



The Scottish Parliament  
Pàrlamaid na h-Alba

## Official Report

### **PUBLIC AUDIT COMMITTEE**

Wednesday 23 February 2011

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**PUBLIC AUDIT COMMITTEE**  
**5<sup>th</sup> Meeting 2011, Session 3**

**CONVENER**

\*Hugh Henry (Paisley South) (Lab)

**DEPUTY CONVENER**

\*Murdo Fraser (Mid Scotland and Fife) (Con)

**COMMITTEE MEMBERS**

\*Willie Coffey (Kilmarnock and Loudoun) (SNP)

\*George Foulkes (Lothians) (Lab)

\*Jamie Hepburn (Central Scotland) (SNP)

\*Mr Frank McAveety (Glasgow Shettleston) (Lab)

\*Anne McLaughlin (Glasgow) (SNP)

\*Nicol Stephen (Aberdeen South) (LD)

**COMMITTEE SUBSTITUTES**

Derek Brownlee (South of Scotland) (Con)

Linda Fabiani (Central Scotland) (SNP)

James Kelly (Glasgow Rutherglen) (Lab)

John Farquhar Munro (Ross, Skye and Inverness West) (LD)

\*attended

**THE FOLLOWING ALSO ATTENDED:**

Mr Robert Black (Auditor General for Scotland)

Angela Cullen (Audit Scotland)

Graeme Greenhill (Audit Scotland)

John Lincoln (Audit Scotland)

Ronnie Nicol (Audit Scotland)

Shirley-Anne Somerville (Lothians) (SNP)

**THE FOLLOWING GAVE EVIDENCE:**

Dave Anderson (City of Edinburgh Council)

Sue Bruce (City of Edinburgh Council)

Richard Jeffrey (TIE)

Alastair Maclean (City of Edinburgh Council)

Donald McGougan (City of Edinburgh Council)

**CLERK TO THE COMMITTEE**

Jane Williams

**LOCATION**

Committee Room 6



## Scottish Parliament

### Public Audit Committee

*Wednesday 23 February 2011*

[The Convener *opened the meeting at 09:31*]

### Decision on Taking Business in Private

**The Convener (Hugh Henry):** Good morning. I convene the fifth meeting in 2011 of the Public Audit Committee, and I welcome to the meeting staff from Audit Scotland and members of the public. I ask everyone to ensure that all electronic devices are switched off so that they do not interfere with the recording equipment.

The first item on the agenda is a decision on taking some business in private. Committee members will see a reference in their papers to items 5, 6, 7 and 8. I will start with items 6, 7 and 8, and I ask members whether they agree to take those three items in private.

**Members indicated agreement.**

**The Convener:** Members will also see that item 5 follows on from item 4 on the Edinburgh trams. Do members wish to split the business on the trams, taking part of the evidence in public and part of it in private?

**Jamie Hepburn (Central Scotland) (SNP):** I think that I am about to say the same thing that George Foulkes is about to say. I do not think that we should split the business; we should have the entire session on the public record.

**George Foulkes (Lothians) (Lab):** I second that—in an unusual alliance.

**Jamie Hepburn:** Absolutely. Not to be repeated.

**The Convener:** Do members agree that we should take the approach suggested?

**Members indicated agreement.**

**The Convener:** Okay, we will not take item 5 in private. In effect, item 5 drops from the agenda and the substance of that discussion will take place in item 4.

## Section 23 Reports

### “The cost of public sector pensions in Scotland”

09:33

**The Convener:** We move on to item 2 and a section 23 report entitled “The cost of public sector pensions in Scotland”. I invite the Auditor General to brief the committee on the report.

**Mr Robert Black (Auditor General for Scotland):** Thank you, and good morning, convener. I would like to offer just a few words and then—with your agreement—I will ask Angela Cullen, who was responsible for overseeing the project, to summarise the key findings in the report.

This is a joint report by the Accounts Commission and me on the cost of public sector pensions, which reflects our complementary but different responsibilities for scrutiny in local government and the rest of the public sector. One of the key points in the report is that there are some really quite big differences between each of the six main schemes, particularly in relation to how much employers and employees pay to meet the costs of each scheme, and in the level of benefits that individual pensioners receive.

This is our second report looking at aspects of public sector pensions across Scotland. I made a report back in 2006, which members might recall. That report considered the financial pressures that were building up in the schemes then. We have prepared this latest report because those pressures remain significant—indeed, the level of interest surrounding public sector pensions has probably never been higher. As I am sure members are aware, and as we mention in the report, a former pensions minister, Lord Hutton, is currently reviewing public sector pensions across the whole of the United Kingdom on behalf of the UK Government. That review is due to publish options for major pensions reform next month.

Audit Scotland's report is intended to supplement Lord Hutton's review by providing much more detailed information to help with transparency and understanding of the costs and features of the main schemes that operate in Scotland. We hope that the report will provide elected representatives—in the Parliament and in the Government, and those who oversee the local government pension scheme—with essential information about the current state of the main schemes in Scotland. We hope that that will be helpful in the context of the wider debate on public sector pensions that we expect will follow once

Lord Hutton publishes his proposals for reform next month.

I ask Angela Cullen to take over and explain some of the main features and key findings of the report.

**Angela Cullen (Audit Scotland):** Our report looks at Scotland's six main public sector pension schemes, which are outlined in exhibit 1 on page 2. They cover most public sector staff in Scotland, including those who work in local government and the national health service, teachers, devolved civil servants, police and firefighters; in other words, they cover around 1 million people—or one in five of Scotland's population—and cost around £3 billion a year to provide.

In the report, we look at the costs of the six schemes, the benefits that pensioners receive, the operation of the schemes in Scotland and their governance arrangements. Pensions are incredibly complex and we have tried to structure our report to make things as transparent and accessible as possible.

Part 1 of the report provides an overview of the key features and benefits of the schemes including how they operate, how much members and employers pay into them, the level of benefits to which pensioners are entitled and what pensioners actually receive. Although entitlements are largely similar, the amount that each pensioner gets varies greatly depending on their pay and length of service.

Part 2 deals with recent reforms and Lord Hutton's current review, which the Auditor General mentioned. It also describes the role of the Scottish Government, the constraints within which it must work and its influence over pension scheme reform in Scotland.

The Auditor General also referred to differences among the schemes in the amount that employees and public bodies pay for pensions. Exhibit 2 on page 9 shows that public bodies contribute between 11.5 and 24.7 per cent of pay towards employees' pensions. On average, employees pay around a third of that, with their contribution rates varying from 1.5 to 11 per cent of pay. Although higher contributions tend to reflect higher benefits, particularly in the police and the fire service, the rationale behind the variation in contribution rates is not entirely clear.

As I mentioned earlier, we also looked at how much pensioners receive. Many pensions are low, reflecting relatively short service, low pay or a combination of both. Exhibit 3 on page 10 shows the average annual pension in each of the schemes and the difference in the average pension received by men and women. However, average pension is only part of the story; after all, some of the current pensioners retired many years

ago. To provide a more accurate picture of the pensions that people are receiving now, we analysed information on annual pensions received by people who had retired within the past two years from the local government pension scheme—or LGPS—and the police and fire service pension schemes and by teachers who had retired within the past five years. That analysis, which is set out in exhibit 4 on page 12, confirms that differences in pension payments are largely related to length of service, and it is important that policy makers and others take that information into account when considering changes that might arise from Lord Hutton's review. It certainly reinforces Lord Hutton's point in his interim report that

"It is mistaken to talk about 'gold-plated' pensions as being the norm across the public sector."

Parts 3 and 4 of the report deal separately with the costs and governance of the five main unfunded schemes and the LGPS respectively. The split reflects the significant difference between the LGPS and the other five schemes, both in their funding and in who is responsible and accountable for their governance.

As the largest scheme in Scotland, the LGPS has more than 450,000 members and is administered by 11 local authorities. It is also the only funded scheme, which means that any surplus contributions are invested for the future.

The Convention of Scottish Local Authorities is leading a pathfinder project, managed by the Improvement Service and funded by the Scottish Government, that is looking at options to rationalise the LGPS to reduce costs and improve risks and governance in future.

Because there are now more pensioners and people are living longer than previously expected, there are significant cost pressures in all the schemes, both in the pensions paid out and in the money paid in towards the costs of providing pensions. The annual amount paid to pensioners has increased by 30 per cent in real terms in the past five years. Over the same period, contributions by employers and employees have risen by 19 per cent in real terms.

In the LGPS, there is an additional cost pressure, because the return on investments in recent years has been lower than expected. The unfunded schemes do not have that cost pressure because they do not have any investments. However, contribution rates may rise in the unfunded schemes because of technical changes in how the rates are set. HM Treasury assumptions for calculating the rates are being reviewed, and that is expected to result in an increase in contribution rates.

Recent UK Government decisions, including the change from using the retail prices index to using the consumer prices index for uprating public sector pensions and increases in employee contributions that were announced in the spending review, are expected to ease the cost pressures on the public sector. The combined effect of all these changes will not become apparent until later in 2011 or in 2012, when actuarial valuations are completed. Those valuations will take into account any changes made by the UK Government, together with the latest demographic data.

Looking ahead to the position after Lord Hutton's review, our report recommends that the Government should consider the differences among the schemes when deciding how best to implement the changes that may arise from the review. Our specific recommendations are outlined on page 5 of the report. We suggest that there is scope for the Scottish Government to strengthen its scrutiny of this major area of public spending.

As ever, we are happy to answer any questions that members might have.

**The Convener:** Thank you very much. I have a couple of technical questions. Perhaps you can clarify the position. Exhibit 2 on page 9, to which you referred, shows that, for the new police pension fund, the employers contribute almost 25 per cent, which is the same as with the old scheme. However, the employee contribution has gone down from 11 per cent to 9.5 per cent. What is the reason for that?

**John Lincoln (Audit Scotland):** The main reason is that police officers will retire five years later and the benefits are slightly lower, so there is less need for employee contributions.

**The Convener:** Okay. You indicate that in the LGPS some employees on higher rates can make additional contributions. What is the maximum percentage of their final salary that a senior member of staff can receive when they retire, if they had the maximum length of service?

**John Lincoln:** If they have the maximum 40 years in the scheme, it depends on when they started. The accrual rate up to when the most recent reforms took place was forty eightieths, so people who were in the scheme until then would get half their salary, which includes the lump sum of three eightieths. Since the reforms, there is no lump sum. However, the accrual rate has gone up from eightieths to sixtieths, so the maximum that they can get is two thirds of their final salary. That will happen only for people who retire in about 35 years' time, because it takes a while for the changes to feed through.

**The Convener:** So at the moment anyone who retires could potentially retire on half their final

salary, but some chief executives in the future may be able to retire on two thirds of their final salary.

**John Lincoln:** Yes, that is correct. That would be in about 38 years.

**The Convener:** Given the furore over chief officers' pay in the public sector, is allowing them to retire on two thirds of their salary rather than on half meant to be a cost saving?

**John Lincoln:** During the reforms, there were a lot of other changes in the local government scheme. One of those changes was to the rule of 85, which allowed people to retire before the age of 65 on a protected salary. That rule has now gone. There has also been a change in the employee contribution so that people on high salaries—chief executives, for example—pay a much higher employee contribution.

Overall, the changes in the local government scheme that happened during the previous reforms getting rid of the rule of 85, the increase in contributions from employees, and the withdrawal of the lump sum—marginally reduced the cost of the scheme for employers.

09:45

**The Convener:** Under the present scheme, if someone has 35 or 36 years of service—thirty-six eightieths, as you described it—and if for the exigency of the service the council decides to allow that person to go early and to draw their pension early, and decides to give them added years, can you confirm that it is the council that will pay the additional contributions for those extra years for as long as the person lives and draws their pension? For example, if a chief officer goes early—as has been happening over the past 10 or 15 years—is it the council tax payers who will pay for the additional boost to an already generous pension?

**John Lincoln:** When someone retires early in those circumstances, the council will ask the pension fund for a valuation of how much it will cost. An actuarial evaluation will be carried out by the pension funders to ascertain what is termed the strain on the fund. The council will then have to pay the additional cost of that person's pension to the pension fund. It will have five years in which to do that.

**Jamie Hepburn:** I thank the Auditor General for his report. Exhibit 3 on page 10 certainly gives the lie, for a significant part of the public sector and for women in particular, to an issue that we hear about often—gold-plated public sector pensions.

Can you give us further details? The exhibit gives a useful breakdown of average annual pensions for men and women, but I notice that

figures are not available for the civil service. Why is that?

**John Lincoln:** We asked the National Audit Office to ask the Cabinet Office on our behalf for that breakdown, but it was not able to provide it within the timescale that we gave.

**Jamie Hepburn:** So it could provide the breakdown but it might take a bit longer.

**John Lincoln:** I think that it may have been able to provide it, but was not able—

**Jamie Hepburn:** Okay.

**The Convener:** Before you move on, Jamie, I ask John Lincoln whether, if the Cabinet Office was not able to provide the breakdown within the timescale required for this report, it has provided the breakdown since.

**John Lincoln:** It has not since provided us with the breakdown, no.

**The Convener:** Is that something that you are pursuing?

**John Lincoln:** It is not something that we are actively pursuing at the moment, no.

**The Convener:** Okay.

**Jamie Hepburn:** I presume that that information is available and that someone could ask for it.

What definition of civil service is used in the exhibit? I am a little surprised that the civil service is at the bottom of the league table, as it were. That can only indicate wild variations in civil service pensions, because I cannot imagine that the top mandarins receive an average pension of £4,222.

