



The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

TRANSPORT, INFRASTRUCTURE AND CLIMATE CHANGE COMMITTEE

Tuesday 14 September 2010

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TRANSPORT, INFRASTRUCTURE AND CLIMATE CHANGE COMMITTEE
19th Meeting 2010, Session 3

CONVENER

*Patrick Harvie (Glasgow) (Green)

DEPUTY CONVENER

Cathy Peattie (Falkirk East) (Lab)

COMMITTEE MEMBERS

*Jackson Carlaw (West of Scotland) (Con)
*Rob Gibson (Highlands and Islands) (SNP)
*Marlyn Glen (North East Scotland) (Lab)
*Charlie Gordon (Glasgow Cathcart) (Lab)
*Alison McInnes (North East Scotland) (LD)
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:

Richard Ackroyd (Scottish Water)
Ronnie Mercer (Scottish Water)
Douglas Millican (Scottish Water)
Alan Sutherland (Water Industry Commission for Scotland)

CLERK TO THE COMMITTEE

Steve Farrell

LOCATION

Committee Room 1

Scottish Parliament

Transport, Infrastructure and Climate Change Committee

Tuesday 14 September 2010

[The Convener opened the meeting at 14:00]

Decision on Taking Business in Private

The Convener (Patrick Harvie): Good afternoon. Welcome to the 19th meeting this year of the Transport, Infrastructure and Climate Change Committee. I welcome everyone back from our summer recess—I hope that all of you had an enjoyable and productive time. I remind everyone present that mobile devices of all sorts should be switched off fully, not just left on silent mode. I record apologies from Cathy Peattie and welcome Alasdair Allan, which is substituting for Shirley-Anne Somerville.

There are four items on the agenda today, the first of which is to seek the committee's agreement to take in private item 4, which is consideration of our work programme. Is that agreed?

Members indicated agreement.

Water Industry Commission for Scotland Annual Report 2009-10

14:00

The Convener: Item 2 is the first of our witness sessions. We are joined by Alan Sutherland, chief executive of the Water Industry Commission for Scotland. Welcome to the committee. Would you like to make some brief opening remarks before we begin questions?

Alan Sutherland (Water Industry Commission for Scotland): Thank you for inviting me. I would like to say one or two quick words, if that is okay.

I am grateful to have the opportunity to discuss our annual report with the committee. It is a good time to do so, because we are 10 years into economic regulation of the water industry in Scotland. During that time, the industry has gone from a position in which its service was not of the best and its financial position was rather weak to one in which Scottish Water is one of the United Kingdom's fastest-improving and financially strongest water companies.

I will give you two statistics. First, household customer bills are around £105 lower than they would have been, due to Scottish Water's response to economic regulation. Secondly, Scottish Water's on-going annual savings are well in excess of £200 million a year, which seems to me to be a good return on costs of regulation of less than £4 million a year.

I hope that those remarks are of some help to the committee. I am happy to try to answer any questions that members have.

The Convener: I will begin by asking you about some of the issues that were new to MSPs last week when they were announced in the Scottish Government's legislative programme. The intention is to introduce a bill to allow Scottish Water to

"evolve from a successful utility into a dynamic water agency".—[*Official Report*, 8 September 2010; c 28251.]

The bill will give Scottish Water greater flexibility

"to develop commercial opportunities and to"

address

"some of the world's water issues."

Scrutinising the bill will take up a significant amount of parliamentary time. There is a reasonable expectation that the committee will have a particular interest in that process. What is likely to be the commission's role in assessing, scrutinising or commenting on the proposals?

What is the level of support in the industry for the Government's agenda?

Alan Sutherland: To be frank with you, I have no more to go on than the First Minister's remarks of last week. I have not seen any draft provisions of the bill or anything else, and the commission has had no opportunity to discuss the matter. However, there are one or two things that I can say. First, we will welcome a new bill that contributes to a greener Scotland and does so in a way that is consistent with the customer interest. Secondly, if you look back at the record, you will note that I—and, I think, the commission—have said that we are not terribly keen on distractions from Scottish Water's core business. That explains why we did not like section 25 of the Water Industry (Scotland) Act 2002, which gave Scottish Water very wide powers. Now that Scottish Water is performing as well as it is, that is much less of an issue for me. If opportunities have been identified in the legislative programme, I look forward to seeing what is in the bill, but at this stage I am afraid that I cannot be any more helpful than that.

The Convener: Is it a matter of concern that there was no consultation before the announcement that a bill was imminent?

Alan Sutherland: My understanding from what the First Minister said is that the bill is about a non-core activity of Scottish Water, not a core water-and-sewerage activity. Our responsibilities, which are clarified in the Water Services etc (Scotland) Act 2005, are to regulate the core activities of Scottish Water. If the bill deals with something that is entirely non core, it is of interest to us, but it does not impact directly on our work.

The question is the old chestnut about how any initiatives of the type in the proposed bill are to be funded. If it were to be done in a way that was detrimental to the household and non-household customers of Scottish Water, the commission would have to seek reassurances that it was something that customers should finance.

The Convener: So at this point you would not say that there is a reason to worry that the agenda that is being promoted—which might get a lot of support in the Parliament, although we have not yet seen the proposals either—will impact negatively on the core business of Scottish Water.

Alan Sutherland: If, for example, the proposals were to be about Scottish Water exploiting its land resources to partner with others and develop wind farms or something of that order, it is conceivable that that would have absolutely zero benefit or cost to the household and non-household customer and would therefore not excite our attention. It would be for the Scottish Water board to address.

The Convener: Thank you. If there are no supplementary questions on the Scottish Water bill, we will move on.

Rob Gibson (Highlands and Islands) (SNP): Good afternoon, Mr Sutherland. Staff numbers have gone up, staff costs are up and operating costs have doubled since 2009 in WICS. Will you outline why that is so?

Alan Sutherland: Staff numbers are up by one in the annual report. I think that you will see in the annual report a mix in the type of staff. Our administration head count has reduced through natural wastage—there has been one retiral and a couple of people have left the office—and we have added experienced analytical members of staff. The reason for that is that ultimately it is a lot cheaper for us to recruit good-quality analytical skills than to go to consultants to get work done. We have a full complement of staff at the moment. Since the end of the year, we have lost two analytical members of staff so we have fewer staff than before. We find it difficult to recruit, so when the opportunity comes we take people with the right qualifications when and from wherever we can get them.

Rob Gibson: I was informed that the full-time equivalent staff in 2009 was 23 and that it is now 26. At the same time as there has been an increase of one or three, depending on how we look at it, the general operating costs have increased by 40 per cent and salaries by 17 per cent.

Alan Sutherland: On salaries, I am afraid that analysts cost rather more to employ than administration personnel—that is the market for those skills. The general operating cost that you are looking at in the annual report is rather misleading. Audit Scotland asked us to change where we put the individual cost codes and how we aggregate them in the annual accounts. The underlying increase is more in line with the overall increase in our spending.

The other thing that ought to be taken into account is that our budget is cyclical. As we get towards the end of a regulatory period and get into the last stages of preparing price limits for the next period, we are at the peak of our workload and we incur more costs in those years. This year, you will see that our spend will probably be in excess of 15 per cent lower than it was last year.

Rob Gibson: We will see how that pans out. Why does WICS hold such a high cash reserve relative to its net assets and how does it intend to use it?

Alan Sutherland: The cash reserve is essentially drawn from three things. At the end of the year, we had been delaying an upgrade to computer systems that had come to the end of

their natural life, because we had a break clause in our quite expensive rent arrangement and we were trying to get to the point where we could move office and upgrade the information technology at the same time. We did not quite manage to last that long, but that is one of the reasons for the cash.

We foresaw the move, which will save £30,000 to £35,000 a year for the next 15 years. After all the up-front costs, that is the saving, which is sitting on our balance sheet at the moment. The balance of that money will be returned to Scottish Water during this financial year. We will take less levy from Scottish Water than agreed.

Rob Gibson: That is good to hear. Considerable emphasis has been placed on issues related to staff incentives and external hospitality, which in your view is a natural part of running the WICS functions. What hospitality spending is shown in the accounts?

Alan Sutherland: I am not sure that there is a separate line in the accounts for that.

Rob Gibson: Are you concerned about it?

Alan Sutherland: As the committee is aware, there has been quite a bit of coverage of that in one of the major newspapers. I personally have learned an important lesson, which is that the means are at least as important as the end. I hold my hands up and say that we did not get that right. Secondly, I assure the committee that we have substantially tightened up systems and processes within the office to ensure that all spending—the means and the ends—is scrutinised very carefully in relation to how it could be presented externally. I am not going to make arguments about value for money on the spend. With 20/20 hindsight, I can say that some of the venues and some of the types of event were probably not appropriate.

Rob Gibson: It is good to be able to talk about those here, especially in the context of your earlier remarks that we are looking at the regulation of Scottish Water in terms of a greener Scotland. Do you think that the way in which WICS operates would be an exemplar in a greener Scotland?

