be a political decision in any case? That decision will be made not by the commissioner, but for political reasons.

**Dr Sawkins:** That has certainly been the case in the past. There is a job to be done, and Ofwat has made a good job of scrutinising the plans of the private water authorities and saying, "You claim that you can cut so much off bills, but we think that you can cut a little more off. You can wring more

of the inefficiencies out of the system." That is a job for a more arm's-length WIC to do.

An independent body, which is not under pressure from ministers day after day to trim, change or tack is required to scrutinise and examine the system. If the WIC was given more powers and was at arm's length from the Government, that would ensure that one of the essential checks was in place. I think that he or she would do a very good job.

**Nora Radcliffe:** I have a question.

**The Convener:** Please be brief, as we are tight for time.

**Nora Radcliffe:** Is there another possible model? You are saying that the WIC could become more arm's-length, more independent and more powerful. Could he also be subsumed into the Scottish Executive?

11:15

**The Convener:** To be fair, Nora, we have said that we will correspond with Dr Sawkins. That would give him a chance to think and give us the chance to consider his detailed response so that we can pursue those matters with the minister. Politicians will always make the decisions, but it is about how evidence, advice and information come to them, what attention they pay to it and how transparent the decision-making process is. We will get detailed information about how decisions are made on all aspects of the water industry.

**Des McNulty:** I have a question.

**The Convener:** What is the subject matter?

**Des McNulty:** It is about customers. The Executive has said that the restructuring will greatly ease pressures on charge levels in the north of Scotland without placing additional burdens on customers elsewhere. Dr Sawkins heard Alan Alexander's response to that question. Do you think that what Alan Alexander said is right? My view is that in reality there is a subsidy to rural areas because it is more difficult to deliver water and sewerage services to those areas. All that we are doing is rebalancing the situation throughout Scotland. Do you agree?

**Dr Sawkins:** Yes. It depends where you place the ring fence around the people that you serve. It is very cheap to serve people in the centre of a city such as Edinburgh and it is very expensive to deliver water to someone in a cottage in a middle of a field 10 or 15 miles outside Edinburgh, yet they are all in the East of Scotland Water region. This is not a north, east or west issue. The point is that it is cheaper to get water to those who live in cities than to get it to those who live outwith cities. I concur with Des McNulty's comments.

**The Convener:** I thank Des McNulty for opening up that issue in the final question. I thank Dr Sawkins for his response, which casts a different light on the issue.

I thank Dr Sawkins for coming along. We will correspond. I never thought that you were mad at any point during your evidence on the previous occasion that you were here. You took an interesting stance on the three-to-one issue, which has been reflected in the discussions that we have had since. Some of the concerns that you raised about merging the three authorities were reflected in our committee report, which the Executive has been given.

I invite the trade union representatives to come to the table.

Is Alex McLuckie joining us?

**Dave Watson (Unison):** He has not arrived. I suspect that there must be a problem with the trains.

**The Convener:** That is okay. We have Dave Watson from Unison and Jimmy Farrelly from T&G Scotland. Good morning and welcome. You have heard some of what we have had to say this morning; I hope that you have found it of use. We are running apace, so I crave your indulgence to go straight to questions. I am sure that in response to questions you can make some of the comments that you might otherwise have made in an introductory statement.

Bristow Muldoon has been our expert on structure, so he will start with questions on that matter.

**Bristow Muldoon:** We have received the written submissions from both unions. Some of the questions that I will ask are on issues that are answered in them, but it will give you the opportunity to put your views on certain issues on the public record.

First, on the structure of the industry in relation to competition, I know that all the trade unions that have an interest in the industry have expressed concerns in the past about the exposure of the industry to competition and to competitive pressures. Are you more confident than you were previously that the Executive's proposals are rooted in a philosophy that is based on a public water organisation?

**Dave Watson:** The bill does not focus on our main concerns about competition. That issue will be addressed by next year's bill, which will focus on the licensing regime.

In relation to Scottish Water, our concerns are accountability and the powers that are being proposed. Those powers are drawn very wide and the board of the corporation can do virtually what it

wants in relation to the structure of Scottish Water. Our worry is that there might be the façade of a public water authority or corporation, underneath which there would be a largely privatised industry in which the services were delivered by private companies. The primary or secondary legislation that sets out the powers of Scottish Water must define more clearly the limits of those powers, especially in relation to structural change in the industry.

**The Convener:** That is an interesting concept. You are suggesting that the organisation could divest itself of aspects of its business through privatisation, and that the iron hand that the minister would have early on would no longer come into play.

**Dave Watson:** The powers in the bill are perfectly clear. The board would have the power to become in effect an enabling authority and all the water, sewerage and other services could be delivered by private companies. There is nothing in the bill to stop that.

**The Convener:** We must pursue such matters with the minister, which is why I wanted to get that point clear and on the record.

**Bristow Muldoon:** Let us move on to the question of the disruption that will occur as the three organisations become one. You were present when I questioned the previous witnesses on the number of staff who are involved in the industry. That is an issue that the unions will have concerns about. How is the move towards a single water authority working? How involved are the trade unions in that process? What impacts will that change have on staffing arrangements in the industry?

**Dave Watson:** When previously we attended the committee, we gave you submissions on the original consultation paper. We were concerned that that consultation paper and previous consultation papers made no mention of staffing issues. The bill is also a little short on mention of staffing issues—no doubt we will come to that later.

In fairness to the new chief executive designate, I must say that efforts have been made to set up an appropriate consultative forum to address what will happen when the current authorities become Scottish Water. The forum has just been established and is meeting this morning in Glasgow. A work programme has also been set out and many of the issues relating to the transfer are being addressed by the trade unions and the transition team for Scottish Water. We are now much happier on that issue than we were a few months ago.