**John Lincoln:** The civil service pension scheme covers a wide variety of staff—including, for example, fairly junior staff in the Scottish Government, clerks, people in jobcentres and so on. The scheme covers a huge variety of staff, so there will be an averaging effect.

**Jamie Hepburn:** Have you been able to break down the figures further, or are the figures shown in the exhibit as broken down as they can be?

**John Lincoln:** We have not broken them down further.

**Willie Coffey (Kilmarnock and Loudoun) (SNP):** Future pension liabilities are covered on page 24 of the report. I have never fully understood why we talk about a pensions black hole facing society. We know that the population is ageing, and we know that salary levels are generally on the up, so I would have imagined that Governments, financial planners and so on would be able to forecast changes in society in order to make provision for future pension liabilities.

It seems clear from the Auditor General's report that some variations are attributable to continued low interest rates; they appear to be one of the bigger factors in determining future pension liabilities.

Exhibit 9 shows the extent of the problem that we potentially face. Over four years, the set-aside goes from £47 billion to £69 billion, which is an increase of nearly 50 per cent. How much of that change in liability is attributable to changes in society, and how much is attributable to interest rates, which have been steady over the past few years?

**Angela Cullen:** It is a mixed picture: we now have more pensioners than ever before because of an historical increase in the public sector workforce; public sector pay has increased over time; and people are living longer. There are demographic factors that influence the number of pensioners, how long they live and the pay that they retire on. However, interest rates are a major factor for the reported liabilities and for their valuation. Interest rates in 2007 were around 5 per cent, but they are now historically low, at 0.5 per cent. That has a major effect on the valuation of the pension liabilities, which now have a much higher valuation than they would have had if the interest rate had been 5 per cent.

**Willie Coffey:** I understand that. It is probably impossible to get an answer, but this is what I am trying to get at. If and when interest rates normalise, recover, change or increase—or whatever the term is—the pension liability will come down significantly, I think. For me, it is about how much of the liability is attributable to interest rates and how much is attributable to societal changes, which we well know about and presumably have been planning for over a number of years. It is hard to see what the breakdown is. Major changes in pension policy could come about because of flat interest rates over a number of years rather than because of changes in society at large.

**Angela Cullen:** Yes—there is a combination of factors.

**John Lincoln:** There is a small section on the issue in Hutton's interim report, which states:

"The changes in the discount rate assumptions ... did not result from adjustments to the assumed security or generosity of public service pensions. Instead ... they were linked to"

interest rates and corporate bonds, and reflect

"the change in assumed risk of corporate defaults during ... the credit crunch."

So, that is what is driving things. The report continues:



"A change of this kind in bond yields has no implications for the actual cost of providing public sector pensions, so such estimates of accrued liabilities need to be used with caution."

I think that that sums it up.

**Willie Coffey:** The conclusion that I draw from that technical information is that quite a lot of the pensions black hole is attributable to interest rates rather than to the societal changes that we have been told all along are the principal reason for the liability increasing.

**The Convener:** Just before I bring in George Foulkes, I want to follow up Willie Coffey's point. Do the figures that you have shown also reflect the changes that the present UK Government has introduced, which will steadily erode the value of pensions?

**John Lincoln:** No. Those figures were from March 2010.

**The Convener:** So will the changes that have now been introduced have the effect of reducing the pensions liability?

**John Lincoln:** Yes. The assumption in the Hutton review was that the change from using the RPI to using the CPI would reduce overall payments by about 15 per cent.

**Mr Black:** Can I perhaps supplement John Lincoln's very full answer to Mr Coffey's question? I refer members to page 41 of our report. As Mr Coffey indicated, it is important to be aware of the overall liabilities in the longer term, which could stretch out for around 70 years. It is also important to be aware that the major factors involved are the interest rates and the actuarial revaluations that are based on those. In the extreme right-hand column of the diagram on page 41, we can see the cost of the scheme in-year. For example, we can see that the local government pension scheme has a positive net cash flow of £266 million. The national health service scheme is similarly positive. However, there are negative figures for the schemes for teachers and the civil service, and the schemes for the police and firefighters break even.

That tells us—perhaps this reinforces the point implied in Mr Coffey's question—that there is not an immediate crisis, as all the funds are being managed appropriately, but we need to ensure that we have a searchlight that looks to the future to see how liabilities are building up in the light of the performance of capital markets and the growth in the number of pensioners and what they are entitled to.

**George Foulkes:** Can we put matters into a bit of perspective? We are talking about 172,300 pensioners. That is the figure given in the key messages in the report. The cost of those

pensions is coming up to £2 billion, which is a little less than the Royal Bank of Scotland pays in bonuses, on top of huge salaries, not to mention pension contributions—paid for out of taxes from the public, including from public service pensioners. Is that correct?

**Mr Black:** We have not audited those numbers, but I acknowledge the point that you are making, Lord Foulkes.

**George Foulkes:** It is about time that we put matters into perspective. Public sector pensions are not generous in the context of some payments that are being made to people in the private sector, particularly in the banks, which provide services that bear no comparison with the services that are provided by the doctors, teachers and nurses whom we are talking about. It is about time that people realised that.

**Murdo Fraser (Mid Scotland and Fife) (Con):** I will ask about the comments on aspects of final salary schemes on page 13 of the report. How many of the six schemes that we are talking about are final salary schemes?

**John Lincoln:** It depends on when the person joined the scheme, to a certain extent. Apart from the new civil service scheme, all the schemes are final salary schemes. People who have joined the civil service in the past three or four years are in the nuvos scheme, which is an average salary scheme. All the rest are final salary schemes.

**Murdo Fraser:** So they are all final salary schemes apart from the most recent civil service scheme. Have you done any comparison with the private sector and considered the percentage of people who are employed in it who are in final salary schemes?

**John Lincoln:** We did not directly compare the numbers.

**Angela Cullen:** We have not made a comparison against final salary schemes, but paragraph 12 on pages 6 and 7 of the report states:

"Around 500,000 current employees are active members of one of the six main schemes in Scotland, which is around 85 per cent of the public sector workforce."

That compares with only 35 per cent of the private sector workforce who are currently in pension schemes. The paragraph says:

"The Pension Act 2008 due to come into effect in 2012 will require"

all private sector

"employers to automatically enrol most employees into a qualifying pension scheme."

Therefore, steps are already in place to try to redress the imbalance, but there is quite a stark difference between the number of public sector

employees who are currently in pension schemes versus the number of private sector employees who are in them.

**Murdo Fraser:** Most private sector employees do not work for banks and are not on very substantial salaries, of course. Thank you.

**Anne McLaughlin (Glasgow) (SNP):** I want to raise an issue to do with final salary pension schemes that is not in the report. I wonder whether Audit Scotland has come across it.

I have not worked for a local authority and am not entirely sure how things happen in them, but I have worked with a vital community project in the voluntary sector. It was a small project that dealt with a number of clients in a mental health setting, and it inherited the pension agreements of staff who had transferred to it. Because of the cuts, which will get worse in the coming years, some money was lost and redundancies had to be offered. When they were offered, there was a wait to find out whether certain people who were in one of the pension schemes and had paid into it for a long time would accept those offers. Obviously, it was hoped that they would not, but they did. The project, which was vital, had to close because it was told that it faced a massive bill—I think that it was liable for more than £1 million, which was impossible for it to pay. How often is that going to happen? How commonplace is it going to be? Projects will have to offer redundancy. Is there going to be a problem in the voluntary sector because of small organisations that simply cannot meet their liabilities?

10:00

**Angela Cullen:** We have not considered that issue specifically in this report. There are quite a few voluntary organisations whose employees are members of the LGPS—there are around 600 admitted bodies in the LGPS, in addition to the 32 councils.

**Mr Black:** It is worth making the rather obvious point that this is not simply a problem for bodies that are admitted to the local government pension scheme. It is an issue to do with the employment rights in law of employees who have been with an organisation longer than two years and are entitled to a statutory redundancy payment. I acknowledge absolutely the point that this situation could tip small organisations without a strong cash flow over the edge. However, we have not considered that in any way.

**Anne McLaughlin:** Is there any scope for you to consider it? Who else would consider it? One of the Governments needs to consider the issue in case it causes a big problem. The project that I mentioned cannot be the only one that is affected. It never expected to be in this position. It accepted

that it had responsibilities, as an employer. However, because the project is small and is dependent on public funding, which is reducing, those responsibilities resulted in closure.

**Mr Black:** My immediate thought is that the Scottish Council for Voluntary Organisations would be the first port of call for information about what is happening to the viability of some of those organisations and the extent to which the issue is a problem.

**The Convener:** Over the past 15 or 16 years, early retirement has become a feature for senior and middle management, as a means by which local government, the health service and the civil service can reorganise. The argument is that downsizing in such a manner enables those public sector bodies to reduce their costs. However, as I have said before, there is an underlying cost to allowing those early retirements, as has become obvious over the past 15 or 16 years. Have you done a calculation of the additional cost to the pension schemes of allowing those earning more than, for example, £50,000 a year to take early retirement? What is the additional cost to the body that allows them to go, in terms of the additional contributions?

**Angela Cullen:** We have not considered that issue specifically. In part 3 of the report, we comment on lump sums being offered. The take-up of those has been relatively high and increased to around 25 per cent of total pension payments in 2009-10. In the report, we say that the costs of any decisions that are made on early retirement are borne by the employer, which must assess the business case for that, as John Lincoln said earlier.

**Mr Black:** In general terms, if a public body is minded to offer someone voluntary early retirement, we would expect it to present a business case that shows a financial benefit to the public purse, over an appropriate period of time. A few years ago—before devolution—in a report that I did for the Accounts Commission on the costs of local government reorganisation, I highlighted the issue of the number of staff leaving during that period and the question whether the substantial cost of that was offset by a financial benefit. It is fair to say that, in the years since devolution, greater discipline has been applied to require people to be able to demonstrate the business case for early retirement packages.

**The Convener:** If a senior director decides to go a bit early and leave with 38 or 39 years' service—let us use the example of eightieths—normally the only justification for giving added years is that there is a saving to the council. However, if the council replaces the director with another director, there is no obvious saving. What penalties or implications are there for a council

that gives added years to someone who is already entitled to a generous pension?

**Mr Black:** It is for the individual local authority, non-departmental public body or other public body to make the business case. It is not impossible that a post at any level would be replaced broadly on a like-for-like basis but consequential vacancies down the scale would not be filled, which might generate the saving. That is not an unknown set of circumstances.

**The Convener:** No, but if that does not happen, the council should not make additional payments to a director who is going in such circumstances.

**Mr Black:** It is difficult for me to comment in the abstract on that, but I acknowledge the point that you make.

**The Convener:** Would the Accounts Commission consider the matter in such a situation?

**Mr Black:** The auditors of local authorities would be vigilant over what was happening with regard to early release of staff.

**The Convener:** Not just chief executives but many heads of service and directors are earning more than £100,000, and many of them have been at that level for only a few years of their working lives. That brings me back to the issue about final and average salary. I do not have a problem with the final salary approach for people who earn modest sums for most of their lives, but I have a problem with people who earn modest sums contributing to generous pensions for a small number of people who have not been at a very high level for long.

If someone is on £100,000, the forty eightieths rule gives them a pension of £50,000 per year in the local government scheme. Is the lump sum calculated on the basis of three times the pension? Does the person get a tax-free lump sum of £150,000?

**John Lincoln:** Until the most recent round of reforms the lump sum was thirty eightieths. There are no lump sums in the new local government scheme, so a person who wants a lump sum must give up a proportion of their pension to get one. If they give up £1 in pension, they get £12 in lump sum—that is the ratio.

**The Convener:** Do the new arrangements apply only to new entrants or do they apply to everyone?

**John Lincoln:** I think that everyone still retains the right to the lump sum of thirty eightieths of salary up to 2009. After 2009 they do not get the lump sum.

**The Convener:** What point in 2009 are we talking about?

**John Lincoln:** I do not recall the operational date. It is probably 1 April.

**The Convener:** Okay. If there are no more questions, I thank the witnesses for their evidence. I am sure that public sector pensions will continue to be a significant issue in the years to come.

### **“Maintaining Scotland’s Roads: a follow-up report”**

10:09

**The Convener:** Item 2 is consideration of “Maintaining Scotland’s Roads: a follow-up report”, which is a topical issue. I invite the Auditor General to comment.

**Mr Black:** Thank you, convener. The only interest that I have to declare is that I own a car. *[Laughter.]*

**Mr Frank McAveety (Glasgow Shettleston) (Lab):** And it is off the road.

**Mr Black:** It was off the road for 48 hours because of an unforeseen pothole.

**Mr McAveety:** Why is that not in the report?

**Mr Black:** I sometimes think that, if we want media headlines, all we have to do is publish a report on potholes. However, to be serious—and we always report on serious matters—this is again a joint report with the Accounts Commission because of its responsibility for the oversight of local government expenditure. As before, I will offer a few brief comments and then hand over to Ronnie Nicol, who was in charge of this project and who will take you briefly through the main findings and recommendations.

