

TRANSPORT, INFRASTRUCTURE AND CLIMATE CHANGE COMMITTEE

Tuesday 2 December 2008

Session 3

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TRANSPORT, INFRASTRUCTURE AND CLIMATE CHANGE COMMITTEE 24th Meeting 2008, Session 3

CONVENER

*Patrick Harvie (Glasgow) (Green)

DEPUTY CONVENER

Cathy Peattie (Falkirk East) (Lab)

COMMITTEE MEMBERS

*Rob Gibson (Highlands and Islands) (SNP)

*Charlie Gordon (Glasgow Cathcart) (Lab)

*Alex Johnstone (North East Scotland) (Con)

*Alison McInnes (North East Scotland) (LD)

*Des McNulty (Clydebank and Milngavie) (Lab)

*Shirley-Anne Somerville (Lothians) (SNP)

COMMITTEE SUBSTITUTES

Alasdair Allan (Western Isles) (SNP)

Gavin Brown (Lothians) (Con)

David Stewart (Highlands and Islands) (Lab)

Jim Tolson (Dunfermline West) (LD)

*attended

THE FOLLOWING GAVE EVIDENCE:

Richard Ackroyd (Scottish Water)

Geoff Aitkenhead (Scottish Water)

Johanna Dow (Scottish Water Business Stream)

Ronnie Mercer (Scottish Water)

Douglas Millican (Scottish Water)

CLERK TO THE COMMITTEE

Steve Farrell

SENIOR ASSISTANT CLERK

Alastair Macfie

ASSISTANT CLERK

Clare O'Neill

LOCATION

Committee Room 1

Scottish Parliament

Transport, Infrastructure and Climate Change Committee

Tuesday 2 December 2008

[THE CONVENER *opened the meeting at 14:01*]

Scottish Water Annual Report and Accounts 2007-08

The Convener (Patrick Harvie): Good afternoon everybody. I welcome you to the 24th meeting this year of the Transport, Infrastructure and Climate Change Committee. I record apologies from Cathy Peattie, and I ask members, witnesses and everybody else in the room to ensure that mobile devices of any sort are not just switched to silent but switched off.

We have just one item on our agenda: evidence on Scottish Water's annual report and accounts 2007-08. Earlier in the year, we heard from Waterwatch Scotland, the Water Industry Commission for Scotland, and the drinking water quality regulator for Scotland. Today, we will hear from Scottish Water.

I welcome our panel of witnesses. Ronnie Mercer is the chairman of Scottish Water; Douglas Millican is the finance and regulation director of Scottish Water; Richard Ackroyd is the chief executive of Scottish Water; Geoff Aitkenhead is the chairman of Scottish Water Solutions and the asset management director of Scottish Water; and Johanna Dow is the financial director of Scottish Water Business Stream. Thank you all for joining us. Would any of you like to make some brief introductory remarks?

Ronnie Mercer (Scottish Water): Thank you for inviting us to the committee, convener. I do not need to introduce the team; you have already done that very well.

I understand that you are using our 2007-08 report as the basis for the meeting. However, we run a dynamic business, and I ask your forbearance if we seem more interested in the year that we are almost three quarters through, and in next year, which will arrive soon and which we are budgeting and planning for right now. It might be useful to consider a couple of issues that have changed markedly between the period that the report covers and now. Doing so might also save some time during questions.

Big strides have been made in leakage, but the target was missed. Part way through 2007-08, we knew that that would happen. We reduced

calculated leakage by 100 megalitres a day in 2006-07, and by 80 megalitres a day in 2007-08, which equates to 9 per cent and 8 per cent respectively. That was the maximum possible reduction with the workforce that we had dedicated to leakage. In other words, we maxed out with the people we had.

No quick fix was available and, last year, we told the regulator that we would have to recruit a much bigger resource in order to get nearer our target in future. That was done during 2007-08. We went recruiting, and the leakage team was systematically doubled over a number of months. We now have more than 300 people working on the task, on which we are spending £18 million per annum—that is about double the previous amount. We think that we will hit the target range of 825 to 855 megalitres a day this year. Last year, we finished at 925 megalitres, so we want to reduce that by another 100 megalitres, but reductions are harder as the figure goes down. That is a big change from what the committee has read. We doubled the team. Part of the way through the year, we told the regulator, "Sorry, you can write your report now—we ain't doing this. We're going to max out again at what we've told you." Since then, we have recruited staff and this year we are on target. That is good news.

Another marked change has occurred in the business of connections, on which Scottish Water put a huge effort into satisfying the concerns of developers and councils. Between 22,000 and 25,000 connections have been made in each of the past two years, with very few complaints to us. I will not go into detail on how that was done. However, the new world order has led to a dramatic drop-off in connection requests and we are now managing downwards rather than upwards in dealing with connection requests. This year, the number will be in the teens of thousands. Next year, it might be even less. That is a change in a different direction from what you have read in the report.

I hope that the annual report shows that Scottish Water is well on the road to becoming one of the best value-for-money packages in the water industry. Increases in household charges remain below inflation, which means that household bills are cheaper than those from seven of the 10 companies south of the border. We share the wish of the Government and the regulator to keep charges steady in the future.

Since the report was published, Scottish Water's retail and wholesale divisions have been successfully separated. That happened on 1 April in this financial year. Scottish Water supported the opening of the business customer retail market to competition, which was a first in the United Kingdom. We are actively involved with all the new

entrants to the market and we are committed to providing a first-class wholesale service.

The regulator—the Water Industry Commission for Scotland, which is known as the WIC to all of you—publishes three reports annually on Scottish Water's performance. One is on customer service, one is on capital investment and one is on cost efficiency. We are pretty pleased by what is emerging from those reports.

The regulator has two key messages on customer service. The first is the overall performance assessment—the OPA—which includes several measures on which we are judged. Members have heard about that in earlier evidence sessions. The WIC's conclusion is that incentives for Scottish Water are working well. The current OPA score is close to next year's target, which members might think would make it easy to achieve. However, the committee should be aware that the measure can go into reverse. We must work hard to maintain our position, because it can go backwards.

The second key message on customer service was from a comparison with England and Wales, which welcomed improvement that narrowed the gap in overall performance with companies down there. The WIC wants Scottish Water to continue to improve on the quality of the water that it puts back into rivers; to reduce further the number of customers who experience inadequate water pressure; and to reduce the amount of water that is lost through leakage, which I talked about. Scottish Water has shown that it is responsive to challenges, so we look forward to making progress on those matters.

The WIC had two key messages about capital investment. The first was that the run rate of spend had increased; at £625 million for the year, it hit the target. This year, which is almost three quarters of the way through, investment has continued at that high level. The run rate is likely to finish higher than last year's £625 million—we hope that it will be more than £650 million this year.

The other key message was a criticism of regulatory sign-off, which I will explain. We have more than 4,000 projects. We build facilities and put them into beneficial use—that means that the customer gets the outputs and their benefit. Some months later, we receive regulatory sign-off, once the various regulators are satisfied that the schemes have fulfilled their required outputs. The target time from completion to regulatory sign-off is now three months. We put our hands up to the fact that that has not always been achieved, but we are disappointed that some have interpreted that as Scottish Water having spent the money but not completed the project. That is clearly not the case. For example, after we built the works at

Milngavie, the water was in the supply to Glasgow and the facility was in beneficial use last October. Regulatory sign-off was achieved in April this year, so it took more than three months. However, two weeks after we had opened the valves, 600,000 people in Glasgow were drinking the water, bathing in it and putting it in their whisky. We missed the three-month deadline for sign-off, but the facility was in use. Since then, we have achieved the three-month deadline in a number of examples, so we are aware of the issue.

The third report is on cost efficiency. This year's report has not been published yet, but we do not expect any surprises. We expect to find that Scottish Water remains in a competitive position in comparison with its counterparts in England and Wales.

We have also been active on waste. The convener has visited the site at Deerdykes, where we started a plant to convert garden waste into pelletised fertiliser. In doing that, we have turned a site with negative value into the opposite: it is now run as an asset with a value. We now have a pollution prevention and control licence—

The Convener: I ask you to conclude your remarks in a couple of moments.

Ronnie Mercer: Okay. Two more minutes and we are there.

We have a PPC licence for Deerdykes and have let the design element of a £7 million contract to build an anaerobic digestion plant there to produce electricity. We have also submitted planning applications for similar plants at Johnstone and Prestwick. We are active on that front. At the water treatment works that we are about to build at Edinburgh, we will put turbines into the water in and water out to give us electricity for the site.

We have a lot to manage in delivering safe, clean drinking water and disposing of waste water throughout Scotland 365 days a year. We believe that, in doing that, we make a significant contribution to Scotland's success and sustainable economic growth. In particular, the two businesses whose representatives are with me—Scottish Water and Scottish Water Business Stream—are especially focused on how they can help the country through the effects of the economic downturn.

The Convener: Thank you for those extensive remarks. Much of what you said relates to continuing work, rather than the work that is mentioned in the annual report that we are examining today, so I will focus on the report. You mentioned the target on leakage as one of those that you missed. In other discussions and written evidence, different language has been used on targets and desired outcomes. Will you explain a

little bit about that and tell us which other targets and outcomes were missed in 2007-08?