We do not regard the creation of Scottish Water as the major threat to jobs in the industry. The

major threat is the so-called efficiency savings that are being imposed on the industry by the WIC and the Scottish Executive. We have always said that because of the scale of investment in the Scottish water industry—as new plant and new technologies are installed—change in the staffing structures is inevitable. No one disputes the fact that fewer people will be required in the industry as new methods of working are introduced. There will also be economies of scale through having only one Scottish water authority.

All those changes will create natural reductions in job numbers, which can be managed over time. We are not happy about the job reductions, but we can negotiate and deal with those issues. Our concern is that there might be artificial targets—as we regard them—over and above that, which will result in cuts in services. We are also very concerned about the safety of our members and the public following the inevitable shortcuts that will be taken to reach those targets. We believe that there could be a real risk to public safety unless the industry is given realistic targets to meet in a sensible time scale.

**Bruce Crawford:** The required target is about £168 million in efficiency savings. Last year's figures show that total organisational costs for the three current authorities came to about £800 million. Of that, £400 million went on operational costs and £200 million on staffing costs. Most of the operational costs are tied up in issues that relate to long-term contracts, infrastructure spending and issues to do with supply. I find it difficult to understand from where the £168 million in efficiency savings can be found, given that staffing costs are only £200 million.

**Dave Watson:** We do not know where the money will come from either. Given that the water authorities, like any other business, have a range of fixed and variable costs, the steps that can be taken are limited, unless whole sections of the industry are to be closed down. We presume that that is not the intention. Estimates for the efficiency savings range from £100 million and £168 million. Generally the figure of £135 million is cited. Regardless of whether the figure is £100 million or £168 million, that is equivalent to about one third of the jobs in the industry as it is currently structured—about 2,000 jobs. We cannot take 2,000 jobs out of an industry such as the Scottish water industry and maintain the current level of service and public safety. We draw the committee's attention to what happened in Railtrack and the gas industry in Scotland, where shortcuts had to be taken so that financial targets could be met. When that happens, public safety is inevitably put at risk. There is no way round that.

**The Convener:** The chief executive designate and chairperson designate touched on that. I

thought that the focus would be on frontline services. One witness said that guys and girls would still be digging the holes and providing the service to customers, because at the end of the day the customers will remain. You are absolutely right about the numbers, and we need to pursue with the chief executive designate and the chairperson designate how they intend to balance the provision of service with efficiency savings. We are happy to do that. Obviously, you will get to see our stage 1 report on the bill, with their responses to that question.

**Dave Watson:** I assure the committee that there are not 2,000 pen pushers swanning around in the water authorities. The targets that have been set can be achieved only by getting at front-end services.

**The Convener:** I have been there before in another life. I will seek clarification from those who should provide it: namely, the new leaders of the water industry.

**Bristow Muldoon:** I understand the concerns that you have expressed about efficiency targets. How do you view the resourcing of Scottish Water more generally? Is it sufficiently well resourced to meet the range of challenges that it faces, whether to improve environmental standards or to deal with the new competition that might be introduced to the industry?

**Dave Watson:** As far as overall revenue lines are concerned, we supported the middle option in the water industry's quality standards paper, largely because we felt that that was a reasonable figure with which the industry could cope, as regards investment. It would be difficult to deliver the level of investment that opting for the higher figure would have entailed. However, the resources available are determined by the efficiency targets, which remain the fundamental issue.

On competition, we have highlighted in our submission a number of provisions in the bill that would place additional costs on Scottish Water. Were there a genuine level playing field, those would probably not add up to much. However, we make the important point that English and Welsh water companies at a similar stage in their development had their debts written off. As far as we can tell, the bill contains no proposals to write off debt for Scottish Water. We regard a debt write-off as very important if there is to be a genuine level playing field between Scotland and the rest of the UK.

**The Convener:** I welcome Alex McLuckie from the GMB to the committee.

We have raised that issue with our previous witnesses and we came to a considered view on it in our report. Your point is noted. Staffing issues

have always been important to the Transport and the Environment Committee and in our reports and discussions with the Executive we have frequently raised those issues. Des McNulty will continue on that theme.

**Des McNulty:** What do you regard as the main issues in the process of transfer? Pensions are likely to be one, but there might be others that you would like to highlight. What kinds of guarantees do the trade unions want in the transfer process?

11:30

**Dave Watson:** I will highlight three weaknesses in the bill. First, there is a section on terms and conditions in Scottish Water that is a bit muddled. In effect, it says that Scottish ministers will approve a decision that is taken by Scottish Water. In industrial relations, we need to know with whom we are negotiating. Industrial relations jargon puts the question crudely: am I talking to the monkey or the organ-grinder? In the section in question, I am not sure to whom I am talking. That needs to be clarified.

The second weakness concerns pensions. To be frank, the bill contains virtually nothing of any use on pensions. There is a vague section that says that Scottish Water can establish pension schemes. There is a brief note in the explanatory notes that some secondary legislation on that point might be introduced. You will appreciate that staff in the industry do not regard that as good enough. We want clear-cut guarantees on existing pension provision to be included in the primary legislation. That is fundamental.

The third omission concerns transfer orders. In effect, only one section—section 23—says that the Transfer of Undertakings (Protection of Employment) Regulations will apply. That is helpful to the extent that we will not then have a row about whether TUPE applies. Anyone who follows such issues will know that TUPE is subject to constant legal interpretation. I lecture on the subject and change my lecture notes almost weekly, depending on a new decision in England or Scotland.

The section is just unclear. We would prefer something not dissimilar to the provisions in the Local Government etc (Scotland) Act 1994. A full staff commission is not necessary, but the convener will remember the sections in that act that, in effect, only confirm the TUPE provisions. They do not add to the provisions in any serious sense. They make it perfectly clear that certain provisions of TUPE apply to a particular reorganisation. To include such sections would reassure staff.

Jimmy Farrelly will illustrate our concerns with a practical example. The committee needs to

understand from some recent cases how we get into difficulties without such protection.

