

TRANSPORT, INFRASTRUCTURE AND CLIMATE CHANGE COMMITTEE

Tuesday 22 September 2009

Session 3

£5.00

© Parliamentary copyright. Scottish Parliamentary Corporate Body 2009.

Applications for reproduction should be made in writing to the Information Policy Team, Office of the Queen's Printer for Scotland, Admail ADM4058, Edinburgh, EH1 1NG, or by email to:
licensing@oqps.gov.uk.

OQPS administers the copyright on behalf of the Scottish Parliamentary Corporate Body.

Printed and published in Scotland on behalf of the Scottish Parliamentary Corporate Body by
RR Donnelley.

CONTENTS

Tuesday 22 September 2009

Col.

DECISION ON TAKING BUSINESS IN PRIVATE.....	2081
“THE STRATEGIC REVIEW OF CHARGES 2010-14: THE DRAFT DETERMINATION”	2082

TRANSPORT, INFRASTRUCTURE AND CLIMATE CHANGE COMMITTEE 20th Meeting 2009, 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)
Murdo Fraser (Mid Scotland and Fife) (Con)
David Stewart (Highlands and Islands) (Lab)
*Jim Tolson (Dunfermline West) (LD)

*attended

THE FOLLOWING GAVE EVIDENCE:

Sir Ian Byatt (Water Industry Commission for Scotland)
Craig MacKenzie (Water Industry Commission for Scotland)

CLERK TO THE COMMITTEE

Steve Farrell

SENIOR ASSISTANT CLERK

Alastair Macfie

ASSISTANT CLERK

Clare O'Neill

LOCATION

Committee Room 5

Scottish Parliament

Transport, Infrastructure and Climate Change Committee

Tuesday 22 September 2009

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

Decision on Taking Business in Private

The Convener (Patrick Harvie): Welcome to the 20th meeting this year of the Transport, Infrastructure and Climate Change Committee. All mobile devices should be switched off.

We have apologies from Alex Johnstone and Alison McInnes. I welcome Jim Tolson, who is attending as a committee substitute.

Under the first item on our agenda, I seek the committee's agreement to take item 3 in private. It involves a discussion of the evidence that we are about to hear on "The Strategic Review of Charges 2010-14: The Draft Determination". Do we agree to take item 3 in private?

Members *indicated agreement.*

"The Strategic Review of Charges 2010-14: The Draft Determination"

14:02

The Convener: With us for our main item of business we have Sir Ian Byatt, the chairman of the Water Industry Commission for Scotland, and Craig MacKenzie, an analyst from that body. I welcome them both to the committee and invite them to make a few opening remarks.

Sir Ian Byatt (Water Industry Commission for Scotland): It is a pleasure to be here, and we thank you for inviting us.

We are currently consulting on our draft determination, which was published at the end of June. Today's meeting provides us with a timely opportunity to answer any questions that you have. We have brought with us a one-page summary of the key messages, which Katherine Russell can give to your officials to distribute.

Our particular function is to work with other regulators and set the prices that Scottish Water can charge its customers. For the years from 2010 to 2015, we have proposed that the charges to household customers should rise by 1.5 per cent below the rate of inflation.

I have talked about a five-year period. In the draft determination document, you will see that we have tables for four years and five years. Originally, we thought that we were doing a four-year determination but we suggested to the Scottish ministers that it should be a five-year determination and they agreed. That is why we are talking about a five-year period, starting from next April.

The price limits that I mentioned would allow Scottish Water to improve our environment and address its duties around public health compliance and customer service.

The determination also depends on the Scottish Government lending money to Scottish Water to help finance its investment programme. Part of that programme is financed by customers and part is financed by borrowing from the Scottish Government. The Scottish Government budget will make not more than £150 million a year available. Our determination is based on the assumption that Scottish Water will need £140 million a year for the five-year period. We are also quite concerned about the timing of that. Anyone who is running a capital programme needs to know that the money is ready when the projects are all lined up. Our determination therefore proposes that £140 million should be borrowed each year, and that it should then go into a reserve fund on which Scottish

Water can draw as it sorts out its capital programme. To go back to the sort of annuality that I lived with when I worked in the Treasury back in the 1970s and 1980s would not give an efficient capital programme.

The determination is a draft. We have invited representations from everyone in Scotland, and that consultation closes tomorrow. We will look at all the representations and decide on what is best, and we will announce our final decision in late November.

I hope that we can be helpful to the committee, convener.

The Convener: Thank you. We will move on with questioning.

The Rural Affairs and Environment Committee's stage 1 report on the Flood Risk Management (Scotland) Bill questioned whether the commission's regulatory regime

"has led to an over-emphasis on purely financial considerations"

to the exclusion of sustainability factors, and it asked whether that required further investigation by the Scottish Government. What are your views on that comment from the Rural Affairs and Environment Committee? If you agree with it to any extent, what ought to be done about it?

Sir Ian Byatt: I certainly think that our main job is a financial job. It is to ensure that customers pay the lowest reasonable cost of fulfilling ministerial objectives. However, those objectives will include sustainability, and I suggest that the operation works best if ministers define their sustainability objectives. Once that is done, it is our job to make sure that they are financed at the lowest reasonable cost. Of course, we work closely with the other regulators. The drinking water quality regulator and the Scottish Environment Protection Agency also define what needs to be done. If you like, we are the financial arm of an integrated system.

The Convener: The draft determination states that it is

"Good for sustainable development in Scotland".

If you are saying that Government needs to define its sustainability criteria better, how can you say that the draft determination is "Good for sustainable development" if that has not been clearly defined?

Sir Ian Byatt: With respect, convener, I did not say that the Government needs to define its criteria better; I said that ministers will define them, and that that is their job. I am not suggesting that they do not do it well. Directions are set out and we follow the draft directions, which ministers firm up. We make sure that we work to getting the

lowest reasonable cost of fulfilling ministerial objectives.

The Convener: In what way, then, does the draft determination require Scottish Water to have regard to social and environmental factors as well as economic ones?

Sir Ian Byatt: I will pitch in first on environmental matters. Leakage is a matter of considerable concern to a number of people. We have set Scottish Water targets for leakage, and we have also encouraged it to do a good deal of work to understand leakage, which is different in different parts of Scotland. There is a whole programme there, and we allocated money to Scottish Water in the last determination so that it would get on with leakage. That is one big area.

In our determination we have also set aside a sum of money—about £245 million—that has not yet been allocated. That is a matter for ministers working with SEPA. Quite a lot of that money probably needs to be spent in Glasgow. Therefore, a sum of money is available to deal with environmental matters. There are also, of course, the ministers' priority objectives, which have already been laid down. All those objectives are being financed.

The Convener: So whatever the extent to which the Rural Affairs and Environment Committee made fair comment in its report, it is a matter for the Scottish ministers to give clearer guidance or to set different objectives if that comment is to be acted on.

Sir Ian Byatt: I remember talking to the chairman of SEPA, who pointed out that he has a sustainability objective whereas I do not. I replied that that was because we take the sustainability objectives from other people; our job is to finance them. So we are involved in sustainability.

