

TRANSPORT AND THE ENVIRONMENT COMMITTEE

Wednesday 14 November 2001
(Morning)

Session 1

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TRANSPORT AND THE ENVIRONMENT COMMITTEE **28th 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)

WITNESSES

Ross Finnie (Minister for Environment and Rural Development)

William Fleming (Scottish Executive Environment and Rural Affairs Department)

CLERK TO THE COMMITTEE

Callum Thomson

SENIOR ASSISTANT CLERK

Tracey Hawe

ASSISTANT CLERK

Alastair Macfie

LOCATION

Committee Room 1

Scottish Parliament

Transport and the Environment Committee

Wednesday 14 November 2001

(Morning)

[THE CONVENER opened the meeting in private at 09:52]

09:59

Meeting continued in public.

Water Industry (Scotland) Bill: Stage 1

The Convener (Mr Andy Kerr): Good morning. I welcome everyone to this meeting of the Transport and the Environment Committee. I have received apologies from Adam Ingram. Des McNulty is on a train and will join us when it comes in. I welcome Bruce Crawford, who has taken part in many of our deliberations on the water industry.

We had a very successful meeting in Aberdeen on Friday. This is our final evidence-taking session on the Water Industry (Scotland) Bill. The man for that job is Ross Finnie, the Minister for Environment and Rural Development. I welcome Ross and his officials, Mike Neilson and William Fleming.

I am happy for the minister to make an opening statement. We are tight for time, as is the minister. If the opening statement is brief and to the point, we will get straight on to questions from members and will proceed through the business as timeously as possible.

The Minister for Environment and Rural Development (Ross Finnie): Good morning. I noted the convener's interesting comment in his introduction that the committee had had a very successful meeting in Aberdeen. The inference to be drawn from that is that I have to try to maintain that high standard.

I will make a brief statement in which I will address two issues that have been widely canvassed: section 25 of the Water Industry (Scotland) Bill and pensions.

I am encouraged that there is broad agreement, including in the evidence from the committee's hearings that we have read, on the need for a public sector water industry that delivers to the

customer a high-quality service at a fair price. The bill tries to meet that overarching objective.

Part 1 of the bill confirms the role of the water industry commissioner. That is good news for customers. They are the people on whose behalf the water industry commissioner works. He is there to set a standard, review the industry from the perspective of the customer and act in the customer's best interest.

On part 2, we have been concerned that drinking water quality regulation needs to be put on a statutory basis. That is desirable, not because drinking water quality regulation is a problem—quality has been improving to a great extent—but because it is in the interests of customers, Parliament and the industry that the arrangements are statutory rather than informal.

Part 3 is the major part of the bill. We have received endorsement of its provisions from many with knowledge of the industry.

It is interesting that the water industry commissioner's advice on charges made it clear that, without the move to Scottish Water, charges for all customers throughout Scotland would have to increase. We hope that Scottish Water will be better placed to meet all the challenges that we face and that, in particular, it will protect the interests of the consumer by delivering the highest possible quality at the most efficient price.

I know that some people have expressed concern about section 25, which they consider to be back-door privatisation. The structure of Scottish Water is being created by primary legislation, so it can be dissolved only by further primary legislation.

I will make two more points on the scope of Scottish Water to become a virtual utility. Scottish Executive strategy is not to pursue the wholesale outsourcing associated with the Welsh Water model, in which—as members will be aware—there are only 140 employees. However, it would be dangerous to impose in legislation restrictions on Scottish Water's scope to enter into other forms of partnership. The proposed arrangements are not dramatically different from the current scope of the three existing authorities.

The second point is on the issue of wide-ranging powers. The crucial point is that those powers will be balanced in section 49 by the duty of ministers to issue directions on the exercise of Scottish Water's powers. Therefore, serious diversification can take place only if ministers and Parliament wish it. I assure the committee that such diversification is not what the Executive intends. Draft directions that I will present for consideration at stage 2 will make it clear that Scottish Water is only being given the powers necessary to enable it to serve its customers efficiently.

Finally, as I indicated to the convener by letter, I am keen to place on record my intentions regarding pensions. I appreciate the fact that the bill talks about the Transfer of Undertakings (Protection of Employment) Regulations applying only to other ordinary conditions. Under section 23, TUPE does not necessarily apply to pensions. For the avoidance of doubt I will, under section 24(3)(b), introduce regulations with the effect of providing the equivalent TUPE protection in respect of pensions. I hope that members of the committee will accept that I have clarified that position by putting it on record.

Those are the principal points, convener. I am aware that time is precious and that the committee wants to ask questions rather than have me dupe them out of that by going on for an overly long time. I see that I am getting a warm smile of approval for that statement from Bruce Crawford.

The Convener: Is he a warm and smiling assassin? We will find out soon.

Thank you, minister. That deals with many of the key issues that we have been discussing.

John Scott (Ayr) (Con): What is the time scale for the competition element to the industry? Why was the licensing scheme, which was discussed in the Executive's most recent consultation, not included in the bill? Does the Executive intend to license Scottish Water as well as new entrants for activities that concern the provision of water and sewerage services to customers when the market is opened up to competition?

Ross Finnie: I make the fundamental point that I took the committee's report seriously. I read it with great interest and bore it in mind. The committee pointed out that the issue was the creation of Scottish Water as a matter of principle and the question whether we should introduce in parallel the licensing regime to deal with the competitive elements. The strong recommendation of the committee was that we should separate those two matters. I regarded that as sound and that is the decision that I have taken. A simple water industry bill—I choose my words carefully—is before the committee.

The further bill, which has been announced in the legislative programme, will have two distinct parts. One will deal with the water framework directive, which concerns the environmental side. We will also use that opportunity to introduce the requirements for the competition regime. I take the advice of the committee on that. Also, given the cross-border activity, it will be important to have a better idea of how it is proposed to deal with that matter in England. I did not wish to expose the fledgling Scottish Water to that complication. I have therefore taken the committee's advice and that is why the two matters are separate.

We are deferring decisions on the kind of licence and the competitive element. Members might agree that there is enough substance in the bill to be getting on with.

John Scott: In essence, you have set up a water company that looks like a private company, in many ways acts like a private company, has many of the powers of a private company yet does not have private investors and has its risks borne by the taxpayer. What is the difference between that company and a fully privatised company and why did you not go the full way?