**Jimmy Farrelly (T&G Scotland):** Without reopening old wounds, I will mention a transfer in April that caused a great deal of controversy. One of our members was subject to a transfer order from a council to a private employer. Unfortunately, the individual fell ill a couple of months before the transfer. At the point of transfer, the company that was taking him over refused to take him, on the basis that, as it said privately, it was stitched up in the transfer order.

The individual came to us a couple of weeks after the transfer. He had applied for social security. He was not getting money from the council and the new employer refused to take him. One of the T&G Scotland officers intervened and managed to get the individual taken back to the council. His pension was protected. If the council had not taken him back, his pension would have been frozen and he would have been forced to go to an employment tribunal to argue either that he was part of the transfer or that he had been made redundant. That happened a short time ago. The grief and problems that the situation caused his family were quite horrific. He was in bad health but had had an excellent record of attendance at work prior to that.

We can generalise on such matters, but we can also bring to the committee specific examples of what happens and the problems that lie within the transfer. It is important that there be statutory provision to ensure that pensions are properly protected in the establishment of Scottish Water.

**The Convener:** I share your concern. I corresponded with the minister about TUPE in the trunk roads contract frequently, although ultimately unsuccessfully. We have experience of those concerns through the trunk roads contracting process. We will bring that experience to bear in our stage 1 and further discussions of the bill.

**Bruce Crawford:** I will ask for more detail on pensions, particularly in light of what happened during the trunk roads contracting process. During that process, it became clear that the Treasury guidance on pension transfer had not been applied. That guidance concerns transfer from public service—in the sense of the civil service—to a private sector organisation. Do you think that it would be useful for the bill to refer to that Treasury guidance as the standard to which Scottish Water must look?

**Dave Watson:** Yes. We have had discussions with ministers, particularly the Minister for Finance and Local Government. Our view is that there would be merit in wider provision than the Treasury guidance, which, as you say, is rather unclear. We would like the Executive to introduce

a Scottish public service pensions bill to cover all those issues. The problem is that every time we deal with reorganisation in the public sector in Scotland, everyone hurries around and devises some new pension provision to deal with the particular circumstances. We would like a public sector pensions bill to deal with all those circumstances and so avoid the need for us to scout through every bill to check that such matters are covered. There are issues around such a bill and we have promised to pull together a proposal as to how it might be done. There are complicated issues around legislative competence and other matters, but we feel that that is the appropriate way forward.

The current issue is that the Water Industry (Scotland) Bill has no pensions provisions and provides no protection at all. We need to include a section that makes it clear that pensions are protected in the new Scottish water authority. There are examples in other legislation that could be called upon, such as the provisions in the Electricity Act 1989 and the Local Government etc (Scotland) Act 1994. We accept that there will need to be administrative changes to pension arrangements because at the moment they are administered by different local authority schemes in different parts of Scotland. We see the merit in doing work on that, but the main point is that we must provide basic protection for staff who currently work for the authorities and ensure that that continues in the new public corporation.

**The Convener:** I hope that the public sector model will encompass that principle. We take your views to heart.

**Des McNulty:** You made a point about negotiating with the water authority but the minister being the decision maker. I suggest that we should be talking about a trinity, as the water industry commissioner is involved in the process, too. What are your concerns about any potential contradiction or limitation in your role given that you will negotiate with only one of the three parties directly? Does that structure imply a trade-off between the customer interest, coming through the water commissioner, and the interest of the people working in the industry, through your representation?

**Dave Watson:** Yes. Industrial relations and bargaining are difficult enough without involving trinities. We talk to the minister and the water industry commissioner. In fairness to the commissioner, he recognises that in a properly managed business, even as is allowed under Ofwat and other arrangements, there has to be provision for sensible terms and conditions, redundancy payments and so on. The current quango structure occasionally results in the situation where our colleagues are bargaining over

terms and conditions and they get to a certain stage when the quango says that the civil service will not let it do certain things. They are then left asking with whom they are bargaining. I need to be able to sit at the table and bargain with the right person—the chief executive of Scottish Water seems to be the logical person to bargain with. I do not want him or her to turn round and say that it depends on someone else, because then I have to stop that discussion and go and talk to someone else.

I understand why the minister wants to include provisions to ensure that there are limitations on that. Experience of the early days of national health service trusts, for example, particularly in relation to senior pay, would be an object lesson to any minister in the importance of not allowing an arm's-length body to have complete freedom. I am quite comfortable with the minister approving a general terms and conditions scheme, but the detailed bargaining within that needs to be left to the people who have the task of managing the industry in discussion with the trade unions.

**Des McNulty:** I have a follow-up question. When the water industry commissioner makes his statements on efficiency savings and projections is he required to have due regard for appropriate terms and conditions?

**Dave Watson:** I heard the questions that you put to the previous witness on the powers of the commissioner. We have no experience of dealing with Ofwat, as it is not a Scottish regulator, but we deal with other regulators, such as Ofgen. Our concerns about the other economic regulators are that they take a short-term view of industry issues. Their viewpoint seems to be "Let's see if we can get the bills down next year or the year after." They do not take a wider view of the economy of the country.

However, major infrastructure regulations, such as for gas, electricity, water and so forth, are fundamental to Scotland's economic future. Our concern has always been that the economic regulators do not take that into account. They say explicitly that social or other consequences are not their responsibility. In the past, we have had this debate with UK ministers. That is why the regulator, in this case the WIC, should have a particular responsibility to take those issues into account. We are concerned about the range of potential powers and how they might be interpreted.

However, we would not support an extension of the role of the WIC to one that is closer to that of Ofwat or Ofgen. Experience tells us that ministers need to take account of those wider issues.

**Fiona McLeod:** Your reply leads neatly into my question. You heard what Dr Sawkins said about



the WIC. You said that you do not support widening the powers, whereas Dr Sawkins said exactly the opposite.