Shirley-Anne Somerville (Lothians) (SNP): How well has Scottish Water done in achieving its targets? There seems to have been relative success on that front in past years, but does that target-driven culture have a downside and, if so, what is it? Are services being neglected or not prioritised because they are not part of a target?

Sir Ian Byatt: I will define three areas: Scottish Water's operational efficiency, its levels of service to customers, and its capital programme. A few years ago, Scottish Water's service to customers was not good, certainly compared with that in England and Wales. There is no reason why things should be done worse in Scotland than in England and Wales and I am glad to say that Scottish Water has greatly improved its levels of service as measured by our overall index of levels of service, which includes things such as water pressure and response to customer complaints. Things are going well, but we want Scottish Water

to do even better. We are not really having problems with that, although whether all the right things are in the index is an interesting question. Waterwatch Scotland has said that the index should include something about engagement. I will park that issue for the moment, but will say something about it when I discuss the capital side.

Scottish Water's operational efficiency has improved dramatically in recent years. At the beginning of the century, Scottish Water was what the financial journalists would have called a basket case. It is no longer that. Operating costs have come down by 40 per cent in recent years, and it is now a company that Scotland can be proud of.

We have said in our reports that we are less happy about capital expenditure. Scottish Water has struggled with a huge capital programme—indeed, it has the biggest capital programme per capita in the kingdom. Things have been slipping. Many things that should have been done years ago have slipped into the future. I recently visited Campbeltown, which represents a real story of how things should not be done. For the next price review, we would like there to be a smaller capital programme. We have studied the matter, and think that Scottish Water will handle a smaller capital programme better. It agreed with us about that. Things are therefore being done.

I return to engagement and customer service, which are issues that have arisen when I have talked to local authorities and others in Scotland. What has happened at Campbeltown illustrates the point. People have said that Scottish Water comes and consults them, but its definition of consultation is telling people what it will do. They say that they would like to be consulted on projects right from the beginning. That approach could and probably should be developed in the next capital programme, but it is not easy if people are trying to rush everything.

14:15

Shirley-Anne Somerville: When we have questioned Scottish Water representatives on issues that are outwith the current target regime, they have been adamant that their job is to meet their targets and objectives. You seem to be talking about the good practice that should apply to any business organisation. Is Scottish Water simply sticking to the targets that are laid down for it and failing to place sufficient priority on good practice?

Sir Ian Byatt: The targets should reflect what customers want. It is most important that they do that. We inherited the Ofwat performance index and we are in consultation with Ofwat on what should happen to the index in future. We also have to take account of Waterwatch comments.

The performance index should be a living document; indeed, it covers most of the things about which customers are concerned. The improved performance of Scottish Water against its targets is therefore a matter of satisfaction for the WIC. If anybody feels that the wrong things are being measured or that important things are not being measured, we will see how that can be taken into account.

Targets are hard, numerical things; they are, of necessity, quantitative and not qualitative. We need also to look at qualitative issues. We may need to think more about that.

Shirley-Anne Somerville: In its submission, SEPA notes the improvement in

“discharge compliance with licence conditions over recent investment periods”

but also that there are

“many assets which currently fail to comply with other licence requirements such as the provision of standby facilities, operational procedures, flow monitoring facilities, telemetry, and other infrastructure requirements.”

Have you looked at that? What can be done to try to improve on the situation?

Sir Ian Byatt: Craig MacKenzie may wish to say something on the matter. Basically, compliance with the environmental side is the area of the overall performance assessment—the OPA—on which Scottish Water is not doing well. Much of what falls into that area is operational. What can be done? SEPA should continue to press the point and we will continue to measure it. Essentially, SEPA and not the WIC knows whether that is being done properly; SEPA is the monitoring body. There is also an overall body, which the Scottish Government runs, which looks at investment results. Where SEPA is concerned about those things, I trust that it goes to that committee and makes the point.

Shirley-Anne Somerville: I take your point that, in the main, targets have to be numerical things. That said, other organisations are able to measure service quality. Does the draft determination place sufficient emphasis on the quality of service that Scottish Water provides?

Sir Ian Byatt: The question is a good one. We have concentrated on the OPA, but perhaps we should do more to go into things such as engagement and the whole customer experience. It would take time for us to build up that work. When I was at Ofwat, we used the OPA, but I also encouraged the customer service committees to look into the experience of individual complaints. We also took in the qualitative side of things. Waterwatch is well placed to do that. It is working on qualitative assessment. I use the phrase “qualitative assessment” and not “qualitative

measure”, given that we are talking about broader assessment and not measurement. If you were to ask someone to measure the success of their marriage, they would not want to do that simply by way of one or two quantitative measures.

Shirley-Anne Somerville: Thankfully we do not have to discuss that at committee, so we can leave it to one side.

The Convener: For some people, I suppose that it might be some of both, would it not? Des McNulty has a supplementary question.

Des McNulty (Clydebank and Milngavie) (Lab): Scottish Water said in its initial submission to the Water Industry Commission for Scotland that it wanted to exclude certain projects from the OPA, but in your draft determination you have ruled that those projects should be included. One of the projects is the Dalmuir sewage works in my constituency, so I have a particular interest in the issue. What does the inclusion of such projects in the OPA mean in practice for people who might be exposed to environmental nuisance?

Sir Ian Byatt: Dalmuir is a public-private partnership project. We have been concerned that some PPP projects have not performed well—one such project is not too far from here. It is all very well to say, “Oh, that’s because of the PPP contractor,” but the ultimate responsibility to deliver good service to customers falls on Scottish Water. That is what we have said in relation to Dalmuir. Scottish Water must get on with it and not be tempted to say that it is someone else’s problem.

Des McNulty: What is Scottish Water required to do in such circumstances?

Sir Ian Byatt: It must get on with ensuring that works do what they are supposed to do. Craig MacKenzie might know more about Dalmuir than I do; in relation to Seafield, it is about stopping the smell.

Craig MacKenzie (Water Industry Commission for Scotland): Some things are written down in the PPP contract; other things could be done by Scottish Water’s management through day-to-day negotiations. We have allowed for extra money in Scottish Water’s PPP allowance to try to ensure that Dalmuir delivers the outputs that it is meant to deliver.

Des McNulty: At this stage before the final determination four years ago, there was strong disagreement between the WIC and Scottish Water about whether the programme that you had set out was achievable. It seems that there is considerably more agreement between you and Scottish Water now. Is that because you have become less challenging or because Scottish Water has become more efficient? How would you

contrast your position four years ago with your current position?

Sir Ian Byatt: That is a good question. Four years ago there was a huge difference between our estimates of the cost of carrying out the programme. Scottish Water, which was being aided and abetted by, or supported by—I am feeling for the right verb—Scottish Water Solutions, said that it would cost £3.4 billion. We thought that £2.15 billion would be sufficient. I think that we have been proved right on that.

The reason for our position was that we had considered, for example, the treatment of unsatisfactory sewage discharges—what I still think of as combined sewer overflows—and we had found that Scottish Water’s initial figures were ludicrously high compared with costs in England and Wales. Many of the works have now been delivered, often at a lower cost than we had allowed for, so perhaps we were a bit too soft on that.