Ross Finnie: Scottish Water is fundamentally a publicly owned company. The Executive and I have a strong view that even when we have the competition element, the use of the network is a quasi-monopoly. I am opposed to private monopolies—I do not see any benefit to them. The public has an interest in dealing with monopoly provision. There are solid, sound and fundamental reasons why water should remain in public hands.

However, I am not daft. I acknowledge that I have to achieve a balance. I have a duty to ensure that customers, who are the people who vote to put everybody in Parliament—not everybody, I apologise to officials—get the highest possible quality at the most effective price. I have to ensure that we have responsibility and accountability, through the Scottish Parliament. We also have to be responsive to both domestic and non-domestic customers. That is why I am suggesting that we have a new form of consultative panel.

I am seeking to create a publicly owned body that has enough commercial freedom to do the job, which is accountable to Parliament and which is responsible to its customers. Those three abiding principles govern the shape and direction of the bill.

John Scott: Do you believe that a public monopoly is likely to deliver cheaper water more efficiently than a private one?

Ross Finnie: Where there is a monopoly, there is potential for abuse. It is right that the public, through Parliament, should control that abuse. Abuse is a potential risk. I do not believe that the private sector should exploit a monopoly for the benefit of a narrow range of shareholders. I want the people of Scotland to receive a high-quality service at the most competitive price.

John Scott: What will be done to ensure that investment does not decline after the reorganisation? It has been suggested that such a decline happened after the previous reorganisation of the industry. Will Scottish Water have the power to borrow more money than the combined amount that is available to the three authorities?

Ross Finnie: There is no question about borrowing powers. The statement of what we want to achieve is clear. In his most recent review, the water industry commissioner asked within which framework he was to operate. The crucial response that I gave was to set out my expectations for the quality of water service and sewerage service provision and the investment that is required to meet them. The key is that ministers set the standard—we cannot do that but not provide the investment.

We are committed to a £2 billion programme in the next four years. Do not ask me to provide details of that as, obviously, there are pluses and minuses. That figure was not just plucked out of the air; it was arrived at by a considered view of how to get water services to the requisite standard and how to improve the sewerage and environmental conditions that are under the control of Scottish Water. I have no intention of changing the directions to Scottish Water in a way that would lower standards, so continued investment will be required.

Bruce Crawford (Mid Scotland and Fife) (SNP): I am encouraged by what the minister said in his opening statement. I have read the letter that he sent to you, convener, about section 28 and how far the single authority will be able to go towards privatisation. I look forward to the material that the minister intends to produce at stage 2, which I hope will be a comfort to many people.

As the minister knows from earlier material, I have tried to tease out the issues of borrowing and its links to investment, charges and capital finance from revenue.

Ross Finnie: I have seen the extensive correspondence with the water authorities.

Bruce Crawford: We received a letter from West of Scotland Water, which shows that its programme for this financial year is split 50:50 between capital finance from revenue and capital raised from borrowing—£96 million is from revenue. That has a direct effect on charge payers. We also have the figures in the 500-page document that the WIC published on Monday. I have not managed to read it all, although I tried to—it was late before I got to bed.

Ross Finnie: There is a summary.

Bruce Crawford: I have that. The document details total borrowings and total levels of investment. By my reckoning, there is more than £507 million of capital finance from revenue, which has a direct impact on charge payers. The figure may be higher than that if one considers the current profile of capital as compared to borrowings. At a previous meeting of the committee, I discussed the matter with Ian Jones, who was an adviser to the committee on the

inquiry into water and the water industry. At the end of his deliberations he said:

“I agree with your point.”—[*Official Report, Transport and the Environment Committee*, 31 October 2001; c 2189.]

He agreed that—

The Convener: What is your question? You must get to the question.

Bruce Crawford: I realise that, but the issue is important because of its impact. Before I ask the question, I must ensure that people understand where I am coming from. The system of capital finance from revenue has an impact on charge payers and the investment programme. Would it not be a better strategy to allow money to be borrowed over a longer period of time? That would allow the necessary investment in the water industry, but keep charges under control.

Ross Finnie: That is a matter I have wrestled with at some length. I do not wholly agree because we have to take a view of the charges and debt levels of any structure. We are close to the point where, if we consider the total revenue generated, we have a little leeway for the next three or four years. The figure of £2 billion represents a substantial investment. As Bruce Crawford knows, there were write-offs when the existing authorities were created. I am not persuaded that borrowing is the key to driving down charges.

10:15

We cannot make the investment disappear. Even the investment is going to have an element of debt and there has to be a balance. The water industry commissioner reported that a sustainable level of charge would be achieved by operating more efficiently, particularly in the management of assets and overheads.

Significant parts of the water industry commissioner's report are devoted to the balance of debt, debt charges and the total make-up of the charges that are passed on to the consumer. It is certainly not the water industry commissioner's view that all that can be achieved by increasing borrowing, because that would leave the industry open to interest charges.

There has been quite a bit of analysis and it is a very serious point—Bruce Crawford is right to raise it. However, I am not persuaded that borrowing is the way to achieve the necessary balance. The company must have regard to its total borrowings. I do not think that any entity, even if it is publicly owned, can ratchet up its borrowings. There have to be returns.

The Convener: Ian Jones's evidence has been raised. He also said:

“the financial models on which the single authority was

projected show that there will be no difficulty at all in servicing the debt. It will be important to continue to monitor the clear revenue and cost sensitivities in the model.”—*[Official Report, Transport and the Environment Committee, 31 October 2001; c 2188.]*

Ross Finnie: Was he saying that there would be no difficulty in servicing the debt even if it increased?

The Convener: Yes. He was considering the projected cost structure of how the models would work and he said that servicing debt is normal and doable, for want of a better word. That evidence from Ian Jones is relatively recent so, arguably, he backs up your point about what can be done to increase the investment and maintain the balance between revenue and capital.

Ross Finnie: We have been assuming an increase of £500 million of total debt. The issue is very important. We have discussed it and I appreciate that Ian Jones is the committee's expert on the matter. It would be helpful if I responded to Bruce Crawford's question in writing and drew on our evidence. I am not saying that there is an argument, but it might be important to set out the basis on which have discussed debt with the water industry commissioner. We need to see whether we are talking apples and oranges or whether there is a closer relationship.