Alan Sutherland: We are certainly trying to do our bit to contribute to a greener Scotland. We have an environmental programme in the office, and we are moving to a smaller office, which is located right next to Stirling railway station, so people will be able to go to work by rail rather than travel by rail and then face a walk of a mile and a half to get to the office. That will be a practical option. However, it is clear that our principal function relates to the financing of Scottish Water and challenging it to do the best that it can. No doubt we will talk about that later.

14:15

Rob Gibson: I guess that we will.

I want to stick with the internal workings of the commission. Have its staff been paid bonuses? If so, what have they been, and where are they shown in the audited accounts?

Alan Sutherland: Staff bonuses are included in the staff remuneration line. They are calculated in two separate ways. The bonuses of administration staff are based strictly on performance. There is a mathematical relationship. There is no subjectivity in the bonus after the performance score has been determined. It is clear that all performance scores have an element of subjectivity, but the bonuses of administration staff are a function of their score.

The entitlement to bonuses of analysts whose basic salaries do not change in real terms over a whole regulatory period increases in each of the four years. That is partly a retention mechanism and partly a way for us to reward those who work hardest.

Rob Gibson: Earlier, you mentioned recruitment problems. Is there a problem with staff turnover, or is the bonus culture that you have identified and explained—

Alan Sutherland: Staff turnover will always be an issue in a small office that is full of talented young people who are recruited from all parts of this country and overseas. Our staff have come from all parts of the world: there are Chinese, South African, American, Canadian and South American people in the office. Many of them have come to live and work here permanently; others have recently finished graduate degree courses in this country and are seeking further work experience. There will always be a churn of staff. I think that most people who leave the office do so with some regret, but they almost always go to jobs with considerably higher salaries.

Rob Gibson: That could explain the remarks about a United Nations of expertise that appeared in your staff map. It is interesting that we have such wide expertise. The obvious question is, are we not generating that expertise in Scotland?

Alan Sutherland: We have some Scots, including me, in the office. It is clear that our recruitment is done absolutely on merit. I must be honest: every time we have a recruitment initiative, the preponderance of applications that we receive comes from non-Scots. That is unfortunate, and it happens not for the lack of trying. We have given presentations to a number of universities in Scotland over time, but they have not been as successful as I would like them to be. As I say, it is unfortunate, as we can give young people very good training.

Rob Gibson: That is an interesting point, which we may take to other places.

Finally, given the state of the public purse, can the commission identify any plans to reduce its staffing or operating costs in the meantime?

Alan Sutherland: As I have said, we are going to cut our budget by around 15 per cent this year, and we will give money back to Scottish Water this year. We have no plans to increase our budget; in fact, we have agreed with the Scottish Government that we will not increase our budget in nominal terms in any of the next five years. Whatever inflation might be—obviously, further quite high inflation numbers have been released today—we will not seek any increase in our budget during that period.

The Convener: I will pick up on one or two of Rob Gibson's points. You said that the hospitality issues that have received so much attention in the press do not have their own budget line. I assume that they are covered under the heading of general operating costs. Is that where—

Alan Sutherland: Without checking, I assume that that is where they are.

The Convener: Okay. So things such as the seminar at the spa hotel would appear under that line.

Alan Sutherland: Yes. I understand the reaction to how that was presented. I have expressed my view—admittedly, it is a hindsight view—but I assure the committee that an awful lot of work was done at the event. A lot of people gave time for nothing. I want to make it clear that it was a working session.

The Convener: I do not doubt that work was done, but perhaps less was done at the £9,000 Christmas party.

Charlie Gordon (Glasgow Cathcart) (Lab): A trip was made to Hamilton races on which more than £14,000 was spent. I presume that that was not work related.

Alan Sutherland: Press reports conflated an event to which we took staff and a two-and-a-half-day off-site working session on detailed planning of the price review. All the costs are included in that figure.

Charlie Gordon: So you are saying that press reports conflated those two things.

Alan Sutherland: If that is how you picked it up, they must have done, because that is not what was spent on the social bit of the session.

The Convener: You acknowledge, with hindsight, that some presentation mistakes may have been made. In presenting next year's accounts, will you have a budget line for

hospitality, so that people can identify clearly what was spent on it?

Alan Sutherland: Subject to working with Audit Scotland and how it wants things like that presented, I cannot see that being a problem. We will not hold any event that does not pass the tests and procedures that we have put in place.

The Convener: So you will discuss with Audit Scotland the separate presentation of that budget line in next year's accounts.

Alan Sutherland: Yes. Audit Scotland comes to all our internal audit meetings, so we can easily raise that matter.

The Convener: That is appreciated. I turn to travel expenses. It has been suggested that WICS uses the services of a company called CGL Chauffeur Drive. How much is spent on that?

Alan Sutherland: If you will give me a minute, convener, I will give a little bit of background on the matter. The company is a sole trader who trades under a somewhat grand name. It is equivalent to a basic car service. Because he is a sole trader, our legal advice is that there are data protection issues in releasing information. We have used this individual to pick up me and others late at night from train stations or airports to take us home. We do not use the service other than when safety or logistics make it necessary to do so.

The Convener: So you are saying that chauffeur services are used when logistics make it necessary.

Alan Sutherland: Yes.

The Convener: In situations when taxis are impossible to use.

Alan Sutherland: We use it because of price. We have checked the price against Glasgow city taxis and others. For example, we incur no wait charge when using this individual.

The Convener: Your usage must be frequent. Whether a contract for chauffeur services is with a small company or a large company, if it costs less than using taxis that implies that it is used very frequently.

Alan Sutherland: I do not think that it does. It implies that he is a sole trader who does not have the other costs of a fully registered large company. It is literally an individual with two cars.

The Convener: Okay. Just to be clear, you do not have a chauffeur-driven car on a daily basis.

Alan Sutherland: I do not have a chauffeur-driven car, and since the press comment, to be honest the hassle of such insinuations being made against me means that when I leave train stations

or airports at 10 o'clock at night, I drive myself home. I do not like having to do it, but given the public expenditure climate that is the way in which I will conduct myself—that is my choice.

The Convener: I hope that you understand my keenness to pursue those questions. In the economic climate that you mentioned, many organisations will have to do things that they would rather not do.

Alan Sutherland: I fully understand why you have asked those questions. I have already given the committee my view on the matter. All that I can do is assure you that any future spend will be scrutinised rigorously to ensure not just that it represents value for money, but that it is justifiable in every way.

Jackson Carlaw (West of Scotland) (Con): I have a final question on the same point. There is an issue that I want to clarify, before any other hare starts running. I imagine that if we are talking about a sole trader, the work in question will have formed a fairly significant part of his business. I assume that he has no connection with anyone in the commission.

Alan Sutherland: No—none at all.

The Convener: As there are no further comments on the accounts, we will move on.

Alasdair Allan (Western Isles) (SNP): We have come through a period in which WICS has kept increases in customer charges below inflation. What impact has that had on Scottish Water, how it has done its business and how it has invested or planned for the future?

Alan Sutherland: There is a lot that I would like to say on that, so I will try to pick out the most important highlights.

I take my hat off to Scottish Water for what it has achieved over the past few years. It has consistently done better than what I have consistently regarded to be the fairly substantial challenges that have been laid before it. God knows, I have had my arguments with the organisation in the past about what it could do in what timeframe, but it has really delivered and done exceptionally well. That is why in Scotland, water bills are, on average, £20 lower than they are in England and Wales; it is why on levels of service, Scottish Water, having improved its performance by something like 40 per cent over the past four or five years, is now on a par with some of the better-performing companies south of the border; and it is why it is delivering a very substantial capital programme, whether that is measured in absolute or per-customer terms. In many ways, it is outperforming by doing more than it was originally asked to do, so all credit to it.

I freely admit that there have been times when I doubted that it would make the progress that it has made. For example, a few years ago, we expressed some doubts about its capital programme, but it has done extremely well in pulling that together and delivering one of the largest programmes in the whole of Great Britain.

Alasdair Allan: Similarly, has WICS looked at alternative models for financing Scottish Water in the future? Has it looked at issues around debt and risk and where they might lie in the future?

Alan Sutherland: At the time of the last parliamentary election, when the then Minister for Environment and Rural Development suggested that it could be Liberal Democrat policy to look at a public interest mutual model—I think that that was the phrase that was used at the time—for Scottish Water, we considered what the implications of that would be. I can tell you clearly that that would have no impact on charges. We could see no reason for there being any impact on charges, were Parliament to change the structure. However, I must emphasise that all the improvements that I have mentioned have been made in a public sector context.

Alasdair Allan: I hate to refer to the press again, but the reason why I ask is that there has been some comment in the press about whether WICS has put money into advancing the case for privatisation. Could you comment on that suggestion?

14:30

Alan Sutherland: There are times when you read things in the press and you wonder, "Where's that come from?" No doubt you guys get that even more than I do. Those who have heard evidence from me over the past 11 years or so will know that the original reason why I took the job of water industry commissioner was to prove that it was possible for a public sector company to trade every bit as effectively as a private sector company. Given that that was my rationale for taking the job in the first place, I am hardly likely to suggest that privatisation is a better way forward.