Ronnie Mercer: The leakage target was one of the main ones, which is why I picked it out. I do not think that much else was missed, but I look to the team on that.

Geoff Aitkenhead (Scottish Water): Targets for the business are spread across outputs to meet ministerial objectives, and our output targets for the year were met. We also have a range of serviceability indicators that represent in a variety of different ways the level of service that our assets provide. We missed the indicator for the number of water supply zones with a concentration of manganese in the drinking water that exceeded the level permitted under the water quality regulations. The pass mark was around 22 of the 370 water supply zones in Scotland showing a level of manganese above the permissible concentration, but we exceeded that concentration in more than 22 zones.

The Convener: Does Douglas Millican have anything else to add?

Douglas Millican (Scottish Water): I do not have anything to add on targets that were missed. However, the principal target on which we focus is the overall performance assessment, which is a basket of 13 measures. We had a target of 213 for the year but achieved a score of 248. If that overall measure sums up Scottish Water's performance, 2007-08 was a year of significant outperformance on the general targets that were set for us.

Des McNulty (Clydebank and Milngavie) (Lab): In his initial statement, Mr Mercer dealt with what Scottish Water is doing to address the leakage problem and whether it is on track to achieve leakage targets for 2008-09. Ian Byatt stated in his evidence to us that water companies that fail to hit their leakage targets must face punishment. What sanctions can be imposed and have you faced any for missing your leakage targets?

14:15

Ronnie Mercer: Scottish Water is perhaps 10 years behind England in chasing leakage improvements. You are all aware that it is not an exact science. We do not measure everything going in and we measure hardly anything coming out, but we accept that there is a leakage problem to be tackled and we have quite a good estimate of the improvements that we should make.

As far as sanctions are concerned, part of the way through last year we said to the Water Industry Commission, "Sorry. We are not going to achieve the target. We need an awful lot more people. We cannot instantly produce them, but we

will recruit them and put them in. We will tell you when we have got them and we will agree a target for next year." That was done. We have doubled the workforce and doubled the spend. If you want to call that a sanction, it is a sanction, but that is what we have done and it looks as if we will now hit this year's target. Some pipes will have burst today because it is a very cold day so we hope that there will not be too many days like today between now and March but, by and large, we think that we will get there this year.

There are no other sanctions, but we have our pride. If we accept a target, we accept it on the basis that we can achieve it. We accepted targets for two years but did not achieve them—we put our hands up for that—and we have accepted a target for this year that we think we will achieve, but we have had to double the resources to do so.

Des McNulty: The salary and remuneration of executive directors is also mentioned in the report. There are two reasons why that is sensitive. One is to do with the culture of city bonuses in the City of London, particularly in the light of the current banking situation. The second is the current dispute involving your workforce. Can Mr Mercer give us his view on how we ended up in a situation in which there are four executive directors of the company, whose lowest salary is £229,000? How did your processes lead to that situation?

Ronnie Mercer: Scottish Water's board does not set the salary levels for its directors; the salaries are set by the Scottish Government. In 2006, the Scottish Government went through an exercise to look at comparators, benchmarking and so on. At the end of that year, it made decisions about the salary levels and bonuses. We got notice from it saying, "Here is what you can do," and that is exactly what has been done. Since then, everyone in the company has been under the public sector pay guidelines. Before that, they were also under them. They are set by the Scottish Government.

At that time, I was interim chairman, and the non-execs on the board and I were very pleased that the Government had done that, because it let us keep some people whom it was vital to keep and to recruit where we needed to recruit. We had already lost half the board at that point. I did not know that I was going to be carrying on as chairman but, when the decision about salary levels was made, I welcomed it. I would rather have criticism of what the executive directors earn and have them here doing the job that you can see is being done than have no criticism and not have the people to do that job. The levels are set by the Scottish Government. You can follow the audit trail and see the benchmarking that was done. Ministers made the decision and then notified us, and it was carried out to the letter.

Des McNulty: It would be interesting to get further information about the benchmarking exercise.

Ronnie Mercer: Sure. The information is all there.

Des McNulty: You said, if I understand you correctly, that salary levels were set in 2006.

Ronnie Mercer: That was when we were given the go-ahead.

Des McNulty: Subsequent to that, when I compare salary levels in 2006-07 with those in 2007-08, there again appears to be an uprating of more than 20 per cent in the relative values.

Ronnie Mercer: Everyone's salary has been treated precisely as the public sector pay policy allows. You can check that out for yourself. In that year, we had temporary step-ups in jobs because the chief executive left the company and we did not replace him for some time. People were given a temporary position, which added to their salary, but the money came off again when the new chief executive, Richard Ackroyd, arrived. That might be distorting what you see. All the information is there; you can count the figures to see exactly what is what. There is an audit trail for that.

Des McNulty: All I can do is go by the figures that are given in the document.

Ronnie Mercer: Sure. We print exactly what people were given. The information is correct. The Government's decision was not to match exactly what the comparative market gives but to aim at something below it. I think that the figure 95 per cent was aimed at and that the figure is even lower now. Again, that can be checked out.

Des McNulty: We are talking about substantial remuneration packages by any criteria.

Ronnie Mercer: The Scottish Government felt that that was what was needed to keep the company going where it was going, so that is what we have done.

Des McNulty: I think that we need to look at that and to ensure—

Ronnie Mercer: It was done under your party; Labour was in power at the time, so you will be able to get the figures okay.

Des McNulty: I understand the dates. I am just asking you to clarify what kind of benchmarking exercise was undertaken and what values people are given now. I am just raising the question about comparability. I may be slightly wrong—but by only £1,000 or £2,000—if I say that you will have four people in Scottish Water who are getting paid more than anyone else in the public sector in Scotland.

Ronnie Mercer: That is correct. It is exactly as the Government decreed. There is an audit trail for all that. I suspect that we should not have it out today, but it is all there if Des McNulty wants to look at it.

The Convener: I understand. I have one slightly related follow-up question. Obviously, the whole world is in a difficult financial situation. We in Scotland are certainly in it, as is the public sector in Scotland. Scottish Water, like every other part of the public sector, has to maintain public confidence and trust in its operations. Does the current situation give you any cause for concern about the perceived fairness of what is happening?

Ronnie Mercer: No, because the salaries were set at the end of 2006. Once you set salaries, people are on contracts. The people are there to deliver a big job. It is not easy to run a £1,000 million turnover company with a £650 million capital investment programme, just under 4,000 employees, 7,000 contractors and £400 million operating costs—it is like running a FTSE 100 company. We are the fourth biggest water company in Britain. The comparisons are done with people who do something similar. In that regard, I do not think that the salaries are untoward. You might think that the figures look like a lot; that might be your opinion and I would not argue with it.

The Convener: So, in the current context, when other public sector workers, not just within Scottish Water but throughout Scotland, are facing tight constraints on their pay settlements, you are not concerned that this kind of situation—

Ronnie Mercer: The people whom we are talking about face exactly the same pay constraints; they come under the public sector pay policy.

The Convener: I invite Des McNulty to ask a final supplementary question on this subject.

Des McNulty: I just want to be clear about this. My understanding of the position is that the rank-and-file employees, if you like, have been told that their pay offer cannot take account of their contribution to improved efficiency in Scottish Water this year, because of Scottish Government pay policy. However, you seem to be saying that the position is different for the executive directors. I would have thought that any pay policy should apply to everybody in Scottish Water and not just to one group.

Ronnie Mercer: It applies to everybody. They all come under the public sector pay policy. They have a salary and bonus systems that are run according to that policy. The pay offer that the employees have is the maximum that can be given under the public sector pay policy. We have asked

whether we can exceed it, but we were told no. They are under the public sector pay policy, which has a maximum on it, and they have got every penny of that max.

The Convener: We will need to move on in a moment, Des.

Des McNulty: Okay. As I understand it, some local authorities have been able to use efficiencies to improve the pay offer for workers. Ministers have told you that you have an absolute top line that you can give to your workforce—

Ronnie Mercer: And which has been given.

Des McNulty: But I presume that ministers will say the same for the salary this year of executive directors. What have they said about last year's salary increases?

Ronnie Mercer: They have not said anything. This year, executive directors, who come under the public sector pay policy, get no increase at all, while the workforce gets 2.4 per cent plus whatever. That is as per public sector pay policy and is the maximum that we can give.

The Convener: It might be worth raising some of these issues with ministers in another context. I am sure that members will use this discussion to inform those questions.

Ronnie Mercer: Sure.

The Convener: We will move on.

Alex Johnstone (North East Scotland) (Con): Last month, the Water Industry Commission told us that Scottish Water performs less well on sewage treatment works compliance than companies in England and Wales. What action has been taken to improve that position?

Richard Ackroyd (Scottish Water): It is true that Scottish Water performs less well in that respect. Indeed, 29 of our sewage treatment plants have failed to meet their discharge consents. There are many reasons for that. In many cases, the assets are old and decaying and need to be refurbished; in other cases, the problem is operational practice or having to deal with trade effluent discharges from industry that are not in line with their own consents.