What did not quite get through the system as well as it should have done—it is perhaps easy to say that—was the scale of the programme. For example, I think that Jon Hargreaves thought that the programme was too big and should be spread out. There was no case for spreading out the programme on cost grounds, but there might have been a case for spreading it out on doability grounds. I think that we have all realised that, which is why we are now thinking about a smaller programme. Scottish Water agrees with us about that—I leave you to determine who shifted most.

Rob Gibson (Highlands and Islands) (SNP): You mentioned the works at Seafield and Dalmuir and said that it is up to Scottish Water to get on with the job. If I understand correctly, the PPP at Seafield was such that the cost of solving the problem would be far greater than the total allocation for the odour problem. If that is so, how can we expect Scottish Water just to get on with it?

Sir Ian Byatt: Craig MacKenzie will correct me if I get this wrong, as I might well do, but I think that more money has been allocated to Seafield.

Craig MacKenzie: Yes.

Sir Ian Byatt: On this occasion, the important thing was to deal with the smell; if that required more money, we were able to do that.

Craig MacKenzie: As I understand it, a study has now been done on the extent of the work that is required at Seafield. Scottish Water included the bid for work, if you like, in its investment programme, which came to the commission in March. That has been fully financed in the final determination.

Rob Gibson: That is—

Craig MacKenzie: I apologise; it is the draft determination.

Des McNulty: I might come back to sewage in the next set of questions. I will address borrowing now. The WICS staff paper 1 states:

“Looking to the future, it may be necessary to prepare for the possibility that the availability of public borrowing is less certain”

than in previous years. It continues:

“If current customers are to continue to be protected from paying the full cost of long-life assets from customer revenue, the Government will either need to make this level of public borrowing available or explore potential alternative sources.”

What potential alternative sources of funding should be explored? What implications would any alternative funding model have for both Scottish Water and customers?

Sir Ian Byatt: Let us start with the history. When we were looking at prices four years ago, there were no real constraints on borrowing, but constraints have started to appear and the Scottish Government is saying that in the next five years the level will be no more than £150 million a year—that is £150 million a year cash. At the moment prices are not going up, but those may be special circumstances, so given that the United Kingdom Government is likely to continue with monetary targets related to inflation of 2.5 per cent a year, we assume that prices will rise. That £150 million, or £140 million, becomes smaller in real terms, so at the end of the five-year period there is a real issue. Will something happen before then? I do not know. You must ask the Scottish Government, because the budget is set for a short period ahead but not for five years.

What should happen? If there were to be a constraint in five years' time or if something happens earlier because of the frightening public expenditure prospect that we are facing in the UK as a whole, the commission would be loth to see the bills go up, so that customers were paying pound for pound for the capital programme. We still think that there should be a degree of borrowing. Scottish Water is not very highly geared—it is about 50 per cent geared—so we believe that continued borrowing is in the interests of customers. Where could that come from? It could come from the PPP arrangements, which have been successful in some ways but, as we have seen, not entirely successful in others. However, the Government has set its face against those arrangements. There is the Scottish Futures Trust, but I do not know whether it will develop in a way that means that it could help in this area. There are also other ways of doing things. For example, Network Rail is borrowing directly from the market. While the money is there, that is fine; Scottish Water is happy and customers are fine,

but we think that it is worth thinking about the possibilities and what might happen, although it is not really a matter for us.

Des McNulty: I will pursue you on two points. First, what would the implications be for customer charges if the £150 million was not available from Government and had to be paid for by increasing customer charges? There must be an arithmetic value for that. Secondly, do you see any in-principle reasons why Scottish Water could not be treated in the same way as Network Rail in respect of borrowing arrangements?

14:30

Sir Ian Byatt: I will answer those questions separately. As far as the consequences are concerned, because the return on capital is related to the risk and therefore to what companies south of the border have to pay, the borrowing could come from non-Government sources without any direct effect on customers' bills. If, however, the money was not available in any circumstances, and customers were paying for the capital programme pound for pound, their bills would start to rise quite steeply, although that would depend on how much of the programme customers were paying for pound for pound.

You asked if I saw any reason, in principle, why Scottish Water could not be treated in the same way as Network Rail. These are matters of public finance for the Scottish Government, not matters for regulation. The commission is particularly concerned with the protection of customers, and the continuation of borrowing protects customers from rising bills. We therefore encourage people to be creative, if necessary.

Des McNulty: I do not think that I have had a direct answer to either of my questions. Do you have a figure that we will all have to stump up in our bills if we have to fund £150 million of investment that is not covered by borrowing?

Sir Ian Byatt: I do not have a figure now because we have not done such a calculation. You can see the way it would go; you would be adding £150 million a year to the costs, which would cause bills to rise.

Des McNulty: Is it possible to get such a figure?

Craig MacKenzie: Scottish Water's revenue is roughly £1 billion, so if you add £150 million to that—assuming that it is only £150 million—that would mean 15 per cent going on bills. That is a very rough estimate.

Des McNulty: Right. That is interesting.

SEPA's submission to the committee expresses numerous concerns about the sewer network. It states:

"We remain concerned about slippage in delivering sewer network improvements in the previous investment programme".

Do you share SEPA's concern about sewerage network improvements? How does the draft determination address that concern?

Sir Ian Byatt: As a matter of principle, I cannot at this point comment on what other people have said in their representations. We will look at all those together; it would not be fair to do it otherwise.

It is correct to say that we are concerned about the slippage of the investment programme, as we have said in various documents. That will include the area that you asked about. The Government established an output monitoring group, and the WIC is the prime agency that produces information for that group. We have continually pointed out to the group that there is slippage and Scottish Water has accepted that. The draft determination allowed for a certain amount of slippage and work still to be done, and there has probably been some evidence of a bit more slippage since then.

Slippage is a great concern to us. What do we do about it? The first thing is to have a more manageable programme, and the second thing is to make sure that we keep pushing away at the numbers and that Scottish Water understands that we are concerned about it. Of course, SEPA is the enforcement agency when it comes to failure of environmental compliance.

Des McNulty: Are there legitimate concerns about the sewerage network that feeds into the plants as opposed to the plants themselves?

Sir Ian Byatt: Now you are taking me into technical matters that I am not particularly competent to judge. Scottish Water's submission as a whole shows what it thinks needs to be done. If SEPA believes that more should be done on the sewerage system as opposed to the sewage plants, it is for SEPA to tell Scottish Water that.

Des McNulty: I will move on to things that you have identified. In the section "Key messages", you highlight the need to address

"the pressing problems of Glasgow's drainage".

I suppose that that focuses on the sewerage network in particular, but it also relates to flooding. My understanding of the draft determination is that it proposes a study of the metropolitan drainage, as opposed to action. Action might not take place until the end of the determination period. Given that the problems have been known about for a considerable time, and given that my constituents near Dalmeir might be rather perturbed about having to wait until 2015 before action might be taken, depending on the outcome of the study, do you think that that is sufficient or appropriate?

Sir Ian Byatt: We are where we are—the comments reflect what SEPA is saying to us. I think that SEPA feels that, because the programme has been carried out at high speed, Scottish Water has often been concerned to get on with short-term rather than longer-term jobs. SEPA would like to see a longer-term, more comprehensive approach, which seems right to us.