Bruce Crawford: I do not suggest that all charges can be controlled by reducing capital financed from current revenue—CFCR—and relying entirely on borrowing. I recognise that there is a role for efficiency savings and will come back to that later. Last year alone, West of Scotland Water spent £96 million through CFCR. All that we will save by way of efficiency savings is £168 million. In terms of the scale of what can be achieved, there is more scope in CFCR than has been recognised. I ask the minister to bear that in mind when he is deliberating on the issue.

The minister referred to interest charges. Interest would be paid over a 30 to 40-year period. Given the life of the infrastructure, that is a normal borrowing process.

The Convener: I am sure that the minister will deal with that issue.

Ross Finnie: That is a fair question.

John Scott: Looking back at Ian Jones's evidence, I think I am right in saying that the acting chief executive gave the committee similar evidence about an acceptable level of borrowing. The minister might wish to examine that evidence.

Ross Finnie: Yes.

John Scott: I think we all accept that the creation of a single water authority will lead to a period of upheaval. Will the resources available to establish Scottish Water be sufficient to meet the

environmental objectives and efficiency targets and to develop a competitive focus?

Ross Finnie: We believe that those resources will be sufficient. We have been fortunate in being able to establish a group to co-ordinate the integration. You have put your finger on it, John. The real trick in effecting a merger is to bring together, with the least dislocation, three disparate organisations with different cultures, backgrounds and operational styles. As you rightly suggest, there is an imperative there. We have had extensive discussions with those engaged in the process. Resources have not been an issue—we have reviewed what is required and have not been told by those engaged in the task that they are being starved of resource. My team is cognisant of the fact that any merger can be difficult—you need only read about what happens in the commercial sector. I was involved in that kind of thing in my past life—this job is so much calmer. We are cognisant of the dislocation that can occur in such circumstances.

Bruce Crawford: In the policy memorandum it is clearly recognised that annual savings of between £100 million and £168 million—which I referred to earlier—are achievable. At the previous meeting, the commissioner said that savings of £130 million were achievable. How much detailed work has gone into examining how much of that is realisable?

Ross Finnie: The work is high level, but from a very detailed base. I regret to say that you will have a few sleepless nights because of this. If we consider the level of detail that the water industry commissioner goes into, it is at a high level—he does not go down into departmental level. He does a lot of mathematical and econometric modelling of the performance of what he believes to be broadly comparable companies in the UK. He studies incidence and variations where he believes that savings can be achieved in the delivery of the different services.

I have had extensive meetings with the water industry commissioner and can assure you that he is very confident—probably more than I am—about the savings that can be achieved. The projection of savings is not just a view expressed by the water industry commissioner. It is the result of a fairly detailed modelling exercise. I was a bit critical of the length of the report, but we need the level of detail that the WIC has gone into. That is where you will find the substance. The WIC is not just saying, “I think it would be better”; he is saying, “Here are comparators of where we stand. Here are the differences and, if we operate efficiently, in the interests of the consumer”—which is the driving force for the water industry commissioner—“this is what I believe can and should be achieved.”

The Convener: Your last hurrah, Bruce.

Bruce Crawford: That was very useful. At the previous meeting, the commissioner was clear, in an answer to Fiona McLeod, that the specifics that you have described were an issue not for him, but for the managers of the water companies.

Ross Finnie: The WIC will have done that comparator econometric modelling and said "I can't see any difference at a high level."

The Convener: Let us get this question nailed.

Bruce Crawford: We are discussing efficiencies now. Most efficiencies in most organisations are driven out by staff costs. We have an organisation that costs about £800 million a year; staff costs are about £200 million a year.

If the commissioner has not done the work on the number of staff that could be lost, as he said to Fiona McLeod, has the Scottish Executive worked out the number of job losses that will result from the efficiency savings? Somebody somewhere should be doing that work and coming up with a figure that everyone can begin to recognise as sustainable and real, as the loss of jobs will be quite substantial.

The Convener: To be fair, the Aberdeen meeting was a long one. As I recall, the WIC and the water authority chief executives also said that there were a number of issues involving investment, resources and the use of bids and capital equipment.

Ross Finnie: Absolutely. It is not a single issue. This is the WIC's second report. It was the WIC's first report that highlighted the fact that the present configuration of the water companies simply could not deliver what he was asking for. At present, the individual water companies are, as the convener said, examining what is required in asset management and efficiency, where the management weaknesses are in managing an organisation of that size and what manning efficiencies are required.

Discussions have already opened up. The three water companies have already indicated their desire to achieve those aims without resort to compulsory redundancies. The trade unions have been in collective discussions with the three companies and are talking about perhaps 1,000 jobs being at risk over the transition period.

Bruce Crawford: A thousand jobs?

Ross Finnie: That is not news. That figure has been in the public domain and has nothing to do with Scottish Water. That was discussed even before I assumed ministerial responsibility for water. The real trick is how we achieve the other savings, rather than putting the whole burden on to manpower savings. That is what would happen

if we were to go down the same road as the Welsh Water model.

The Convener: We have a vast wealth of knowledge on these matters, because we have raised the same issues with every witness we have had. We have a lot of business to get through.

Bristow Muldoon (Livingston) (Lab): My first question concerns the structure that you have decided to go for—a single public corporation. Other possible models have been examined, and I want to ask about the co-operative model, which the committee considered in the water inquiry. As you will be aware, some people in the community and some MSPs still think that that model is worth examining. Did the Executive consider that model as an alternative?

Ross Finnie: We have had a number of meetings about that model. With a more co-operative or mutualised model, public ownership can be retained, but the debt has to be moved out of the block to someone who is prepared to lend.

If an external lender is looking at a company that, according to the external regulator, is operating at inefficiencies of around £130 million and is properly placed in the market, the company will not get a credit rating that suggests that it is a goer. If there are criticisms that the assets are not being managed properly, or as well as they might be, that is not good news for an external lender either. All the evidence suggested that we had a big job to do and that, if we wanted to protect Scottish Water in the public sector, we had to create it in the first instance as a publicly owned company. The question of having recourse to external finance was not really a starter, given the perceived or actual performance of those companies in their present state.