Alasdair Allan: Has WICS given any consideration to the value that might be placed on Scottish Water? I understand that a figure of £50 billion has been suggested. Is that the case?

Alan Sutherland: You might have seen a figure for the replacement cost of Scottish Water's assets, which is based on the situation in which we had to start again from nothing and had no reservoirs, pipes, treatment works and so on. It would probably cost somewhere between £40 billion and £50 billion to put all of that in. However, that is not what Scottish Water is worth in market terms.

Alasdair Allan: I am thinking of a replacement value, am I?

Alan Sutherland: Yes. You could not sell Scottish Water tomorrow for £50 billion. The price would be of a different order of magnitude.

Alasdair Allan: I am sure that it could also not be sold for the figure of £3 billion that was floated as a sale price by those who favour privatisation.

Alan Sutherland: The question of the sum for which you could refinance Scottish Water would be a matter for the debt markets and the level of prices and so on at the time. I do not think that you can come to a strong view on that. I have noted some of the valuations that have been included in the Beveridge group report and the Scottish Futures Trust's work, but neither of those bodies consulted us on our view of what the value would be. I am sure that, if I spent some time, I could tell you what a comparative value would be, but it is not something that I have spent any time doing.

Charlie Gordon: I want to ask about the overhang projects from the previous regulatory periods, which I believe are worth around £169 million. To be fair, against the scale of the overall programme, that is not a substantial sum to have built up over the two periods, but it seems like a lot to ordinary members of the public.

You seem more bullish about the ability of Scottish Water to spend up its programme, but we still have that overhang. What is being done to address that?

Alan Sutherland: With some projects more than others, Scottish Water has encountered difficulties in getting planning permission, gaining the required consents and finding technical solutions, and that has led to some delays. However, your earlier words about the need to put that in some kind of context were important. We are talking about an organisation that has been delivering a capital expenditure programme of something like £5.5 billion over the past 10 years, so £169 million is not a huge amount of money. The situation is perfectly in line with the situation south of the border and with what is experienced by other utility companies.

A couple of years back, my concern was that it looked like the figure could be an awful lot more than £169 million. Had it been, say, three or four times that amount, I would not be sitting here saying that Scottish Water had done a very good job in turning round its capital programme, but I have to say that I think that it has done a very good job. In some ways, doing a regulatory job, it is easier for me to sit and be critical of Scottish Water, but I have to give credit where it is due, and Scottish Water deserves credit for what it has done.

Rob Gibson: I was interested in your remark that the public corporation is delivering. Over the years, you have compared the performance of Scottish Water with that of the privatised companies in England and Wales. I wonder whether any other country has adopted water modernisation in the fashion that happened in England and Wales.

Alan Sutherland: I am not aware of any other country in the world where there has been a wholesale privatisation of the businesses and assets in the way that was done in England and Wales. There are some elements of private water companies in South America, but there is also a substantial public service delivery element there. France has the two big French companies that manage concessions all round the world.

To judge from our contacts, most countries do not want to privatise their water services. We have had a number of visits from China, South Africa, New Zealand and various other places that are interested in what is happening in Scotland and how, in the Scottish context, we have been able to have a cost-efficient water company operating in the public sector, because other countries have not found it easy to achieve that. We sometimes beat ourselves up as a country, but it seems to me that this is an example of something that is going quite well.

Rob Gibson: Thank you.

Marlyn Glen (North East Scotland) (Lab): You mentioned that you have moved to a smaller office next to Stirling railway station. I have some more general questions on sustainability. How easily can environmental considerations be integrated into the short-term, five-year regulatory timescale? How is the commission adapting to allow Scottish Water to plan for longer-term environmental sustainability?

Alan Sutherland: That is genuinely a really good question. Up to now, the four or five-year regulatory periods have been good because there has been pressure on Scottish Water to up its game and deliver the environmental catch-up, and the pressure of that treadmill has been useful. You highlight an important point, which is something that we have genuinely begun to work on over the past year: a considerable number of projects are viable economically but have paybacks that are considerably in excess of the five-year regulatory period. The board of a company such as Scottish Water will clearly be a bit nervous about committing to such things when the payback depends on what the regulator might do in five years' time.

There are any number of initiatives with longer-term paybacks, such as asset rationalisation in some areas and longer-term commitments to

make better use of the assets that the company already has. We are trying to put in place a regulatory regime whereby, if Scottish Water identifies such things to us and states how much they will cost, we will give an undertaking that we will not take away the benefits that flow to Scottish Water before there has been full payback of the investment that it has made. It is clear that that is in our interests and ultimately in customers' interests, because we want to encourage Scottish Water to take such initiatives. As I say, lots of them exist. We tried to set the ball rolling in the final determination by identifying several issues for which we gave Scottish Water a little money and said, "Please go away and have a look at this sort of issue. Come back to us with your proposals and we'll see what else we can do in this area."

The Convener: At some point, we will know the range of public duties on climate change that arise from the Climate Change (Scotland) Act 2009. I assume that WICS will have an interest in ensuring that those duties can be met without detracting from the ability to maintain an effective and cost-effective public water agency.

Alan Sutherland: Absolutely. I will give one example in which the committee might be interested. Scottish Water's leakage rate has reduced by more than 450 million litres a day from its worst point. Extrapolating from data that were collected and published by Business Stream—Scottish Water's retail subsidiary—shows that the carbon that reducing that leakage has saved is equivalent to taking 75,000 cars off the roads in Scotland. To put that into perspective, that is half of all the private cars in Edinburgh. The importance of the contribution to carbon reductions that that leakage reduction makes cannot be overstated.

The Convener: I agree completely. Is it embarrassing that the WICS chairman is involved with a leading climate change denial think tank, the Global Warming Policy Foundation, which essentially recommends that the Government should broadly ignore the Intergovernmental Panel on Climate Change's recommendations?

Alan Sutherland: I do not get involved in whatever extra-curricular activities my chairman engages in. He is a busy man and he is involved in all sorts of things.

The Convener: You can see that it would be hard to take seriously such a voice saying that Scottish Water is taking climate change seriously.

Alan Sutherland: I ask you please to look at the commission's final determination, which shows that we not only financed the climate change obligations that ministers asked for but added more money into the pot. We added money for looking at more sustainable solutions to address

cryptosporidium problems. We added money for looking at the operation of sustainable water catchment management solutions, such as that at Forehill in Aberdeenshire. We also put in money for a metering trial. We have already begun a range of activities that I hope you will conclude are at least a small step in the right direction.

The Convener: I am sure that much welcome work is happening. In brief, you do not feel that Sir Ian Byatt is compromised by his two conflicting roles.

Alan Sutherland: Sir Ian Byatt plays a role in chairing the commission. He was one of the commission members who accepted and agreed the determination. As far as that role is concerned, we should be judged on that document and not on whatever else he is reported to have said or done.

Charlie Gordon: In setting out in your final determination the indicators against which Scottish Water is monitored, you have used an indexed score tool called the overall performance assessment. This year, the overall measure of delivery is mentioned—an OMD alongside the OPA. The new overall measure of delivery tool uses information on the progress of projects and their associated expenditure to provide another score for delivery progress, which sits alongside the overall performance assessment. Why was the overall measure of delivery introduced? Was the overall performance assessment felt to be inadequate?

14:45

Alan Sutherland: No, the two tools just do different things. The OPA measures a range of outputs that are important to customers, on matters such as contact experience, the performance of waste water treatment works, the likelihood of hosepipe bans and performance on leakage.

What the OMD does—I am sorry about all the acronyms—is say, "Scottish Water told us that it would deliver its capital programme at this rate; it set out the various stages of the capital programme, how quickly work would be done and how much would be spent in getting there." The OMD mechanism allows us to track mathematically the relationship between Scottish Water's actual progress and what it told us at the start of the year that would be.

The OMD allows us to be confident about whether progress is on track. It provides an objective number, which relates back to Scottish Water's projections. It is a complementary tool and is not immediately relevant to the customer, because what is relevant to the customer is whether a project is completed, on stream and providing benefits to the community.

Charlie Gordon: Have you considered whether there could be a downside to moving from an output-based approach to measurement to a more target-based approach? Our old friend the law of unintended consequences might kick in. There have been examples of that in the target-driven culture in the health service, when services that did not relate to a given target were neglected or not prioritised.

Alan Sutherland: The last thing that an economic regulator wants to do is create an incentive to do the wrong thing. When we put together a price review or monitoring tools, we are acutely aware that we must ensure that Scottish Water is focused solely on increasing value to customers, through better services and lower bills. That is what we do.

Let me be clear. The measure of capital performance that we are talking about is not a target that we set for Scottish Water; it simply enables us to draw the relationship between what Scottish Water said that it would do and what it is actually doing. It measures Scottish Water's performance against what the company said that it would do. There is no role for us to say, "You should have done this." Scottish Water says, "We will get this number of projects through the first stage of the capital process by this point," and the tool enables us to say, "Yes, you did that," and weigh the importance of that against progress at a later stage of a project. No perverse incentives are built into the system.