You referred to the WIC as an economic regulator. However, section 1(2) sets out that:

“The Commissioner has the general function of promoting the interests of customers of Scottish water.”

Could we not ensure that the WIC acts not just as an economic regulator but in the interests of customers? In your submission you suggest that in an increasingly competitive environment the WIC could be seen to be promoting private companies. I immediately wrote a margin note to ask whether that provision would allow the WIC to work harder for the domestic customer not just in terms of charges as, in Scotland, the domestic customer is still concerned about water quality. The WIC should look at customer interests as well as at the economics. Would you consider widening the powers of the WIC?

**Dave Watson:** That could be done. Our experience of dealing with other economic regulators, which has been long and painful, tells us that it will not work in that way. The reality is that the big commercial organisations lobby the economic regulators effectively. They get their message over in a way that domestic customers, who are diverse, find difficult to do. Greater powers can be given to the WIC, but the commercial organisations will use the WIC—whether he likes it or not—to promote their own interests.

There are also wider concerns about what the true role of the regulator is. Issues such as the economy of Scotland and social exclusion, which are political issues, quite properly are within the remit of the Scottish Parliament. As such, they should not be siphoned off to an economic regulator.

I am always wary of creating bodies that give ministers the opportunity to hide behind other groups—not that I am suggesting that they would do such a thing. However, in the past, that has happened. When tackled on issues in the electricity and gas industry, ministers have often said, “That is not for us, gov—it is for Ofgen or Ofel, or God knows who else.” Those wider issues are the responsibility of ministers. It is for ministers to ensure that they keep up to the mark on them.

**Fiona McLeod:** If the water industry commissioner is not going to become the champion of the customer, do we have to look at customer consultation panels for that?

**Dave Watson:** Yes.

**Fiona McLeod:** I understand that you have some comments to make about the panels. I

agree that it is an extraordinary power for the panel conveners to appoint members of the panels. I am not sure whether we have time for this now, but I wonder whether you could give us an introduction and perhaps a follow-up on an alternative model for setting up those customer powers, which bring about a much more democratic and closer relationship with the customers. I have grave concerns—although I will not tell you the comments I wrote down, which were rude. I think that we have gone about this the wrong way, from the top down instead of from the customer up. Could you explore that?

**Dave Watson:** Frankly, if my trade union or that of any of my colleagues wrote a rule book along those lines, I am sure that we would be up in court with the trade union commissioner. The idea of me, as a senior official, being able to say who sat on all our union committees would be a nice power to have on occasions, but I do not think that I would get away with that.

The issue of panels is not of direct concern, although we acknowledge the customer's role as very important. Staff in the industry live and work in their communities; the water industry is particularly closely tied to its community, because water is not delivered from some central ivory tower. Whatever staff in the water industry do, the bulk of them are out there in their communities, delivering water and sewerage services. They are concerned that those communities have a say. I think that some bottom-up organisation has to be built up, and the organisation should not be able to remove or not appoint people who may not always articulate convenient points of view. To give one person that authority seems extraordinary. I am happy to consider the point.

There are other models. It can be ensured that people come from a range of representative, community-based organisations to participate in such groups, which then tend not to depend on the patronage of one or more people for the views that they express.

**The Convener:** I will perhaps have to write to Ofdave to get the solution to that question—but that is another matter entirely. At this point, I will close this brief but very interesting evidence session, which, combined with the written evidence that witnesses have supplied, gives us plenty of issues to raise with the minister in future. I thank my colleagues from the trade unions for coming along.

11:46

*Meeting adjourned.*

11:50

*On resuming—*

## Budget Process 2002-03

**The Convener:** I reconvene the meeting, although that means that at least one other member will have to join us while the minister makes his opening statement. I apologise for the delay. The committee has set itself a fairly massive undertaking and has lost some time. I appreciate that the minister has a pressing engagement and must leave us at 12.15. It is useful that that time scale is externally imposed, as that will ensure that members obey it. If we do not pursue some matters with the minister, I am sure that we can correspond to clarify issues as we have done before. Does the minister wish to make an opening statement?

**The Minister for Environment and Rural Development (Ross Finnie):** No. Perhaps there was some confusion between the clerks and my office. It was not entirely clear what would be discussed—the range of subjects seemed broad. We did not narrow the definition of the discussion. However, given the time scale, it is preferable anyway that we proceed straight to questions. I appreciate the difficulties, but I think that you share my view that it would be enormously helpful if the committee narrowed the scope of the discussion, as it would make such exchanges more valuable and productive.

**The Convener:** The committees and the Executive continue to work hard at making the budget process more effective. I hope that, as the years go on, we will do that. I appreciate the minister's comments. We share that view.

John Scott will ask about foot-and-mouth—an issue that we raised in correspondence.

**John Scott:** Does the minister have up-to-date figures on the impact of foot-and-mouth in Scotland and its effect on Scotland's rural economies? Is the minister taking mitigating measures, particularly in the farming sector, which has suffered greatly this year?

**Ross Finnie:** As the member knows, I am taking such measures. I am with the Transport and the Environment Committee today, but I was with the Rural Development Committee yesterday, and I now think that I had my papers in reverse order.

The figures that have been provided continue to be current. We have not allocated further funds, but we are in constant touch with the two groups of bodies in Dumfries and Galloway and the Borders. We have people who are covering the impact throughout.

As the committee knows, Dumfries and Galloway Council and Scottish Borders Council submitted recovery plans to the Executive. Some elements of those plans had different time scales. Dumfries and Galloway's plan was slightly more comprehensive and had elements with long time scales.

Officials in my department are in close touch with various bodies, because matters do not centre only on the local authorities, the local enterprise companies and the tourist authorities. My understanding of the reports that I receive is that we continue to make satisfactory progress with all the parties involved. It is slightly surprising that that is a question not only of money, but of finding in difficult times some projects that need that resourcing.