As the convener has just acknowledged, this is a matter of great public interest. There has been almost unprecedented media coverage of this particular report. We previously looked at road maintenance in 2004, and this report examines the progress that has been made by both Transport Scotland and local councils on implementing the recommendations that we made then. This report is therefore a follow-up to a previous report in which we made a set of clear recommendations. It reviews changes in the condition of the road network since 2004, how much is currently being spent on road maintenance, and how road maintenance is being managed.

I would like to emphasise that the report is based on information that was collected between March and October 2010, so it does not consider the impact of this winter. In particular, it does not consider the severe weather that we all experienced round about Christmas. Even so, I have to say that what we found is rather disappointing. The condition of Scotland’s roads

has worsened since our previous report. More significantly, the expenditure trends and the scale of the backlog in maintenance mean that the asset value of the network is not being sustained. As I have said on other occasions, deferring essential expenditure is a serious issue. In the first place, we are simply storing up problems for the future if we do not maintain the infrastructure. Secondly, we are simply passing on to our children and to future generations the burden that arises from our consumption of the assets that we inherited from the previous generation. There is a significant issue relating to fairness between our generation and the generations to come.

The Government, local authorities and all public bodies are having to make extremely difficult spending decisions on their competing priorities. However, in view of the fact that our overall performance is slipping back, we suggest in the report that we need to think more radically about how Scotland's road network is managed and maintained. We have suggested that there might be some kind of national review on behalf of the Government that allows all the parties to come together and seek the solutions that are urgently needed.

At this point I will hand over to Ronnie Nicol, who will say a little bit more about some of the key findings.

**Ronnie Nicol (Audit Scotland):** Scotland's road network consists of almost 56,000km of road. Transport Scotland is responsible for 3,400km of motorways and trunk roads, and councils are responsible for 26,000km of classified roads and 26,400km of unclassified roads. The road network is valued at £38 billion in its present condition.

Despite public spending in Scotland rising by around 25 per cent since our previous report, the condition of Scotland's roads has worsened. Only 63 per cent are now in acceptable condition.

Trunk roads tend to carry higher volumes of traffic at greater speeds, so they need to be maintained to higher standards for safety reasons. Although trunk roads are in better condition than council-maintained roads, the percentage of trunk roads in acceptable condition has declined—from 84 per cent in 2006 to 78 per cent in 2010.

The condition of council-maintained roads has also declined. For classified roads, 70 per cent were in acceptable condition in 2005, but that figure fell to 66 per cent by 2010. Unclassified roads, typically those in built-up areas, are in the poorest condition, with only 58 per cent in acceptable condition.

As the condition of our roads declines, it is no great surprise that the cost of repairing the road maintenance backlog is increasing. The estimated cost of removing all network defects in Scotland,

no matter how slight, is more than £2.25 billion, which is £1 billion more than in 2004. The road maintenance backlog for trunk roads is now £713 million. For council-maintained roads, it is £1.54 billion—although we know that that is an underestimate, as it does not include the cost of removing all the defects of councils' bridges, lighting and footways.

10:15

Various surveys by organisations such as the Automobile Association, the Royal Automobile Club Foundation and Transport Scotland have shown that users' satisfaction with road conditions has decreased over time.

It is perhaps surprising that we have reported a seemingly limited impact from the severe winter of 2009-10 on the latest road condition results. Although that winter caused significant damage to the road network compared with a normal winter, it tended to affect those roads that were already categorised as being in the worst condition, so their deterioration did not register in the road condition data.

During 2009-10, a total of £654 million was spent on road maintenance in Scotland, of which £162 million was spent on trunk road maintenance and £492 million was spent on council-maintained roads. Although that represents an increase in expenditure of 5 per cent compared with 2004-05 after taking account of general inflation, road construction inflation was considerably higher than general inflation over that period. The effect is that, in purchasing terms, councils spent 13 per cent less, and Transport Scotland spent 32 per cent less, on road maintenance in 2009-10 than they did in 2004-05.

Transport Scotland estimates that it would need to spend £275 million to get trunk roads into a steady state, whereby a fixed amount of roads need structural maintenance each year. Councils estimate that, to maintain roads in their current condition, they would need to spend £45 million more each year for the next 10 years on long-term structural maintenance. The consequences of not spending at that level are forecast to result in a £1 billion decline in the value of the local road network and a 10 per cent reduction in its condition.

Despite the challenging financial outlook, it is still somewhat disappointing to note the limited progress that has been made on implementing the recommendations that were made in 2004 on the management of road maintenance. I will give you some examples to illustrate that. Asset management plans for roads, supported by appropriate inventory and information systems, are a fundamental requirement of good

management. Although the Society of Chief Officers of Transportation in Scotland—SCOTS—provides support to councils in developing them, only a third of councils have complete road asset management plans in place, and several councils do not have sufficient data on the condition of items such as bridges, footways and non-illuminated signs.

Furthermore, councils could do more to benchmark their road maintenance costs and their performance against other councils and the private sector as a way of identifying potential improvements. The 32 councils use a variety of different performance indicators, and that lack of consistency in the measures that are used makes it difficult to compare performance.

There is also scope for more partnership working on road maintenance issues. There is some joint working or collaborative activity between councils—much of it at an early stage—but Tayside Contracts remains the only example of a multi-council consortium being established to undertake road maintenance, and it dates from before the reorganisation of local government in 1996. As we have said in our report, there is scope to develop a costed model that would help councils to assess and understand the benefits of sharing services.

In his earlier comments, the Auditor General referred to the difficult decisions that the Government and councils face about spending on road maintenance and other services. There is an urgent need to explore new ways of working, and the national review that we propose represents an opportunity to stimulate service redesign and increase the pace at which the potential for shared services, partnership working and a more flexible use of resources is examined.

I hope that these remarks have been helpful to the committee. My audit team colleagues and I will be happy to respond to any questions.

**The Convener:** I thank the Auditor General and Ronnie Nicol for a comprehensive introduction to a significant issue for us all. You have posed a challenge to politicians of all parties on how they address it. It is quite sobering and worrying to hear what you have had to say.

The Auditor General's point about the responsibility of the current generation of decision makers not to pass on a burden to future generations is well made. We have been the beneficiaries of good long-term planning and better times. There is some evidence that we are spending for the short term but not thinking in the long term.

Audit Scotland might not have looked at this, but I understand the difficulties that councils have had in responding to two pretty severe winters that

have had a huge impact on our local and national road network. The Auditor General gave us an amusing anecdote about his car being off the road because it hit a pothole, which is an experience that will have been shared with anguish, not amusement, by thousands of people across Scotland. Those who have their cars damaged by potholes are frustrated when they attempt to make a claim and the council's insurers fall back on a tried and tested routine of asking whether the pothole has been reported. If it has not, the council accepts no liability or responsibility. Therefore, when people see a pothole, it is important that they do not just moan about it but report it, to protect the interests of other motorists.

I understand that part of the problem is the budgetary situation, but it is increasingly evident that, when there is a local response to reports of potholes, the councils in general do not fix the problem for the long term. They merely respond to the problem to avoid an insurance liability. I can comment only on the area that I live in and represent in Renfrewshire, which Ronnie Nicol will be familiar with. Some roads virtually have ditches running down the middle of them and you cannot go near the side of the road on others unless you want to inflict significant damage on your car. What has happened is worrying, to say the least. In fact, it is appalling.

There used to be a phrase about not throwing money down the drain. Now we see councils wasting money by throwing it down potholes. They are putting on temporary patches, which are only there for days before they start to unravel, but the councils can say that they have responded to the report about the pothole. There is no way on God's earth that those repairs are going to last.

However, I know companies across Scotland that are saying that they can do a job that, although it might initially be more expensive, will solve the problem with a solution that will last and save the councils money in the long run. What do we need to do, first, to get some common sense applied to the problem and, secondly, to address the immediate financial burden of a repair that might be more expensive but which—to come back to the Auditor General's exhortation—will better serve us and future generations? What needs to be done to bring that common sense to the approach?

**Mr Black:** We have no easy answer to that. If we had, we would share it with you. It is one of those occasions on which the analysis asks more questions than it answers. As we say in the report, the Government, along with partners in local government, including Transport Scotland, needs to think seriously about a long-term solution. It is disappointing to find after five years that the picture is still pretty mixed as to whether local

authorities have asset management plans that make sense, that comparative performance information systems are not there and so on. We need to move beyond all that pretty quickly.

**Murdo Fraser:** I endorse the convener's remarks. The problem, though, is not just with local roads; driving on the M90, as I do several times a week, I find myself weaving from one side of the road to the other to avoid all the cracks and potholes. Many other drivers do the same and one has to wonder how long it will be before there is a serious accident—or, indeed, more than one—as a result.

It is made clear on page 3 that the report is based on evidence that was collected up until last October. We will all be familiar with the impact of the severe weather over the past three months on the roads, but the report predates that and does not take it into account. Would it therefore be correct to suggest that the current situation is much worse than that revealed in your report?

**Ronnie Nicol:** Yes. We carried out the audit work for this report last summer and autumn, and the statistics from SCOTS that we have used are for a similar period.

I should point out, though, that our report notes the bad winter of 2009-10, which resulted in a significant deterioration in the roads. However, as I said in my introduction, that deterioration did not really register because the worst roads were already in the worst category. The correlation between very bad weather and the bad condition of roads is certainly very evident.

**Murdo Fraser:** Perhaps we need another category—"extra worse", perhaps—for future reports.

I was interested to read in the second key message that public spending in Scotland increased by 25 per cent in the six years since your last report. When funding was increasing, money was still not being spent on repairing the roads—you might say that we did not fix them when the sun was shining—and, now that we are in a period of austerity, one has to wonder where that money will be found. What response did you get from councils when you asked them why, when their budgets were increasing, they did not invest properly in road maintenance?

**Ronnie Nicol:** As this was a follow-up audit, we were essentially looking at the data that we had received in the previous audit. On this occasion, we focused on levels of spending, backlog estimates and the condition of roads; we did not audit councils individually and did not ask them specifically why they had made certain spending decisions.

**Murdo Fraser:** Exhibit 6 on page 11 compares the situation in Scotland with that in England and Wales. It is clear that we are in a much worse position than they are; for example, the backlog cost per kilometre in Scotland is almost 50 per cent higher than it is south of the border. Why is the situation in Scotland so much worse?

**Ronnie Nicol:** I am afraid that we did not drill into those differences to find out the reasons for them, but we thought that it might at least be of interest to present the picture.

**Mr Black:** That is another issue that has emerged from the report to which others will have to provide answers.

**Murdo Fraser:** I do not know how we are fixed with regard to following up this report, but it is an issue that we could consider.

**Mr McAveety:** In much of this discussion it seems that personal testimonies are required. It would be helpful if committee members helped each other in their appeals to local authorities.

This is an emerging major issue, and the recent weather has certainly made the situation much worse. I thank Ronnie Nicol for his very helpful introduction, but I have a few issues that you might wish to comment on further.

10:30

If there is any issue that has no big problem of tension between national direction and local autonomy, it strikes me that it is road maintenance, because although it affects people it does not raise the kind of accountability issues that arise in relation to care services, health services, police services and fire services.

The first issue is that the initial report came out in 2004, but a number of years later fundamental matters have not been addressed. One of those is asset management, as Ronnie Nicol said. We need national and local direction on that. Perhaps we can consider that issue.

The second issue, which is raised in paragraphs 15 to 17 of the follow-up report, is the marked contrast between council-maintained unclassified roads and trunk roads. There is a massive disparity in that regard, and it would be helpful to consider how we narrow the gap with the resources that we have.

Thirdly, we must ask how come there has been no radical shift in consortia arrangements, after all the exhortations at national and local level about partnership working and collaboration. I would have thought that we could have made substantial inroads in that regard.

Finally, when we talk about £2.25 billion, everyone is terrified, and rightly so, because it is a

massive amount of money. How do we bridge the gap? I presume that spending £2.25 billion would give us a Rolls-Royce, de luxe service. Are we just looking for a Lada service?

**Ronnie Nicol:** The figure was provided by professional transport managers, so it reflects their judgment on keeping the roads in an acceptable, usable condition.

**Mr McAveety:** What role is there for national direction in the debate, given that despite the publication of a major report little has changed dramatically?

The differences between Scotland and England were mentioned. Is remoteness an issue? We had particularly bad winters last year and this year, which might be an issue. It is a wee bit colder up here than it is in other parts of the United Kingdom—or so I seem to have noticed over the years.

**Ronnie Nicol:** I think that such factors are part of what has driven us to recommend that everyone comes together to have a new look at things at a national level. There has been a division of labour on who does what. Attention has been given to prioritising the most important routes—that is why we have trunk roads, classified roads and unclassified roads. A significant amount of money has been available, but it has not cracked the problem. Now is the time to have a more fundamental look at what happens and how it happens.

The shared services issue is interesting, because there has been much activity. What is the missing ingredient that makes service sharing happen? That is the puzzle. The review and the coming together of people to talk about making fundamental changes might be a catalyst that offers a way in.

**George Foulkes:** Please excuse the pun when I say that we seem to keep trying to reinvent the wheel. Lord Wheatley had it right in the early 1970s—

**Jamie Hepburn:** Is he still in the Lords with you, George?

**George Foulkes:** No. I am talking about the late Lord Wheatley. He is no longer there—at least, I did not notice him, anyway.