How do we do that? We have ensured that the financing is available in the five-year period as a whole. Of course studies should be done, because the last thing we want is people rushing on with work without having studied it properly. I hope that the studies will be done quickly and that the jobs will be got on with as fast as possible, but it would be foolish not to do the studies.

The evidence for that statement has come out of other things. For example, it turned out that the £3.4 billion that was talked about in 2005 was greatly exaggerated because the studies had not been done. When the studies were done, the work was done at a much lower cost. The lesson is to proceed at a steady, proper pace. History might have been against us, but unfortunately we cannot do anything about that.

Des McNulty: It is perfectly reasonable and fair to say that studies should be done and that we need to spend money wisely, but we have already heard that the length of the draft determination period is going to be a year longer, so we are really talking about a five-year period before action can be taken. Is it not possible for the studies to be done more quickly and for the determination to be adjusted in the context of the need for implementation? The metropolitan drainage problems in Glasgow have been known about for a very long time. I do not think that it is ideal to wait five years—that is the determination period—until the work is started.

Sir Ian Byatt: We are not saying that. We are saying that the studies should be done faster than that. We have said by what point the studies have to be completed.

Craig MacKenzie: It is 2012.

Sir Ian Byatt: So we are not waiting until 2015. We are saying that we want to get on with these studies. Some of them should be completed by 2011 and some by 2012. We have a timetable for that. If people meet that timetable—that is not in our hands, because we are not the people doing the studies—the money is available.

Des McNulty: So the money will be available to take the work forward.

Sir Ian Byatt: Definitely. However, if the study is not done and people come along and say, "Terribly sorry, it's taking us longer than we

thought," it would not be wise of us to say that they should get on with the work before the study is complete.

Shirley-Anne Somerville: Could the studies have been carried out in the previous determination period? Could we already be at the stage of completing the works if the studies had already been done in previous years? It has been said that the problems have been known about for some time, but nobody seems to have done anything about them. We are where we are because the problems were not tackled in a previous period.

Sir Ian Byatt: Some things were tackled in previous periods. In the current price review, we financed certain studies, which included the Ayrshire coast, Glasgow and Edinburgh, so a certain amount of work has been done. However, SEPA believes that there is a bigger problem and that more should be done. We think that that is fine, and the finance is provided under the draft determination; the process can fit in thereafter.

Des McNulty: In the draft determination, you state that you are

"not persuaded by Scottish Water's claim for specific investment to increase sewer capacity to prevent increases in sewer flooding due to growth."

How did you come to that decision?

Sir Ian Byatt: I will have to turn to Craig for help on that one.

Craig MacKenzie: The statement relates to Scottish Water's claim that, if premises are added to the sewer network, investment is required because more capacity is required. The company gave no output figure; what customers are getting for their money is therefore unclear. Our usual rule before sanctioning the use of customers' money is that there must be a clear and measurable output figure. That did not happen in this case. Our view is that issues of sewer capacity and so forth are best dealt with when connections are made.

Sir Ian Byatt: Scottish Water may want to come back to us on that one.

Des McNulty: The issue relates to development planning. Developers who wish to build new houses or whatever are being asked to make payments to Scottish Water for sewer capacity. Despite being asked to do that, they cannot reserve capacity. They are being asked to pay for something that may not necessarily benefit them. In some ways, the closer someone is to a sewage plant, the less certain they are to benefit. Is investment management an issue?

Sir Ian Byatt: We believe that Scottish Water is financed adequately to provide strategic development capacity. People can now see

Scottish Water's strategic capacity on its website. Before the last determination, there was a lot of concern about development constraints and a lack of capacity. We have been trying to keep an eye on that one, although I cannot say that there are no further issues in that regard. Having travelled to Orkney, Shetland and Stornoway, I would say that the cries have gone away, notwithstanding that special factors apply in those places.

We are much happier about the amount of money that is available to Scottish Water, but that does not mean that people are necessarily happy with what the company does in every development. People have to keep Scottish Water to what it says it will do. If someone produces a generic complaint, we take notice and push Scottish Water on it. We have had no such generic complaints, only issues about rural and island areas.

Cathy Peattie (Falkirk East) (Lab): My question is on leakage. In the draft determination, you state:

"We propose to require a further substantial reduction in Scottish Water's leakage to its proper economic and sustainable level."

How is the sustainable level of leakage defined, and how are the elements within it quantified?

Sir Ian Byatt: The economic level of leakage can be found by comparing the cost of producing water with the water that we would not have to produce if the level of leakage was not so high. That work would involve a lot of measurement across the network in Scotland. Indeed, work is on-going in that respect and targets have been set, even before the work is completed. The amount of leakage in Scotland is so gross that something has to be done. We need to do that before we look at exactly what the economic level is.

In turning to the sustainable level, one ought to think about the carbon emissions that result from pumping water through underground pipes. Although we know that we can never get leakage levels down to zero, we also know that carbon emissions are involved. We are beginning to get some idea of a carbon price—indeed, the EU emission trading system now has such a price—and it would be perfectly possible to extend those studies from what you might call pure economics to the economics of a situation in which carbon emissions have a price.

14:45

Should we go further than that? We are always ready to pursue any argument about sustainability, but water is a renewable resource—after all, it comes out of the sky all the time. Part of the issue about water quality is the sewage that is

discharged into rivers and coastal waters. That situation has improved enormously. I cannot provide a Scottish example but I know that, in Yorkshire, Yorkshire Water has certainly improved water quality—and done something about environmental sustainability—by taking action on the sewage going into rivers and other waters.

Cathy Peattie: I am pleased for the people of Yorkshire.

As you said earlier, SEPA would like

“more robust and targeted statements of objectives”

on leakage. How do you intend to develop such objectives?

Sir Ian Byatt: We have, in a sense, three marking places. First, there is our current position, which is that leakage is being reduced substantially year on year. When Scottish Water failed to meet the target the first year that it was introduced, we told the organisation that it had to put more effort into that.

The second staging point is the level of leakage south of the border, which, at the moment, is way below the amount that Scottish Water is leaking. The third and final stage centres on the studies that I have mentioned, which would involve different work in different parts of Scotland. A whole programme of activity is being undertaken, and I am happy to come back in five years to tell the committee about the next stage. In short, we and Scottish Water are engaged in the process, but the fact is that the organisation itself has not been engaged in it all that long.

Cathy Peattie: Scottish Water could play an important role in helping Scotland to meet its greenhouse gas targets under the Climate Change (Scotland) Act 2009. However, I see nothing about climate change or indeed Scottish Water's public duty in that regard in the draft determination document or the “Key messages” document that you have circulated to members. I am aware that Scottish Water has made the duty priority 2, even though the Government has made it priority 1. What discussions have there been on climate change? You have talked about sustainability, emissions and carbon counting, but I see no vehicle for monitoring Scottish Water's intentions or, indeed, achievements in that respect.

Sir Ian Byatt: If I may say so, those are very good questions, and we do not have all the answers to them yet. Some issues, such as the pumping costs, can be addressed. An interesting pumping issue has emerged on Loch Ryan, which we want to study because we think that the management of the loch will involve pumping some of the nastiness over a hill into another bit of sea. Because such a move will create carbon

emissions, we have drawn attention to it and, as I say, want to carry out some research on it.