I am also conscious of complaints, which I heard when I was down in Dumfries and Galloway, that some of the money was being directed far too much into paying for supervisory advice, rather than going direct. I have taken that criticism on board and we are ensuring that the answer to a person's question is not, "Please speak to a consultant," but that funding goes to genuine projects that need it. I do not have total figures on that matter with me, but I am happy to provide the committee with them later.

The impact surveys, however, have been printed and are on the Executive website, but I do not know the web address. I hope that you will forgive me for that, convener. We will continue to ensure that the impact surveys are put into the public domain.

Regarding the actual progress in Dumfries and Galloway and the Borders, our approach is to stay right on top of the groups that are carrying out those recovery plans. I am well aware that progress is slow, particularly in the tourism industry, and is not being helped by other world events. Regarding whether we are alert and alive to that issue and whether it will change our judgment, the difficulty is that, as you know, we allocated substantial sums of money across the Executive, not just out of this department's budget, to deal with tourism promotion. I have no doubt that Wendy Alexander and her team are looking closely at where that money should be best spent in what are now dramatically changed circumstances.

**John Scott:** In the light of those dramatically changed circumstances, do you not envisage a need for a Scotland-wide recovery plan? Adjoining areas are being affected.

**Ross Finnie:** We in Scotland think dearly of different areas, such as the Borders and Dumfries and Galloway, but the first point for the tourist is whether they will come to Scotland at all. The

strategy must be, first, to get tourists to come to Scotland before one sells the next part of the package. The recovery plans, therefore, apply Scotland-wide.

The money that I have given to Quality Meat Scotland is purely and simply to try to restore consumer confidence in the red-meat industry. I believe that doing it that way will have an impact from the northern tip of Shetland to the southern part of Wigtown. One has to approach it that way to restore consumer confidence. There are elements that involve us in looking at the local plans, but there are also areas of Scotland-wide expenditure, particularly in tourism and in the livestock sector.

**The Convener:** We need to be careful about straying into other committees' responsibilities and areas. The Enterprise and Lifelong Learning Committee and the Rural Development Committee come to mind. We must be conscious of that and of the fact that we have fairly limited—

**Ross Finnie:** I am not responsible for asking questions.

**The Convener:** Absolutely. My remarks were addressed to committee members, not to the minister.

Fiona McLeod has a follow-up question on renewables.

**Fiona McLeod:** Again, there might be a bit of crossover.

**The Convener:** We will listen closely.

**Fiona McLeod:** We received a letter from the Deputy Minister for Environment and Rural Development, Rhona Brankin, in reply to some of our questions about renewables. We understand that it is her responsibility, and that of the Scottish Executive, to promote renewables, but that the Department of Trade and Industry, which is responsible for energy, provides a lot of the money.

I have questions about some the comments in Rhona Brankin's letter; I will come to the specific one about the wind farms in the Solway later. The deputy minister says that the Scottish Executive

"is supporting the work being done by Highlands and Islands Enterprise on the development of a Marine Energy Test Centre in Orkney."

How is the Executive supporting that work?

**Ross Finnie:** We support it in the sense that we supply almost all of Highlands and Islands Enterprise's essential expenditure and in the sense that we have made it clear to all the enterprise agencies that environment and energy are among the expenditure elements that they should prioritise. I suppose that that support is

slightly indirect.

Fiona McLeod has put her finger on one of the essential difficulties: we have the role of promoting such projects, but the funding for their research and development has been retained at the Department of Trade and Industry, which is responsible for energy. I make no bones about the fact that that split is slightly awkward. The way in which the renewables obligation has fallen out is that it drives us to consider some of the cheaper forms of renewable energy. There is nothing wrong with that—we need to do more of it—but we also need some of the more complex elements. We have an interest in being involved and in expressing our wish to promote renewables projects, and we are making it clear that, if we get such applications across our desk, we will give them priority.

12:00

**Fiona McLeod:** If the application comes across your desk?

**Ross Finnie:** We are a single department; Ms Brankin and I do not sit at the other end of an office—

**Fiona McLeod:** I do not mean your desk; I mean the environment desk.

**Ross Finnie:** Ms Brankin acts as my full deputy; there are matters for which she has day-to-day responsibility. However, at the end of the day, I am the Cabinet minister and Ms Brankin enjoys the luxury that, if she gets it wrong, I get sacked. I have to read all the correspondence and be well aware of what is going on in my department. That is how departments are run.

**Fiona McLeod:** Perhaps I can put it differently. The applications come to the environment department, but you do not have a budget line that allows you to put money into those applications.

**Ross Finnie:** We could. Take wave energy, for example. If the promotion of wave energy required assistance through the marine energy test centre, it is my department that would consider giving additional assistance from our budget. It is important that we are involved in such projects, even if they are being run in co-operation with the enterprise agencies. There are other agencies—I simply cite the marine energy test centre as an example.

**Fiona McLeod:** Where in your budget would that assistance come from?

**Ross Finnie:** It would have to come straight out of the environment line. We are not necessarily talking about huge sums of money; we are talking about assisting a range of projects for which we have allocated sums.

**The Convener:** I am conscious that we are dealing with a specific area. You will have time to reflect and correspond with us on those matters, minister.

**Ross Finnie:** Fiona McLeod is looking for an answer to her question about which budget line assistance for the marine energy test centre would come from.

**Fiona McLeod:** And how much you would have to give.

**Ross Finnie:** That would depend on the request, but I will take the generality of that.

**The Convener:** That would be useful. We move through the budget process in interesting ways. We are as concerned as you are, minister, about the need for focus. I hope to get greater focus now, because we move to questions relating to the water industry, which will allow us to pursue some areas that are relevant in legislative as well as budget terms.