As I recall, the best time for road maintenance was when we had regional councils in Strathclyde, Lothian and Tayside. The fact that the Tayside procurement consortium still exists testifies to that; people in Tayside are still working together. That was a much better time. Now we have tiny local authorities, which do not have the resources for road maintenance unless they work together. As Lord Wheatley said, the large estuarial authorities

had many more resources and were able to do the work.

That was not a question. My question is this: am I right in saying that the money for road maintenance comes out of the block grant, so it comes out of the same budget that covers other transport projects?

**Mr Black:** Yes.

**George Foulkes:** I get the impression—this is not a party-political point in any way—that officials in the Scottish Executive or Government transport department are preoccupied with prestige projects, such as the Forth replacement crossing, which is a total waste of money, and that there is no glamour or excitement in keeping the roads properly maintained. Is that an unfair analysis?

**Anne McLaughlin:** Would trams fall into that category?

**Mr Black:** If I may, I would prefer not to respond to the latter part of Mr Foulkes's comment. On the former part, as some committee members might be aware, I have had a long career, which has included many years in local government. I can recall as far back as the time of Strathclyde Regional Council and the cuts that were required as a result of International Monetary Fund intervention. Some really quite difficult decisions had to be made in relation to what we used to call the structural maintenance programme and on-going pothole filling, gully emptying and so on. Going right back to those days, for understandable reasons, members of local authorities said, "We must preserve the care services. We can postpone the structural maintenance." That was a feature of the 1970s through to the 1980s, and we have now seen it in the new millennium. One of the really difficult issues for any policy maker, whether a politician or an official, is to balance the long-term benefits and costs and the immediate pressures on budgets.

On Tayside Contracts, I was very much involved at the time of the last reorganisation in persuading Dundee, Perth and Angus to retain that organisation. Again, however, there was an understandable pressure for people to control their own destiny, and that was not an easy set of conversations. However, Tayside Contracts did survive and, as far as we know, it is doing quite well.

The point that Ronnie Nicol made a moment ago is central. Somehow we need to unlock this debate and get everybody around the table to think seriously about how we tackle the issue in the future.

**George Foulkes:** Of course the one good thing about trams is that they do not create potholes, do they?

**The Convener:** We will leave that one for the moment.

**Mr Black:** We will revisit a response to that.

**The Convener:** George Foulkes makes a significant point: leaving aside whether you are in favour of a replacement Forth crossing or any of the other big infrastructure projects, politicians will have to make decisions over the next few years about whether to invest in very expensive and open-ended projects or whether to address the basic infrastructure. It is quite clear that we might not be able to afford both. Politicians locally and nationally will face huge challenges.

**Jamie Hepburn:** I want to follow on from what Frank McAveety and George Foulkes talked about. I refer specifically to part 3 of the report, on improving the management of road maintenance. I note that exhibit 11 on page 23 sets out the benefits of a shared local road maintenance service, drawing on John Arbuthnott's review on behalf of the Clyde valley community planning partnership. How widespread is that approach? I note that paragraph 80 suggests that that type of approach is being taken forward by some of the local authorities in the south-east of the country. Is that happening anywhere else?

**Ronnie Nicol:** I am not sure that we have a lot of information on that.

**Graeme Greenhill (Audit Scotland):** I do not think that we could come up with any examples, other than what is included in paragraph 80. As you say, action has begun in the south-east, but it is very much at an early stage.

**Jamie Hepburn:** So even the local authorities that make up the Clyde valley community planning partnership, where the review was done, have not particularly taken forward the approach, as far as you are aware.

**Ronnie Nicol:** Obviously, the Arbuthnott report covered quite a large range of services. As I understand it, other services have been looked at before this particular area.

**Jamie Hepburn:** Okay. In paragraph 84 you refer to the importance of Transport Scotland and local authorities working with utility companies to try to minimise the impact of road works on those who use the roads. I presume that you are talking about times when it is known that utilities are going into a new development or that there will be road works anyway—so that the road is not dug up for gas works to be put in, only for it to be dug up two months later for electricity cables and so on to be put in. Is that what you mean?

**Ronnie Nicol:** Yes. Potholes often occur where a road has been dug into for some reason and has been patched up. There are also issues with the same bit of road being dug up on more than one

occasion because of a lack of co-ordination between the different utility companies. A lot is being done within the industry to improve the situation.

**Jamie Hepburn:** Case study 3 is West Lothian Council's considerate contractor scheme. Does the scheme try to co-ordinate the activities of the various utility companies?

**Ronnie Nicol:** Yes. That is included as an illustration of what we are talking about.

**Jamie Hepburn:** You refer to it as a positive example. Is the scheme being run anywhere else, as far as you are aware?

**Graeme Greenhill:** Not as far as we are aware from the survey responses that we received from councils.

**Anne McLaughlin:** I thank the convener for enlightening me about the practice of the insurance companies and why you have to report every pothole. I was at a residents meeting in the east end of Glasgow last week at which one of our councillors read out a list of about 25 streets in which he had reported potholes. I could not work out why on earth he was doing that, but that is obviously why. I remember when Councillor Alf Roberts was on "Coronation Street"—

**George Foulkes:** Goodness me!

**Anne McLaughlin:** I do not remember it, actually—I remember the repeats, George.

People were always asking, "How are the potholes in Rosamund Street?" It was a dull issue, but it is now the hot topic of the day, for obvious reasons. It is about more than car damage; I wonder whether there has been an increase in the number of accidents. I would be utterly astonished if there had not been, as I am constantly seeing cars that are being driven in front of me suddenly shoot off to the right. The drivers cannot possibly have time to check whether there is somebody behind them. When a driver sees that their vehicle is about to go into a big crater, it is their instinctive reaction to move around it. I would be interested to know whether any work is being done on that.

Ronnie Nicol has talked about a national coming together, and the convener and Robert Black have talked about how we all must work on the issue together. It is probably our—the politicians'—fault that such a short-termist approach is being taken to it. Whenever a Government or a local authority wants to invest in taking a long-term approach to any problem at all, politicians from all political parties jump up outraged because such-and-such a service will not get the funding that it used to get. The money must come from somewhere and, as the convener said, decisions will have to be made. We, the politicians, must make decisions on the basis that there are some things on which we



really have to work together. We should not be afraid to consider long-term solutions for fear of Opposition politicians jumping up and down saying, "That's an outrage," and telling us that we should be doing this or that with the money. A lot of the fault lies with us. I am not convinced that all of us sitting around the table agreeing that will effect any change, but I live in hope.

**Willie Coffey:** Members have already touched on some of the more obvious problems connected with the issue, but I have a question for Ronnie Nicol. Do you know what we are paying for the materials that we use to fix the roads? You are giving us a clear message that the costs and spend are going up and up. My attention was drawn to the case study on page 23, which refers to a new technique called crack and seat that seems to be bearing fruit in saving considerable amounts of money. Are we paying an awful lot more for the materials that we use to fix the roads than we might be paying? Your recommendations for the future would clearly be to review what materials we use, what is appropriate and how works can be co-ordinated better among local authorities—an issue that one committee member has already mentioned. What information can you offer in that area?

**Ronnie Nicol:** I remind you that this was a follow-up audit and that the amount of audit work that was carried out was relatively limited. We tried to illustrate for the reader some of the interesting things that are happening as local authorities try to do things differently, but we do not have a breakdown of the spend. As we mention in the report, we know that the inflation factors for the things that contribute to what is spent on roads maintenance have been much higher, but we do not have any details on the split between how much is spent on labour and how much is spent on materials. We did not go into detail on the techniques that any maintenance operations use, either.

10:45

**Willie Coffey:** The picture presented by the Auditor General's report is certainly mixed—and that is an understatement. Local authorities and other elected members will certainly have to bite the bullet soon and try to adopt a more co-ordinated and integrated approach. Ronnie Nicol mentioned a case study; I do not know where it was carried out but, if it is anything to go by, there is some hope. The use of better materials will bring benefits in the future, and we could also recycle road materials to repair the roads.

You may not be able to answer this question. The number of vehicle movements on the roads must have increased considerably since the publication of the previous report—I am thinking

not only of cars but of heavy goods vehicles—and the number of vehicles on the roads must be a contributory factor in the condition of the roads. Furthermore, we have recently had severe winters. Is the salt that we have used another contributory factor in the decomposition of road surfaces?

**Ronnie Nicol:** Priority is given to roads with the highest levels of traffic, in acknowledgement of the fact that greater use leads to greater wear.

**Graeme Greenhill:** Paragraph 10 on page 7 of the report says:

"The volume of traffic on Scotland's roads has increased by 27 per cent overall in the last 15 years."

Much of that increase relates to traffic on trunk roads.

**Willie Coffey:** Do the materials that we use to de-ice the roads have an effect—ultimately causing the potholes that we see in the spring and summer?

**Ronnie Nicol:** That is a technical issue that we did not consider in any detail. However, as a friend of mine who is a roads engineer once said, "We build roads to last for 30 years. The problem is that people start to use them." [Laughter.] Inevitably, the more a road is used, the more it wears. Everyone acknowledges that.

**Willie Coffey:** Wise comments.

**Nicol Stephen (Aberdeen South) (LD):** I was interested in the new reconstruction technique that is mentioned on page 23 of the report. It is clear that some of the changes in the way in which our roads are upgraded or reconstructed could be having an impact.

Committee colleagues will know that in many instances a sandstone-coloured finish has been introduced in the 100m of road before traffic lights, roundabouts and other junctions—particularly but not exclusively on trunk roads. When the finish was first introduced, it was explained to me that a new and slightly experimental approach was being taken in order to give a better grip and to get a better safety record at those junctions. However, the finish is softer and does not last as long as other finishes. Therefore, if you commit to it, you have to invest in maintaining it. There are quite a number of examples of that sandstone finish on the trunk road network having deteriorated markedly.

I will give one important example. Some people here will know the section of road in Aberdeen between Great Western Road and Cromwell Road as you go up Anderson Drive. An entire section has failed where one strip of tarmac joins another that the construction company has been laying. Could the contractor be held responsible for that?

At the moment, a seam is opening up in a section of carriageway that is approximately 600m long. It is the outside carriageway of a busy trunk road going through the centre of Aberdeen, and it is very dangerous. I would be interested in getting a bit more insight into such issues, and I would be interested in a further follow-up report, given the importance of this subject and the substantial deterioration in many aspects of the road network over the past few months.

My final question relates back to Murdo Fraser's comment about the M90, but it applies to any trunk road dual carriageway with a 70mph speed limit. If a significant pothole appears on such a trunk road, is there any time limit or target for repairing it? In some cases, we have had to wait for weeks for dangerous—indeed, life-threatening—potholes to be repaired. Ultimately, this is not only about legal liability and compensation claims; as more than one member has said this morning, these potholes could cost lives.

**Ronnie Nicol:** Much of the detail that you have asked for is beyond the audit work that we carry out. Certainly there is a problem with surfaces that for safety reasons have been laid on top of roads: they tend to deteriorate because, as you have acknowledged, they have other purposes.

We did not look in detail at how contractors are held to account, but we know from our general intelligence how local authorities operate. They are always seeking to ensure that contractors who have to work on a piece of road restore it to a certain quality, and I have no doubt that all the local authorities have officers who check that type of thing. However, I am afraid that we did not examine the issue in this audit.

As for your question about targets, although we do not know enough to be able to give you the numbers today, we do know that quicker responses are required for certain categories of roads. There might be, say, a 48-hour target for a particularly busy road or major artery; it might be longer for roads that are less busy. However, although those targets are certainly in the system, we did not audit their efficacy.

**Nicol Stephen:** And the target would be 48 hours rather than, say, 48 days.

**Ronnie Nicol:** Yes. One of my colleagues has certainly mentioned 48 hours as the target for a fairly high-priority area.

**The Convener:** I thank the Auditor General and Audit Scotland staff for their contribution to this discussion. I suspect that a future audit committee and, indeed, transport committee of the Parliament will want to return to the issue, given the shared view that the problem is worsening and will be a challenge to us all.

Before we move on to item 4, which is an evidence-taking session on the section 23 report "Edinburgh trams interim report", I will suspend the meeting for a few minutes.

10:52

*Meeting suspended.*

10:58

*On resuming—*

### **"Edinburgh trams interim report"**

**The Convener:** The next item on the agenda is consideration of a section 23 report from the Auditor General, "Edinburgh trams interim report". I welcome to the meeting Sue Bruce, chief executive of the City of Edinburgh Council; Donald McGougan, the council's director of finance; Dave Anderson, the council's director of city development; Alastair Maclean, head of legal and administrative services at the council; and Richard Jeffrey, the chief executive of Transport Initiatives Edinburgh. Sue Bruce will make some opening remarks.

**Sue Bruce (City of Edinburgh Council):** Thank you, convener. First, I thank the committee for this opportunity to respond to its questions about the Auditor General's report. At the outset, I should advise members that we find the report to be fair and balanced and that we will be putting a report to the council's own audit committee. However, that item is scheduled for March, just after the forthcoming mediation.