Bristow Muldoon: The committee's overall position agreed with the public corporation model that the Executive is pursuing.

I will move to pensions, which you addressed in your letter and in your introductory remarks. I welcome the commitment that you have given today to introduce regulations to guarantee pension rights for staff in the water industry. Could the committee be provided with draft regulations before the bill is passed?

Ross Finnie: It is extremely important that I made that commitment on the public record. Such a statement by a minister has serious implications. This is a committee of the Parliament, so by making a commitment to the committee, I make a commitment to the Parliament.

We hope to have the regulations before the bill is passed, because the committee should also have other regulations by stage 2. The financial

management memoranda and other items should also be provided. Much work has to be done. We will do our best to provide the regulations before the bill is passed, but I cannot put a time on when they will be ready. The documents will have to be produced, but I am not sure whether I can provide the regulations. That commitment is now made to the Parliament.

10:30

The Convener: The earlier, the better, for us. If we have the documentation at stage 2, that will allow us to lodge less detailed amendments. I appreciate that other pressures come from the overall bill. We will correspond with the minister on the matter.

Bristow Muldoon: In what situations does the Executive expect to use its power to take back excessive funds or funds that are not being invested properly? If there are no examples, why is the power in the bill?

Ross Finnie: The situation would have to be clear. The definition of surplus returns us to my answer to an earlier question. The job of ministers—whoever they are—is to set standards for achievement. Those standards go wider than simply financial standards. Water quality is the key factor and environmental objectives will also have to be set.

No funds are surplus until all those obligations have been met. However, if those obligations were met, it would not make a great deal of sense to have Bristow Muldoon shouting at a minister that we should invest more in such-and-such a project, when money that was not being used to meet Scottish Water's objectives was sitting in Scottish Water.

The tests are that we do not use such powers to reduce the quality, the standard and the objectives that are set for that management and that we do not try to fudge the situation. The clear role of Parliament as scrutineer is to ensure that that does not happen. I have no intention of doing those things, but you are considering the long run. As long as we set out clear objectives for Scottish Water and make it accountable to ministers and to Parliament, those difficult and awkward questions must be asked in Parliament. If ministers tried to use sleight of hand, I imagine that one or two members would be alert to that.

Bristow Muldoon: What scope does the bill provide for the Executive to invest in some of the commercial ventures that it has been said Scottish Water might become involved in?

Ross Finnie: We must learn to walk. I do not wish to give directions about engaging in non-core activities. It is imperative that the putative management performs. Whatever the shape of the

board, it must show its consumers and Parliament that it can perform. I am not anxious to give directions that would allow the company to divert its energies into non-core activities.

In my previous life, I believed greatly in sticking to the knitting. Scottish Water has a job to do in the next few years discharging its key functions. The directions that we will give it will relate to its core activities, which are defined in section 60(2).

The Convener: Following Bristow Muldoon's question, we were going to move on to Scottish Water's core activities, but you have indicated that you will correspond on the directions you can issue and the powers you have.

We will move on to matters relating to the environment and sustainability, in which the committee has several interests.

Fiona McLeod (West of Scotland) (SNP): Section 47, on environmental matters, comes under the heading "General duties". Is that an appropriate place for environmental matters to appear in a water bill? Should those matters not be up front—at the start of the bill? How do we ensure that Scottish Water works in a sustainable fashion? Will Scottish Water be asked to produce evidence that it has in its annual report and, if not, how will the company be measured to ensure that it adopts acceptable working practices in relation to sustainable development?

Ross Finnie: There are two issues. The prospective legislation for the water framework directive is clearly an environment bill. I regard the environment as an extremely important aspect of my responsibilities, but we must remember that the core function of the company will be to provide water and sewerage services. That is not to downgrade the importance of the environment, but it would be rather odd if the environment was the core concern. What is important is that we have incorporated a section in the bill specifically directed at environmental issues. I would be interested to know whether any previous minister has inserted in legislation anything like section 47(4), which says that Scottish Water

"must, in exercising its functions, act in the way best calculated to contribute to the achievement of sustainable development."

As Minister for Environment and Rural Development, I am pleased that that is in the bill. I cannot possibly have drafted that, but it sounds like something I said. To embody that in a bill is a serious commitment; frankly, it should be in more bills. It places a serious obligation on Scottish Water.

Fiona McLeod: Will you clarify why Scottish Water will not be asked to produce an annual report on its environmental and sustainability work over the previous year?

Ross Finnie: Reporting is not necessarily best handled within the body of a bill. We are examining the financial and reporting requirements and will produce those in the regulations. That is an obligation on the Executive. If Scottish Water has to report on the wider discharge of its functions, it is logical that it should also have to report on its discharge of section 47(4).

Fiona McLeod: So you are saying that the requirement will appear in the guidance.

Ross Finnie: That would be logical.

Fiona McLeod: That being the case, will you give examples of circumstances in which section 47(5) would apply—in what circumstances would it be inconsistent to require sustainable development?

Ross Finnie: There is a difficulty. If there was a major accident, it would be invidious to argue that environmental obligations had to be met in dealing—perhaps over a longer period—with that accident. Any service provider that has underwater carriers always has a problem in consistently dealing with all the environmental and sustainability issues. There must be some leeway, but that must be the exception rather than the rule. The clear obligation in section 47(4) is the primary obligation that Scottish Water must discharge. My view is that any reporting by Scottish Water must include all the matters that it is statutorily charged with discharging.

Maureen Macmillan (Highlands and Islands) (Lab): The bill states that the principles of sustainable development—

Am I on the right question?

The Convener: Number 14.

Maureen Macmillan: The question is on the Scottish Environment Protection Agency. I was so busy working out everything I was going to say that I missed the place.

When we took evidence from SEPA in Aberdeen, it expressed concern that although Scottish Water might achieve rates of return on capital investment, that would not necessarily mean that the projects from which there would be the most environmental benefit from such investment would be prioritised. In other words, the easy schemes would take precedence over the schemes that were necessary, environmentally. How can you ensure that decision making on capital investment is focused on environmental outcomes?