Jackson Carlaw: I presume that none of your staff is required to sign an oath of allegiance to the science of climate change. Your staff are entitled to hold their own views and express them freely.

Alan Sutherland: I assume so. I have never asked them to sign documents of that nature or any other.

Jackson Carlaw: I just asked, in case there was a sinister undertone to the suggestion that it would be incompatible for anyone who had not done that to work for WICS.

The Convener: If the member is able to provide a draft of such an oath, I would be interested in seeing it.

Jackson Carlaw: No doubt.

Does Alan Sutherland have a view on Scottish Water's marketing of insurance policies to domestic customers?

Alan Sutherland: I know that I do not like getting those phone calls and letters. I have expressed that view.

Jackson Carlaw: Are you of the view that they are necessary?

Alan Sutherland: My household contents insurance covers me for burst pipes. I cannot comment on anyone else's insurance.

Jackson Carlaw: I understand that many people's household insurance covers such situations. Is unfair advantage potentially being taken through the marketing of insurance policies to domestic customers along with lurid examples of the emergency situations in which people might find themselves? Householders might be unaware that the anticipated emergencies might be covered by their current policies. Have you investigated or considered the issue in your capacity as regulatory authority?

Alan Sutherland: It is a non-core activity of Scottish Water, not something that would fall within our remit. I assume that Scottish Water has checked its legal position on doing that, but it is really not for me to comment further than to say that I do not like getting the letters.

Jackson Carlaw: I see. Okay. Thank you.

Alan Sutherland: I get lots of them.

Jackson Carlaw: As do we all. I am interested in what you say and will pursue the matter elsewhere.

Although it is early days, over the past couple of years there has been a degree of competition in the business supply sector. Five bodies are now licensed to supply, including Business Stream, which currently has a 90 per cent market share. What are your observations on the period since that opportunity was made available?

Alan Sutherland: To be honest, I am pleased with the way in which things have progressed. An article in one of the Sunday newspapers said that there was only a 50 per cent awareness among small and medium-sized enterprises in Scotland that they could choose their supplier of water, but I took great heart from that. A year ago, the equivalent survey said that 25 per cent were aware that they could choose and, two years ago, no one knew. The fact that, in two relatively short years, half of Scottish businesses—one assumes that the bigger ones know if the smaller ones do, although that is maybe an heroic assumption—know that they can renegotiate and get themselves a better deal on either price or level of service is good news.

I have been surprised, as I had expected competition to be all about price. I thought that water supply was a basic utility service and that the people who would benefit most from competition would be larger production enterprises—paper mills, chemical plants and things of that ilk—but that does not seem to have been the case. The businesses that seem to have benefited most are those with diverse, disparate

sites—those with lots of small shops, pubs, bank branches and stuff like that. Most encouragingly—I speak as a taxpayer—the public sector in Scotland has taken advantage of the competition. The universities have fronted a contract whereby they have renegotiated to get a better price and a better level of service. I am pleased to say that the Scottish Parliament was part of that contract as well, so you are paying less for your water service than you otherwise would have done because of competition, which must be good news.

Jackson Carlaw: How uncomfortable a fact for my SNP colleagues, given what they said earlier.

Alan Sutherland: I do not know whether it is uncomfortable or not.

A national health service board is now using smart metering at its different sites in order to understand how water use varies across its estate and it has been able to make fairly substantial reductions in its water use and effluent discharge because of that. What customers have wanted has been less about price and more about enhanced levels of service and more advice—particularly help in reducing their carbon and water footprints.

Jackson Carlaw: It is suggested that there is a certain amount of frustration about the process of making a change, with some businesses that are trying to switch still experiencing difficulty in getting connections. Is that insurmountable, or is that just the reality of something that is new?

Alan Sutherland: To the extent that there is real evidence of problems, that is probably best ascribed to teething problems. I certainly do not think that we have had a repeat of some of the issues that have happened in the energy market with misselling or anything of that ilk and I am encouraged by that. The whole area of connections is getting better; it is a matter on which we are doing extensive work with Scottish Water and other stakeholders to ensure that we improve further. Over the next six to nine months, we will no doubt be in a position to announce some changes in that area, which I hope will make that easier. We are also involving the development community in that.

I am not aware of people having difficulty switching suppliers. I know that, with one or two of the suppliers, if I go on their website, I can do all that I need to do to switch my usage to them using a fairly simple web-based form.

Jackson Carlaw: To paraphrase a question from my colleagues on the left, can you think of any other Parliament anywhere in the world that is using a non-state-funded water supplier?

Alan Sutherland: Sorry?

Jackson Carlaw: Any non-state supplier of water. You do not need to answer that question—I

thought that that was the kind of partisan nonsense that we were indulging in previously.

Finally, do you have a view on whether your own roles as a market developer and a regulator are compatible?

Alan Sutherland: I am glad that we do not have the concurrent powers under the Competition Act 1998 that some of the regulators have south of the border, because, if there is a competition complaint, it can be quite difficult to be judge and jury on in the higher court when one has already made the decision in the lower court, as it were. That is the situation that those powers cause to arise. In our case, that would not happen, because a substantive competition complaint would go to the Office of Fair Trading and it would deal with the complaint. Clearly, we want a framework that is sufficiently clear and understandable to anyone so that such complaints need not arise.

The Convener: I am not sure whether Jackson Carlaw has a taker on the call for partisan nonsense, but Rob Gibson has indicated that he would like to ask a further question.

Rob Gibson: Heavens, no. With the experience of the past 11 years, would WICS expect Scottish Water to become cash positive at any point?

Alan Sutherland: It depends what you mean by cash positive.

Rob Gibson: Have a stab at assuming that it could make a profit.

Alan Sutherland: Will Scottish Water always be borrowing cash each year because it will be enhancing its asset base and addressing the environmental and public health challenges that we face, certainly for as far ahead as I can see, given that the timetable for the implementation of the water framework directive ends in 2027? There is a fair degree of visibility on some of this and I think that it is highly unlikely that Scottish Water will not need cash. What the implications of that are for Government public expenditure is probably a separate calculation. That is a question that, to be honest, you are probably better asking officials in the finance department in the Scottish Government rather than me, because they know the intricacies of that accounting and understand it rather better than I ever will.

The Convener: There are no further questions, so I thank Alan Sutherland for his time.

14:59

Meeting suspended.

15:00

On resuming—

Scottish Water Annual Report 2009-10

The Convener: Moving to item 3 on the agenda, I welcome to the meeting Ronnie Mercer, chairman; Richard Ackroyd, chief executive; and Douglas Millican, finance and regulation director, all from Scottish Water. Mr Mercer, do you wish to make any brief opening remarks?

Ronnie Mercer (Scottish Water): Yes, convener. Thank you very much for inviting us to the meeting.

I think that the past year has been pretty good for Scottish Water. I do not think that its operational performance has ever been better—drinking water quality has reached a very high level and we take extremely seriously our responsibility to protect public health.

Given the committee's comments last year that we did not say enough about climate change, we have tried to highlight what we have been doing in that respect. Scottish Water Horizons is taking shape to ensure that we can use most of our skills and assets in this area to reduce emissions further and that we continue to invest in Scotland's renewables future.

In many ways, the harsh winter showed Scottish Water at its best; the teams went out and did really well in all weathers. I am pleased that that was seen.

Finally, now that we are almost halfway through the financial year, I can say that customer service has continued to improve and momentum has been maintained on the investment delivery programme. We have a price freeze this year and next and are continuing to knock down leakage. We have set out in the report a bit of a vision that Scottish Water's board, management and staff have of being

"Scotland's most valued and trusted business, one that we can all be proud of."

Last year's performance makes me think that we have a chance of fulfilling that vision.

The Convener: As in the previous session, I want to begin by asking about certain recent events, particularly the legislative programme that the First Minister announced. As I said before, the proposal about Scottish Water was relatively new to MSPs, although I admit that its future has been commented on by the different sides in the argument. How much, if any, notice did you at Scottish Water have that the First Minister would set out in his statement to Parliament not exactly a

specific written proposal at this stage, but a clear direction?

Ronnie Mercer: Scottish Water and, in particular, its staff were very pleased to hear those who are effectively the owners say that they think the company is doing quite well. This is a business and an industrial-type company. We make a lot of that, and the thousands of people who work for us will be pleased to hear the good news that the owners think that we are generally doing the right things.

We have been in the renewables business for quite a wee while now. One or two of you might have been to Glencorse—I believe that you have been, convener—which is a small example of a site that, with its turbines in the water going in and turbines in the water going out, will be about two thirds self-sufficient. At the moment we produce—and therefore do not need to buy—only about 5 per cent. of the energy we use. We are on our way to 10 per cent but, over the past year or so, we have been looking at the wider picture of our estate and whether we can use some of it for bigger wind farm activities. Of course, we would not use the output directly; it would go on the wires and we would take it back off again. We have identified half a dozen sites and, after advertising for partners in the *Official Journal of the European Union*, picked two preferred bidders for them. A lot of work now needs to be carried out to understand what the yield and so on might be. We talked to our owners last year about moving along that way, so I was delighted to hear last week that the policy of saying, "That's a good idea and we'd like to do more of it," is being endorsed. That was pretty good news.