Before we get into questions, convener, I should restate that our intention is to be helpful and that we welcome the opportunity to be open and transparent about the Auditor General's report. However, I want to reflect on concerns that I have raised with regard to the forthcoming mediation. As committee members will know, the City of Edinburgh Council and TIE are committed to finding a way of making progress with this initiative and delivering best value for the people of Edinburgh. However, mediation is coming up within the next fortnight, and this will be a fairly critical time for all concerned. The City of Edinburgh Council, TIE and, indeed, the consortium have been putting significant effort into ensuring that we go into the mediation process with a positive foot forward and are open-minded in finding a solution that benefits the city of Edinburgh and wider Scotland. During questioning we might stray into areas limited to mediation—I will take guidance from our legal adviser, if necessary—and if that happens, we will respectfully inform members. Otherwise, we are here to be helpful to the committee.

11:00

**The Convener:** Thank you very much. Can you confirm that the City of Edinburgh Council is clearly responsible for all decisions on the management, progress and implementation of the project?

**Sue Bruce:** The City of Edinburgh Council is clearly the client in the project. TIE, which is wholly owned by the council, is the arm's-length organisation responsible for the operational delivery of the tram. The council has put in place monitoring arrangements to enable it to take decisions with regard to its own wishes and aspirations for the tram, but TIE takes the operational decisions.

**The Convener:** Yes, but as the organisation responsible for the budget, for awarding and authorising the contracts and so on, the City of Edinburgh Council is responsible for monitoring and supervising efficient use of resources and effective progress.

**Sue Bruce:** I think that that is a reasonable assertion.

**The Convener:** And the leader and deputy leader of the council have, through the appropriate board of the council, made the decision to authorise the chief executive to have delegated authority to permit TIE to sign contracts.

**Sue Bruce:** That is the case. The council's policy decision is to proceed in this regard and the arrangements that were set up at the outset are exactly as you have described.

I have steeped myself in this issue but, having been in post for only seven weeks, I might need to defer to my colleagues for more detailed comment.

**Donald McGougan (City of Edinburgh Council):** Perhaps I can help. The council decided to delegate to the chief executive the authority to authorise TIE to enter into contracts but, because the final stage of contract negotiation took longer than expected, the chief executive at the time did not take advantage of that delegated authority and brought the report back to the full council for the decision to authorise entering into contracts. I do not think that it would be fair to say that the decision was made by the leader and the deputy leader; it was actually a formal decision of the council.

**The Convener:** Would the recommendation have come from whoever ran the appropriate policy board—or was there actually no recommendation at all and Edinburgh had no view on the matter?

**Donald McGougan:** The recommendation came from council officials—in other words, from

me and the director of city development, who at that time was Andrew Holmes.

**The Convener:** But the process itself would involve a recommendation being made and whoever convened that board or meeting taking ownership of it and putting it formally to the meeting. Is that correct?

**Donald McGougan:** No.

**The Convener:** No?

**Donald McGougan:** The process at a council meeting is that the council considers an officer report and the different political groups on the council can take a view on its contents. Someone on the council will then move either the recommendations in the report or, if they do not agree with them, amendments to the report.

**The Convener:** Who on behalf of the council moved the reports on giving delegated authority to instruct TIE to enter into contracts?

**Donald McGougan:** I cannot remember who moved that report at the council meeting, but it will be a matter of public record.

**The Convener:** Right. So we could find that out. You could revert that information to us.

**Donald McGougan:** Yes.

**The Convener:** Essentially, all the big decisions have been made by the City of Edinburgh Council, and TIE reports to the council for those decisions. Is that correct?

**Donald McGougan:** Yes. The council is the project owner and co-funder, and TIE is the delivery agent.

**Richard Jeffrey (TIE):** May I add a clarification? A number of different governance arrangements are in place between the City of Edinburgh Council and TIE. The latter has an operating board and a parent company, TEL—Transport Edinburgh Ltd—which is also a 100 per cent-owned subsidiary of the City of Edinburgh Council. There is also the tram project board, which has certain authorities delegated to it. All the decisions that fall within the delegated authority of the tram project board are made by that board. If decisions are required that go outwith the board's delegated authority, they are referred back to the council.

**The Convener:** Okay. I will just finish this bit, then I will bring in George Foulkes. Who chairs the policy and strategy committee of the council?

**Sue Bruce:** The leader of the council.

**The Convener:** Right. The convener of that committee ruled on, I think, 13 May 2008, under your standing order 22, that a changed commercial position in procurement negotiations for the Edinburgh tram network constituted a

material change in circumstances and suggested that the matter be reconsidered at that meeting. So that came from the convener, rather than from officials, although I presume that the convener was briefed by officials, as Mr McGougan has suggested. What was the nature of the changed commercial position at that time that necessitated that move by the committee convener?

**Dave Anderson (City of Edinburgh Council):** Perhaps I can address that. My understanding—it was about eight weeks after I arrived at the council—was that during the period of about nine months in the run-up to that particular meeting there had been further negotiations in relation to the additional novation of the systems design service contract to the council, and a settlement was arrived at between TIE and the consortium in relation to the novation of the SDS contract to the consortium to take over responsibility for design management. At that point in time, there was a change to the financial settlement with the consortium. There was also provision made for compensation to the consortium of £3.2 million in the event that tramline 1b did not proceed. My recollection, from very early on in my time in the council, is that that was the change that was being referred to.

**The Convener:** Okay.

**George Foulkes:** I want to go back a bit to the decision. Sue Bruce said that the Auditor General's report is fair and accurate, which is something that I agree with.

**Sue Bruce:** I said that it was balanced.

**George Foulkes:** Paragraph 22 of the report states:

"The ... Government's grant ... was conditional on CEC approving a final business case".

That is one of the big decisions to which the convener referred. What was the procedure within the council for approving that final business case?

**Donald McGougan:** That constituted part of the report to the council in terms of the final approval of the project. The business case for the tram is very complex and includes a number of components: the estimated capital costs of the project; the cost of operations; the maintenance of the project or the trams going forward; development assumptions about the Edinburgh economy and the wider economy; patronage assumptions; and time savings in relation to public transport journeys. All those aspects came together in the business case.

The business case was prepared by TIE with significant inputs from independent consultants and others. In terms of patronage, for example, a huge number of complex and technical financial transport models are run. They were run by Steer

Davies Gleave and Colin Buchanan and Partners. Development assumptions were reviewed by our own planning department and by Pidea; patronage assumptions were reviewed by Lothian Buses; and the whole thing was reviewed by officers in finance and in city development within the council.

**George Foulkes:** That is a very helpful answer. You had a business case produced by TIE and there was input from Colin Buchanan, from Pidea and from Lothian Buses, and then it came up to the council. What is the procedure within the council for assessing such a case? You have to make your own assessment and make a recommendation to elected members. Who did that?

**Donald McGougan:** That is what I was trying to say. Officers in the council were involved in—

**George Foulkes:** Which officers?

**Donald McGougan:** In city development and in finance, and in planning in relation to the development assumptions, and then in the transport section in relation to the work that Steer Davies Gleave and Colin Buchanan and Partners did. Across the council, a whole variety of officers was involved.

**George Foulkes:** Who was the lead officer—the person who put his or her name to the paper that went to the council recommending the approval of the final business case?

**Donald McGougan:** The answer to that is the same as was given in the answer to a previous question: it was the director of city development and me as director of finance.

**George Foulkes:** Two?

**Donald McGougan:** Yes.

**George Foulkes:** Is it not better to have one officer who is ultimately responsible, rather than two?

**Donald McGougan:** The normal practice for reports to the council is that one officer would sign it off.

**George Foulkes:** Which officer signed it off then?

**Donald McGougan:** The normal practice is for it to be the service director with senior responsibility for the project. In this case, that was the director of city development. However, because of the size, scale and importance of the project, it was felt advisable to have the director of finance involved in the sign-off process.

**George Foulkes:** What about monitoring progress after the approval of the final business case? Who was the officer responsible for keeping

an eye on how things were going and reporting to the council on progress?

**Donald McGougan:** In terms of the whole project—

**George Foulkes:** Yes.

**Donald McGougan:** The senior officer responsible is the director of city development, but—

**George Foulkes:** Always the director of city development.

**Donald McGougan:** No, sorry. I will finish. We also have a nominated officer from within the department of city development, who is the tram monitoring officer. Within our governing arrangements with TIE, that officer has responsibilities. However, I have continued to be a joint signatory with the director of city development to the progress reports that have been submitted to the council.

**George Foulkes:** One thing that comes out clearly from the report is that there was confusion at different levels and at different periods of time over who was actually responsible for ensuring that this project was delivered on time and for ensuring that the council was informed about it. TIE and TEL and Lothian Buses and the whole structure—which we will come to later—contributed. You are telling me now that even within the council a number of officials had different responsibilities.

I have a question for Sue Bruce. Was that not bad practice? Within the council, is it not better practice to have one official who is responsible to you, and through you to the council, rather than having three or four officials?

**Sue Bruce:** A key element is that each officer involved should be clear about their roles, responsibilities and accountabilities. That is now the corporate policy of the council. Each relevant officer has corporate responsibility for the elements of the project on which they can provide key advice.

**George Foulkes:** Even with corporate responsibility, and with the chief executive having ultimate responsibility, I would have thought that a wise chief executive would say that one person should have continuing responsibility for monitoring things, for ensuring that everything is up to speed and for ensuring that everything in the business case is actually being achieved.

11:15

**Sue Bruce:** As Donald McGougan said, we have a tram monitoring officer who works to Dave Anderson, so city development is the lead directorate for delivery of the tram project. Donald

McGougan, as section 95 officer for the council, has lead responsibility for providing guidance, advice and direction on financial matters. The two directorates work closely to provide collective advice to the council. The key issue is about each officer having clarity about their roles, responsibilities and accountabilities.

**George Foulkes:** I will leave it there.

**Jamie Hepburn:** Can the chief executive of the City of Edinburgh Council tell me whether she is satisfied that the governance arrangements that are in place for the project are sound?

**Sue Bruce:** As we said, the Auditor General's report raises questions whether the governance arrangements are sound. As a chief executive coming in to the council, I want to satisfy myself across the board about governance arrangements, whether to do with this or any other project.

**Jamie Hepburn:** We are interested only in this project today.

**Sue Bruce:** The Auditor General has raised these questions and we are certainly looking at the matter to see whether a change of direction or further clarity is required.

**Jamie Hepburn:** May I ask the gentlemen who have had longer involvement in the project whether they are satisfied that the governance arrangements are sound?

**Dave Anderson:** I believe that the governance structure is complex, but that all the adequate checks and measures in relation to reporting progress on the project are in place. Where the project currently stands is a symptom not of the governance arrangements, but of the contractual dispute with the consortium.

Exhibit 12 on page 34—

**Jamie Hepburn:** If I may interject, surely an aspect of the governance arrangements is managing the contract. What is the governance structure for, if it is not for that?

**Dave Anderson:** The management of the contract is a matter for TIE, as the council's arm's-length company, and the consortium. Both Donald McGougan and I are members of the tram project board. Every four weeks we attend the board and get a comprehensive update on exactly where the project stands and on issues related to it.

Throughout the duration of our time in post we have been privy to the strategy adopted by TIE to deal with the dispute with the contractor.

**Donald McGougan:** The governance arrangements were reviewed at the start of the project as part of the previous Audit Scotland review. They were obviously part of an Office of Government Commerce review at that stage and

the recommendations were that the governance arrangements appeared to be sound. However, I agree with the chief executive's comments that, given that we are four years into the project and given the contractual difficulties that have emerged, it is certainly time for us to have another look at the governance arrangements. That would be the correct thing to do and we want to do that as we come out of the mediation process to see whether we can focus on the best way forward on the project for the people of Edinburgh.

**Jamie Hepburn:** Is that work under way? What is the early prognosis?

**Sue Bruce:** Page 35 of the Auditor General's report reflects the Office of Government Commerce's comments on the requirements of corporate governance in an organisation such as this. It identifies three roles, which the Auditor General's report recognises are present. As Donald McGougan said, we have to sort out a number of issues in terms of the delivery of the project, some of which will be discussed in mediation in the immediate future.

We want to examine the effectiveness of the governance arrangements. We have in place the roles that would be expected to be in place for the governance of such a project but we want to reflect on the matter and see whether any adjustments and improvements can be made and whether further clarity can be provided.

**Jamie Hepburn:** Do you agree with the recommendation in the Auditor General's report that Transport Scotland should have a greater role in the process?

**Sue Bruce:** Yes. Transport Scotland is a major stakeholder in the project and I would certainly welcome its involvement, given the expertise that it can bring to the table. Clearly, as it is a major stakeholder, it will want to satisfy itself that the governance arrangements are appropriate.

**Jamie Hepburn:** You say that Transport Scotland is a major stakeholder, but in what sense is it a major stakeholder? You and Mr McGougan have both stated clearly on the record that the City of Edinburgh Council is the complete owner of the project. That is the case.

**Sue Bruce:** I said that the City of Edinburgh Council was the client. Transport Scotland is a major funder of the project and therefore, by definition, it is a major stakeholder.

**Jamie Hepburn:** But it does not own the project, does it?

**Sue Bruce:** No, but as a major funder on behalf of the Government it is entitled to express a view. If Transport Scotland were at the table, that could only be helpful, to be honest.

**Jamie Hepburn:** Do you not feel that the recommendation that Transport Scotland should be involved is a bit of an indictment of the management of the whole process? That body needs to come on board because it has the expertise that you do not have.