Ross Finnie: Your question raises two issues. First, we directed the water industry to set out its expected quality and standards—indeed, those were the governing criteria for the water industry commissioner. As a result, the position can be

reinforced through those criteria. As Fiona McLeod pointed out, we will not always achieve the perfect solution, but—although I cannot give an absolute guarantee on this point—if there is a quality and standards obligation and an obligation to meet certain environmental standards, the water industry will have to square how on earth it makes those matters priorities, given that the duties are statutory.

Maureen Macmillan: SEPA also raised the interesting issue of the social dimension. The organisation was particularly worried about sewerage in rural villages. It felt that, despite the fact that there are places where better sewerage would be of great social benefit, it was not being provided because it was either easier or more lucrative to deliver facilities elsewhere. SEPA thought that there should be special Government support for sewerage schemes that bring social benefits to a particular area. Do you have any comments on that issue?

Ross Finnie: I will make a couple of very important points. In paragraph (b) of section 46, we make specific provision for people who

“are ordinarily resident in a rural part of Scotland.”

I am absolutely committed to the principle that the bill should allow people in Scotland to have equal access to an equal service. Although that will not happen overnight, that provision ensures that we will not opt out of remote rural areas. To do so would simply be unacceptable. The water industry commissioner believes that everyone will benefit from the introduction of Scottish Water, but the requirement, duty and obligation on the authority should—and will—provide considerable comfort for people in remote and rural areas.

Maureen Macmillan: My next question, which is about the drinking water quality regulator, centres on the European convention on human rights. Although the evidence that we have taken on that aspect of the legislation is broadly favourable, it was pointed out that section 8(3) provides protection for persons regarding disclosure of confidential information—I know that that follows Court of Session rules—but that section 9(5), which concerns power of entry to premises, makes it an offence to refuse to provide the regulator with information. Furthermore, there is no protection against self-incrimination in criminal proceedings, which creates something of a discrepancy with the Environment Act 1995. What is the reason for the omission? Are you convinced that the bill is ECHR-compliant?

Ross Finnie: Those are two quite complex questions. We were aware of ECHR problems when we drafted the section. After taking separate advice, we believe that section 8(3) is ECHR-compliant.

I will ask William Fleming to respond to your question about section 9(5), because I think that a distinction must be made between the collection of information and the point that you made.

William Fleming (Scottish Executive Environment and Rural Affairs Department): Sections 8 and 9 focus on getting to the bottom of water quality problems. There is a distinction to be drawn between collecting information to rectify something in practice and collecting information for prosecution purposes.

Given the importance of public health, the intention here is to try to move the balance towards the collection of information, even if it is recognised that having been collected, the information will not subsequently be used for a prosecution. The information will be used to allow people to identify what is wrong and remedy the deficiency in practice.

Maureen Macmillan: Are you saying that the information could not be used in a prosecution?

William Fleming: Yes. The collected information would probably be inadmissible in a court because of ECHR implications, but it would still be useful for the regulator to have the information so that he could go about ensuring that the problem did not arise again.

Maureen Macmillan: I see the distinction.

We understand that the regulator is to have operational independence from Scottish ministers. How can you ensure that that happens? What mechanisms exist for it to happen? Will you explain the difference between your relationship with the regulator and your relationship with the water industry commissioner?

10:45

Ross Finnie: The first distinction I draw is between the regulator, wearing his hat as a regulator, and—I choose my words carefully—ordinary civil servants.

The Convener: Is there such a thing?

Ross Finnie: Ordinary civil servants cannot come to decisions without ministerial approval. The regulator can do that; he can ignore me. That places him in an interesting position, but it is the right position to be in. If that individual believes that, given the information that they have, action needs to be taken, it would be absurd if the minister could make a decision on different criteria, such as pressing cost. That is the fundamental difference and we believe that, by making the distinction, we have taken a slightly different route from that taken elsewhere.

Although it is a modest change—you could argue that we should set up an entirely separate

and independent body—it is sufficient. It means that someone has the requisite information, has access to do what is required to be done and can take those actions speedily. Giving that position statutory underpinning is a substantial advance in protecting public health. I hope that it removes ministerial interference in matters of public health.

Fiona McLeod: You say that you want to give the regulator a statutory basis, that you want to move from the informal position and that the regulator can say no to you in a way that a civil servant cannot, but that he will still be placed in the civil service within your department. What consideration did you give to other locations for the drinking water quality regulator? I am thinking of the Food Standards Agency, which was mentioned last week, as it is involved in public health regulation.

Ross Finnie: The slight difficulty with the Food Standards Agency is that although we have a branch in Scotland, we do not have a Scottish food standards agency. The Scottish water authority will be controlled by the Scottish Parliament, so it is appropriate that the drinking water quality regulator should be part of the Scottish process. The situation should not be confused by there being a cross-border organisation.

Secondly, it is certainly possible to debate whether professional integrity and independence are achieved only if an organisation is in a separate building in a separate town, but I think that that is unnecessary. It seems to me that if we are relying on the professionalism and integrity of an individual it is unnecessary to create some kind of small quasi-quango with a separate office and staff.

In some senses we are making a modest move, but it is a major move in terms of the independence of control of drinking water quality, which has never existed.

Fiona McLeod: The minister said that there will be Scottish regulation of Scottish water. When we allow new entrants in, post-common carriage, will it be clear that they will be regulated by the Scottish DWQR?

Ross Finnie: Absolutely.

Fiona McLeod: That will be clear.

Ross Finnie: Absolutely.

Des McNulty (Clydebank and Milngavie) (Lab): I will ask about the function of the water industry commissioner. We asked the WIC whether he was happy that Scottish ministers need not take on board his charging advice. His reply was:

“I am confident enough in the quality and robustness of

our analyses that, if Scottish ministers wanted to disagree with them, we could debate the issue. No doubt ministers would have political reasons for disagreeing, which would reflect the issues that their constituents were raising.”—*[Official Report, Transport and the Environment Committee, Friday 9 November 2001; c 2260.]*

What criteria, other than political, will you use to determine whether you accept the WIC's advice? If you do not accept his advice and produce your own advice, as set out in the bill, are you advising yourself?

Ross Finnie: I suppose that we could be. That is a danger. On the other hand, the crucial reason why I have no difficulty with that is that the WIC's essential job, as we discussed earlier and as the committee no doubt discussed with him, is to set the revenue cap on the consumers' behalf. He does that with regard to water quality, the level of investment required and resources. As part of the process, he explains how he arrives at the cap and what is required of the industry to meet his figures.