We have approached the problem with a range of measures and are now on a gradual trajectory downwards, with the number of failing works reducing every year. A key lever in that respect has been the capital investment programme, under which we are progressively upgrading sewage treatment plants around Scotland. To deal with trade effluent, we have taken on what I will call an active policing role; for example, we send a team of people to talk to traders about what they have to do to stay within their consents. We also keep a focus on operational practice. I think that,

as a result of those measures, the number of failing works will continue to fall in the not-too-distant future.

Alex Johnstone: Although you exceeded your overall performance assessment target for 2007-08, you state in your annual report that you still have to catch up with the standards of water companies south of the border. What action has been taken in that respect?

Richard Ackroyd: Are you talking about general or particular actions?

Alex Johnstone: General actions.

Richard Ackroyd: We are doing a whole host of things. The Water Industry Commission regulates Scottish Water by comparing its performance with water companies south of the border in particular—and, to some degree, internationally—and, indeed, under the whole OPA regime targets are set that require us to catch up.

How do we do that? For a start, we visit an awful lot of other companies both in and outwith the water sector to look at best practice. One of the big levers is innovation; the water industry tends to be relatively risk averse and, therefore, traditional. However, in the past month, we have made a new appointment of a director of technology and innovation, whose role is to broaden the use of information and engineering technology and generally to encourage our business to be much more innovative.

Alex Johnstone: Scottish Water's performance has been improving markedly against that of its English and Welsh competitors—or, should I say, comparators. Do you expect that, in the near future, it will be at the top of the tree, matching the best performing companies south of the border? If so, when will that happen?

Richard Ackroyd: Part of the answer to that question depends on the outcome of the 2010 to 2014 regulatory price review. Our plan, which we submitted to the WIC in May, targeted upper quartile—or top three—performance in the UK by 2014, but that depended on certain assumptions about the investment that would be available to us.

14:30

Shirley-Anne Somerville (Lothians) (SNP): We heard from Waterwatch Scotland that qualitative measures of customer service are as important as quantitative measures. For example, it is not just about how quickly you answer the phone—which you are doing very well—but about what happens when the phone call is answered. How is that level of service measured, and how are you performing relative to your counterparts?

Richard Ackroyd: It is measured principally through customer surveys and the like. We carry out two types of survey: a general survey, in which random customers are asked about their views on Scottish Water, and a transactional survey, in which we interview people who have had reason to contact us, usually about a problem of some sort. The ratings that we get from those customer surveys are relatively high. We got ratings of about 80 per cent for customer satisfaction in the transactional survey. Those ratings dipped in August, when the wet weather resulted in quite a few flooding incidents—including repeat flooding in some places—which understandably was reflected in reduced scores. Nevertheless, apart from that kind of blip, which can be attributed to a particular event, we are on a rising trend.

The issue is cultural. I agree that the quality of service is more important than the speed. We can improve service quality through a progressive shift over time. We have to get the right kind of people—people who are motivated by providing good service rather than by operating assets—to interface with our customers. We are on a journey to improve progressively the way in which the business behaves.

Shirley-Anne Somerville: Have you set targets for customer service parameters?

Richard Ackroyd: At the moment, there is no regulatory target around those parameters. However, we anticipate that it is coming soon, and that the OPA measure will change in the near future to take account of such qualitative measures, to enable comparisons to be made with companies in England and Wales.

Shirley-Anne Somerville: So you have set no internal targets, as you are waiting for the OPA to change.

Richard Ackroyd: We have internal targets for the current measures. I am struggling to remember off the top of my head exactly what they are. We are not quite there yet—we are slightly below our targets—but we are on a rising trend.

Shirley-Anne Somerville: It would be useful if you wrote to the committee with anything that you wish to add.

Richard Ackroyd: Sure.

Shirley-Anne Somerville: In evidence to the committee, the drinking water quality regulator for Scotland stated:

“customers’ perception is not being addressed as well as it might be”

in relation to

“parameters ... such as taste, odour and discolouration.”—
[*Official Report, Transport, Infrastructure and Climate Change Committee*, 4 November 2008; c 959-960.]

How do you evaluate customer perception on such issues, despite the fact that you might be meeting your regulatory targets?

Richard Ackroyd: The crude measure for such issues is currently the number of complaints. The taste of water is quite subjective, and we can only find out how people feel about it by asking them. We are aware that it is an issue, and that some people find the chlorine taste in particular quite unpleasant. That can usually be improved quite a lot by putting the water in a jug in the fridge to chill it, which takes away the chlorine taste. However, it cannot always be eradicated. If someone lives close to the outlet of a water treatment works, they will experience a higher level of chlorine in the water than will a household a few miles away—there is a gradual degradation through the system. It is not possible for us to ensure a consistently even level throughout the system.

Shirley-Anne Somerville: I appreciate that, but there is still a perception among some customers that the drinking water is unpleasant, and it is not just their tough luck because they happen to live at a particular point in the system.

You mentioned that the measure is the number of complaints, but that is not a proactive way for a company to deal with such issues. We are talking about a change in culture, rather than the company sitting back and waiting for people to complain. Is anything being done on that?

Geoff Aitkenhead: We are proactive on that as well as on observing, tracking and trending customer feedback and complaints. We collect over a third of a million water samples from customers’ taps during the year, which are tested in laboratories for a range of parameters. However, a group of our staff on a taste panel also test for taste and odour.

It is worth noting that the capital investment programme that we are running in the current regulatory period from 2006 to 2010 has a focus on drinking water quality in terms of a number of parameters and disinfection control, which keeps the level of disinfectant in the water between acceptable bands, so that it is an effective disinfectant and within the tolerance bands of taste and odour. By the end of the current regulatory period, more than 4 million of our customers will benefit from investment to improve disinfection control.

Alison McInnes (North East Scotland) (LD): The drinking water quality regulator’s report stated that there were 64 water quality event notifications in 2007-08. According to the regulator, Scottish Water is not taking measures to reduce the number of such notifications. Is that correct? If so, why are you not trying to reduce them?

Geoff Aitkenhead: Two definitions are used in this field: an event and an incident. We encourage our staff to report events in the same way that we encourage them to report near misses for health and safety. It is crucial that we understand what has happened every time a piece of equipment in a water treatment works fails, even if it has no impact on water quality. In the eyes of the drinking water quality regulator, an event is something that changes the risk of drinking water quality being affected. We encourage our staff to report such events so that we can understand what caused them and do something to prevent a recurrence. I would be concerned if the reporting of events suddenly disappeared or went off the radar screen, because we would not get the feedback that we need on how the assets are performing.

Alison McInnes: I understand the distinction that you have drawn. However, you said that you want to learn from each event, so one would expect the number of reported events to reduce eventually. Can you take any action to respond to events more quickly and to learn from them?

Geoff Aitkenhead: We can take certain actions. On each and every occasion, we examine the root cause of the event. I have just mentioned that the investment programme in the current period includes a considerable amount of investment in disinfection control and new disinfection equipment. The drinking water quality regulator rightly takes a great interest in such equipment, because if disinfection fails in a drinking water supply it puts the population at risk. We never want to be in that position, so we are upgrading disinfection equipment. That is an example of our learning from what has gone wrong and putting in better equipment to safeguard public health.

Alison McInnes: What actions do you take to ensure that information about events that happen in different geographic areas are shared across the company?

Geoff Aitkenhead: We run continuous improvement teams in each of the eight operating areas, which come together periodically under the auspices of our chief scientist. Included in the Scottish Water-wide group are the people who make decisions about asset investment and those who make decisions on how we operate. The various key players in Scottish Water therefore come together regularly to discuss drinking water quality and what has gone wrong or where risks have emerged, what we will do about it and how we will tackle it consistently across the company.

Des McNulty: I want to ask about your information technology systems—not the customer care issues, but the actual IT systems. I was given to understand that you plan to change significantly where your IT systems are run from, and that

there are concerns about standards in that context.

Ronnie Mercer: A new innovation and technology chap has started with us. I think that he has been in post for a few months.

Richard Ackroyd: It has been a few weeks.

Ronnie Mercer: It is not even a few months. We recognise that we might need to step up our IT game a bit. We depend hugely on telemetry—we monitor the whole country from a control room in Glasgow—so IT is a big subject for us. Richard Ackroyd can give you more detail.

Richard Ackroyd: We do not have any concerns about IT, other than that we see potential—

Des McNulty: Will you first explain what you are doing, Richard? Maybe we are talking to each other and no one else understands.

Richard Ackroyd: Let me check whether we are on the same wavelength. You might be referring to some changes that we made earlier this year when we let a series of contracts for IT service provision, some to UK service providers and some to overseas service providers. The arrangement has been in place for about six months and it appears to us to be working well within the parameters of what we set out to achieve. The prime reason for letting the contracts was to gain access to expertise that we did not have in-house and to make cost efficiencies in our IT service provision. Moving forward, the issue is how we maximise the potential of IT, which is an issue for businesses everywhere. We believe that we have the potential to do even more in that area.