We also need to look at electricity generation in sewage works. In fact, from my regular conversations with Ronnie Mercer, the chairman of Scottish Water, I know that the organisation is thinking about that. If its business plan were to contain any such proposals, we would be delighted to consider them sympathetically.

Cathy Peattie: But this is a five-year draft determination. You cannot simply think about climate change; there is a public duty to do something about it, and I am interested in hearing how you intend to push that issue and ensure that the duty is fulfilled in the foreseeable future. The fact is that in five years' time it might be too late.

Sir Ian Byatt: One question that arises from the Climate Change (Scotland) Act 2009 is: who is the enforcement authority? I assume that the Government is the main authority and that, as such, it will tell Scottish Water, which it owns, what it thinks it should do. I would be happier if the mechanism worked that way instead of making the commission, SEPA and everyone else sit around and think about what should be done. I entirely agree, however, that we have to get on with the matter.

It is possible for us to make adjustments to prices within the regulatory period. We would prefer not to do that because we want stability for the business, but, if in a couple of years the need to do something about carbon emissions were strengthened and ministers told us that much more needed to be done, we would talk to Scottish Water, which would tell us what the work would cost. We could then make an interim adjustment to price levels to finance it. There is a mechanism, but the question is: where does the ball start? I think that it should start with ministers.

Cathy Peattie: So you accept that in the long run there is a cost to customers, in either on-costs or environmental costs, in achieving the climate change targets.

Sir Ian Byatt: It will be our responsibility to examine the costs and to ensure that they are the lowest that is reasonable. However, in a way, we are following other people. We are happy to follow them and to do what we can but, given that we have no particular expertise in climate change, it may be confusing if there are too many cooks deciding where to go.

Cathy Peattie: As a public organisation, surely you have a responsibility to get up to speed on the issue.

Sir Ian Byatt: We accept that we have a responsibility—that is not in question. The question is: how will that responsibility be

discharged? We will discharge it by being ready to examine any costings, to indicate what effect they may have on prices and, if it is the right thing to do, to pursue the mechanism for ensuring that whatever has been decided can be financed.

The Convener: Have you had any discussions with ministers or Scottish Water about the nature of the public duty that will be imposed on Scottish Water as a result of the Climate Change (Scotland) Act 2009?

Sir Ian Byatt: I have not been party to any such discussions, but I do not know about everything that goes on, I am glad to say.

The Convener: Mr MacKenzie, are you aware of any such discussions?

Craig MacKenzie: I am. I would like to clarify some points in the draft determination and to indicate what remains to be clarified. Ministers have another bite at the cherry when setting the objectives for Scottish Water. Towards the end of this month, they are required to specify further objectives, which are the objectives that Scottish Water must deliver in the 2010 to 2015 period. Up to now, everything has been done in draft. The last round of draft determinations included priority 1 objectives that we are required to finance within the determination. Separately, there were priority 2 objectives, which we could finance but only if that did not disrupt prices in any way. As Cathy Peattie identified, the climate change objectives fell within the second category.

Before the determination is finalised, ministers have an opportunity to categorise some of the climate change objectives as priority 1 objectives. Beyond that, if the position remains uncertain, it is not a case of waiting until 2015 before action can be taken. There is unallocated financing in the draft determination. If that is carried through into the final determination, it will be a source of financing if action is required to meet the challenge of climate change. We do not have to wait until 2015 for that to happen.

Sir Ian Byatt: There is £245 million, but it cannot be spent on climate change as well as the work in Glasgow. We must think about the relativities. When ministers make decisions and send us the final determination, we will respond to their priorities.

The Convener: It could be argued that, in Glasgow or anywhere else, climate change should affect every pound that we spend, instead of being seen as something additional. Even if ministers are reconsidering whether climate change should be made a priority 1 objective—we hope to hear something from them on that—it seems clear that a public duty will be imposed. It will appear as part of Scottish Water's objectives early on in the 2010 to 2015 period, which we are discussing. It seems

reasonable that, not necessarily solely at the door of the commission, Scottish Water or ministers but somewhere between the three, we would put a ballpark figure on that to be discussed as part of the draft determination.

Sir Ian Byatt: We would all be in favour of having a ballpark figure put on it, but one has to think of the mechanism by which that ballpark figure would be arrived at. The process would start with ministers outlining their priorities, whether in the statement that will be made later in the month or in some other way.

The Convener: And ministers have not done that yet.

Sir Ian Byatt: No. As Craig MacKenzie says, their final views on the priorities will come later. Do we have an exact date for that?

Craig MacKenzie: I think that it will be towards the end of the month. It will be around the same time that all the responses to the draft determination come in.

Sir Ian Byatt: So there is that. However, even if ministers do not do something this time or want to do something later, there is a mechanism to deal with that. We would pursue the whole costing side: ministers would tell us what they thought that we should do—they might want various options and alternatives to be costed to see which would be the most economical from the point of view of the customers—and we would then do the work. There would be a mechanism for changing things; the first immediate mechanism, which Craig MacKenzie is correct to emphasise, is that money has already been allocated to these things within the price limits in the draft determination.

The Convener: It is a matter that we will have to take up with ministers. However, I would have thought that some of the people who responded to the consultation—which, as we have noted, closes tomorrow—would benefit from ministers making their intentions clear before that period ends. They have clearly not done so yet.

I will allow a supplementary question on the same point before we move on.

Des McNulty: I would not want to see action on climate change being set against action to deal with the metropolitan drainage issues in Glasgow—that would not be at all appropriate. Glasgow is already quite sensitive as a result of ministerial decisions, and we would not want to throw that one into the mix.

I wonder whether, given what Sir Ian Byatt has said about the Water Industry Commission's particular role in connection with climate change, there might be an issue of lag. It was only recently that the Climate Change (Scotland) Act 2009 was enacted and ministers sent their policy instructions

through the process. It might therefore be reasonable for the committee, following the evidence that we have heard today, to write to the minister to ask whether he is sending any supplementary policy instructions or indications to Scottish Water and the WIC in light of the requirements of that act that might in any way affect the draft determination. An exchange of such correspondence would help to clarify the position for everyone.

The Convener: That is a useful suggestion.

Cathy Peattie: Recent press reports have noted that effluent that goes into Pease Bay in East Lothian is treated by Scottish Water with ultraviolet disinfection techniques during the bathing season but not at other times of the year. It seems that part of the reason for that is to reduce carbon emissions. It is puzzling that Scottish Water, as has already been said, seems to be more interested in being green than in improving water quality in the area.

Sir Ian Byatt: The question is really for Scottish Water, which has taken the action. As I understand it, the logic of its argument is that it is a bit cold to bathe in the sea in the winter in Scotland, although I hesitate to say that I would not bathe in the sea in Scotland in the winter.

The issue has arisen in England and Wales, particularly in the south-west. It is expensive to treat water all year round, especially if nobody is swimming in it. However, we want as much clarity as possible about the environmental aspects.