If we do not accept the WIC's fundamental recommendation, we must have a serious explanation for the consumer. Beneath that are a number of other issues. Given that the delivery of the key objective of the revenue cap will be in the hands of Scottish Water, there is a case for considering whether we require to follow all the WIC's recommendations to achieve the objective. There is bound to be a commercial view and an operational view.

If someone does not accept the overall objectives, hell mend them, but in some circumstances, there might be things in the WIC's overall advice the timing of which we want to change or on which we might take a slightly different view, while remembering the overall objective of meeting the revenue cap that the WIC has set.

Des McNulty: In other words, the WIC has to produce advice that is based on his economic models.

Ross Finnie: Remember that ministers cannot reject the WIC's recommendations in private. There is no prospect of a minister getting away with having received the WIC's report and slipping it into the night: there is a statutory requirement for the report to be published. If a minister chooses to ignore the WIC's advice, he cannot do so quietly. He has to be public and explain to you, who represent the public, why he has chosen to ignore the WIC's advice or to come to a slightly different view.

Your point is good, but there is no question of that situation arising. The present statutory provision makes it clear that the water industry commissioner's report must be published in full.

Des McNulty: Do you think that the WIC's independence is sufficiently enshrined in legislation or are we relying too much on the strength of the incumbent's personality?

Ross Finnie: I mean no disrespect to the individual concerned, but I hope that we are not dealing with the WIC on an individual basis, although I concur with the view that Mr Alan Sutherland is robust. We are talking about the transparency of the system, the way in which the WIC provides advice and the fact that it has to be published and so we have to give a public response. That seems to me to open up all the opportunities for the appropriate committee of the Parliament—in this case, the Transport and the Environment Committee—to hold ministers to account on why they might take a view different to that proffered by the WIC. That seems to me to be the proper way of holding ministers to account in this key area.

John Scott: May I explore a what-if scenario? I know that you will not want to comment on it fully, but I will paint the picture nonetheless. In the run-up to an election for the Scottish Parliament, the water industry commissioner might say that prices should rise to secure more investment, which would not necessarily be acceptable to the Scottish public at large. One can easily envisage that the minister might come to Parliament and say, “I am not allowing prices to rise.” That would probably be accepted by Parliament, yet in the long term, it would damage the structure and efficiency of Scottish Water. Would you care to comment on that scenario, which I perceive as being a real possibility?

Ross Finnie: You have obviously worked out that scenario using the dates that we have for the elections. You must be referring to a situation that might arise some time in the future, given that the present run of the review is 2002-06. Your question is hypothetical and I am reluctant to speculate on it. It is not a view that this minister in this office takes. You may be proffering it as a position for another party to take, but it does not represent the view of the Executive.

Des McNulty: I will probe you just a bit more on the possible tension between the water industry commissioner's role as the economic regulator and his role as the consumers' champion. In that context, should the water industry commissioner have powers to produce social and environmental action plans as the Office of Gas and Electricity Markets does for energy markets? Has that role been considered in the context of the bill?

Ross Finnie: No it has not. You are talking about a very much more substantial office. With the level of expertise that the water industry commissioner is expected to bring, his key task is to have regard to economics. He cannot ignore the

framework within which the industry is set. We have to consider the amount of time, effort and energy that goes into the focus of seeking to protect the customer. The revenue cap is recommended to set the framework within which charging would subsequently be arranged. It seems to me that the stakeholders' wider interests ought to be part of the accountability function that is retained by the key accountability stakeholder—the Parliament.

We are setting out the statutory framework, particularly for the environmental matters that Fiona McLeod just raised. The discharge of those functions is the responsibility of the board. It is for the board to report to Parliament and it is for the Parliament and ministers to adjudicate on whether people are discharging their functions adequately. That is where the stakeholder is the public, represented by Parliament.

Des McNulty: I am concerned about the role of the commissioner and the advice that he gives to you being focused so heavily on economic issues and efficiency. That might make it difficult for other considerations, such as social and environmental issues, to be taken into account.

Ross Finnie: In arriving at his decisions on what it is fair and reasonable to impose on the industry, the water industry commissioner has to take account of all the duties that are placed on the industry. Although it is not his prime function, he cannot ignore a direction under section 47(4)—or whatever the section that Fiona McLeod was pursuing was. That is a duty and an obligation. He cannot say, "There is no cost attached to that, so it does not come into my equation". He is required, under the legislation, to take account of any direction or statutory obligation that is placed on the industry. He does not operate in a vacuum, although his prime focus is to arrive at an economic decision.

Des McNulty: That is right in terms of the legislative obligations, but he will make economic judgments about one investment option versus another investment option, the social and environmental costs of which might vary. In a sense I am highlighting the fact that social and environmental considerations are often particularistic and local and are not necessarily to do with legal obligations. Are we constructing a situation in which the water industry commissioner is producing models that do not necessarily relate to circumstances on the ground and that make it difficult to take account of the social and environmental consequences of decisions?

11:00

Ross Finnie: You must go back to my first or second answer to Bruce Crawford. The detailed

management and running of the company must rest with the board. We cannot allow the water industry commissioner or anybody else to try to second-guess local and national projects. We must draw a distinction between the duties and obligations of the board to discharge the functions of the company, and its accountability to Parliament. That distinction must be drawn—as I said in answer to Bruce Crawford's questions on level of detail—at a fairly high level. Notwithstanding the fact that an enormous amount of analysis and work goes into the process, it would be wrong for the water industry commissioner to act as a quasi-auditor. That would not be a helpful development and would not produce the results that Des McNulty wants.

The real solution is to have a board that is clearly aware of its statutory duties, obligations and directions and for ministers and Parliament to be alive and alert to ensuring that it discharges them. At that level of detail, the board is responsible, not the water industry commissioner.

Fiona McLeod: Are you saying that section 47(4) puts the duty of sustainable development on the board and that therefore there is no need for a similar section to give the same duty to the water industry commissioner?

Ross Finnie: No. I am saying that, as stated in section 32(3)(d), the water industry commissioner is required, when forming his advice, to take account of all the statutory duties and obligations that are placed on the company and the board. He cannot arrive at an econometric model, part of which simply discounts the costs that are attached to sustainable development, water quality and the minister's direction on quality and standards. He must take all those into account when arriving at the advice that he tenders to ministers.