Des McNulty: What percentage has been sourced outside the UK as opposed to being kept in Scotland?

Richard Ackroyd: I cannot give you a percentage now. However, as an example, our IT helpdesk is based in Portugal and we do some systems development work in India. Apart from that, it is all onshore. Is that right, Geoff?

Geoff Aitkenhead: Yes.

Des McNulty: Are you content with the specification and delivery standards that are being provided to you?

Richard Ackroyd: Absolutely.

The Convener: I move on to climate change. Scottish Water has acknowledged that it has a rising emissions trend. Can you put a figure on that?

Richard Ackroyd: There is a figure for our carbon footprint on page 12 of the annual report.

The figure quoted for 2007 is 469,000 tonnes of CO₂ equivalent. That will increase. You will see from the footprint chart on page 12 that most of our greenhouse gas emissions are driven by two things: pumping, because water is heavy and energy intensive to pump; and aeration, in modern treatment processes. The kind of legislative standards that we have to meet, particularly for improved waste water treatment, can only be met with energy-intensive treatment processes.

The issue that society as a whole and policy makers have to address over coming years is how we get the right balance. How do we improve the aquatic environment without increasing greenhouse gas emissions? All we can see is an increasing trend. We are making some progress in offsetting that by becoming more energy efficient in the way that we operate the business. Some of the things that we are doing are not rocket science. It is about ensuring that when you have a choice about when you operate plant, you operate it at times when there is less energy demand.

However, the biggest lever for improving our greenhouse gas emission performance is to offset by using renewable energy. In his opening remarks, the chairman gave the committee some examples of the things that we are doing. There is potential to go further. At the moment, we are working with partners to set up pilots to consider how we can increase our capacity, particularly for wind generation.

The Convener: I would like to stay with the current trend for the moment. We will come on to what can be done about it. You mentioned 469,000 tonnes of CO₂ equivalent. Can you tell me the scale of the upward trend?

14:45

Geoff Aitkenhead: In round figures, each four-year regulatory period—with the creation of new assets, particularly for waste water treatment—adds 10 per cent to our electricity consumption. We can take that figure as a surrogate for our carbon footprint.

The Convener: All other things being equal, is that a continuing trend?

Geoff Aitkenhead: Yes, at the moment.

The Convener: Can comparisons with other water companies or similar industries usefully be drawn? Does your performance on climate change and energy consumption compare well with that of other companies?

Richard Ackroyd: Comparisons can certainly be drawn with companies in England and Wales. Geography is a big driver. This is a generalisation, but in Scotland we benefit to a degree from the fact that most of the population lives on or close to

the coast, and the water is up in the hills and gravitates towards populations. That is not the case in all parts of the UK.

Our renewable generation is not as high as that of some water companies in England and Wales, but it is higher than that of other companies—we are in the pack. The challenge for us is to increase substantially our renewable capacity.

Ronnie Mercer: We are not currently asking for money to do that—we talked about that when we gave evidence on last year's annual report. It costs money to become carbon neutral, because you have to build things. However, through our commercial people we are pursuing electricity suppliers who might do that for us. Mott MacDonald is completing an exercise for us in which it is considering what can be achieved if we do not do anything but have it done by companies that are in the business. We will continue to consider that approach, so that instead of looking for a lot of money from our customers to do things ourselves, we get other people to do them, which I think would achieve what you are after.

The Convener: You will be well aware of the climate change targets that will be in the Scottish climate change bill, which we expect the Scottish Government to introduce in the next few days. As you know, the UK Committee on Climate Change, which might have a role in advising the Scottish Government, has advised that there should be a strengthened approach involving interim targets.

You said that there are things that the Government is doing or could do that might make it easier for you to reduce your carbon emissions. If we assume good will in that context, can Scottish Water's operations make a proportionate contribution to Scotland's climate change targets?

Richard Ackroyd: Yes, they absolutely can.

The Convener: The target is to achieve an 80 per cent reduction in emissions, and in the meantime a reasonable trajectory towards that.

Richard Ackroyd: There is no doubt that 80 per cent is very ambitious. We have a report that gives us a strong steer on what we would have to do to achieve an 80 per cent reduction. A big cost will be attached to that, because it involves the building of substantial amounts of wind generation plant, which raises many issues. Our approach is to say, "We do not have access to the capital that we need to do that, so we need to find partners who do have access to the capital." For our part, we can offer the facts that, first, we are a landowner, and secondly, we are the biggest consumer of electricity in Scotland, so we are an attractive customer and we will be even more attractive if we can offer the kind of power take-off contracts that generators want. The direction that we are taking is to partner with organisations that

can provide the capital and build the generating plant, so that we can take the renewable power.

The Convener: Aside from renewable energy generation, there are issues to do with leakage. There are good reasons apart from climate change for dealing with leakage—if you reduce leakage you will spend less money and energy on pushing around water that will not be used.

Can anything else be done on the efficient use of the water resource at the tap? Most electricity suppliers provide consumers with information about how to use less electricity, but I am not sure whether people receive similar messages from Scottish Water.

Richard Ackroyd: I want to mention how we design our engineering assets, which has potential. In the design of treatment works and distribution systems, we are taking far more account of the need to avoid pumping. The more we can use gravity, the better.

The impact of metering on demand is interesting. Although the surveys are now a few years old, the available evidence is that water metering has some impact on customer demand, but not much—the effect might be up to 10 per cent but it erodes over time. We also need to take into account the fact that metering is expensive, and that hardly any domestic households in Scotland are on water meters. The substantial costs of installing, reading and replacing water meters—meters have only a 10-year asset life—would have a big impact on customers' bills, so there is a question over whether the benefits would justify the costs. However, for a whole host of reasons, metering is, and will continue to be, on an upward trend south of the border. We need to take into account the degree to which we want metering to be available in Scotland.

The Convener: Devices that simply display how much water is consumed, without necessarily tying that into charging or metering, can make households more aware of their consumption. Companies that market such devices suggest that such awareness can help to reduce consumption. Have you considered testing out that hypothesis or making such devices available?

Richard Ackroyd: We have not tested that, but my view is that we have real data from England and Wales on what customers do when what they pay is based on metered consumption. To be perfectly honest, I think that meters with a price signal are likely to be more powerful than ones without it.

Des McNulty: Before Scottish Water came into being as an across-Scotland company, its three predecessor companies applied different charges, which were regional averages, given that the costs of providing water and sewerage services vary

from settlement to settlement. Does Scottish Water still assess the costs of providing services to individual customers or groups of customers? Is that part of Scottish Water's calculation of costs? Is it possible to provide a carbon cost for providing services to different categories or groups of customers? To some extent, that might influence people's thinking.

Douglas Millican: In terms of straight financial costs—if I may park carbon costs for a minute—we have a reasonably good understanding of the costs of supplying different groups of customers. In effect, that underpins our charging schemes. Given the principle of average charging across Scotland, we look at the costs of serving a particular group of customers across Scotland and ensure that the costs of serving that group are recovered through the charges for that group. All household customers in Scotland might be considered as one group of customers. We ensure that the costs of supplying household customers are recovered through the charges on households. Equally, we ensure that the charges of serving very large water users reflect the costs of serving such users. For each group across the country, the charges reflect the average cost of serving that group.

Carbon costing, or carbon accounting, is probably in its relative infancy compared with what it might be like in five or 10 years' time, but we are starting to consider such costs. For example, in looking at future capital projects, we are starting to consider how we properly take account of carbon costing. However, it is early days on that particular journey.

Des McNulty: I suspect that massively different costs are involved in providing water and sewerage services to an urban community that is close to a supply compared with serving a remote rural area, but I did not get a sense from Douglas Millican's answer that Scottish Water still measures that. Those differences would be measured if we had differential geographical charging. Does Scottish Water measure that?

Douglas Millican: Yes. We capture our costs at a pretty detailed level for each water operational zone and each sewerage zone across the country, so we have a fairly good understanding of the regional differences in the cost of supply. However, it is ministerial policy that charges should be harmonised across the country. People pay the same for a given level of service whether they are in Edinburgh or Lerwick.

Des McNulty: Is it possible for you to publish at least a summary of information on regional differences in costs of supply?

Douglas Millican: We are moving in the direction of doing that. Under the Water Services

etc (Scotland) Act 2005, business customers can get a differentiated charge or a reduction in the standard tariff if they do things that will save Scottish Water money—the facility is known as a section 29E arrangement. To support the development of that market, we are in the process of augmenting our existing asset capacity and development report with, among other things, details of headroom in infrastructure and local costs. We will work on that over the next six to 12 months.

Ronnie Mercer: To some degree, the creation of Scottish Water gave us the chance to equalise the customer service that people in Scotland receive, no matter where they live. We spend disproportionately in a geographical sense to do that—it is a fact of life. I take roadshows to all parts of the country, and we always look at what we spend in different areas. The differences are quite marked, but they give everyone the chance to receive the same service. Creating one company has made it possible to equalise customer service, which I understand is Parliament's policy.