**Bristow Muldoon:** Given that the minister has not had notice of my question, he might not be able to answer the detail of it, but we still wish to explore the general principle.

Between the publication of the annual expenditure review and the draft budget, there have been a small number of changes in the environment budget. One such change that we have noted is that, for 2003-04, there is a reduction of £10 million in the planned funding of water. Is that reduction generated from some of the planned savings that will be achieved in the water industry as part of the Water Industry (Scotland) Bill? Does the Executive expect to benefit from those planned savings or will the savings all be retained in the water industry to keep costs low for consumers and to improve the competitive position of Scottish Water?

**Ross Finnie:** To deal with the first question, the adjustments were all part of what any Government must do, which is to make difficult choices in reordering priorities, particularly in relation to health and other departments. Every department and every minister had to review where they were. On this occasion, we had some flexibility in examining the levels of accounts in the water industry—I will ask Mike Neilson to deal with that.

The situation was slightly exceptional. We have to hope that we can contain the level of increases in charges and try to reduce the total amount of public spending. That will not be easy to achieve, but we will have to try to do it. At least, we have to provide that, on a revenue basis, we are allowing the full capital programme to proceed.

**Mike Neilson (Scottish Executive Environment and Rural Affairs Department):** In terms of the capital spending and surplus of the

water authorities, the assessment that was made was that, given the decision to set up Scottish Water and the growing efficiency expectations, we should expect to see a flat profile of public spending. That means that the public spending for 2003-04 will now be flat, compared to 2002-03.

**Bristow Muldoon:** Obviously, many of the efficiencies that are being put in place are designed to prepare the industry to be able to compete effectively against new entrants to the market. Is there a danger that the fact that the Executive's budget is benefiting from the efficiencies to the tune of £10 million this time could act as a handicap to Scottish Water?

**Ross Finnie:** I hope not. When setting charges, we are required to set out a number of factors, such as the quality and standards that we expect from the industry. Ministers have to retain the ability to set out the water quality that they expect to be achieved and that will be one of the advantages of having the new company under public control. Once that is set out, ministers must decide what the necessary capital investment would be to deliver that quality, which might be the same as or more than the existing level of investment. Following from that would be the difficult juggling act of the setting of charges and public expenditure.

That all has to be dealt with in any review of strategic charges. It is crucial that the first element is not forgotten. Clearly, if someone else were in charge, that element could be eliminated but that is not what we want to happen so a compromise must be struck to square the circle. However, the quality standards must not be compromised. I cannot withdraw money as it suits me; that could be done only if all of the objectives that are involved in providing water at the highest possible quality and the most competitive price had been met.

**Maureen Macmillan:** I have two specific questions. I will understand if the minister cannot answer them today and would rather answer them in writing.

The financial memorandum to the Water Industry (Scotland) Bill states that transitional costs of between £3 million and £5 million are anticipated and that the Scottish Executive will propose funding of £3 million by way of a budget revision this autumn. From where in the Scottish budget will that money come?

**Ross Finnie:** It will be contained within the total amount of expenditure allocated to the water industry.

**Maureen Macmillan:** The financial memorandum implies that the Scottish Executive will limit transitional funding to that one-off grant. Is that correct? It is understood that there will be

savings from the sale of property and reduced waste costs if Scottish Water is created. Will those savings be created after other transitional costs have been incurred?

**Ross Finnie:** Yes and no. We have to remember that two things are happening.

The process of examining and trying to respond to the level of performance within the water industry was started two and a bit years ago, with the report of the water industry commissioner. That report set challenging targets and suggested that the water industry in Scotland had not progressed at a pace that was consistent with the rest of the United Kingdom and elsewhere. The three companies are working to meet some of the targets that were set by the water industry commissioner. As the member knows, the companies got together and decided that the only satisfactory way of meeting those targets was to have a shared resource. That decision led to the discussions on creating a single water authority.

There are already obligations on the water industry to make savings. We expect some of those savings to be made in the transitional period. I accept wholly the point that we will not be able to deliver on the total quantum of those savings until the three companies have been put together.

**The Convener:** Bruce Crawford will ask his question next. We are running short of time, so the question will need to be short and sharp, as will the response.

**Bruce Crawford:** It will be, convener.

I refer to the letter that the minister sent to the convener on 12 October and draw the minister's attention to the page on which what I take to be the signature of one of his staff appears. I am intrigued by the terminology and by the effect that the water authorities' profit has on the budget. The letter states:

"The reason why the DEL total for the Environment Portfolio is lower than the Capital Budget is that the Water Authorities' profit has a negative effect on the Resource Budget."

Will the minister explain that to me? The terminology is unusual and I do not understand how there is a negative effect on the resource budget. Perhaps that will have to be explained in writing.

**Ross Finnie:** My expert in resource accounting is sitting next to me. You and I will both hope to understand his answer, Bruce.

**Michael O'Neill (Scottish Executive Finance and Central Services Department):** Another way of understanding the figures is by seeing them as profit surplus. That surplus is taken away from the £513 million for water in the resource budget,

leaving the aggregate departmental expenditure limits for water of £302 million. That is how the water authorities' profit has a negative effect on the resource budget.

**Bruce Crawford:** The figures do not refer to £10 million as a surplus; they refer to about £300 million. I am having difficulty following the correlation between the £10 million that we were talking about a minute ago and the surplus of £200 million, which has an effect on the overall capacity of the DEL budget that we are now talking about.

**The Convener:** Are you talking about the difference between £533 million and £398 million?

**Bruce Crawford:** The official was talking about the difference between £533 million and £201 million.

**Ross Finnie:** There seems to be confusion here. Even I have spotted the fact that we are talking about a capital budget, not a revenue budget.

**The Convener:** Okay.

**Ross Finnie:** I ask Michael to clarify.

**Mike Neilson:** Two basic figures appear in the DEL. One is the size of the capital programme of the water authorities. The second is the surplus that they generate on their operations. The £500-odd million is the capital programme figure; the £200-odd million is the surplus that they generate.