Fiona McLeod: Is that strong enough to ensure a commitment to environmental matters and sustainable development? Do we need to insert a section 32(3)(f) that says that the water industry commissioner must consider sustainable development?

Ross Finnie: I do not wish to be flippant about the question. The bill places a huge number of obligations on Scottish Water. It seems to me that the proper and sensible approach is to place an obligation on the water industry commissioner to take into account all the obligations, but it is not necessary to repeat all those obligations in the bill. The option of using that obligation is available. If it is believed that the commissioner is not taking the obligations into account, there is clear statutory cover for saying that the commissioner is not properly discharging his duties. The bill is explicit as to what the commissioner must take into account.

The Convener: If there are no more questions on the WIC, we will move on to questions on consultation panels.

Fiona McLeod: The convener of a consultation panel is to be appointed by you, minister. That convener will then appoint the members of the panel. How will that provide the new customer consultation panels with a broad and representative membership? How will the new consultation panels be more independent than the present committees?

Ross Finnie: As Fiona McLeod is aware, there is presently one consultative committee for East of Scotland Water, one for West of Scotland Water and one for the North of Scotland Water Authority. I am rather concerned that, as we are creating a single Scottish water authority, the consultation panel ought to contain a broader range of domestic and non-domestic customers to take account of the local sensitivities in a service that covers all Scotland.

The first answer is that I want the panel to be more broadly based. It is extremely important that we get the balance right and I am exercised about the consultation panel including people who represent both domestic and non-domestic consumer interests. I do not want to duck the issue, but I am trying to posit something that will not become too regulated. I do not want to end up with four, five or six quangos. I want a panel that will include people who have sufficient sensitivity to domestic and non-domestic consumers' interests, and that will allow its members to raise issues if they are dissatisfied. After all, their first recourse ought to be to the board and the chairman.

I also want to be able to gauge public feeling about delivery of the service. Before I come to any decisions, I will be interested to hear whether anybody holds the view that the consultation panel is a non-starter. The convener will appoint members and ministers will have to approve terms and conditions. We will have to consult before we make those appointments.

The consultation procedure is set out in subparagraph 6(4) of schedule 1, which states:

"Before appointing the other members under subparagraph (2), the Convener must consult the Commissioner and such bodies representing consumer interests as the Scottish Ministers may direct."

We are trying to reach a situation in which we do not end up with an overly bureaucratic model, but something that is considerably better and more responsive than the present situation, which I am not happy with.

I do not know what responses the committee has had, but all the responses that I have received indicate that the present arrangements are not

satisfactory. They are tied in with the commissioner who, as Des McNulty said, concentrates more on answering the fundamental questions at a higher level. He does not address some of the lower-level concerns of domestic and non-domestic consumers. In order to make that separation, I am keen to have a responsive panel that can inform ministers, the Parliament or the board. I would rather that those groups were informed—in reverse order to that which I have just cited—about the concerns of consumers.

Fiona McLeod: When will you publish the guidelines on ministerial appointment of the convener and on the convener's appointment of board members? Everything seems to come back to the Scottish minister.

The Convener: The minister can correspond with us on that point. We want to ask more questions. I am happy for us to correspond on that matter. Is there anything else that you wanted to cover, Fiona?

Fiona McLeod: No, I think that we have covered what I wanted to ask.

Bristow Muldoon: In evidence, both the chairman designate and chief executive designate of Scottish Water said that they would, in all likelihood, support direct billing of their customers as opposed to billing through local authorities—as is currently the case. They believe that one of the possible benefits will be improved collection rates of domestic bills. Has the Executive had discussions with local authorities about the potential of such a move? If so, how have local authorities reacted? Would such a move require primary legislation and was any consideration given to putting that provision in the bill?

Ross Finnie: I last spoke to local authorities yesterday afternoon when I met the Convention of Scottish Local Authorities to discuss billing, which is a serious issue that Scottish Water faces. It is not a change that will be made in the next two or three years. We need a statutory instrument to extend the existing system and I think that we will do so to cover the years until 2005 to give cover to the industry.

There is a big issue here. We could spend hours debating whether rateable value has any relationship with water consumption, but we must be careful that we know what we are jumping into before we jump out of the current system. It is my view—I think that the chairman designate and chief executive designate share it—that there is much work to be done before we can embark on a major change. I do not want to anticipate the management's view, but I would not be surprised if, having got Scottish Water up and running, the management saw that change as its next big exercise.

That change would not require a statute, but we could expect a wide debate on the matter because it is serious. The questions are whether we need meters everywhere, or whether there is another method that could be used. What about dislocation and disruption? COSLA and the local authorities are concerned about that and that issue formed part of yesterday's discussions.

I say to the committee what I said to COSLA—I acknowledge that this is a big issue but I do not believe that the change can take place overnight. We would have to be clear about the effect on the models of transferring to a totally different system, not just in relation to whether the change would be efficient, but in relation to its impact on individual consumers. How could we deal with that transfer and the possible transitional period? It is a big issue and it is therefore not in the bill. It is a matter for the management of Scottish Water to deal with in consultation with all its customers.

Bristow Muldoon: I have a supplementary question about an issue that the Subordinate Legislation Committee raised with the Executive when it was considering the bill. The issue is associated with local authorities and section 54 of the bill. Section 54 gives Scottish ministers power to require local authorities and assessors to pass information to Scottish Water to enable it to set charges. I want to tease out what sort of information the Executive envisages being passed. Would it include summary information about collection rates of council tax and water rates? Would it include detailed information about individual customers? One concern could be that sensitive information about individuals' or businesses' outstanding council tax debts might be passed to a third party, such as Scottish Water. Is that the intention or is the intention for overall collection rates to be passed to Scottish Water?

Ross Finnie: I am fairly certain that under data protection legislation, local authorities are not entitled to give information to Scottish Water other than information relating to the collection of water rates debts. However, I understand what you are getting at because it is a uniform collection system. Scottish Water will certainly need successful collection rates and—as the chairman and chief executive have no doubt already said—it will need to have a better profile of the nature of individual customers in order for it to arrive at the right decision.