The Convener: You could keep the committee informed of developments in the area.

Geoff Aitkenhead: Understanding the unit costs of production and transmission in each part of Scotland is linked to the issue of managing energy efficiency. In the business, we use our understanding of local costs of production and transmission to make choices. We have multiple feeds into many areas of Scotland, especially the central belt and larger urban areas. We make choices about which sources we will deploy to the maximum: Richard Ackroyd made the point that we use gravity sources to the maximum, where we can. In that decision-making process, minimising cost is always balanced with security of supply, to ensure that we safeguard the availability of water to everyone.

Alex Johnstone: I have a couple of questions that fall under the heading of climate change. I want to go back to a question that you answered a moment or two ago, on the electricity that you generate within your asset base. In your report, you state that currently you meet about 5 per cent of your electricity demand in that way and envisage increasing the figure to 10 per cent. You spoke about aspirational targets for the longer term, but how much is being done right now? How much progress are you making year on year towards generating within your asset base the electricity that you use?

Richard Ackroyd: In March this year, the figure was 5 per cent, as the report indicates. It is now November, and the figure is still probably about 5 per cent. However, as Ronnie Mercer mentioned, two big developments are in the pipeline. One is

the new treatment works in Glencorse, to serve Edinburgh, which is a big plant that will generate about two thirds of its power from turbines in the inlet and outlet mains. The second is the composting facility at Deerdykes. In the last couple of months, we have received consent from the Scottish Environment Protection Agency to build an electricity generation plant on the back of that. Those two developments represent another step forward. Geoff Aitkenhead will comment on other measures that we can introduce in the short term.

Geoff Aitkenhead: We are monitoring closely the development of technology in the area. The turbines that we have at the moment tend to have relatively high head loss across them. Turret, outside Crieff, is a good example. For many years, we have generated electricity to run the Turret water treatment works, but we also export electricity from the facility to the grid. However, the water comes out of a dam at a high level and falls to a treatment works with a significantly different elevation. The technology of the future will enable much more power generation from low head loss turbines. There is much less head differential across the turbines that we are installing at the new treatment works in Glencorse. The rate of progress is not fast at present, but we are watching the technology closely and we are more than ready to move into the arena when opportunities arise.

15:00

Alex Johnstone: My next question is on a different matter, although it also comes under the heading of climate change. The projections that have been made for climate change in the medium to long term show that parts of your asset base might be at risk. What risks do you anticipate will arise due to climate change and what impact will they have on your business?

Richard Ackroyd: The most immediate risk is flooding from rivers, particularly flooding of water treatment assets. Like the other water companies in the UK, we have done a piece of work to identify assets that are at risk. In May, we proposed some investment to address that in our first-draft business plan to the Water Industry Commission. The chairman was involved in a national review group on the matter, so he might wish to comment.

Ronnie Mercer: Water UK has considered the weather events that occurred last year. There was a massive problem with flooding in the Severn Trent Water area, where hundreds of thousands of customers were left without water. Heavy flooding also washed away water treatment plants in Yorkshire. Water UK is trying to pick out the assets that are the most vulnerable to one-off climate change events.

We think of climate change as a gradual increase in temperature over a number of years, with erosion of the coastline. That is one angle, but our interest in climate change lies in events such as the one-in-100-years storm that happened in England in 2007. We have to ask how many of our installations would be affected if we had such a storm, which is what Geoff Aitkenhead has been doing. He has also been examining what it would cost us to make things more robust and whether we could build walls around installations to protect them. Electricity companies are doing the same thing in relation to their substations.

We have a list of the installations that are most vulnerable to one-off climate change events, as opposed to long-term climate change events. As we sit here today, the former are just as important. The English companies have submitted massive plans to Ofwat and are saying that there is a lot that they need to take care of and that the cost of doing so will put bills up. There is a balance between what we can afford to do and the risk of one-off events that cause damage on the scale that Severn Trent Water suffered.

We have an advantage in that, in a number of places, our water supply is higher up—Glencorse is above Edinburgh and Milngavie is above Glasgow—so if bad flooding occurs, it will not affect those supplies. The Severn Trent Water installation that was flooded was on a river, which washed it out. We have a similar situation in Aberdeen, so there is a bigger chance that a problem will occur there than in Glasgow or Edinburgh. We have a risk analysis running all the time, and our audit committee is considering what we need to do. We are more into that than the long-term thing. We will gradually nibble away and become more self-sufficient in a generation.

The big step that we can take is for electricity suppliers to build on our sites—at their expense—and for us to use their electricity.

Alex Johnstone: Are you confident that the culture within Scottish Water is designed to adapt to and accommodate those risks over time?

Ronnie Mercer: Yes. We are alert to the risks. I was on a committee at Water UK in London, so we are aware that some of the things that happened in England had never happened before. The company that was washed out—Severn Trent Water—could not supply people with bottled water because the roads were flooded and it could not reach them—the company physically could not get water to people. We had never had animals suffer from drought before and it was thought that such things could never happen. In such situations, we have to think outside the box and I am happy that our people at the top end of the business are doing just that. They are examining what happened in England and considering what we

could do to contain the problems if the same things happened here.

The answer to the question is “Yes—but we have not yet built walls around everything.” We are still considering what we might need to do to get to that point. That is our job—that is what we have to do.

Rob Gibson (Highlands and Islands) (SNP): I turn to complaints, which is an important matter for customers. Gary Womersley from Waterwatch Scotland told the committee that

“the largest number of customer complaints comes under the Scottish Water customer service heading. That tells us that it is still within Scottish Water’s gift to remedy those complaints.”—[*Official Report, Transport, Infrastructure and Climate Change Committee*, 7 October 2008; c 858.]

Why are there still so many complaints in this area?

Ronnie Mercer: Was he talking about industrial or domestic customers?

Rob Gibson: I think he was talking about domestic customers.

Ronnie Mercer: We get a lot of calls that are not complaints, but inquiries or requests for clarification. We still think that the number of those calls is too high, but they are not actually complaints. We get complaints about loads of things, including discoloured water—an issue that has been talked about today and something that we feel we should be tackling, despite the fact that the water is technically good enough to drink. There is a downward trend in the number of complaints that we receive.

Richard Ackroyd: There is a downward trend. What can we do about the situation? The biggest thing that we can do is prevent things from going wrong. In the six months or so during which I have been at Scottish Water, the organisation has shown that it is brilliant at recovering when things go wrong. However, the challenge is in avoiding things going wrong in the first place. That is part of the culture change that we are undergoing in the business. If we can get things right the first time, that will improve issues for the customer and reduce the number of complaints, but it will also save us money. Going back to fix things costs money.

Rob Gibson: On complaints—I was going to raise this earlier, but it is pertinent now—you have talked about the 29 odour and sewage treatment problems that are being dealt with. The report states that there were seven in 2007-08 and eight in 2006-08 and that it is planned that 14 will be addressed between 2006 and 2010. You say that 13 other improvements have been agreed with the Scottish odour steering group: those improvements will be completed by March 2010. A

lot of questions about odour are being asked of you. Where have those questions come from?

Ronnie Mercer: Odour is big on our radar and it is an issue that worsens from time to time. Everybody knows about what we are doing at Seafeld, but what are we doing everywhere else? I can see “Dalmuir” on Des McNulty’s lips. We are undertaking work in other places, as well. Geoff Aitkenhead might be the best person to tell us a wee bit about the odour assault—if I can call it that—that we are pursuing. You are right to suggest that odour is a big issue for us.

Geoff Aitkenhead: The Scottish odour steering group consists of people from the Scottish Government and Scottish Water. At the beginning of the current regulatory period, we identified the waste water treatment works that were the root cause of most customer complaints about odours, and we prioritised those for investment through this period. A concerted effort has been made around the works that were prioritised for action, and the investment plan is delivering across those. We will complete that job in the next regulatory period. The list was identified for the eight years of quality and standards III—2006 to 2014—so it is work in progress.

We have invested in odour management. For example, we had quite a serious problem two years ago in Eyemouth in the Borders, but the steps that were taken have been effective. We are seeing a difference in communities where investment has been made.

Rob Gibson: I am particularly interested in whether you can give us any examples from the past one or two years. How many people complained about the odour from Seafeld? Can you give us that figure?

Richard Ackroyd: I do not think we can give you a figure off the top of our heads. We could find that out.

Ronnie Mercer: Yes—we have that figure logged somewhere. The figure for this year is probably lower than the figure for the previous year because of the summer that we had. The problem varies with the weather.

Rob Gibson: I know. I am asking how much is being spent on tackling the problem and what priority is being given to it. Seafeld has a large catchment of people, so I would be surprised if it did not attract a higher number of complaints. It is, however, a massive problem compared to the problems in Eyemouth, Dingwall or wherever.

Richard Ackroyd: Indeed, and Seafeld is going to be sorted, although it will not be cheap to sort it. It will cost something in the order of £35 million to install odour protection equipment there, which

takes us right to the heart of the difficult choices that have to be made.