**Sue Bruce:** Transport Scotland can bring an additional dimension.

**Jamie Hepburn:** A dimension that you do not have.

**Sue Bruce:** It brings its own views as a core funder of the project. Transport is what it does full stop. I have had the benefit of working with Transport Scotland previously on other projects in Scotland and I have found them helpful to work with. They bring their own expertise to the table, and we should welcome that.

**Jamie Hepburn:** If you are saying that you need its involvement, does that not indicate that this project was somewhat beyond the City of Edinburgh Council in the first place?

**Sue Bruce:** Not necessarily. What I am saying is that if Transport Scotland can bring something useful to the discussion, we should welcome that.

**Murdo Fraser:** I want to follow up Mr Hepburn's line of questioning about Transport Scotland. The Auditor General makes it clear in paragraphs 70 to 72 of his report that, originally, Transport Scotland was represented on the tram project board but that in June 2007, after the parliamentary vote on the funding of the tram project, ministers instructed Transport Scotland to withdraw from the project board. Was the City of Edinburgh Council consulted by Transport Scotland before it took the decision to withdraw from the board?

**Donald McGougan:** No, we were not consulted; we were notified.

**Murdo Fraser:** You were just told. It was a fait accompli by that agency.

**Donald McGougan:** Correct.

**Murdo Fraser:** What effect did the withdrawal of Transport Scotland from the board have on the project? Is it something that you regret?

**Donald McGougan:** At that stage of the project, we recognised that the conditions had changed around the provision of the grant, that the Government's contribution was capped and that Transport Scotland was withdrawing on the back of that. Given the stage that the project was at, it was felt that we needed to ensure that TIE had the delivery capability to ensure that the project was taken forward in accordance with the overall objectives.

**Murdo Fraser:** Do you feel that that was achieved?

**Donald McGougan:** We can see from the Auditor General's report that elements of the project have been successful and have gone well. However, we are clearly in significant difficulties with the contract related to the provision of the infrastructure. Those are complex matters. The Auditor General in his previous evidence stressed the complexity of the issues. Because those issues are subject to mediation and could be subject to future legal action, we do not want to go into them in any detail in front of the committee today. However, although there are complex legal and contractual issues surrounding the project, I expect that they would have arisen even if Transport Scotland had retained a seat on the board.

**Richard Jeffrey:** May I add something? The contractual disputes between us and the consortium were clearly not part of the original plan. As those disputes have arisen, we have supplemented our resources with a range of recruits and consultants who have specialist expertise in the areas that are in dispute. The resource and capability of any organisation is not set in stone at any given point in time; it needs to evolve to match the challenges that face the organisation.

**Murdo Fraser:** I do not think that members of the committee want in any way to disparage the management of the project by the City of Edinburgh Council, but we all recognise that things have not gone according to plan. On the back of the Auditor General's report, we are trying to get a handle on the extent to which the withdrawal from the project board of Transport Scotland in 2007 had a negative impact. Had it stayed at the table, would that have made a difference? Mr McGougan, in your answer to me, you sort of indicated that its expertise might have been helpful.

**Donald McGougan:** To answer that question would require speculation and I do not want to speculate on what might have happened as we went through the process.

**Murdo Fraser:** Okay. Perhaps we can look forward. The Auditor General has recommended that Transport Scotland should have a more active involvement in the project. Do you see that as being advantageous at this stage?

**Donald McGougan:** The chief executive has answered that question, and I agree with her answer.

**The Convener:** I would like to pursue that, as I am a bit confused. Even with the benefit of hindsight, you are saying that whether it would have been beneficial for Transport Scotland to continue to be involved is a matter of pure speculation. However, Sue Bruce and you have

said quite clearly that it would be helpful if Transport Scotland were to come back into the process. What has caused you to believe that Transport Scotland's involvement could be helpful to the process, given that you cannot say whether it would have been helpful if it had not withdrawn in 2007?

**Donald McGougan:** I cannot look into the future, either—

**The Convener:** You have said that it could be helpful—

**Donald McGougan:** Yes, it could be helpful. The other point that I would make is that, although Transport Scotland is not part of the tram project board, it has been closely involved in a monitoring role over the period that we have been talking about, and we have discussed with it all the issues that have beset the infrastructure part of the project and have had the benefit of its guidance at some level with regard to the generalities of the project. What we are talking about post-mediation is a different situation. Given that we are where we are, and that the project is so far behind due to the difficulties that we are facing, any assistance that the council and TIE can receive from any other agency would be helpful.

**Richard Jeffrey:** Can I—

**The Convener:** Let me follow this through for a minute, Mr Jeffrey.

Mr McGougan, you and Sue Bruce have said that it could be helpful if Transport Scotland were involved, but you are saying that you cannot offer a comment about whether it would have been helpful had Transport Scotland stayed involved. Why is that?

**Donald McGougan:** It could have been helpful.

**The Convener:** That is a bit different from saying that it is pure speculation. Your considered opinion is that it could have been helpful.

**Richard Jeffrey:** We should not confuse the lack of involvement of Transport Scotland through formal governance procedures with it not being involved in the project at all. We have kept Transport Scotland regularly updated and have had conversations with it around various issues that the project has faced. Some of those conversations have been helpful.

**Shirley-Anne Somerville (Lothians) (SNP):** Mr McGougan, earlier you said that, after the emergence of the contractual dispute, it would be useful to consider the management process that has existed throughout the project. There is no doubt that that is complex. However, the issues have not emerged only recently.

There is a delay because of the mediation, and I appreciate that you do not want to make quick

decisions with a new chief executive in post and the mediation under way. However, were any discussions had 18 months or two years ago, when the writing was on the wall about the difficulties with the project? The diagram in the Auditor General's report about the decision-making process is exceptionally complex. Did no one think at the time that it might be useful to review the governance procedures because they were not working effectively?

11:30

**Richard Jeffrey:** I know that the questions were for Mr McGougan, but I can answer them. The contractual difficulties have emerged and evolved over a period—they did not appear suddenly one day. When I joined the project nearly two years ago, the contractual difficulties were clear.

The strategies that we have adopted to deal with the contractual difficulties are a different issue from governance. The existing governance arrangements through the tram project board, the TEL board and the relationship with the city council have been discussed, and decisions have been taken about strategies and tactics. The question of how the governance is structured and should be structured in the future has not prevented such decisions from being taken.

**Shirley-Anne Somerville:** I appreciate that and I will return to your strategy and tactics later. Did no discussions about governance take place until the Audit Scotland report suddenly flagged up the fact that the arrangements might be overly complex and that you might need to examine them? Did nobody in the council or TIE think, "Hold on a minute—can we have an internal review and see whether a better way exists?"

**Donald McGougan:** Several reports about governance have been provided to the tram project board. Reports that have been submitted regularly to the council have included commentary on governance and governance issues, which have been considered all the way through.

The governance arrangements that are shown in the Auditor General's report are complex because the project is particularly complex. In TIE, we have brought private sector non-executive directors to the table and tried to ensure that the council's interest is reflected properly, but we have allowed people to get on with delivering the project. We have tried to match that with the governance all the way through. The governance has been under constant review.

**Dave Anderson:** I repeat that nothing in the current governance structure has contributed directly to where the project stands, which relates to a contractual dispute between TIE and the contractor. The reviews of governance have

considered its evolution as we move forward to TEL's role and Lothian Buses operating the network.

Under OGC guidance, it is clear that the models and roles that are set out in the Audit Scotland report are working sufficiently for the project's governance. The big issue is that the strategy and tactics have—rightly—had to deal with the potential for future litigation, so matters must be kept in commercial confidence.

**Shirley-Anne Somerville:** Your initial point about the situation being all down to your contractual dispute is an opinion on which we can agree to disagree and that we can discuss another day.

On the strategy and tactics, I met Mr Jeffrey not long after he started in his post, which I described as being mission impossible. The Audit Scotland report expresses concerns about management, although I certainly have a lot of respect for several individuals in TIE who have dealt with the project. Nevertheless, questions are—rightly—being asked about the strategy and tactics that have been adopted, part of which has been a reliance on Queen's counsels' opinions and taking everything to official disputes. That approach has been followed through in the past couple of years. In the city, much was made of the fact that that would prove that TIE's and the council's opinion and analysis of the contract were correct, which would solve everything.

With the benefit of hindsight, we can see that the approach has not taken us far. We are two years down the line and we have spent an enormous amount on QCs' opinions and legal disputes. Now, we are going into mediation. Is that the wrong way of going about matters? My concern about mediation now is that the relationship between both sides is bad. Perhaps mediation should have taken place before we hired expensive lawyers and hit each other over the head with QCs' opinions.

**Richard Jeffrey:** Clearly the strategy and tactics that we have adopted have not delivered what they were designed to deliver; they have not brought the project back on programme and we are not seeing the level of on-site productivity that we could and should be seeing. The question is whether at the time they were the right things to do—I believe that they were. We have tried extensively to work in partnership on this contract—indeed, it sets out clear obligations on both parties to do so. We have tried both informal and formal mediation—there was a significant mediation event in June 2009—and a whole range of other tactics to get the contractor to meet what we believe are its obligations under the contract. The latest evolution of that is a more formal mediation process involving the City of Edinburgh



Council and, on this occasion, Transport Scotland to seek a mutually agreed way of resolving differences and moving forward on the project. Obviously until we achieve that aim we will not know whether we have hit on the right tactics or strategy, but we have tried everything that we think it was reasonable for us to try and done everything that we could to avoid formal disputes. If the parties believe strongly in their positions and neither is prepared to compromise, the contract provides for a formal dispute resolution mechanism.

**Nicol Stephen:** Has the Scottish Government, which I believe you said has invested £500 million of taxpayers' money in this project, ever expressed concern about the governance arrangements?

**Donald McGougan:** Yes. We have had several meetings with members of the Scottish Government over the period and Mr Swinney has expressed concern about the project's progress and a desire that we be able to bring the project to a conclusion as soon as possible. In joint meetings with TIE and CEC representatives, he has challenged our tactics and strategy and has encouraged us to go to mediation. I might be being unfair to him but I have to say that I do not think that any serious concerns about the governance arrangements have been raised either by Mr Swinney or by Transport Scotland.

**Nicol Stephen:** Has the Scottish Government ever suggested alternative governance arrangements that it would like to be put in place?

**Donald McGougan:** No—and, to be fair to the Scottish Government, I think that it would take the view that governance is a matter for the City of Edinburgh Council as owner of the project.

**Nicol Stephen:** You mentioned discussions with the Cabinet Secretary for Finance and Sustainable Growth in which he expressed concern about progress on and the handling of the project. How many of those meetings have taken place and who else has been present at them?

**Donald McGougan:** I think that there have been four meetings involving CEC representatives, me and representatives of TIE, TEL and Transport Scotland.

**Nicol Stephen:** Are the meetings regular or should they be regarded as unusual or unexpected occurrences or crisis meetings?

**Richard Jeffrey:** I have been involved in a number of the meetings, some of which I have held without the city council being present; indeed, the city council might well have held meetings at which I was not present. I would describe them as ad hoc. They are not regularly programmed, but I would not describe them as crisis meetings either.

They are not called to discuss a specific issue or point; they are more general update meetings.

As for your other question, other people, including the transport minister and representatives of Transport Scotland, have been present on occasion.

**Nicol Stephen:** At whose request have these meetings taken place?

**Richard Jeffrey:** I would think that it is probably a mixture. Some have taken place at my request, some at the suggestion of Transport Scotland and others at ministers' request.

**Nicol Stephen:** Has the Government ever suggested taking over delivery of the project?

**Richard Jeffrey:** Not to my knowledge.

**Nicol Stephen:** So there have been no discussions about an alternative delivery mechanism for the project.

**Richard Jeffrey:** Not with me.

**George Foulkes:** On a number of occasions, you have confirmed what the Auditor General said—that ownership lies with City of Edinburgh Council. Nicol Stephen has just referred to that again.

I would like you to be really honest about this. Are you not being a bit coy and a bit cautious about the main problem of governance in City of Edinburgh Council? In the administration, you have had one group that favours the trams and one group that does not favour the trams and has been doing everything that it can to undermine the project. Is that not true?

**Sue Bruce:** As I perceive it—although you must bear in mind that my perception is relatively recent—all political groups within the council have the right to express their political views, and they do so. It is the council's policy position that the tram project should progress. Since I have been in the council, I have not witnessed any active intervention to undermine that progress. Individual elected members are entitled to their views, but the council's policy position is that the project should proceed, and that is what people are working towards.

**George Foulkes:** I think that it was before your time—although perhaps people who were there before your time can confirm that. It is not helpful to have a joint administration—or a coalition, such as we have in London now—in which one part is enthusiastic about a project and the other part does not favour it and has been deliberately undermining it, stirred along by Shirley-Anne Somerville and others on the sidelines.

**The Convener:** I do not think—

**Dave Anderson:** From my long experience in public service, I know that unity of purpose and direction are important. That said, the position of the administration in the coalition agreement that was signed was quite clear about the different party-political positions of the Liberal Democrats and the Scottish National Party. There has been no material impact on the governance of the project or the contract but there has undoubtedly been an impact on the public perception of the project.

**The Convener:** Okay—and we are not going any further into personal speculation about the role of any individuals within this Parliament.