As for the waste-to-energy business, I know that the convener has been to Cumbernauld—he gets around. We are having that opened by Cabinet Secretary Lochhead this month. We are in that in a smallish way and we have other ideas. Our owners are aware that we have been active on these things; we talked to them about our activities before the report came out and said that we might do more.

Richard Ackroyd might want to say something about the World Water Council.

Richard Ackroyd (Scottish Water): We proposed a range of activities to ministers. Ronnie Mercer has mentioned renewable power generation and waste. I could also mention that we are starting to get some momentum on fibre optic cables in sewers as a business opportunity. Also, some ideas were mentioned in the First Minister's speech that came from ministers or ministers' advisers. I am talking particularly about the reference to setting up an institute that is similar to the Stockholm International Water Institute and about the Scottish Government bid to

host the world water forum in 2015. We need to discuss those issues further with the Government so that we can put some flesh on the bones and work out exactly what it would like us to do.

The Convener: Thank you. I come back to the question about prior notice or awareness that Scottish Water would come up in the legislative programme. I do not have his statement in front of me but, from memory, the First Minister sketched out quite a striking scale of ambition: Scottish Water would not only remain a public sector water company but become one of the largest renewable energy generators in Scotland. It would be a public sector energy generator on that scale. Were you given to expect such a scale of ambition? How realistic is it?

Ronnie Mercer: We have discussed how we become, if not quite self-sufficient, as close to it as we can get. Are we driven by the environment? Yes, but we are also driven by the electricity bill. We have the biggest electricity bill in Scotland and I have been pressing my colleagues to get it down a bit. Richard Ackroyd is still contemplating how to do that. It might be a property agent who is renting out land to someone, or someone might be involved in a power deal because they have given their land to someone who is making electricity; there are various ways that we can benefit from more electricity production, but the original idea was about knocking down our electricity bill and whether we could produce what we use, which is a lot more than we are producing now.

The Convener: You have touched on one or two of the other issues that I wanted to raise, but I want you to say something about the practical implication of what the First Minister said. What legislative change or changes in Scottish Water's management practice or staffing levels are needed? Do you have the skills already in place to begin to go down that route?

Richard Ackroyd: We already have expertise within the group, in our business Scottish Water Horizons, which is part of the non-regulated activity. It has expertise in renewable power generation and waste management; that is what it has been doing. It has also been doing the work on fibre optic cables in sewers. We will grow that business and its activity. It might well need more people to cope with a greater number of projects. We will deal with that.

Ministers have proposed some other activities to us, and we need to talk with them about the detail of what they envisage. That will start to tell us about the kind of expertise we need. I am mindful of the comment that Alan Sutherland made earlier: that it is important that we do not allow any of those activities to distract us from the focus that must be on the core water and waste water activity in Scotland. That will be at the forefront of our

minds. We will ensure that we resource the proposals in a way that does not take skills away from that business.

The Convener: As there are no further questions on the imminent Scottish Water bill, we will move on.

Rob Gibson: Why can some water companies in England and Wales charge less than Scottish Water charges?

Richard Ackroyd: There is probably one substantive reason. Two of the three companies that charge lower average bills than we do are Severn Trent Water and Thames Water, both of which serve densely populated areas. The cost per customer in such areas is very much lower than it is in areas with large rural populations such as we have in Scotland.

Rob Gibson: Is Northumbrian Water in a similar situation?

Richard Ackroyd: Northumbrian Water is interesting. Its area does not have the same density of population, but it has an enormous reservoir at Kielder Water and the available supply greatly exceeds demand. One of the factors is that Northumbrian Water has had far less need for investment in developing water resources than companies in most other parts of the country.

Rob Gibson: I thought that it would be useful for us to contemplate that. I understand the geographical factors.

Can you explain how Scottish Water calculates depreciation and how the total value of assets relates to the ability to borrow? I know that you had a lower surplus last year than you have had previously, but the issues about depreciation are tied up with our understanding of exactly what you make and what you have to spend.

Douglas Millican (Scottish Water): Fundamentally, the business is financed and operated on a cash basis. That involves looking at the cash costs in a given year or regulatory period and the sources of cash. That is why on page 18 of the annual report and accounts we have a graph that shows the balance of cash in and cash out. That is the critical way in which the business is financed and managed.

Depreciation is in effect an accounting estimate that reflects the consumption of the underlying stock of assets in a given year. In our business, there are two elements to that depreciation. There is the element that relates to the infrastructure, which is generally the below-ground water pipes and sewers, and the element that relates to the non-infrastructure, which is typically pumping stations, water treatment works and sewage works.

We refresh the depreciation charge on the infrastructure element every four or five years to look forward to what we believe will be the long-run cost of maintaining that infrastructure in a stable condition. Part of the £28 million increase in that charge last year was a result of a reassessment of the long-term cost of maintaining that infrastructure. However, that does not affect in any way the short-term cash cost; it is very much a 20-year perspective.

The other aspect of the increase in depreciation, of about £34 million, was to do with the above-ground assets such as water treatment works and waste water plants. That reflects the fact that we have run a large capital investment programme over the past few years and a number of assets have completed construction and come into use. An example is the new water treatment works for Glasgow at Milngavie—a scheme costing more than £100 million that has now come into use. That is now an asset that gets depreciated for the first time. Such assets have added to our depreciation charge in the current year. The charge will continue to rise in the next few years as further assets come on stream, such as the Glencorse works outside Edinburgh.

I stress that the depreciation charge reflects the accounting presentation of our performance. What really matters in running the company, or in the way in which the commission regulates us, is primarily the cash flows that are associated with the business.

Rob Gibson: Talking of cash flows, you have had surpluses of up to £200 million in a year and the figure is probably more than £700 million over the life of Scottish Water. You have explained why that calculation is made. Do you see it as an asset to the company and that it can think of itself as cash rich?

15:15

Douglas Millican: Those surpluses are accounting surpluses. In effect, the cash that is represented by those surpluses has, every year, been ploughed in to part-finance the capital investment programme. If those surpluses from the cash-generating operations of the company had not been present, the amount that we have had to borrow would have been higher, the amount that we have invested would have been lower or customer prices would have been higher.

Rob Gibson: I am aware of the debates that we have had about those. Does Scottish Water expect to have to borrow in the commercial markets over the coming years? How would that affect the balances?

Richard Ackroyd: We would expect the water and sewerage core business to require borrowings

as far as we can see, assuming that Scottish Water maintains a capital programme of any reasonable size. Where that borrowing comes from—from the Government or from the capital markets—is a decision for Parliament. We are no different from any other water company in the UK on that measure. They are all increasing their net borrowings every year—many of them are much more highly geared than we are—and that is the consequence of having large investment programmes such as the water industry has had for some years.

Rob Gibson: We understand that that will go on until 2027 and so on. Do you envisage that, as a water utility, you can ever become cash positive?

Richard Ackroyd: No. Not as a water utility.

Rob Gibson: So, as a public company, you will always be in the business of developing the assets.

Richard Ackroyd: There are choices concerning how we deal with what I will call a cash requirement. We can borrow, we can adjust the level of customer prices or we can seek to generate the revenue from other sources outside the core business. We can move any of those variables up or down. Some are easier to move than others; some carry political implications more or less than others. That whole issue will be a source of dialogue between us and ministers as we go forward.

Rob Gibson: Let us turn to another aspect of your accounts. Can directors' salaries and bonuses be justified in the current economic climate? We know, from very public discussions, that we are talking about very large salaries and a bonus scheme that matches them. Can you tell us a bit more about that?

Ronnie Mercer: Sure. I will handle that question, as my colleagues do not decide their salaries and bonuses, although they earn their bonuses. As you are aware, the bonuses are paid on the basis of performance—we have discussed that before at great length. The salaries that they earn are based on an exercise that was undertaken using the Government's advisers in order to get the best management we can afford and not lose them to others because what we pay is so far behind. That exercise was undertaken some time ago and the salary for the job was set before we knew which individual would be appointed. Richard Ackroyd got the job, but the salary was nothing whatever to do with him. The bonuses are intended to create success, and they are part of the company's success.

The salaries and bonuses in Scottish Water are lower than those in the other 10 water and sewerage companies in the United Kingdom, and they are probably lower than those in the six

electricity and gas companies. They were set to attract to the top jobs the people we need to drive a company with a £1 billion turnover and to keep the people whom we want to keep, although it is not always possible to do that, as people move on or get bigger jobs. The salaries and bonuses are now a lot closer than they were to those that the other companies offer but, of the 11 water and sewerage companies in Britain, they are probably still number 11. They look out of place in the public sector—I totally agree with that—but the company is not a typical public sector company; it is run as a business and it needs people at a certain level to make it run that way because of the complexities of it. It appears that whoever makes the decisions has been getting them right, because we are getting a reasonably successful company that, hopefully, is spending the money wisely.