Rob Gibson: I have asked questions about the issue for several years, so it is nice to hear about the latest situation. It takes years to deal with the problems, and I understand the background. It would be interesting to know whether customer complaints include complaints about odour or whether they are separate. Some idea of the number of complaints would also be helpful.

Ronnie Mercer: We talk about odour complaints separately. Odour complaints tend to be in a different box, so the information on the numbers probably exists.

Rob Gibson: That is very handy.

Des McNulty: My recollection is that, when places with odour problems were identified, certainly Dalmuir and possibly Seafeld were left off the list because, at that time, you did not have a solution for the problems. One problem—particularly for Dalmuir, and you can confirm whether the same is true for Seafeld—is that they were early private finance initiative projects that were misspecified. Although there have been some attempts to re-engineer Dalmuir, there are still some fundamental problems and it requires substantial investment to make it fit for purpose. Did you say that you have secured agreement in principle from the Water Industry Commission for Scotland to spend the money that is needed to resolve the situation at Seafeld? If so, is the same true of Dalmuir, or are we not at that point yet?

Ronnie Mercer: We can say that we have identified the amount of money that is needed to fix it.

Des McNulty: Do you mean the amount that is needed to fix Seafeld or Dalmuir?

Ronnie Mercer: Seafeld. Douglas Millican will comment on Dalmuir, as he has worked on it.

Douglas Millican: It takes a long time to solve the problems. On Seafeld, we now have an agreement with the City of Edinburgh Council on the odour improvements that are to be made under the plan. We are going through a process with the PFI company to tender for bids to do that work. We expect the work to begin in spring 2009—there will be nearly two years of construction, so it will be 2011 before the full improvements are made. The work is big and complex. We have a clear agreement with the City of Edinburgh Council, as the regulatory authority on the improvements, and we will incorporate that in our regulatory submission to the WIC for the next price review. However, we are getting on with making the improvements in any case.

On Dalmuir, we have gone through a process with the PFI company of making several

improvements to the site in the past couple of years. We are also, with the local authority, in the second phase of an odour improvement plan. No more substantive works are currently planned, but we are in regular dialogue with the PFI company and are meeting senior management tomorrow.

The Convener: Still on complaints, we go back to Rob Gibson.

Rob Gibson: We have cleared the air on that issue. [*Laughter.*] Well—I had time to think about that one.

Poor performance in claims handling has been identified. Does that affect Scottish Water's reputation?

Richard Ackroyd: I am sorry—who has identified poor performance?

Rob Gibson: It is to do with the claims handling organisation Gallagher Bassett.

Richard Ackroyd: Some people have expressed to us the view that it is not appropriate that Gallagher Bassett and other such organisations—let us not personalise it by talking about one company—handle claims. I do not agree. In a contentious situation in which a person is claiming X compensation and we do not agree that they are entitled to it, a process must be gone through to resolve that, and experts are needed. Some issues move from customer service to dispute resolution, which is when expertise is needed.

Rob Gibson: Waterwatch Scotland said that the issue is still a cause for concern. Is it becoming less so? In next year's annual report, will you be able to tell us that things have got better?

15:15

Richard Ackroyd: It depends on the concern. People who do not get what they think they ought to get are usually concerned. That is what is usually at the bottom of such things.

Rob Gibson: What are you doing to address concerns about the claims-handling process? Are you changing your methods? Are you changing the company that you use?

Richard Ackroyd: We are not planning any particularly radical changes. I take the point that people's views must be fully aired and understood. We must treat people with respect—by and large, we do. However, isolated instances will always arise. If they come to our attention, we will address them.

Rob Gibson: On compensation, we have heard about guaranteed service standard payments being paid to people who do not actually need

them. How are you changing the system as a result of complaints?

Douglas Millican: The GSS has been in place for some time. When we sent our first plan to the Water Industry Commission for Scotland last year, we set out the concept of moving towards providing a rebate of charges to customers when we failed to provide the service that they had, in effect, paid for. We are developing that theme, and there will be an updated position in the business plan that will go to the commission in March. Ultimately, that work will be inextricably tied in with improvements that we will be able to finance.

The updated business plan will go through the price determination process—as mentioned earlier—through to autumn next year. Our customer code of practice will then say exactly how the system will operate from 2010 onwards.

Rob Gibson: You are realigning your approach to new concerns of customers.

Douglas Millican: Yes.

Rob Gibson: How much does the complaints procedure cost the company? How many people are needed?

Richard Ackroyd: I would need to obtain precise data before I could give such figures to the committee.

Rob Gibson: Could the data be compared with data from England and Wales?

Richard Ackroyd: No comparators are published, as far as I know—although there are comparators for the amount of compensation that is paid out under the various schemes.

Scottish Water employs a lot of people in customer contact. The chairman said earlier that not every contact is a complaint. Equally, if we can be proactive and can visit dissatisfied people to discuss their concerns, we can resolve those concerns to everybody's satisfaction in 90 per cent of cases. We put more focus on that type of activity than do some of the companies south of the border. That costs us, but it is the right thing to do from a customer service perspective. It protects our reputation and is probably a key part of improving the customer service culture in the business.

Rob Gibson: It would be useful to have information on that in the annual report.

Richard Ackroyd: We can get you some information.

Douglas Millican: Yes. Complaints handling is a relatively minor part of our overall costs. If we consider our GSS performance, we see that it is consistently above 99 per cent. Complaints are very much the exception rather than the rule.

Charlie Gordon (Glasgow Cathcart) (Lab): Mr Mercer, in your pre-emptive stri—I beg your pardon. In your opening statement, you referred to regulatory sign-off of capital projects. You drew a distinction between completion of a project and its coming into operation as a new asset and its subsequent sign-off. We got the impression that sign-off was a bureaucratic requirement that could and should be speeded up.

However, Sir Ian Byatt recently said:

“Although ... Scottish Water increased the value of the programme that had reached the construction stage, relatively little had been delivered to the project completion stage and even less had been signed off by the quality regulators as fit for purpose.”

There appear to be two stages: the project completion stage and regulatory sign-off. Will you tell me a bit more about why he is critical of the proportion of the programme that has been completed quickly?

Ronnie Mercer: An outputs monitoring group meets every three months to consider the outputs that are the results of what we have spent. The Government, the regulator and Scottish Water are part of that group. As Charlie Gordon correctly said, it is not just about spending £625 million, but about what we get for it. At the end of the year, we are judged as much on the outputs that we have achieved as on the money that we have spent. I understand that we are up there on the outputs, although we certainly failed on some of the regulatory sign-offs—we put our hands up to that—but I shall ask the members of that monitoring group about that. I think that Geoff Aitkenhead is on it.

Geoff Aitkenhead: Three distinct stages in the life of a project are relevant. The first is completing the asset sufficiently to put it into use, so that our customers get benefit from the investment. That is a key stage in the development of any project. There is a second stage of getting an acceptance certificate within Scottish Water for that new asset, which involves handing over its operation to our colleagues in the operations part of the business.

Charlie Gordon: In effect, that would be the commissioning of the new project.

Geoff Aitkenhead: It is post commissioning; at the beneficial-use stage—the first of the three stages—we commission the asset. We put it through some rigorous tests, put it into use and the customers get the benefit of it. The acceptance stage comes when we have completed the training of the operators and all the operation and maintenance manuals are in place. Our operators then sign a certificate to confirm their acceptance. With those stages behind us, we look to the regulator to verify that the investment has been delivered and that it does what it is supposed to

do. We now have an agreement with them that three months are allowed between acceptance and regulatory sign-off.

Charlie Gordon: You said that Sir Ian Byatt was being critical when he spoke to the committee about the second and third stages.

Geoff Aitkenhead: Sir Ian Byatt's doubts are about the verification process, in which the quality regulators—either SEPA or the drinking water quality regulator for Scotland—come to Scottish Water to verify that the investment has been made and that it does what it is supposed to do.

Charlie Gordon: I thought that Sir Ian was making bald statements rather than merely expressing doubts. He was drawing attention to what he appears to regard as a failure in the process.

Ronnie Mercer: We took him up on that because I felt that what he said was not the case. What is the point of having an outputs monitoring group that measures outputs every quarter and states whether they are okay if he is going to say that? I think that he was swayed by the regulatory sign-off. As far as he is concerned, the asset does not really exist until we get that sign-off, because the regulator might turn it down. There is something to that, because we might accept something that Sir Ian, SEPA or the drinking water quality regulator would not, but we felt that there was a wee bit of a mix-up. Regulatory sign-off is important and the investment might fail at that point because the regulator does not agree to sign off the asset, but the beneficial-use stage means that the output already exists. We took that up with him and told him that we thought he had given a wrong impression. We agreed to disagree on it.

Charlie Gordon: I am just trying to clear up the systematic ambiguity.

Ronnie Mercer: Sure. It is a good point.

Charlie Gordon: I tend to accept that, in the real world, although the dragging of the regulatory sign-off is a problem, it is not a show-stopper. The process appeared to have only two stages but, in fact, it has three stages because there is also the quality sign-off. The regulator takes the view that that is a problem, but you say that the asset comes into operational use—I accept that ordinary people would consider that to be the most relevant indicator—and that there is an output monitoring system. In effect, you are saying that there are four elements to the system.