The logic of resource budgeting is that the surplus that is generated by the use of public sector assets cancels negative public spending because it is not the consumption of public resources—money is being put back into the pot. It should be emphasised that the internally generated surplus is less than £200 million, compared to an investment programme of more than £400 million. The difference is finance from borrowing, as was discussed earlier.

**Ross Finnie:** The whole question of resource accounting is not helping. It might be helpful if the convener and I were to discuss whether a detailed briefing could be given on resource accounting. Members will not be able to perform their function properly and ask ministers the questions that need to be asked if they are having difficulty with the terminology and the way in which RAB differs from conventional accounting.

Perhaps the clerk and Mr Neilson could arrange a briefing, if that would be helpful to the committee. It seems to me that the process is not being helped by a change in accounting methodology, which is not easy for those who are unfamiliar with accounting terminology.

12:15

**The Convener:** We have discussed that in the past. We are in a dark room and not finding each other. We need to ensure that we understand each other's way of doing business. That applies to the overall budget process, in terms of how we interrelate with the Executive.

A briefing on RAB is taking place at lunch time today, which many members will attend. In addition, it would be useful to have those discussions with you, minister.

**Ross Finnie:** Members of the committee have a legitimate task to perform. If we simply do not understand the basics, we will not get a clear understanding of where we are.

**Bruce Crawford:** I have heard the explanation, but it seems that £200 million less capital will be available to the water authorities. However, from the minister's reaction, I can see that that is not the case.

**The Convener:** It would be worth corresponding on that specific point.

**Ross Finnie:** The offer of a briefing is genuine. I recognise what the parliamentary committees ought to be doing and they should be doing it on a basis of knowledge, not of ignorance.

**The Convener:** I am happy to take up the minister's offer. It is a good offer and we will discuss it.

As you have to leave now, minister, we will correspond with you on our other questions. We will also take up your kind offer of a further briefing on the RAB.

I welcome Sarah Boyack, the Minister for Transport and Planning, and her officials. Do you have an opening statement or would you like to go straight to questions?

**The Minister for Transport and Planning (Sarah Boyack):** I am happy to go straight to questions. I know there were other issues following on from the first set of answers.

**The Convener:** We continue to have a fairly tortuous budget process. If you speak to Ross Finnie later, you will find out how difficult it has been for us. We strive to get clarity from the Executive with regard to priorities and budget allocation, but we are not yet getting there. I hope that we will do a bit better in this session.

**Des McNulty:** Can you identify how we may begin to understand your process of prioritisation between competing projects and priorities within your portfolio? An example would be the publication of the annual expenditure report and other budgetary reallocations in the Scottish Executive. Will you explain how that process takes

place and how we can track it and the way that budgets are put together and transmitted to us?

**Sarah Boyack:** I suppose that the strategic roads review is one of the major exercises that the Executive has carried out since it was established in 1999. We had five key criteria for deciding which road projects it was appropriate to proceed with. If you remember, we started off with a list of 18 projects. From that list, we prioritised five roads on the basis of the policy indicators of safety, integration, environment, economy and access. We weighted those different policy objectives and had a fairly thorough analysis of all the road projects.

At the time, the northern extension of the M74 came No 1 on the list, but it did not get the go-ahead in 1999. Subsequently—after the last spending review, when I received more money for the transport budget—I was able to prioritise that road into our roads programme.

For each budget, there is a process of setting priorities. In the past year, we have published our Scottish transport appraisal guidance—STAG—which lets us begin to evaluate across different modes of transport. Historically, we have always prioritised within modes of transport. On the technical side, that helps us with a clear set of policy objectives, which flow through from the programme for government and give us overall objectives. Within the different budget lines, we have measurements that let us prioritise projects.

I hope that that gives you a sense of how, practically, we prioritise projects and policies.

**Des McNulty:** I have two follow-up points. A lot of the criteria are set in generic terms. Clearly, they are translated into quantifiable measures in your department. Is there any intention of beginning to show what kinds of criteria are applied and what kinds of quantifiable measures are used in establishing policy priorities?

The second issue is how the weighting between the priorities is set out. On the face of it, when different kinds of criteria are applied and different kinds of judgments are made, it can be difficult for people to track through the process to find out how decisions are finally arrived at.

**Sarah Boyack:** It is probably fair to say that that requires some effort. For example, an awful lot of supplementary information came out on the strategic roads review, which gave a sense of how we thought through the different projects.

I was just talking to Bob Tait to enable the committee to discuss the STAG approach. We consulted on STAG over the summer and have now properly published it. If the committee wanted to follow the issue of privatisation another step forward, it could do so. The most recent project

that we used STAG for was the Larkhall to Milngavie railway line. We used our traditional value for money indicators, as well as the policy choices that are set out in STAG for evaluating a major project—so we have started to apply STAG in day-to-day decision making. Following that up might help people to get a better sense of how we arrive at such project decisions.

**Des McNulty:** I think that would be helpful.

**Fiona McLeod:** End-year flexibility follows on almost directly from that.

Last time you came to the committee you said that end-year flexibility applied to worthwhile projects. We would like to hear what criteria you use to determine which projects deserve end-year flexibility.

**Sarah Boyack:** The Minister for Finance and Local Government sets the overall objective that the projects must be worth while. They must also be deliverable. We have to look across the transport policy objectives for developments that we would like to take place. I refer to the announcement on the Caledonian MacBrayne ferries that I made yesterday. That was the kind of project that fitted those criteria perfectly. It was a high policy objective for us to improve lifeline ferry services and two new ferries were needed, so that fitted the bill for an EYF bid.

I understand that the Minister for Finance and Local Government will issue the full list of EYF projects in November, which will show the range of projects that have come through that process.