15:00

Cathy Peattie: I am told that there are surfers all year round—you learn something every day.

How is the issue managed in the draft determination?

Sir Ian Byatt: Scottish Water submits a business plan with certain objectives, and those objectives include the extent of tertiary treatment.

Jim Tolson (Dunfermline West) (LD): SEPA and Water UK are concerned about the possible implications of the transfer of trade effluent responsibilities. How would accountability and performance incentives work if the trade effluent responsibilities were transferred and what would be the ultimate impact on customers and the environment?

Sir Ian Byatt: The suggestion is to transfer the responsibilities on advice on trade effluent. Enforcement in relation to what is put into the sewers would remain with Scottish Water.

Jim Tolson: SEPA's submission to the committee states:

"We cannot support the proposal for further studies at Loch Ryan, which will lead to further delays to improvements required under the Urban Wastewater Treatment Directive and Shellfish Waters Directive."

You touched on issues to do with Loch Ryan earlier. How do you respond to SEPA's opposition to further studies at Loch Ryan and its argument that the improvements cannot be delayed?

Sir Ian Byatt: We will respond to that in our final determination. I would rather not respond to it today, because I want to consider all the matters together, rather than pick them off one by one. SEPA makes an interesting point. I am not trying to have an argument with SEPA, but there is an interesting climate change issue as a result of the additional pumping. As committee members have said, we need to get on with the business of implementing the Climate Change (Scotland) Act 2009. However, we will see what other people have to say and we will put it all together. I assure everyone that we will take all the comments seriously.

Jim Tolson: I hope so.

Charlie Gordon (Glasgow Cathcart) (Lab): Do you accept that the draft determination could have been more transparent in its reasoning and evidence? For example, why is there a disclaimer stating that staff papers cannot be relied upon?

Sir Ian Byatt: That is a purely legal point, as there is a legal issue about who takes decisions. The commission takes the decisions and therefore it is those decisions that are in the draft determination and which have legal standing. Of course, we rely on staff papers greatly and on the excellent work that is done in our office. We could not operate without those. In terms of substance, we rely on them.

On transparency, I will turn it round and ask you a question. How thick do you want the documents to be? In the past, we produced very large documents—the kind of thing that needed one of those accountant's briefcases to carry round. This time, we decided to go for much shorter documents, on the basis that important people such as committee members would read them. We are trying to be transparent. Of course, you can never win in the transparency game, because somebody will always say that we should have put something else in. However, the real test is whether opinion formers and decision makers find the process transparent, rather than what some official in Water UK happens to believe and writes down on a piece of paper.

Charlie Gordon: I will rise to your challenge, Sir Ian, and say that some people want a sweetie and others want a box of chocolates—I am more of a box-of-chocolates man, myself. I stress that we are not necessarily talking about appendices or

whatever, as there has been criticism of the reasoning in the draft determination.

Sir Ian Byatt: It is one thing to criticise the logic and reasoning; we are responsible for that. However, we tried to give you the sweetie and the box of chocolates by publishing the staff papers. I thought that those papers would have the same status, but the lawyers told us that they had to have a different status; nevertheless they are all available, they are jolly good and they have been well done.

If you want more staff papers in the final determination, I am sure that the matter can be considered—I must be careful about what I say, because I might be in trouble when I get back to Stirling. We are desperately trying to get the right degree of transparency and consultation. There is a danger that if more and more goes into the documents people will say, “Thank you for that learned report. I must read it some time.”

Charlie Gordon: We will move on. You say in the draft determination:

“Scottish Water’s financial strength should, at the end of this regulatory control period, be on a par with the stronger companies”

in England and Wales. How do you test financial strength? How will the draft determination ensure that enhanced financial strength is achieved?

Sir Ian Byatt: The table on page 9 shows financial strength in terms of the net cash flow from operating activities, less tax paid, divided by net debt, which is an indicator that is used in the City to test utility companies’ financial strength. Scottish Water comes out rather well compared with some other companies, partly because it is less geared than some other companies. For example, Anglian Water is incredibly geared—I think that its debt is around 85 per cent of the regulatory capital value, whereas in Scotland the proportion is around 55 per cent. Scottish Water is stronger than some of the companies that have borrowed—some people might think that they have overborrowed. We want to maintain that financial strength and we think that it is right and proper that it should be maintained.

Charlie Gordon: Will you keep an eye on that throughout the regulatory control period?

Sir Ian Byatt: We certainly will.

Charlie Gordon: Why is the rate of return for Scottish Water lower than that allowed for other state-owned or state-funded enterprises?

Sir Ian Byatt: It is not lower than the rate that is allowed for all state-owned enterprises. A 4.1 per cent return on the regulatory capital value is rather lower than the 4.5 per cent that Ofwat has allowed in its determination. There is quite an element of

judgment in that regard. On the train on my way here I read an interesting article by someone from Halcrow, who argued that if the English companies go to the Competition Commission they might find that they get a lower cost of capital than the 4.5 per cent that Ofwat has suggested.

There is no doubt that currently the cost of capital is difficult to calculate. There is uncertainty in capital markets and interest rates are very low, as we know to our cost from our bank accounts. Initially, there was a spread between gilt-edged rates and corporate bonds, but that spread is falling a bit. A lot of corporate bond money is being raised. We are thinking about a five-year period, during which I suspect that interest rates will stay low—that is what the governor of the Bank of England is telling us—and corporate spreads will come down. I think that 4.1 is just as good a number as 4.5, and the two are not hugely different in the context of projections about what will happen in future.

The key point for us is that Scottish Water is borrowing from the Scottish Government and should be fine on that, but if it needed to borrow from somewhere else we think that it would be in a position to do so.

Charlie Gordon: I want to press you on the comparators that you mentioned. The rate of return that is allowed for Scottish Water is lower than that for Network Rail, Royal Mail and Welsh Water.

Sir Ian Byatt: Do you mean looking forward?

Charlie Gordon: Yes.

Sir Ian Byatt: Welsh Water will get whatever Ofwat decides is right for the industry as a whole. In respect of Network Rail, it depends on the borrowing conditions in the capital markets. Network Rail has a huge capital programme and there is a certain amount of political uncertainty around its case. You have to judge these matters according to the particular sector. Water is quite a low-risk sector, so it will tend to have returns at the lower end of the spectrum.

I re-emphasise that there is huge uncertainty in capital markets. It is beginning to look as though the capital markets are recovering, but it is a wise man—in fact, it is not a very wise man—who is sure about these things. If we have any evidence that we have got the figure wrong, we will, of course, look at the Ofwat figure. We put out our 4.1 per cent return in the draft determination on 30 June and Ofwat put out its own draft determination in late July. In November, we will probably speak at the same time and you will be interested to see whether we speak with the same voice. We are independent of each other.

Charlie Gordon: The commission takes into account

“the Minister’s decision not to take dividends in its assessment of the cost of equity.”

Why have you assessed the cost of equity in that way when others take the view that the cost of equity should be independent of dividend policy?

Sir Ian Byatt: When I was a student many years ago, I was taught by Professor Modigliani. The article that I read did not allow for any taxation in the system, but there is taxation in the system. Debt is tax allowable, whereas equity is not, so the Modigliani-Miller theorem is fine as a piece of textbook economics, but there are problems applying it in the real world.