Ronnie Mercer: Every three months, the output monitoring group looks at what we are having built and what the outputs are. The Government sits on that group—correctly so, given that it is helping to fund some of the activity. If we were not getting any outputs, the group would certainly have

flagged that up; I do not think that, in this case, that is what it was saying. It was saying that outputs were being delivered. Rightly, however, Sir Ian Byatt said, "You didn't get the regulatory sign-off, so as far as we're concerned, things might not be right until you do."

Charlie Gordon: Although you have accepted that there is a problem and that there is room for improvement, you do not see it as a major concern.

Ronnie Mercer: No—but we should definitely get slicker at regulatory sign-off. Occasionally, sign-off might be held up because, although outputs are being delivered and customers are getting the benefit, something might not be quite right. If, for example, we find ourselves having to use three rather than two pumps, we might say to a contractor, "We're not signing that off. The output is kind of being delivered, but it's not working the way it should." On those odd occasions, we might not pay the last 5 per cent of the money. However, as I say, we accept that we have to get better at sign-off, because it looks as if we have not done something that by and large has been done.

Charlie Gordon: In January, the Water Industry Commission for Scotland expressed concern that Scottish Water might not be able to deliver the investment programme efficiently—in other words, without putting pressure on the contracting market. I repeat that the comment was made in January. [*Laughter.*] By that, the commission meant that you might take up all the contracting capacity. As a result, other school, road or hospital projects might not go ahead and there might be a negative impact on everyday life because of, for example, the many road works that are caused by your operations.

In recent evidence, Sir Ian Byatt told the committee that, in work that had been carried out to identify what size of programme would be efficient, the conclusion was that it would be of the order of £450 million to £500 million rather than the £600 million-plus programme that we are discussing this afternoon and which is being carried out. I appreciate that current events might have overtaken such matters, but have you been affected by pressure in the contracting market?

Ronnie Mercer: No matter whether the market contracts, we would like the spend to be a bit lower so that it is more manageable. Of all the people sitting at the table, Geoff Aitkenhead has pretty much the hardest job almost all the time, because it is very difficult to keep the whole show running, spend at that rate and get the outputs. Regardless of whether the contracting market exists, I and—looking down the table—the team would like the spend to be £500 million rather than £600 million a year.

In any case, I am not so sure that our market has shrunk markedly. House building is another matter, but I am not sure that in the game that we are in, in which our projects are up against the M74 and the next Forth bridge, things are so different yet.

Geoff Aitkenhead might wish to comment.

Geoff Aitkenhead: In 2006-07, which was the first year of the current regulatory period, we found it difficult to mobilise the engineering resource, by which I mean the design engineers and the guys who could put contracts together. We needed between 800 and 1,000 engineers to get the programme designed and under way.

In the final quarter of 2007-08, we hit a peak in the contracting and constructing resource, which is the focus in the middle of the regulatory period. It was not easy to get the resource that we needed, because the civil engineering sector was very hot at the time. That sector is still busy, although in the current circumstances work is falling off, but not as quickly as it is in the building sector.

Something that will help is the break the cycle initiative, which seeks to smooth out the profile of delivery over regulatory periods. As the history of regulated utilities shows, there is a boom-and-bust cycle in the construction part of the business. Towards the end of the regulatory period, construction activity dies down and, because no one knows what will be in the next regulatory contract, work is not started. In 2005-06, at the end of the previous regulatory period, we let go the engineering resource that worked for Scottish Water, only to have to try and get it back again in 2007.

This year and next year, we will keep the engineering skills here in Scotland by starting work early on the feasibility and design of the 2010 to 2014 programme. That is not perfect, but we are trying hard to take the massive dip out of engineering activity and to retain the skills base in Scotland.

15:30

Charlie Gordon: You have told us the size of programme that you prefer because of pressures on project management and what I call the lumpiness of programmes. If those issues were addressed and the scenario changed, could that result in increased costs?

Geoff Aitkenhead: No—the reverse is the case. The result will be more efficiency. If we can produce a smooth profile of work from 2010 to 2014, we can go to the market with our order book to share with the supply chain the work that is coming in its direction, so firms can plan for and resource it and share the efficiencies of that

planning with us. We honestly believe that, through smoothing the profile and working with the supply chain, we will realise efficiencies.

Des McNulty: Under the Flood Risk Management (Scotland) Bill, which Parliament is considering, Scottish Water is designated as a responsible authority and given a duty to exercise flood risk management functions. How will the bill's requirements affect Scottish Water's current and future investment programmes? How well geared up are you to exercise the role that the bill sets out for you?

Richard Ackroyd: We are in new territory. We need more dialogue with SEPA and with councils. The broad issue is how we deal with flood water in ways that do not involve building great big storage tanks or laying huge new lengths of sewer, because that is expensive in cash and carbon terms.

Geoff Aitkenhead can talk about what we are doing in Glasgow, which is a good example of the way forward.

Geoff Aitkenhead: The essence of the bill—that all the agencies should work together—is really important. There are various accountabilities and responsibilities for flooding, and clarity in that landscape will help.

The work that we are doing in Glasgow is important as it exemplifies how agencies can work together to address flooding issues and, in particular, to develop surface water management plans. Glasgow City Council planners are showing a lot of foresight in their plans for the Commonwealth games village and by including sustainable urban drainage systems in plans. We are working closely with them to understand our contribution to those plans and to develop integrated solutions to surface water flooding, which has hit Glasgow's east end over the years.

That model can be used elsewhere. It hinges on local authorities, SEPA and Scottish Water. Local authorities act not only as planning authorities, but as highway authorities in relation to understanding the effect of highway drainage on surface water flows.

We will play a full part in developing flood risk management plans, in which I see significant scope for surface water management, rather than enhancing the size of the infrastructure below ground, which would be impossibly expensive.

Des McNulty: My question focused on the bill's impact on your current and future investment programmes. I know that it irritates organisations such as Scottish Water to find halfway through a regulatory period that new duties have suddenly been imposed on them, as probably happened with SUDS in the first place. Are you confident that

the dialogue is happening and that the mechanism through which you work with the WIC is sufficiently flexible to allow you to do what you need to do without undue tensions?

Geoff Aitkenhead: In the second draft business plan, which we will submit in March, we have allowed a sum for the studies that will be needed to develop flood risk management plans.

Following our discussions with local authorities and SEPA, we decided that, in the immediate future—so this is in our next business plan—we will get the studies done, which will involve understanding the scope and scale of the problems and thereafter deciding on the right integrated solution for Scottish Water and local authorities in particular to work on and put in place. We have made an allowance in the second draft of the business plan to fund the studies that will be needed.

Des McNulty: Is there anything that you would like Scottish Government ministers or the WIC to do to help you discharge your obligations?

Richard Ackroyd: Planning is key. We will be happy if we get the resources to do the studies and the planning.

Geoff Aitkenhead: We discussed the issue with the commission, which has an open mind, particularly on big schemes such as the Glasgow scheme. We must acknowledge that the solution will be implemented over several regulatory periods, so we should look for ways to secure the funding, albeit in price-review-period chunks. It is not a finite project for one regulatory period but will run over several periods. Clearly, the discussions must continue with the commission, which needs to understand how the process will work in practice, but it is open to working with us and Glasgow City Council to understand how such large urban schemes will be funded over several regulatory periods.

Ronnie Mercer: The English and Welsh group that I was asked to join to help with its problems used the Glasgow situation as a good example of how a council and a company could get together to map things out. There is no point in the company doing certain things if the council does not do its bit with other waterways. The English and Welsh group used the Glasgow situation as a good example of a company and a council getting together to discuss how to get a holistic solution, if I may use the current jargon. We therefore have a wee bit of form in that regard.

Des McNulty: I will move on to a different topic.

When Sir Ian Byatt appeared before us last month, he was positive about Scottish Water and its achievements. He was probably most positive about the introduction of Scottish Water Business

Stream, which he said was an innovation in Scotland and meant that things were being done differently and in a different style. What is your view of those differences?

Ronnie Mercer: I will pull in Johanna Dow—for a start, she is here, which is good.

We have separated Business Stream completely from Scottish Water. It has different people in it—people who are used to the retail world, which is not one that we had to be in before. Sir Ian Byatt has visited Business Stream, and I can understand why he thought that it looked and felt different. However, the main point is not whether we think that it is different but whether the customers think that it is different. That is the only thing that matters. Johanna Dow should be asked about that because she deals with the customers.

Johanna Dow (Scottish Water Business Stream): I do that on a daily basis.

Ronnie Mercer: Tell Des McNulty a wee bit about what the customers think.

Johanna Dow: The introduction of competition into the Scottish market had three aims: to drive value for money for customers; to offer them improved service; and to introduce innovation into the market. What has happened in Business Stream in a short time has ticked all those boxes. On value for money, we have found already that the threat of competition has been enough to drive a complete transformation in the industry. Thirty per cent of the customer base now pay less in business charges than they did previously, and they are being offered discounts on the published tariffs that were agreed with the WIC.