Bristow Muldoon: I know that we are pressed for time, so a written response might be helpful. I was referring to section 54(3)(a)(i), which refers to "setting, levying or collecting council tax or council water charges".

Perhaps the minister could deal with that issue in correspondence.

Ross Finnie: That is high-level information so we had better correspond on it.

The Convener: I want to deal with one substantial issue before the minister leaves, which is support and targeted relief for the voluntary sector. As the minister will be aware, that has been a big issue for the committee's report. The committee is of the view that a targeted relief scheme should be established.

Should there be provision in the bill for such a relief scheme or, alternatively, should the current transitional relief scheme be extended until there is a more fundamental review of charities? In other forums, I have heard you say that charities and other organisations need to be looked at in the round. The bill does not suit that process because other work is being done on charities. However, the committee remains convinced that there should be some form of targeted relief scheme. We seek your views on that.

Ross Finnie: This is an extraordinary and very serious issue. We could start at the philosophical level, and ask what is the appropriate way in which to deal with persons who need relief, and whether that should be dealt with separately. In other words, we could simply accept that the water industry and Scottish Water have duties and obligations that are broader than water delivery. Those duties and obligations encompass environmental obligations, which also come under the industry's prime function.

We could argue that as far as charges are concerned—whether water charges, electricity charges or any other utility charges—society ought to recognise the need to put arrangements in place to help charitable organisations or low-paid members of society meet and discharge their obligations. I know that that is not what the convener is talking about, but there is at least a respectable argument that suggests that the correct and proper way in which to deal with persons who find charges difficult to meet and who see the charges as an imposition is through what one might loosely call some kind of social security provision.

11:15

If we conclude that that is not appropriate and that Scottish Water—as a public company—should have obligations placed upon it, we must to be clear about the next piece of legislation down the track, and about whether we would be able to impose any such obligations on an industry in which there is competition. We would then get into a different and difficult situation in which, through people paying charges to Scottish Water while obtaining relief, Scottish Water's ability to compete was put at risk because of obligations that its

competitors did not have.

There is a big public debate around that matter and I wish to make it absolutely clear that I am concerned that there should be systems in society for charities or for low-paid individuals. However, it is not a matter of addressing that simply through the existence of certain sections in the Water Industry (Scotland) Bill.

In the three existing water authorities, there is a history of offering relief. I was interested to note that the Transport and the Environment Committee wanted to narrow the focus by granting relief to specific charities for whom the volume of water usage seemed to be disproportionate to the fixed element of the charge. The bill—in particular section 37—allows us to make provision for some kind of targeted relief scheme. I would have preferred that the committee's report contained more detail on that, so that we could test the idea. I have not closed my mind to such a scheme, but I am bound to say that the wider issues cause me some concern. I am not concerned about the recommendations of other reports in relation to charities, but I could not envisage those being implemented within the Water Industry (Scotland) Bill. They would have to be dealt with as a separate matter, with the Scottish Parliament taking a perfectly principled decision on giving relief to charities, but doing so right across the board. That could be a matter for the Scottish Parliament, but if it trespassed into social security legislation, it would become a matter that is reserved to Westminster.

I am sorry to duck the question, but there are big issues at stake. I have not closed my mind to proposals for a targeted relief scheme. This issue will not be resolved this morning. I have deliberately left a provision in the bill that would permit such a scheme. However, there is a bigger debate surrounding the matter. I am sorry to go on about it, but it is a very important issue.

The Convener: We are aware of that bigger debate and we, too, seek evidence on a possible solution. Once we find that big idea, we will get it to you as quickly as we can, minister. However, you have more resources than we do—but that is another matter.

Des McNulty: I want to highlight a particular issue, because this is not just a question about the size of charities. There are particular charitable organisations, such as churches or scout groups, that have traditionally held premises as part of their operations. Although I accept the general principles that the minister highlights, the committee is concerned about the specific effects on particular types of organisations of the proposals that are before us. We want to highlight that concern to the minister and his ministerial colleagues.

Fiona McLeod: Given that the wider debate on charities relief is still to be had, will you use section 37 to extend the transitional relief scheme until we have an answer to the bigger question?

Ross Finnie: I cannot give that commitment, but I have not closed my mind on the matter. I explained that my political inclination is to recognise the seriousness of the issue. The committee acknowledged in its report that the measures that we are talking about could apply either to the organisations that are covered by the existing transitional arrangements or—as Des McNulty highlighted—to a fairly narrowly focused group. I am happy to continue to consider the matter, but I do not wish to give a commitment, for the reasons that I have outlined.

The Convener: That completes the questioning. I thank the minister for attending—I know that he has other engagements today. We look forward to including his remarks in our report.

I advise the committee that the stage 1 debate on the general principles of the bill will take place soon. If the principles are agreed by the Parliament, we will carry out line-by-line scrutiny of the bill at stage 2. I thank all the individuals and organisations who provided written and oral evidence to the committee during the evidence-gathering stage. I am sure that members agree that the evidence was of a high standard and that it greatly enhanced our understanding of the bill. The next stage is for us to consider a draft report on the bill. Consideration of draft reports is usually done in private—do members agree to discuss in private our draft report on the bill?

Members indicated agreement.

Petition

Water and Sewerage Industry (Competitiveness) (PE399)

The Convener: Agenda item 3 is a topical item, on petition PE399, by Dr D H S Reid, on the structure of the water industry in Scotland. The Public Petitions Committee agreed to pass the petition to the Transport and the Environment Committee with the recommendation that we take it into account as part of the committee's consideration of the Water Industry (Scotland) Bill.

In our recent inquiry, we considered the structure of the water industry in Scotland in great detail and we are also considering the matter with a view to producing our stage 1 report on the Water Industry (Scotland) Bill. We considered and scrutinised thoroughly the issues that are raised in the petition. I suggest that we treat the petition as written evidence for stage 1 of the bill, which will allow us to include the petitioner's comments in our appraisal of the situation. I also suggest that we send the petitioner a copy of the committee's recent report of our inquiry into water and the water industry. In the light of our current discussions, those suggestions are sensible. Are they agreed to?

Members *indicated agreement.*

The Convener: We now come to consideration of the possible contents of the committee's draft report. As agreed, we will discuss the matter in private. I thank members of the public for coming along.

11:23

Meeting continued in private until 12:25.

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