The key issue when thinking about the rate of return is what the risks are. We want to cover the risks that are generic to the water industry. We are therefore doing a job that is similar to the job that Ofwat does. We do not see any reason why the risks in Scotland should be different from the risks in England and Wales: it is the same kind of activity with the same kind of environmental obligations and the same kind of environmental regulation. We should therefore be in parallel.

The question with the dividend issue is, if ministers do not take dividends, what happens to the money? We suggest that it should go into a reserve fund. At the end of the regulatory period we would ask, “Has Scottish Water outperformed?” If so, and if there was money in the reserve fund, it would be transferred into a gilts buffer, which would be available for ministers to do with as they wished. There would be a benefit to the Scottish Government from not taking dividends, which would come through the reserve and the buffer.

Charlie Gordon: Why is your approach to inflation in the draft determination different from that taken by Ofwat?

Sir Ian Byatt: That is an interesting question. We are seeing plunging inflation, although the numbers depend on which inflation index you take. I think that the retail prices index is the best indicator, because it measures what people really pay; it comes out of the old cost of living indices. We want to know what people are paying for their water compared with other things. At the moment, the different measures point in different directions.

The retail prices index has come down to negative numbers—I think that it was -1.2 last month and -1.4 the month before. We do not know what it will be in November, but that is the crucial month. We are suggesting that if it is a very low number in November, the best thing to do would probably be to freeze the prices for customers. If that means that there is a bit of extra money for

Scottish Water, we would keep down the next price limit, which would use up that extra money on the grounds that customers would quite like to have a price freeze if that is what comes out of the system. We would love to hear what people think about that.

15:15

Charlie Gordon: And on the comparison with Ofwat?

Sir Ian Byatt: I am not sure that I know. Ofwat might want to do something different. We could ask for a price reduction if the retail prices index comes out with a negative number when adjusted by the K factor. The money could be given back to customers or bills could be frozen. That is a policy option. One of the reasons why our determination is in draft is that we think that it would be sensible to freeze prices, but others might have different views, and we will listen to them.

Rob Gibson: I will turn to some of the issues that Waterwatch Scotland raised. It has pointed out that

“stable water charges do not necessarily equate to affordable water charges. Support for low income households unable to meet their obligations to pay for water and sewerage services remains inadequate”.

How does the draft determination address inadequate support for low-income households?

Sir Ian Byatt: Affordability is a wide and important problem, and is particularly acute in south-west England. I suspect that it is less acute in Scotland, where bills are much lower. The first thing, therefore, that we would argue is that we are generally keeping bills down to reasonable levels, so the affordability issue is diminishing rather than growing. Secondly, household customers are charged on the basis of their council tax bands, and the council tax is allegedly a redistributory tax; we do not operate it. We are keeping bills down and people who are living in low council tax bands will pay less.

That might not be enough to deal with affordability. I would love to see work done—perhaps Waterwatch Scotland could do it—on defining the problem of affordability and where it really arises. “Affordability” is a good word; there are lots of things that we around this table cannot afford, but none of us would say that we are poor—affordability and poverty are not the same issue. The problem with utility bills—I am speaking as much about electricity as about water—is that they might drive people into poverty. However, if they rise by less than the rate of inflation, they will not do so. I would like to see the issue of affordability unpacked a bit.

Rob Gibson: The council tax has been frozen, but water charges have not.

Sir Ian Byatt: Indeed, but it might be that water charges will be frozen. We have been discussing that.

Rob Gibson: That might become the case, but it is not the situation at the moment. Waterwatch Scotland has based its evidence on experience up to this point.

Sir Ian Byatt: Indeed.

The Convener: I will allow a supplementary question before we move on.

Jim Tolson: On affordability, my colleague's question was about households, but I would like to consider the voluntary sector, in particular small community organisations that are currently exempt from charges. It is felt that if they are faced with water charges, many organisations or the community facilities that they provide might have to end. I see no mention of the voluntary sector in the draft determination. Is it your submission that the exemption from charges for the voluntary sector should continue, and if not, why not?

Sir Ian Byatt: No one is suggesting that the voluntary sector should be charged. It is a big issue in England and Wales—it is known in Manchester as the rain tax, where it is to do with surface drainage. I do not believe that this is an issue in Scotland. Is it?

Craig MacKenzie: The Scottish Government has confirmed that the exemption scheme will continue in its current form until 2015.

Jim Tolson: And beyond that?

Sir Ian Byatt: That will be a matter for the Scottish Government.

Jim Tolson: That is helpful.

Rob Gibson: Waterwatch Scotland has pointed out that

"the costs associated with the set-up and ongoing maintenance of the competitive market"

were

"paid for by all customers".

Have those costs led to savings in other areas of Scottish Water's operations?

Sir Ian Byatt: Yes. We did a little piece of work, which is available on our website, in which we considered the costs. The division of Scottish Water into its retail and wholesale sides was done by identifying whether activities were retail or wholesale, but there were some activities that nobody wanted to own. The exercise was useful and Scottish Water saved quite a lot of money, although I do not have the exact numbers to hand.

Scottish Water Business Stream also saved quite a lot of money. Over four years, the savings would have paid for the Central Market Agency and all the instruments of contestability.

In addition to that—I stress "in addition"—non-household customers have gained. About 30 per cent of those customers are now getting a better deal. Therefore, the facts are, first, that a cost-benefit analysis on the costs of Scottish Water and the CMA showed a very good rate of return—a payback of three to four years from investment is very good. Secondly, customers have gained. That is our position.

Rob Gibson: You said that areas were identified

"that nobody wanted to own".

Can you specify one or two such areas?

Sir Ian Byatt: I do not know that I can do so now. People could see simpler ways of doing things, as is always the experience when one goes into how things are done. People say, "We've always done it this way," but there are different ways of doing things. As it turned out, Scottish Water agreed that things could be done differently and saved quite a lot of money. It could be called a special management review-type operation.

Rob Gibson: Can you say how much was saved, as a matter of interest?

Sir Ian Byatt: I cannot. Craig MacKenzie might be able to do so. I think that it was millions of pounds.

Craig MacKenzie: I do not have the numbers to hand. We can send the committee a copy of the report that we published last year, if that would be helpful.

Rob Gibson: On regulatory reporting, Waterwatch Scotland said:

"£2.5m has been allocated—WWS would like further clarity on what customers are receiving in return."

Can you provide that clarity?

Sir Ian Byatt: What will customers get from better regulatory reporting? The answer is lower bills, in due course, because regulatory reporting enables us to keep a firm grip on bills. In that regard, there are huge savings in Scotland compared with England and Wales. It was because of regulatory reporting that Scottish Water understood that it must do something about its operating costs and levels of service and took action. We want to develop regulatory reporting to ensure that that valuable benchmarking continues. I cannot tell you exactly how much the benefits will be, but they have been substantial so far and have

outweighed by a great deal the costs of the reporting exercises.

Rob Gibson: I have often been at pains to dig into the potential for confusion when direct comparisons are made with water companies down south, because those companies work to a different timescale. Is the comparison now more obvious than it used to be?