On innovation, we now have a business solutions capability in the business that looks at many environmental incentives to help our customers reduce their water consumption—innovation plays a big part in that. For example, we have smart metering technology, water loggers and so on, which help customers to track their consumption on individual sites with a view to reducing their overall consumption and, ultimately, their water bills. Other innovations are the introduction of e-billing tariffs and allowing our customers to input all their meter readings and view their bills online. Again, all those aspects are innovative, and they ultimately help the customer to reduce their overall bill.

On improved services, we now offer a complete package of at least 60 different services to our customers. We find that competition has helped to drive and improve the level of service that is available to customers. I guess the ultimate measure is customer satisfaction. We have found that, over the period of competition, customer satisfaction has improved significantly, which is

always a good barometer that something is working.

Des McNulty: I am sure that my colleagues have other questions, but I want to follow that up. Is there a read-across whereby you might consider doing for domestic customers some of the things that you do in the business setting? Although Business Stream is separated out, is there a flow of good practice from it into the domestic setting?

One of the arguments against taking business customers away from domestic customers was that you have a relatively fixed supply cost. Have the improvements for business customers potentially come at the expense of domestic consumers? Can you offer us any view on that and on what will happen perhaps not immediately but in the longer term? Will the balance between business charges and domestic charges change?

Richard Ackroyd: The first thing to say about charging is that the WIC sets charges—it sets the retail charge for the household customers and the wholesale tariff for the business customers. I ask Douglas Millican to tell you how cross-subsidies and costs are dealt with.

Douglas Millican: I go back to my earlier answer, which was that we need to ensure that the charges that we recover from each sector cover the costs of each sector. When business separation was taking place and Business Stream was being taken out of Scottish Water, we identified that roughly 90 per cent of the cost of servicing business customers came from wholesale supply—the physical supply of water and the physical taking away of waste water—and that, on average, 10 per cent was to do with the retail and customer service aspect that went across to Business Stream. We still charge Business Stream—or, indeed, any other retailer—the 90 per cent element.

The financial risk to us is one whereby if Business Stream is helping its customers to reduce their water consumption, we lose 90 per cent of the value of any reduction. However, pre-separation, Scottish Water was trying to encourage our customers to reduce their water consumption, because that is good environmental practice and it improves their efficiency, so we have run that risk for some time.

One of the benefits that has come from separation is that, as well as the commercial agreement, a series of codes and agreements govern the relationship between us and retailers. The key code is an operational code that sets out clearly the terms and conditions of service that we must provide to Business Stream and other retailers. That has helped to sharpen up some of the processes inside Scottish Water, which is to

the benefit of not just business customers but household customers.

Des McNulty: Can you give us any examples of that?

Douglas Millican: One example is speed of response to customer requests and how we deal with issues where there might be a risk of service failure.

Shirley-Anne Somerville: We heard from Sir Ian Byatt that there were large organisations with a large number of water connections that could benefit from the retail market opening up. Do you think that customers have enough awareness that that market has opened up to competition and understand how they will benefit from it?

Ronnie Mercer: Given that Jo Dow is an accountant, I am sure that she can quote you a figure. We do brand awareness exercises.

Johanna Dow: There is very good awareness that the market has opened up to competition, particularly among our largest industrial customers. There is probably less awareness at the smaller end of the market, among small and medium-sized enterprises, such as hairdressers and high street businesses. The WIC is doing a good job of publicising the fact that the market has opened up to competition, which helps. We are running our own campaigns, too. As Ronnie Mercer said, brand awareness is the key thing that we measure now. When we set up Business Stream there was virtually no brand awareness at all. As far as everybody was concerned, they were being served by either Scottish Water or the water board. Since we started trading, we have got brand awareness up to about 37 per cent. The target for the end of this year is to get it up to 50 per cent.

In the past, the only correspondence that customers had from Scottish Water was the bill, which was quite a negative experience. People now get their bills from Business Stream. We are much more proactive, as you might imagine, because we are a retail organisation, so we are writing to people to tell them about water efficiency and how they can reduce their bills, all of which helps.

15:45

Ronnie Mercer: It is a wee bit ironic, because by pushing brand awareness we are telling the market that it can go somewhere else. We are almost advertising the market, which is interesting, but we are doing the brand awareness campaign because we think that it is the right thing to do.

Shirley-Anne Somerville: How are you doing that? Are you prioritising larger companies and organisations?

Johanna Dow: We are doing it wholesale. However, the industrial sector is more aware of us because the bigger customers usually have one-to-one account management—a person will sit down with them quarterly. In general, we make contact with our smaller customers only through correspondence or by telephone. The onus will always be on the larger customers, because there is face-to-face contact with them.

Shirley-Anne Somerville: You said that about 30 per cent of customers have benefited. Were you talking about larger organisations? In the current circumstances, small and medium-sized enterprises will want to make savings, so it would be good if companies such as Business Stream focused on improving contact with that sector.

Johanna Dow: We are focusing on that part of the market. The 30 per cent figure includes our large industrial customers but covers a broad range of customers. This year we launched a direct debit campaign, which was very much targeted at SME customers. We are telling customers that if they are willing to pay by direct debit we will offer them a discount against their tariff.

In December or January we will launch a big programme for all our SME customers, which will be about efficiency savings. Our approach will be similar to the approach that has been taken in the electricity industry. We will write to customers to say, "Do you realise that simply by turning off your taps or taking other action you could reduce your bill by X per cent?"

Shirley-Anne Somerville: That leads me nicely to my next question. When Sir Ian Byatt gave evidence to the committee he said:

"There is a green tinge to the agenda."—[*Official Report, Transport, Infrastructure and Climate Change Committee*, 4 November 2008; c 972.]

You mentioned potential environmental benefits, such as a reduction in water consumption. What else is happening?

Johanna Dow: I mentioned initiatives such as smart metering. We have worked with a number of large customers, including Tesco and B&Q, to put smart meters on site and allow the customer to monitor and compare performance at different sites. For example, B&Q can monitor water consumption in similar-sized stores in Glasgow and Edinburgh, which allows comparisons to be made.

For large industrial customers we also offer rainwater harvesting. That is quite a new product, which is very environmentally focused. We are considering new incentives such as green tariffs, whereby we will offer customers a tailored tariff that is focused on improving water efficiency and reducing usage. A number of things are

happening—that is where the innovation ticket comes through. We have a chance to focus on driving change through the market by considering innovative solutions that we can offer.

Technology is changing all the time, so we are keeping an eye on what is happening in the market and trying to pick out best practice. A benefit of opening up the market to competition after the electricity and gas markets were opened up is that we can consider what happened in the electricity and gas markets, pick out what worked best and try to apply those approaches to the water industry.

Ronnie Mercer: Business Stream's solutions team is made up of a group of engineers and will grow during the next two years—I know that because I have read the business plan. The team has chipped in heavily.

Johanna Dow: That is definitely true. It is considering efficiency.

Ronnie Mercer: We send the team members out to sites and say, "Go, look."

Shirley-Anne Somerville: Is the good practice that you are picking up in the business sector being applied in the domestic sector wherever possible? Are lessons being learned?

Ronnie Mercer: It is hard to answer that, because the mindset in a retail company is quite different from the mindset in a wholesale company—we are glad of that when we see both companies in action.

We have metered all but about 8,000 business customers. Metering will not be physically possible for a handful of customers, so I think that a few thousand will be left over. A handful of customers do not want meters, and I do not know what we will do about that. By and large, however, most business customers will be metered. The metering project has been massive and has gone on for three years. For the first time, people know what they are using.

We were asked about domestic meters and I can tell members that the metering project has made customers damned interested in what the meters say—that is for sure.

Shirley-Anne Somerville: We talked about metering when we were talking about climate change. I take the point about the different cultures in different parts of the organisation, but it would be good if Scottish Water and Business Stream regarded the climate change agenda as a top priority that is equally important to both sides of the business. Is that happening? I understand that you have different agendas and operate in different settings, but there should be a shared agenda on climate change.

Ronnie Mercer: I think that it is shared. Business Stream chose Reforesting Scotland as its charity of the year. A green light is on in Business Stream; people do not think that only Scottish Water can be green because it builds things and pumps water. For example, the solutions team looks for on-site leaks, so that it can save big customers money. Businesses often do not realise that they are losing water and have been losing it for years.

Shirley-Anne Somerville: We talked about improvements that are being made as part of the environmental agenda. Is competition creating barriers or unforeseen problems in that regard?

Johanna Dow: In all honesty, I think not. The opening up of the market to competition is driving innovation and is constantly bringing in new retailers, who offer new services and products, all of which is positive. I struggle to think of any negative connotations of competition in that regard.

Ronnie Mercer: I cannot think of any, either.

The Convener: That concludes our questions. I thank all the witnesses for taking the time to come and answer our questions. I think that the witnesses said that they would write to us with further information on one or two issues. We look forward to hearing from them.

Meeting closed at 15:51.

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