**Fiona McLeod:** STAG is your set of criteria, which you apply to your budget. Do you apply the Minister for Finance and Local Government's criteria to determine suitability for EYF or do you use the STAG criteria and then the EYF criteria?

**Sarah Boyack:** Effectively, we use both. A project must meet our transport policy objectives as well as broader objectives for the whole of the Executive. A project is not guaranteed EYF support just because it is my No 1 objective. The top transport objectives have to be evaluated across the Executive.

**The Convener:** That sounds like "STAG-EYF" criteria.

**Sarah Boyack:** Please do not.

**Mr Murray Tosh (South of Scotland) (Con):** I am aware that the department has done a lot of work on appraising the existing route action plans for trunk roads and that a lot of schemes are being re-evaluated. What happens when you bring in the new appraisal guidance? Will all the appraisal work that has already been carried out have to be revisited, or is the recent system of assessing projects broadly compatible with the new STAG?

Does the new system make that much difference?

**Sarah Boyack:** Bob Tait might want to answer in a bit more depth. My understanding is that projects that have previously been through the policy process and been approved at the other end will not be re-evaluated, but new projects will be assessed under the STAG process.

**Bob Tait (Scottish Executive Development Department):** That sums it up. There will not be a fundamental reappraisal of work in the pipeline.

**Mr Tosh:** So if something is approved, it will remain in the framework for possible implementation. Presumably, prioritising means determining a running order within specific RAB programmes and using STAG to select projects on a year-to-year basis.

**Bob Tait:** STAG will have most effect on projects such as those that emerged from the transport corridor studies, such as the A8 transport corridor. Those projects will be assessed from first principles using STAG.

Some of the schemes from the route action plans are fairly modest and we will not seek to go back to first principles. For any new work, which will include the next round of public transport fund bids, STAG principles will be applied.

**Maureen Macmillan:** I want to ask a few questions about Highlands and Islands Airports Ltd.

The events of 11 September meant extra security, even at small Highland airports. Did HIAL have to absorb the extra security costs or was it able to access another funding stream for such emergencies?

**Sarah Boyack:** That is a detailed question that I will have to get back to you on. I do not know whether HIAL has asked us for extra grant support for that. Such a request has not crossed my desk. It would be best to ask for a specific answer in correspondence.

**Maureen Macmillan:** I also wanted to ask you about the economic role of HIAL. You will be aware that one operator has called for special treatment on airport charges from HIAL. Although one operator cannot be given preferential treatment, what scope is there in the HIAL budget for providing economic development by supporting airlines that want to come into Inverness?

**Sarah Boyack:** I think that HIAL is keen to talk to airlines, particularly budget airlines, to examine new services that could operate in and out of the HIAL airport network. Sandy Matheson is keen on new developments and there are opportunities—which are budgeted for—to attract new companies. It is a question of making sure that those companies align with the available

opportunities. I know from discussions that attracting new business, whether for passengers or for freight, is high on HIAL's agenda—the company is examining the issue carefully.

**Bristow Muldoon:** My question is a general one on the future of the ScotRail—or rather, Scotland's passenger railway—franchise. At what stage and how do you envisage engaging the Transport and the Environment Committee and the Parliament on the longer-term commitments that will be involved in any new franchise, which might extend for another 15 or 20 years? That will involve the Executive in spending commitments for a long period.

The original round of franchising was based on the existing network, or on having 85 per cent of the existing network guaranteed as part of the franchise. I would expect a new franchise in Scotland to expand services—I imagine that that is the minister's and the Parliament's aspiration—and that that expansion would incur financial costs. How will that process work between the Executive and the Parliament?

12:30

**Sarah Boyack:** There are two elements to that question. First, the figures are not in the current budget round that takes us up to 2003-04. As, based on current estimates, the ScotRail franchise will be replaced in 2004, a new approach will have to be made. There will be parallel discussions on the spending review in the Scottish Executive next summer and our continuing discussions with the Strategic Rail Authority on our overall priorities for rail expenditure. Secondly, when we get further on with the ScotRail franchise, we will be keen to ensure that the committee is played into that whole issue.

**The Convener:** As members do not have any other questions on the budget, I thank the minister for attending this meeting. I appreciate the specific nature of the questions on which you will get back to us. I do not therefore expect a response on every aspect of the budget. We look forward to your correspondence.

Our next step will be to consider the terms of our response to the Finance Committee. We will consider that draft response at our meeting next week, when a draft report will be issued to members. Does the committee agree to consider the draft report in private?

**Members indicated agreement.**

## Subordinate Legislation

### Building Standards (Scotland) Amendment Regulations 2001

**The Convener:** Item 6 on the agenda is the Building Standards (Scotland) Amendment Regulations 2001 (SSI 2001/320). I see that Murray Tosh does not want to stay for this item—I cannot think why. This negative instrument was laid on 24 September 2001. The time limit for parliamentary action expires on 14 November and the committee is required to report by 12 November.

The Subordinate Legislation Committee considered the instrument on 2 October and agreed to raise some technical points with the Executive. They related to a typographical error and whether the Executive is planning to consolidate the regulations. The Subordinate Legislation Committee reconsidered the instrument yesterday and was content with the Executive's response on those technical points.

Do members have any questions or comments that they wish to make?

**Fiona McLeod:** Is the Executive going to consolidate the regulations?

**The Convener:** I did not receive the detail of the Executive's response, but the Subordinate Legislation Committee was happy with it.

**Fiona McLeod:** I shall read the *Official Report* of the Subordinate Legislation Committee.

**The Convener:** We will inform members of the Executive's response when we receive the *Official Report* of that meeting.

Are we agreed that the committee has nothing to report on the instrument?

**Members indicated agreement.**

**The Convener:** I advise members of the press and public that we are now moving into private session to consider the appointment of an adviser for our inquiry into aquaculture.

12:33

*Meeting continued in private until 12:45.*



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