Sir Ian Byatt: I think so. The standard statistical work is always illuminated by an exercise in which consideration is given to whether there are special factors in Scotland, south-west England, Wales or wherever. That is gone over carefully with Scottish Water.

Back in the early years of the century, Scottish Water's costs were very much higher and it said, "Don't you understand that that's the way the world is?" Lo and behold, it has got its costs down and we are in a much more illuminated position. In the draft determination, we say that Scottish Water should be in the upper quartile of where English companies were in 2007-08. We accept that there is a lag—Rob Gibson has made that point on a previous occasion. I agree with him, but Scottish Water has been able to move faster than the English companies. It started later but it learned and has got on very well with that work.

Rob Gibson: That is interesting. Thank you.

Finally, why is there no objective on or funding to address external sewer flooding, given that it is a major concern for customers? Can you offer any reassurance to customers that Scottish Water will have an incentive to address the issue in the coming years?

Sir Ian Byatt: I would not want to say that at the moment, because there are other important priorities, but we will take seriously what Waterwatch Scotland has to say about the issue.

The Convener: Des McNulty has one more supplementary.

Des McNulty: I actually have two, but I hope that they will be short.

The Convener: Indulge yourself.

Des McNulty: First, I ask for an update from your perspective on the success or otherwise of the retail competition initiative, and on how it is delivering change in the water and sewerage industry in Scotland. We heard from Scottish Water on the issue relatively recently. I would like to hear, from a regulatory point of view, what your opinion is on the matter.

Sir Ian Byatt: I never expected the initiative to move fast. There are now about five companies and another is in the pipeline. We are encouraged by the fact that companies are prepared to come in and it is interesting that they have gone for

different sectors of the market. Some have gone in where there are specialist measuring devices and some have gone into other sectors.

We think that the initiative is going quite well. We do not want to measure its success in terms of the number of people who switch, as was done in the electricity sector, because I think that that is the wrong way to do it. The big issue is how customers are dealt with—so far, 30 per cent of customers are saying that they are better off. We will produce another report on the matter in the new year. The key issue is how the customer feels about it: so far, so good.

Des McNulty: My second question is about the perennial issue of rainwater run-off and the fact that it goes into the sewerage system and becomes a cost to the paying consumer. Is there any hope that the problems of rainwater run-off can be better managed through the regulatory system, or can it be designed out through how we will build infrastructure and housing in the future?

Sir Ian Byatt: I will say a little bit about at least two aspects of that question. First, there is the issue of rainwater getting into the sewers, which is what the Scottish Environment Protection Agency refers to as sewer infiltration. It is leakage in reverse and it reduces the capacity of the treatment works to deal with foul waste. That is certainly on our horizon. I cannot tell you with authority to what extent it has been dealt with in the draft determination, but it is certainly one of the issues on which we have had representations.

Secondly, how new properties are designed will depend on the incentives for people who occupy and own those properties. As far as non-household customers are concerned—public services and businesses—we have been pushing for Scottish Water to get on as fast as possible with introducing meters. We want to ensure that its charges to retailers reflect costs, so that there is a proper incentive.

15:30

As far as householders are concerned, we are proposing a metering study, to which we hope everyone will contribute in some way. When I was in Orkney, people said to me, "We've been thinking about putting rainwater catchment systems on houses, but it costs a lot of money and there's no incentive to do so." The incentive is likely to come from metering.

Household metering is a sensitive political matter. It is time that Scotland thought systematically about it, so we have put money in the determination to enable Scottish Water to carry out a study. The study must be carried out in consultation with lots of other people. After that, we can consider where things are going. It would

be foolish to rush the issue. Much has been learned in England and Wales. I remember the early 1990s, and the position south of the border is now very different.

Des McNulty: Could metering tie in with what we were saying about our responsiveness to climate change?

Sir Ian Byatt: It absolutely could. It is encouraging that we now have a carbon price, which is coming out of a market mechanism—the European emission trading scheme—which can be included in the economic calculations, as it should be.

The Convener: Do members have further questions?

Cathy Peattie: Forgive me if this seems trivial. I am concerned about the size of font in the draft determination. If we want people to comment on the draft, it needs to be readable. There is good practice in Parliament's approach to publishing reports. I ask that fonts and presentation be considered in the future. I am not happy with the draft, which would be difficult to read for anyone who has a problem with small print.

Sir Ian Byatt: Do you mean that it is too densely written?

Cathy Peattie: The font is too small.

Sir Ian Byatt: I am sure that we can adjust that.

Cathy Peattie: It is a minor issue, but it makes a difference. I had to find my other glasses last night.

Sir Ian Byatt: I entirely agree. We will certainly consider the issue.

The Convener: If there are no more questions from members, is there anything that witnesses want to add that has not been covered in our questioning?

Sir Ian Byatt: You have interrogated us thoroughly. If the committee were minded to comment on the draft determination, we would look forward to hearing what you had to say. Comments should be received by tomorrow, but we could probably grant you a small extension.

The Convener: That is much appreciated. I thank both witnesses. The committee has agreed to discuss in private the evidence that we have heard.

15:33

Meeting continued in private until 15:55.

Members who would like a printed copy of the *Official Report* to be forwarded to them should give notice at the Document Supply Centre.

Members who wish to suggest corrections for the archive edition should mark them clearly in the report or send it to the Official Report, Scottish Parliament, Edinburgh EH99 1SP.

The deadline for corrections to this edition is:

Friday 2 October 2009

PRICES AND SUBSCRIPTION RATES

OFFICIAL REPORT daily editions

Single copies: £5.00

Meetings of the Parliament annual subscriptions: £350.00

WRITTEN ANSWERS TO PARLIAMENTARY QUESTIONS weekly compilation

Single copies: £3.75

Annual subscriptions: £150.00

Published in Edinburgh by RR Donnelley and available from:

Blackwell's Bookshop

**53 South Bridge
Edinburgh EH1 1YS
0131 622 8222**

Blackwell's Bookshops:

243-244 High Holborn
London WC1 7DZ
Tel 020 7831 9501

All trade orders for Scottish Parliament documents should be placed through Blackwell's Edinburgh.

And through other good booksellers

Blackwell's Scottish Parliament Documentation

Helpline may be able to assist with additional information on publications of or about the Scottish Parliament, their availability and cost:

Telephone orders and inquiries

**0131 622 8283 or
0131 622 8258**

Fax orders

0131 557 8149

E-mail orders, Subscriptions and standing orders

business.edinburgh@blackwell.co.uk

Scottish Parliament

All documents are available on the Scottish Parliament website at:

www.scottish.parliament.co.uk

For more information on the Parliament, or if you have an inquiry about information in languages other than English or in alternative formats (for example, Braille; large print or audio), please contact:

Public Information Service

The Scottish Parliament
Edinburgh EH99 1SP

Telephone: 0131 348 5000

Fòn: 0131 348 5395 (Gàidhlig)

Textphone users may contact us on
0800 092 7100

We also welcome calls using the RNID
Typetalk service.

Fax: 0131 348 5601

E-mail: sp.info@scottish.parliament.uk

We welcome written correspondence in any language.