Rob Gibson: You have been meeting performance targets. We understand why people receive bonuses in that situation, but do they receive bonuses even if you do not meet all your performance targets?

Ronnie Mercer: No. The targets are set by the regulator. If people merely hit all the targets, that is recorded in the regulator's annual report and they get nothing at all in bonuses. If they exceed the targets—which does not happen in all cases—they earn bonuses for doing so. If they merely hit the targets, they get nil; they get their money for the steps after that.

Rob Gibson: It is handy to have that explanation. Given the tight state of finances at the moment, do you think that salaries and bonuses of this sort are justifiable?

Ronnie Mercer: I totally understand what people think when they read about them, because they look out of place in the public sector, but they do not look out of place in the private sector. You might say that Scottish Water staff are not in the private sector, which is true, but we are asking them to imagine that they are and to run a company as if that were the case—those are the ready instructions that you give us. The approach is working and it is part of the success that we are having at the moment.

Rob Gibson: Given that there may be shrinkage in the money that is available from the public purse, will there be cuts in staffing or operating costs? Will there be cost cutting at the top, or are staff likely to be removed?

Ronnie Mercer: We are given targets for capital efficiency and operating efficiency that are quite stringent, to say the least; I do not yet know exactly how we will meet them. Those targets have to be achieved over five years. I will ask Richard Ackroyd to comment, as he has the job of meeting them.

Richard Ackroyd: One of our core principles is that we should reduce the cost of providing the water and sewerage service year on year. The Water Industry Commission sets us some challenging targets. Even if the commission did not set us such targets, that approach is ingrained in our psyche and the way in which we run the business.

In the previous price determination in 2010, the targets that the commission set us for the period up to 2015 were, in round numbers, a 10 per cent reduction in operating cost and a 15 per cent reduction in capital cost. In practice, that means that for each 100m of water main that we will lay in 2015, the cost will have to be 15 per cent lower than the cost of laying 100m of water main in 2010. That is baked into the price settlement. If we do not achieve the targets, we will find that we underperform the price determination. Conceivably, if we are far enough behind, we may run out of cash to run the business.

The name of the game is to make things more efficient. We go at that in a variety of ways. We are running a substantial number of what I will call change programmes or change initiatives in the business. Those include finding ways of working more efficiently with contractors—removing the duplication of cost that arises when you manage a contractor or other parties in the supply chain—and completely redesigning some of our internal business processes. Earlier, there was discussion of customer connections. We are redesigning the customer connections process with the objective primarily of improving the customer experience but also of reducing the cost of running the business.

There are numerous examples of such initiatives. Technological change is another. In the past two years, we have set up a team in the business that is focused entirely on finding innovative ways of doing things. Some of those involve technological innovations, whereas some involve innovation in how we run the business. For example, we are trialling a technology that would seal leaks in pipes from the inside, by injecting into the water mains little plastic platelets, as they are known, that find the leak and fix it. That is a much cheaper operation, with no disruption to the customer or digging up of highways. There are various pump technologies to make pumps run more efficiently and effectively. We are always looking at that kind of thing. Finding ways to run the business more efficiently and effectively is how we earn our bread and butter.

Rob Gibson: I mentioned staffing. Is it likely that there will be a reduction in the number of your staff? I am well aware of the thin blue line in the area where I live.

Richard Ackroyd: Sure. We have been reducing the number of staff in the business every

year since Scottish Water was formed. We expect that, by the end of this year, there will be somewhere between 130 and 150 fewer people than there were at the start. The language that I use when I talk to people in the business about the situation is that we are committed to doing this in a civilised way. It is all done through voluntary schemes, taking opportunities not to fill vacancies and redesigning business processes to cope with it. That is how I envisage we will carry on—every year we will find ways of getting more efficient.

The Convener: I will follow up Rob Gibson's question about salaries and other payments. One of the reasons extreme salaries are a matter of public concern is not just what is happening in the rest of the public sector but what is and has been happening in the whole of society for a number of years, including in the private sector, which is the increasing gap between rich and poor and what that says about the values of our society. The same questions could reasonably be put to private sector organisations, which are responsible for spending their customers' money, whereas in Scottish Water's case it is public money, although it does not come directly from taxation. You acknowledged that Scottish Water has a sense of responsibility for those kinds of issues. Several political parties have at least talked about adopting a maximum wage ratio policy between the highest and lowest paid in an organisation. What is the maximum wage ratio in Scottish Water?

Richard Ackroyd: It is about 1 to 20.

The Convener: Are you comfortable with that or are you looking to bring it down?

Richard Ackroyd: I am not making a value judgment about it; it is for parliamentarians and politicians to do that. If there were legislation about it, we would take account of it. We operate in a marketplace of people. We are conscious that we have to pay enough to get good people, but we certainly do not want to pay more than we have to for appropriately qualified people. We are always working with that dynamic. It is not just about how much people at the top of the organisation get paid as against those right at the bottom. We do not have what I would call low-paid people in Scottish Water. We are not a minimum wage type of organisation.

The Convener: Does the ratio of 1 to 20 include cleaners in your offices?

Richard Ackroyd: We do not employ cleaners, because that work tends to be contracted out.

The Convener: The ratio would be more extreme if you did.

Richard Ackroyd: No, the lower-paid roles in our organisation are predominantly in the call centre.

The Convener: My point is that lower-paid roles have simply been moved to another organisation.

Richard Ackroyd: I am not going to debate whether it is right to have a wage ratio of 18 to 1, 20 to 1 or 22 to 1. We operate in a marketplace. There are always occasions when we have to respond to the marketplace. Sometimes we have to pay more. In the north-east of Scotland, for example, we compete with the oil and gas industry for people with electrical, mechanical and IT experience, and that is an issue for us. There are other occasions when we find that the market for some skills has moved the other way and we can employ people at lower wages than previously. That dynamism will always be with us—we cannot escape it.

The Convener: I would like to hope that anyone who was not utterly ideological about such questions would say that we operate within a marketplace and within a society and that those things need to be kept in balance. Do you agree with that?

15:30

Richard Ackroyd: Certainly, although what "in balance" means is subjective. If you compare Scottish Water with a number of other water companies, you will find that the ratio in Scottish Water is a lot lower than it is in many other companies.

The Convener: There are no further questions on finances, so we will move on.

Charlie Gordon: Gentlemen, the regulator judges Scottish Water's performance against an overall performance assessment—the OPA—which comprises 12 indicators. In the year under discussion, you achieved a combined total of 291 points on those indicators, beating your target by about 21 per cent. However, by 2014 the regulator wants you to achieve a score of around 380 to 400, benchmarked against the top-performing water company south of the border. Which of the 12 indicators is your lowest scorer currently and which areas need additional effort if you are to match the top performers by 2014?

Richard Ackroyd: The area where we need the greatest improvement is reducing the number of environmental pollution incidents.

Douglas Millican: When you compare last year's performance with future performance, the other aspect to consider is that two other changes are being made. Three new measures are coming into the OPA basket for this new period, one of which is to reduce the number of pollution incidents. The others are to do with security of water supply and assessed customer service. There is also a change in how the measures work,

particularly in relation to water quality. Whereas, historically, we have scored very well on water quality, the way that that will be assessed in this new period means that we have further to go. We have work to do across environmental pollution, security of supply and water quality. Even in areas where we have done well in the past, there is still scope to get better, such as on managing unplanned interruptions to customer supply and taking more customers off the low-pressure register for water supply.

Charlie Gordon: So, how sanguine are you about getting up to 380 or 400 points by 2014?

Richard Ackroyd: We are not at all sanguine. We regard that as a very challenging target. We have developed plans, so we know what we have to do and we know something about how we think we will do it, but sitting here and saying that is different from doing it. We are not at all sanguine about it.

There is quite a big risk factor on the OPA measure. We have a number of large sewage treatment works across Scotland, many of which are operated on our behalf by others. If one of those sewage works fails its discharge consent in any one year, we lose somewhere around 40 points. You will see that that could quite easily make the difference between just passing and failing by a very large margin against those targets.

Charlie Gordon: I will ask you something that I asked the regulator. Is there any aspect of the approach to targets that you feel creates a danger that the law of unintended consequences will kick in? We have seen that before in the health service, where people become focused on targets and perhaps take their eye off other things that are not necessarily linked to the targets.

Ronnie Mercer: I listened to the earlier evidence. On the bonus question, on which Rob Gibson correctly pushed us, Scottish Water hit the extended target on the OPA tick box, but it did not hit it on the output delivery measure. They are two separate things: one is what the customer sees and gets and the other is whether we got the outputs right at the right time and at the right cost. In the bonus system, Scottish Water got one and not the other, which tells you that it works. Just because it got one, that did not mean that it got the other. The system is intended to make you get both, but the organisation failed on one of them. I do not know that the targets are a distraction in any way, but different measures matter. I do not think that there are any unintended consequences—you tell me.