**George Foulkes:** You just have to read—

**The Convener:** Just before I move on to consider a different aspect, did you have a point to raise, Frank?

**Mr McAveety:** Nicol Stephen asked Richard Jeffrey about governance arrangements, and Richard said that they had not been raised with him. Dave, did I hear you say that they had not been raised with you either? I heard you say that, but I do not think that the whole committee heard. I would like to get your view on the record.

**Dave Anderson:** The issue of governance has never been raised by the cabinet secretary with the city council, to the best of my knowledge.

**The Convener:** Before we move away from this particular line of inquiry, I would like clarification of the point that Mr McGougan made about Transport Scotland being regularly updated. Was Transport Scotland updated before it signed off further payments to you?

**Donald McGougan:** Yes, there is a process in place whereby Transport Scotland receives a four-weekly progress report on commercial issues, programme issues and cost issues. Applications for payments are synchronised with that process. A progress meeting takes place every four weeks between Transport Scotland representatives and representatives of the city council. We also have a quarterly review of the project at a more senior level with representatives of Transport Scotland.

**The Convener:** An arrangement was put in place before any money was signed off by Transport Scotland to come to you. Was the model for that arrangement suggested by Transport Scotland?

**Donald McGougan:** Yes. The grant letter was agreed between Transport Scotland and the city council's officials, with assistance from representatives of TIE, but the standard processes for reimbursement were agreed between the city council and Transport Scotland. I think that they reflect the arrangements that Transport Scotland has for other projects.

11:45

**The Convener:** Shirley-Anne Somerville described the problems that were emerging. At any time, did Transport Scotland query why a substantial part of the £500 million was being signed over with no or very little discernible progress?

**Donald McGougan:** Those issues have been discussed with Transport Scotland, certainly at the quarterly meetings and almost certainly at the monthly meetings, although it is more likely to have been at the quarterly meetings, which were more strategic. We have all been concerned with progress on the project and with the timing of the expenditure.

**The Convener:** Notwithstanding such concerns, Transport Scotland was quite happy to sign off a substantial portion of the five hundred and something million pounds.

**Donald McGougan:** Under the terms of the grant letter and the grant conditions, Transport Scotland is obliged to do that.

**The Convener:** That is right—it is obliged to do that—but that grant letter was something that Transport Scotland put in place itself. It put in place a process that obliged it to pass over the money notwithstanding any concerns.

**Donald McGougan:** The grant letter was agreed between Transport Scotland and the City of Edinburgh Council.

**The Convener:** Had the grant letter been differently constructed, Transport Scotland might have been able to say, "You're not getting another penny until we see progress." However, because Transport Scotland had drafted it in a certain way, as agreed by yourselves, it had no obligation, as you have said, other than to hand over the money at certain stages.

**Donald McGougan:** I understand that Transport Scotland representatives are coming before the committee and I would be more comfortable if you took up those issues with Transport Scotland.

**The Convener:** We can certainly ask them about the matter.

**Jamie Hepburn:** When was the grant letter signed off?

**Donald McGougan:** It was signed off before the contract was signed for the project.

**Jamie Hepburn:** Do you have a rough date for that?

**Donald McGougan:** It would have been in early 2008.

**Jamie Hepburn:** That was after the Parliament voted to proceed with the project and grant the £500 million—and the votes were not unanimous, incidentally.

**Donald McGougan:** Yes.

**Anne McLaughlin:** I know that Transport Scotland witnesses are coming in next week, but I wish to clarify something. There seems to be a line of questioning that suggests that Transport Scotland had completely washed its hands of the project. Mr McGougan and Mr Jeffrey, you have both referred to Transport Scotland monitoring things and suggesting meetings. You have mentioned the body fairly frequently in relation to the on-going business. Did you, at any stage, ask the advice of Transport Scotland? I am sure that you did. Was its door open or shut? Has Transport Scotland washed its hands of the matter? Is it actively involved in monitoring the project?

**Donald McGougan:** Mr Jeffrey will also have a go at answering the question, but I can say that Transport Scotland is absolutely actively involved in monitoring the process, and we have regular discussions with it about the best way forward.

**Richard Jeffrey:** The individuals whom I have dealt with have been very helpful. To use your terminology, Ms McLaughlin, I think that it is an open door.

**Anne McLaughlin:** I have a question for Sue Bruce. This is a little bit of speculation, but I think that you will be able to give some form of answer. The Auditor General has called for Transport Scotland to get more involved now and work in a more hands-on way, given the circumstances in which we find ourselves. If you had been appointed chief executive of Transport Scotland seven weeks ago, how would you be feeling about that? If you had come to the project as chief executive of Transport Scotland at this point and were adopting a more hands-on approach, what is the first thing that you would do?

**Jamie Hepburn:** Good question, Anne.

**Anne McLaughlin:** Thanks, Jamie.

**Mr McAveety:** And would you have applied for the job?

**Sue Bruce:** Would I have applied for the job? No, I would not.

Transport Scotland coming in to sit with us, inside the grouping rather than on the outside, means that its expertise is brought straight to the table all the time; it is a peer, if you like.

What would I have done first? The Auditor General's report was in the brewing at that time and the first thing that we have been doing is to look to the Auditor General's report and then deliver, jointly, an action plan that addresses the

issues to come out of that, some of which will undoubtedly be reflected on in the mediation process that will begin shortly.

We want to reassure ourselves that if the governance arrangements can be improved, we have explored what they might look like and what the role of Transport Scotland might be. Transport Scotland was involved at the outset, but its role changed and it has fulfilled that role. We are now suggesting collectively that Transport Scotland should come back to the table, reflecting what the Auditor General is saying. We would look to Transport Scotland for advice, experience and views on the governance arrangements and so on. However, we must settle on what the scrutiny arrangements will look like further to that, given that Transport Scotland is currently involved in the external monitoring arrangements. If Transport Scotland comes to the table, there must be satisfactory scrutiny arrangements.

**Anne McLaughlin:** The decision to go to mediation was made in December. I appreciate that things do not happen overnight, but it has taken three months for the mediation to take place and every day that we wait for the mediation costs a huge amount of money. Why has it taken so long?

**Sue Bruce:** Several people probably want to comment on that. I welcome the decision to go to mediation and we are all undertaking an absolutely enormous amount of preparation for it. As has been noted around the table, we have already been involved with arbitration, informal mediation, lawyers and all sorts of things. It is absolutely critical that we get the forthcoming mediation right, so that we achieve a positive outcome that delivers for the people of Edinburgh from the investment that has been made and that will, we hope, continue to be made in the future.

The preparation for the mediation has been huge and has included work at a range of levels on the soft side and relationship building. Without straying into the formal terms of the mediation, I have been involved—along with the leader of the council and others—in meeting senior personnel from the consortium to ensure that we have a common understanding going into the mediation. We want all parties to go into it open minded, with a positive foot forward and looking for common ground to try to get an outcome. There has been an absolutely huge amount of preparation.

Could the mediation have taken place any earlier? The intervention of the seasonal break over Christmas and new year probably added to the delay. It may be difficult for the public to understand why it has taken us so long to get to the table, but bringing parties together for this type of mediation is complex, given all the material that needs to be reviewed, all the backstop positions

that need to be identified, and so on and so forth. It would have been difficult to bring it together any earlier—we might have managed to bring it forward by a fortnight or so. However, if we can get the right outcome through the mediation, those three months spent in preparation will have been time well spent.

**Dave Anderson:** The delay in commencing the mediation has not necessarily been down to TIE and the council. We are dealing with a consortium that has three constituent parts, so we are dealing with a complex set of issues relating to three commercial companies that potentially have a lot to gain or lose from the outcome of the mediation. Agreeing the mediator to be appointed, the venue and the exchange of documents that are required on both sides to enable the mediator to make judgments is a lengthy process but it is important that we get it right, as our focus must be on getting the outcome that represents the best value for this city.

**Anne McLaughlin:** That is a perfectly legitimate explanation. My view is the same as the one Shirley-Anne Somerville expressed earlier—that the mediation should have happened a long time ago; nevertheless, I welcome what you say about relationship building. We cannot underestimate the importance of mediation, which is different from legal action. It is about relationship building and working together to get the best possible solution. You are all keenly aware of the fact that every day that the mediation is delayed is costing us money. It is absolutely crucial that we get this right, and the best chance of getting it right is mediation.

I do not suppose that you are going to say no to this, but are you confident that everyone involved is approaching the mediation as a means of resolving the problem rather than as a stepping-stone to legal action?

**Sue Bruce:** I am, actually. All the parties around the table have reflected upon where we have been and where we are. This is not a good place for any of those parties to be in because of the cost and time overruns, and because of our reputations and the impact that the situation is having on the city and the wider reputation of Scotland's public sector. The consortium will also be concerned about that.

Having met all the key players, I am convinced that people are entering into in the spirit that we have been to a lot of different places to resolve the problem and we have to get a resolution out of the discussions that are coming up. Those discussions will be complex and detailed, but we want to look for common ground to secure a strategic way forward. From what I have seen and heard, I believe that people are earnest going into the mediation and are looking for a positive outcome.

**Willie Coffey:** Despite the obvious searching questions from members around the table, it is important to give you the impression that we are behind you in wanting to take the project to a successful conclusion for the city of Edinburgh and for Scotland.

I know that Sue Bruce and Richard Jeffrey are relatively new to the project. Sue has extensive experience of local government and Richard has a history in civil engineering, and they bring all that to the table. As a relative outsider to the process, I wish you both every success in bringing the project to the conclusion that we hope for and expect.

I have a couple of questions that look backwards. The Public Audit Committee usually gets an opportunity to look at past projects that have completed, but we are in the middle of this one. At the outset, I was struck by the large number of disputes that have arisen. According to the Auditor General's report, the number was around 800 initially, although I know that that figure has been whittled down considerably. However, it is a huge number of disputes for a project. Do you have a view about why that has happened?

As you will recall, convener, in the past four years we have looked at major capital projects and we have seen the initial phases, designs or specifications for those projects as being a problem area that we might be doing too quickly or too soon, or not putting enough thought into. That can give rise to disputes during a project. Would the witnesses say that some of the disputes have arisen because of contractual inaccuracies or lack of detail at the outset? Alternatively, are we dealing with large numbers of unexpected outcomes, as the spade has been put into the ground and we have discovered unforeseen problems? The public in Edinburgh and Scotland would like to know why you are having to resolve such a large number of disputes.

**Richard Jeffrey:** A large number of factors have led to the large number of disputes or claims. At the heart is a difference of opinion between the client and the contractor about the interpretation of the contract. All the issues, claims and disputes will be subject to mediation and might, in future, be subject to litigation. It is not appropriate, therefore, to go into the details behind that because doing so might prejudice the mediation or any subsequent litigation.

**Sue Bruce:** I agree with what Richard said. Looking forward to the mediation, I feel that the final position will undoubtedly be rooted in a contract as is absolutely necessary in these circumstances. We are talking about the ethos, or climate, as we go into mediation. I hope that the mediation achieves the settling-down of the

relationship and, if we get a positive outcome, the ethos for how we will work in future. That will impact on the climate for dispute resolution and so on. So one of the things that we want to consider as we go into mediation is the spirit in which the parties do business.

12:00

**Willie Coffey:** I will not go further into the issue, for the reasons that Mr Jeffrey gave.

**The Convener:** The witnesses cannot speculate on the outcome of mediation, but you hope that it will go in your favour. If any part of the discussion does not go in your favour, where will additional costs come from? Who will bear the responsibility?

**Dave Anderson:** First, it is not arbitration but mediation, so it is about reaching a mutual agreement on a way forward. The focus of mediation, from our perspective, is to deliver a working tram, in the first phase into St Andrew Square, for a guaranteed maximum price, with clarity around price certainty and the allocation of risks going forward. We are working towards that end and trying to get the best possible financial outcome from where things currently stand.

**The Convener:** Sure, but given what the cabinet secretary said about the Government's contribution being capped, who will bear additional costs to City of Edinburgh Council or TIE that emerge from the mediation or from the project in general?

**Donald McGougan:** We have reported to the council that it is unlikely that we can do what we want to do within the funding envelope of £545 million. We have been charged with doing contingency planning in relation to a figure of up to £600 million.

The contingency planning is well developed and is in the public domain, and it relates to utilisation of the prudential framework in relation to provision of resources that the council has identified in its long-term financial plan, which runs for 10 years from now—although we realise that we have only a one-year settlement from the Scottish Government.

Within the long-term financial plan, we have identified resources that can be used for infrastructure development. As we consider the business case for the tram going forward, we also anticipate that the surpluses that would be generated would support further borrowing. Between those two factors, we are undertaking contingency planning up to a level of £600 million.

**George Foulkes:** I very much welcome Willie Coffey's positive remarks about the scheme—it is good to get such endorsement from Kilmarnock. I

want to follow up his question, which Dave Anderson started to answer, and which was helpful. The aim is to get agreement as quickly as possible to get the tram operational to St Andrew Square. If the mediation goes well, when do you expect to be able to give a date from which the tram will operate? I am not asking you to give a date now; I am asking when you might be able to give the date.

**Dave Anderson:** It would be unwise of me to commit to that. Richard Jeffrey and TIE have carried out their own diligence in relation to what they think a reasonable contractor, acting reasonably, could deliver in a particular timeframe, including sectional completion dates for the stretch from the airport to Haymarket. The remobilisation of the contractor is one of the issues that will be discussed at mediation, so it would be imprudent of me to offer a specific date and put it in the public domain. We should not be doing that at this point.