Douglas Millican: The OPA now contains 16 measures that cover a range of water quality, customer service and environment issues, on all of

which we need to improve. I think that the OPA now reflects the balance of things that matter to customers—

Charlie Gordon: Does the OPA now have 16 measures? I mentioned 12 indicators in my question and you mentioned three new indicators.

Douglas Millican: Sorry, one of the existing indicators was split into two.

Charlie Gordon: I see.

Douglas Millican: We have wrestled over the past few years with how, in delivering a five-year capital programme, we can get an objective measure of whether we are on target, especially when we are midway through that programme. Clearly, spending the money is not necessarily a good proxy for achievement. Over the past 12 months, we and the Water Industry Commission have wrestled with that issue and we have come up with a new measure—the overall measure of delivery. I do not say that the OMD will be perfect, but we have together endeavoured to stress test it by looking at the what ifs. What if the programme is way off track in this or that area? What if we are ahead in some aspects and behind in others? Does the measure produce perverse results that could cause unintended consequences? I cannot guarantee that any new measure will not do that, but between ourselves and the commission a lot of work has gone into stress testing the OMD to try to ensure that it provides a reasonably objective measure of performance on capital delivery as we go through the five years.

Charlie Gordon: You will concede, gentlemen, that those agonies are not fully reflected in your annual report.

Richard Ackroyd: That is an interesting observation.

Charlie Gordon: However, we have got it out of you today.

Ronnie Mercer: Indeed.

The Convener: If there are no further questions on targets, Alasdair Allan will move us on to the next issue.

Alasdair Allan: We have already touched on Scottish Water's environmental commitments such as on leakage, which it is fair to say improved last year as compared to the previous year. Mention has already been made of how realistic the targets are for Scotland's sewerage system. How realistic are the targets for reducing leakage to less than 500 million litres per day by 2015?

Douglas Millican: Our target is to reach the economic level of leakage by 2014. The figure for the economic level of leakage changes over time, depending on issues such as the relative demands that are placed on our system, and varies from

zone to zone around Scotland. After we accepted the commission's final determination, we set out in our delivery plan our current view that the economic level of leakage is probably about 612 megalitres a day. We have an agreed programme with the commission to work together to get a better understanding of that as we go forward, so that number might change. However, our current view is that the figure is probably closer to 600 megalitres per day than 500 megalitres per day.

Alasdair Allan: You mentioned the variation in different parts of the country. Why is there variation? What are you doing to try to overcome it?

Richard Ackroyd: The level of leakage is driven by a number of factors: the state of the infrastructure, which is better in some parts of Scotland than in others; the impact of ground conditions, in that some ground will dry out and get wet more quickly and move more, which puts a strain on the pipes; and even the nature of the water, in that water of a more acidic nature, such as from moorland sources, can corrode the pipes. Another factor that we are thinking about—it would be wrong of me to say that we are 100 per cent on top of this yet—is that the best way of achieving the economic level of leakage might be to drive really hard in some parts of Scotland and less hard in others. In particular, we need to bear in mind that driving down the level of leakage is one of the best ways of addressing potential supply/demand imbalances. As we get more sophisticated at doing that, we would expect to be actively managing the situation so that we would have different levels of leakage in different places for good reason.

Alasdair Allan: You mentioned the different types of pipes and environments. I am often asked how much asbestos or clay piping still exists in Scotland. Can you tell me?

Richard Ackroyd: I cannot give you a straight factual answer to that; we would have to follow it up. There are still asbestos pipes in the network, and a lot of research has been done about the implications of that and the best thing to do about it. It is an issue that the industry is addressing, but if you want a precise figure, we will have to send it to you later.

Marlyn Glen: Does WICS's function as an economic regulator constrain Scottish Water's implementation of sustainable solutions that are more costly in the short term?

Douglas Millican: Historically, it has been up to Scottish Water to put together a business plan setting out what we believe are the resources that we need to run the company and deliver services to customers while making the improvements that are needed in order to deliver ministerial

objectives. Therefore, the onus is primarily on us to develop the most appropriate solutions, given the improvement challenges. In general terms, the solutions that we have put forward have been ultimately supported by the commission, although it has often not supported us with regard to the amount of money that we have said that those solutions require.

Mr Sutherland alluded to the dialogue that we have started to have about the approach to the price review from 2015 onwards. We are starting to think about how we can introduce mechanisms that will enable us to promote investment that will deliver environmental benefits, even though they might take longer than five years to pay back. That is a rich vein to explore.

Marlyn Glen: How do Scottish Water's greenhouse gas emissions compare to those of other industries in Scotland, and what are you doing to reduce sewer infiltration?

Richard Ackroyd: I am not sure that I can tell you how we compare with other industries in Scotland. We have focused on being able to measure our own greenhouse gas emissions, and the report contains information on that. We are encouraged by the fact that, in the last year for which figures are available, there was for the first time a reduction in our greenhouse gas emissions. We are pleased about that because, year after year, the whole of the industry, including us, has been building new treatment plant that, by and large, has to be energy intensive in order to meet the water quality and waste water standards that legislation requires us to meet, and that has been driving up our greenhouse gas emissions. None of the counter measures that we have put in place previously have been enough to address the increase but, for the first time, we have seen a modest decline. Clearly, our aim is to keep on top of that and keep driving emissions down.

In order for us to make a real dent in our emissions, two things must happen. First, we must increase the proportion of renewable electricity that we use; and, secondly, society, policy makers, Government and legislatures are going to have to give some thought to how to balance out the issue of greenhouse gas emissions with the issue of environmental impacts in other parts of the environment. The issue is particularly graphic in our industry. Is it right that we should continue to build ever more intensive sewage treatment processes to deliver a marginal improvement of water quality in a river if that comes at the expense of increased greenhouse gas emissions? How can we make those balances and trade-offs? That is where the debate needs to go in the coming years.

Marlyn Glen: That is interesting; we can follow up on that.

Metering has the potential significantly to reduce water consumption and I understand that £7 million has been earmarked for metering trials. Why have you allocated that amount and not more or less? I am particularly interested in why you have not allocated more. Also, why are Scottish Water's costs for metered water higher than those elsewhere?

15:45

Douglas Millican: I will take the questions in reverse order. We have very few meter customers: we have about 2.4 million unmeasured household customers but only around 600 metered houses. It costs more to supply metered than unmetered households simply because of the cost of installing and maintaining the meter, reading it and sending out the bills.

I turn to the metering trial. We are working with Government officials, the Water Industry Commission, the Scottish Environment Protection Agency and Waterwatch Scotland to explore the nature of a trial—we are looking at testing a number of different scenarios. We are in the process of working up what the trials might look like, with the intention that a plan will go to ministers for their approval by the end of this financial year—March 2011—which is the objective that they have set us.

The Convener: My question follows on from Marlyn Glen's question on climate change and Alasdair Allan's question on leakage. Both those sections in your annual report say what the figure has gone down by, but not what it has gone down from or to. I am sure that that information is readily available, but I wonder whether it would not have been appropriate to include it as context. I appreciate that more information is given this year but, for example, anyone reading the climate change section will see the percentages indicated in the footprint and would see that there was a reduction of almost 10,000 tonnes of CO₂ equivalent, but would not be able to put that information into context. Similarly, anyone reading that there had been a reduction of 99 million litres a day would not be able to put that into context unless they knew that the level had gone down to 704 million litres a day, I think that is the figure—

Richard Ackroyd: On leakage?

The Convener: Yes.

Richard Ackroyd: It is. I think that the figure for the previous year was just over 800 million litres.

Douglas Millican: Yes. It has come down by 99 million litres.

The Convener: Knowing that it has come down by 99 million litres makes sense only if you see the other figures.

Ronnie Mercer: I am sure that we can do that.

Richard Ackroyd: I assume that we can also do that next time for greenhouse gases.

The Convener: Thank you.

Alison McInnes (North East Scotland) (LD): I return to the issue of compliance. Under the waste water quality targets, I was interested to see that you managed to reduce the number of unsatisfactory intermittent discharges by 102. Your target was significantly higher, however. It looks as if about 143 unsatisfactory intermittent discharges still need to be improved. What are the problems in doing that? How do you intend to address the problem?

Douglas Millican: Are you referring to page 11 of our annual report?

Alison McInnes: Yes.

Douglas Millican: Originally, the number of discharges that were expected to be improved as part of the quality and standards IIIa investment programme was 277. As we did studies in each of the catchments to look at what was required, the figure went up to 307. We delivered 264 of that total by March 2010—in effect, we have about 40 to go. Some of the discharges are complex. It was important to identify absolutely the investment that was required. In that way, we ensured that the investment was targeted appropriately.

The single largest scheme that remains to go is in the Meadowhead and Stevenston areas of Ayrshire. A scheme is about to launch there to address the unsatisfactory intermittent discharges in the area. We have one or two others, but that is the single biggest scheme to go. The key thing was to ensure that we did the study work in order to target appropriately the investment.

Alison McInnes: That makes sense. We know from the report and from earlier reports that you have already invested more than £200 million in improving the quality of drinking water. You have indicated that you intend to spend another £20.5 million on improvements in that area. Can you tell us where those will be targeted?

Douglas Millican: Can you give me the page reference? We have a large water quality improvement programme as part of the new regulatory period, so I want to be clear on the context.

Alison McInnes: I cannot give you that reference right now. Can you talk about your improvement programme for the current session?

Richard Ackroyd: There are two major chunks. One chunk consists of the one or two large schemes that are part of the overhang programme that we discussed earlier. The largest of those schemes is the new Edinburgh water treatment

works at Glencorse, which is just up the road from here, and there is another one at Aviemore. We have a handful of those large-ish schemes that we intend to finish off.

In the programme that started in April this year, the biggest single water quality improvement issue is around small treatment plants, particularly in the Highlands but also in one or two other rural areas. We are working to reduce the risk of cryptosporidium contamination. Those plants tend to be small membrane treatment plants that might be serving a community of a few houses that has had very rudimentary treatment until now.

Rob Gibson: I want to raise the perennial matter of the Seafield works in Edinburgh, which was a very big job. Where are we at with that just now, given the number of years that it has taken to reach the stage of dealing with the situation?

Douglas Millican: I assume that you are referring to the odour issues at Seafield.

Rob Gibson: That is correct.

Douglas Millican: There has been significant improvement in the plant's operating performance, particularly since Veolia Water took over the management following its acquisition of the private finance initiative contract.

The capital investment upgrade is a two-year programme: we are now slightly over halfway through it, and we expect it to be completed by spring 2011.

Rob Gibson: That could be good news for tens of thousands of people in Edinburgh.

Jackson Carlaw: As I—and my parliamentary colleagues, I imagine—go about the doorsteps, I find that the world can be falling off a cliff but people still want to talk about the state of the roads. Being a politician I am always looking for someone other than myself to blame, and I see that the Scottish road works commissioner has decided that I should blame Scottish Water.

The commissioner's annual report for 2009-10 says that 86 per cent of the temporary reinstatements on Scotland's roads that are more than six months old are down to Scottish Water; and that the quality threshold of the reinstatements that are undertaken has fallen, as at present only about half of those repairs are acceptable.

I remember the chairman of Network Rail being lambasted for not getting his overalls on during his holidays to go out and personally fix the railway lines. I am not suggesting that you go out with a bucket and spade to do the work, but are you the guilty men?

Richard Ackroyd: Mea culpa. No, to be serious about it, I absolutely agree that that matter, and the state of the roads in general, is a big issue

from a customer point of view. The road works commissioner is a relatively new creature, and it has been a very effective appointment because it has shone the spotlight on that area. We must acknowledge that we have a substantial way to go to improve on that.

We are not at the starting line: we come from a position in which the water industry in Scotland—Scottish Water and our contractors—accounts for the greatest number of highway excavations. I say that to provide some context; it is not an excuse at all. To provide further context, I understand that the road works commissioner has issued letters to all the utilities in Scotland requiring action plans for improvement. We agreed an action plan with the road works commissioner a few months ago. As of today, we are ahead of the interim targets that we set in that plan.

Jackson Carlaw: Which would be what?

Richard Ackroyd: There is quite a substantial number of them. They are around issues such as the quality of reinstatements, core samples and the proper following of noticing procedures.

I think that the issue is one on which we will make progressive improvement. It is not one that will be solved overnight, but by the time the commissioner publishes his next report, you will see some improvement. We will get better faster. I say that because in addition to the programme of surveys of reinstatements that the commissioner carries out, we do our own with our contractors, and we are already seeing substantial improvements in the percentage of reinstatements that meet the standards that are required. In the most recent period that we measured, one contractor hit a rate of 100 per cent. I am confident that performance is getting better, but it will take time before it becomes good enough.

Jackson Carlaw: I am interested in the role that the Scottish road works commissioner has played. Was all this unknown before? Was it below the radar? Was a perceivable level of complaint and public concern being expressed? You say that there is now a focus on the issue, as a result of which some negotiation is taking place around the measure of improvement that should take place, but what was happening before? Why was the matter not dealt with effectively?

Richard Ackroyd: It would be wrong to say that the quality of reinstatements was an invisible issue and that no attention was paid to it. That would not be true. We deal with customer complaints, we carry out customer surveys and we address such issues on a one-to-one basis with the various roads authorities. However, I think that it is a truism that in a business such as utilities, if a regulatory body shines a spotlight on an issue, it generally causes people to pay more attention to

it, which results in performance improvement. That is what has happened in this case, and that is a good thing.

Jackson Carlaw: I would like to ask a question on insurance policies, which I pursued earlier. If you were sitting in the public gallery, you will no doubt have heard the concern that I expressed, which was about the extent to which insurance policies are an aspect of your business, the extent to which such policies are necessary and the extent to which they are understood, particularly by elderly people, some of whom have brought the issue up with me on doorsteps after receiving offers of such insurance. I have been unable to give frank advice, other than to tell them to check their domestic insurance policy in the first instance.

To what extent has that become an aspect of your business?

Richard Ackroyd: Insurance policies represent a valuable but modest source of non-regulated income. We get somewhere less than £1 million a year in commissions on the premia that are paid on those policies.

The overall context is that, as with many products of such a nature, a proportion of people find them irritating, do not like them or get confused by them, but the feedback is that a bigger proportion of customers value them. We are not unique in offering such products. The product in question is a HomeServe product. That company's main channel to market has been through marketing in association with utility companies. You will find that pretty much all the utilities market such products alongside insurance companies.

It is an activity that is very heavily regulated through the insurance market's regulatory mechanisms, which pay attention to the clarity with which information is conveyed to people. There are all sorts of rules about misselling and all that kind of thing, and we and HomeServe are obviously extremely careful to avoid falling foul of any of those.

Jackson Carlaw: Okay.

The Convener: Are there any further questions for the panel?

Alison McInnes: I have a stray question that I could not fit in earlier. Waterwatch Scotland produced a report last month on the introduction of competition into the industry. The report raises concerns about the idea of deposit requests. It says that in future,

"Business Stream ... intends to apply a condition from its current Terms and Conditions more strictly"

than has been the case in the past,

"which would see a number of its current customers having to provide a deposit for water charges. Failure to provide this deposit will lead to Business Stream disconnecting their supply."

What is the scale of that? What percentage of the overall bill could the deposit be? At the moment you are still in almost a monopoly position, in that you are providing more than 90 per cent of the business. Does that disadvantage local businesses at a time when they are struggling to deal with costs?

16:00

Ronnie Mercer: I cannot answer that point properly, but we are referring to page 15 of Waterwatch Scotland's report, which I have in front of me. It does not provide the figure, so I cannot quote it, but Business Stream has put a £75 charge on people who continually do not pay their bill and have to be chased for it. That is a penalty for not paying.

I will make a wider point, since you have brought up the Waterwatch Scotland report, which purports to be a competition report. It concerns a number of complaints, which come to less than 1 per cent of the entire number of business customers. In the past year £90 million of business has been openly tendered among the five companies—I think that Jackson Carlaw mentioned the same point earlier. That is a quarter of the entire business in Scotland, which is a total of roughly £350 million a year—£90 million coming to 25 per cent in round figures. That was tendered openly to the biggest companies that you could think of. I will not name them because of commercial confidentiality, but some of them are drinks businesses, some of them are in the oil business and some of them are paper mills. There is not one single mention of the fact that 25 per cent of the entire business has gone out for open tender in something that is called a competition report.

Right now, £75 million is out to tender for public sector work. That is nearly another 25 per cent—it is twenty-something per cent. There is no mention of that in the report, either. That will be decided during this calendar year. That is not in one chunk of £75 million, but in three packages of £25 million each. Losing any one of those means losing something like 7 per cent of the business; losing the three packages means losing twenty-something per cent.

I do not put much faith in a competition report that does not mention any of the competition that has actually been going on. I am not a politician—I took a chance to say something because I got a door opened.

I will come back to your question, Alison, on the matter of the £75 that is being charged to people who do not pay their bills. That is intended to be an incentive for people to remember to pay bills. Business Stream has a lot of problems with people who either do not pay or do not indicate that they are there—vacant sites that actually have folk in them are sometimes discovered. Mechanisms have to be put in to force the position. It is not that Business Stream is trying to screw the country further. In the time that it has been in place it has taken 20 per cent out of its cost base; 40 per cent of customers are now paying less than they did before and, by the end of this year, 50 per cent of customers will be paying less than they did before; £9 million has come back to Business Stream in efficiency savings. A lot of things are good about competition, too, but I cannot tell you the exact figure that you seek, as it is not in the Waterwatch report. I will come back to you on that.

Alison McInnes: I do not doubt that you need to protect your revenue, but I do want to see the figures, so it would be helpful if you could provide them in writing.

Ronnie Mercer: We will get them for you.

The Convener: I thank you all for the time that you have spent answering our questions.

16:03

Meeting continued in private until 16:08.

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