**Richard Jeffrey:** However, let me add that if we are to get the project back on an even keel, cost certainty and programme certainty need to be resolved.

**George Foulkes:** Excellent. I was also encouraged by Donald McGougan's answer to the convener's question, in which he talked about the 10-year plan. Can I take it that you hope that the extension to Leith, Newhaven and Granton will be included in the council's forward plan?

**Donald McGougan:** It remains the council's policy to build the tram from the airport to Newhaven but there is a recognition that that will need to be done incrementally. The first thing that we will focus on when we come out of mediation is to get to St Andrew Square. After looking at the costs and affordability of that we will look at the other increments from St Andrew Square through to Newhaven. I would not want to say that we have resources for that until we know the outcome of the mediation.

**George Foulkes:** But there are two or three possible additional sources of funding: the Scottish Futures Trust, if it continues to exist, and the other one, which is for infrastructure development. I have forgotten the name of it.

**Donald McGougan:** Tax increment financing.

**George Foulkes:** Yes, TIF. I could not remember the acronym. Would the council look at such things?

**Donald McGougan:** The council will look at all possible sources of funding in order to provide the tram all the way to Newhaven, which is, after all, the policy. Certain projects have been identified for the TIF pilot scheme and a business case is being built around them.

**George Foulkes:** Can you explain TIF a little more?

**The Convener:** We can do that another time. We do not have the luxury of being able to spend a lot of time on this.

**Donald McGougan:** We would also be happy to speak to the Scottish Futures Trust and Transport Scotland about how to bring the project to completion, but as far as mediation is concerned the current focus is on getting to St Andrew Square.

**George Foulkes:** My understanding is that you were planning to co-ordinate the administration of the buses and trams and that David Mackay would be chair of both. However, he has given up and you are now advertising for a new chairman of Lothian Buses. Do you still plan to integrate the two operations?

**Sue Bruce:** You are right. A new chair of TIE has recently been appointed and the post of chair of Lothian Buses is being advertised presently. The ultimate aim of all the parties is to have a properly integrated transport system led by Lothian Buses.

**George Foulkes:** Led by Lothian Buses?

**Sue Bruce:** Yes.

**Richard Jeffrey:** I have a very close working relationship with the senior management of Lothian Buses, which sits on the tram project board as well as on the prepare for operation committee, which is a separate sub-committee of our board. It is clear that the integrated transport system will in effect be bus-led and the expertise and experience that exist in Lothian Buses will be vital in that.

**Dave Anderson:** It is important to remind ourselves of the strategic rationale behind this project. This is a city of 477,000; it is growing at 2,000 or 3,000 people per annum; and growth forecasts suggest that by 2030 the population will be 540,000. According to the 2001 census, there were 85,000 daily in-commuters to Edinburgh. That figure is well over 100,000 now; indeed, the 2011 census will tell us just how much more. The tram was always conceived as part of an integrated transport solution—and part of a wider network originally with the Edinburgh airport rail link but now with the Edinburgh to Glasgow rail improvement programme and the construction of the Gogar intermodal project—to facilitate access to a much wider labour market. Compared with other European cities with a high gross domestic product per capita, Edinburgh is almost unique in not having a light rail, metro or tram system. On the other hand, Glasgow benefits from an installed base of fixed-rail network that allows people to get around Strathclyde and which is a fantastic asset

for that city. This is a long-term investment for the city of Edinburgh and we are really focused on delivering it and ensuring that we produce the best possible outcome.

**The Convener:** I know that Murdo Fraser has some questions for TIE, but I have one last question for the City of Edinburgh Council. Who was responsible for drafting the contracts that were signed off?

**Donald McGougan:** TIE was responsible for drafting the contracts and took extensive legal advice on that matter.

**The Convener:** But did the chief executive of the City of Edinburgh Council, as project sponsor, consult the council's own solicitors for a view on whether the contracts were fit for purpose and robust?

**Alastair Maclean (City of Edinburgh Council):** I can answer that. The chief executive did take a view from my predecessor, the then council solicitor, and reliance was based on a duty of care letter that was obtained from the same legal advisers who were advising TIE on the detail of the contract.

**The Convener:** Are those legal advisers external to the council?

**Alastair Maclean:** Yes. TIE is the contracting party in the contract, and it rightly took detailed and expert legal advice. Where there is community of interest between parties, such as with the City of Edinburgh Council and TIE, there is often a duty of care letter from the external legal advisers. Such a letter was obtained by the council in this case.

**The Convener:** Yes, but TIE took legal advice on the suitability and robustness of the contracts. The council is the major sponsor and through the council Transport Scotland made payments. Did the council take its own, separate legal advice or did it take the same legal advice that TIE got?

**Alastair Maclean:** I think that I answered that question. We took the same legal advice from the same advisers as TIE, which is perfectly normal in this type of scenario where there is community of interest between two parties who are connected, with TIE being the delivery entity and the council being in the position of financial guarantor and project sponsor.

**The Convener:** So you accepted the legal advice that was given. If any deficiencies or defects are subsequently shown in the contracts, are the external legal advisers liable in any way for that?

**Alastair Maclean:** That is a bit of a hypothetical question.

**The Convener:** Is it?

**Alastair Maclean:** Yes. We are dealing here with hugely complicated issues and, as we have heard already, a number of issues have got us to where we are today. The focus right now is on taking matters to mediation and seeking to get resolution. I am sure that later on there will be a period of time for people to reflect on what happened and why, but here, today, is not the right time to do it.

**The Convener:** It might not be the right time, but is it entirely hypothetical to consider that there might be further legal implications? You suggest that because it is hypothetical you have not considered those implications.

**Alastair Maclean:** The council and TIE are looking at every avenue and option that is open to them. I am afraid that it is not appropriate in this meeting, as we go into mediation, to dwell on that. I am sure that the Auditor General himself has pointed out that we should not do that. As I understand it, he excluded from his report the contractual arrangements and disputes. So, if you do not mind, I do not want to be drawn on that.

**The Convener:** I am not going into the detail. It might not be appropriate—I accept what you say—but that is different from saying that it is hypothetical, is it not?

**Alastair Maclean:** It is hypothetical because right now we do not want to look backwards. The team here are committed to looking forward to try to get a resolution for the benefit of the public purse.

**The Convener:** We may differ in our interpretation of the word hypothetical, so we will leave it there.

**Murdo Fraser:** I want to ask Richard Jeffrey some questions about TIE and the context for the project. I appreciate that you have been with TIE for only about 18 months, Mr Jeffrey, but I am sure that you will be familiar with the background.

**Richard Jeffrey:** I have been with TIE for almost two years.

**Murdo Fraser:** Am I correct in saying that when TIE was originally set up it had four projects? There was the Stirling-Alloa-Kincardine rail line, the Edinburgh congestion charge, the Edinburgh airport rail link and the tram project. As we know, the Stirling-Alloa-Kincardine railway line project was transferred to Transport Scotland and the congestion charge did not proceed. That left the EARL project and the tram project, but of course the EARL project was dropped in 2007 by the Scottish Government, which left only the tram project. Am I right in saying that the tram project is now the only one that TIE is taking forward and that it consumes all the work of the people within TIE?

**Richard Jeffrey:** That is correct, apart from a minor role that we still have. Technically, we are still the statutory undertaker for the EARL project. Although the Government decided not to proceed with the project, it has never been formally cancelled, so, legally, it still exists and we therefore have a role as the statutory undertaker.

**Murdo Fraser:** That is helpful. So, from the summer of 2007, the jobs of all the people who have worked within TIE—you and your predecessors—have depended on the continuance of the tram project. Did that lead to a culture within TIE of wanting to see the tram project continue, come what may?

12:15

**Richard Jeffrey:** I do not think that it did. To an extent, what you say is speculation about people's motives.

What always impresses me is the dedication and commitment of my team to seeing the tram project built. I recently held a number of small focus groups with all my staff to talk about what the future might hold. There is wide recognition that the bulk of the people who work for me have what you might call nomadic careers, in that they move from project to project. The vast majority of them know that when this project comes to an end they will move on to other projects with almost certainly different employers. What motivates them is being part of delivering infrastructure that will be here for generations to come and which will make a difference to the city.

Is there a passion and belief among the team that the trams are a good thing and they want to see them built? Absolutely. Are they motivated by their own job security? I do not believe so, because the bulk of them are used to moving from employer to employer as projects come and go.

**Murdo Fraser:** Could that passion to see the project completed have led to TIE putting a more optimistic spin on the project's prospects in reports to the council or Transport Scotland?

**Richard Jeffrey:** Again you are speculating about what people's motives might be. There are 60 people in TIE who are all individuals and have their own motives and approaches.

**Murdo Fraser:** But what I suggested could have been the case.

**Richard Jeffrey:** Many things in life are possible. You are speculating about what people's motives may or may not be.

**Murdo Fraser:** Am I right that the annual running costs of TIE are around £12 million?

**Richard Jeffrey:** Yes, but that would be a high year. Typically, we would expect the running costs

to be just under £10 million. That is a combination of our internal staff costs, fairly extensive use of external legal professionals at the moment because of the level of dispute, external construction specialists and the usual raft of overheads such as insurance and rent and rates. We also pay for the council staff who are engaged in the project and pay Lothian Buses for the time it contributes to the project.

**Murdo Fraser:** Okay. The project is currently around two years late and it may well run later than that. For every year that goes by we are running up additional costs for the running of TIE that are over and above all the other costs involved with construction, so that is a factor that clearly must be borne in mind.

I will give you an opportunity to respond to a question that was put earlier to the council. Can you give us an update on the likely total cost of the project or on likely completion dates?

**Richard Jeffrey:** No. I have consistently said that I will not engage in speculation about the potential cost of the programme, particularly until we have a resolution to the current disputes with the contractor. The Auditor General's report accurately reflects the fact that for the vast majority of the project's elements we feel confident about being able to predict final costs and outturn consequences. However, for the main infrastructure construction project, while we still have the dispute with the contractor it would not be sensible to start to speculate, because it all depends on what resolution we can reach through mediation or whatever other mechanism.

**Murdo Fraser:** So we really have no idea at this stage when, or whether, the project will be completed or how much it could cost?

**Richard Jeffrey:** As I said, it depends on the outcome of the mediation.

**Shirley-Anne Somerville:** I appreciate that you do not want to speculate about the date, but the report states:

"It is possible that trams will not be operational until at least 2013."

I asked last week for clarification of what that means and was guided to today's panel of witnesses, so I am looking to you to give me further information about what it means, even if you do not want to go any further.

**Richard Jeffrey:** I will pick up on a comment that one of my colleagues made earlier. It is obviously possible to look at the scope of work that is still to be completed and make an assessment as to how long it would take on the basis of a reasonable contractor working at reasonable productivity rates. Until we have certainty about the productivity rates that are going

to be achieved, as opposed to those that are, if you like, technically achievable, it is hard to say how long the work will take.

I use this analogy: we can estimate how long it will take us to drive from Edinburgh to Glasgow by considering the distance and our average speed, but if we do not know what speed we will be driving at, we do not know how long the journey will take.

**Shirley-Anne Somerville:** When you considered what a reasonable contractor could do, were you thinking that the whole line or part of it could be completed by 2013?

**Richard Jeffrey:** We can extrapolate productivity rates for any part of the line or for the whole line.

**Shirley-Anne Somerville:** Does the sentence, "It is possible that trams will not be operational until at least 2013"

refer to the whole line or part of the line?

**Richard Jeffrey:** I think that it probably refers to part of the line but, as I said, the programme and the timescale will be a subject of mediation.

**Shirley-Anne Somerville:** We heard that the council is now working to a ceiling of £600 million and we heard about the 10-year prudential borrowing analysis that it has been doing. Was the money that has been earmarked for prudential borrowing for the trams earmarked for other projects, or are we talking about new prudential borrowing that the council will take on?

**Donald McGougan:** I was talking about a provision in the long-term financial plan, which gives us spending capacity. That capacity was not earmarked for any other project, but it clearly carries with it an opportunity cost, in that it could have been used for other things.

**Shirley-Anne Somerville:** Is £600 million the estimated cost of getting to St Andrew Square? In the analysis of City of Edinburgh Council's prudential borrowing, are you assuming that you can deliver the tram only as far as St Andrew Square for that? Are you looking to do more prudential borrowing in future?

**Donald McGougan:** We did not come at the issue from the perspective of the cost to St Andrew Square. There is no connection with the potential cost to St Andrew Square. I was referring to a contingency plan, which the council determined on some eight months ago, which was based on a figure that was 10 per cent more than the funding envelope, so it was about seeing how we would get another £55 million, if that was required. That is all. We are not saying that the cost to St Andrew Square is £600 million.



**Shirley-Anne Somerville:** I appreciate that. We are simply looking at a percentage increase in cost, but we have no idea whether that will get us to Haymarket, St Andrew Square or anywhere else. That was not the basis of the exercise; the council was simply considering how it would get to £600 million.

**Donald McGougan:** We were looking ahead and contingency planning up to £600 million. When we come out of the mediation we will need to review the prospects for timescale and cost.

**Shirley-Anne Somerville:** There has been speculation in the press recently that the council or TIE will ask the next Government for more money. Has such a strategy been considered as part of contingency planning?

**Donald McGougan:** That is not part of the contingency planning at the moment, but I think that I said in answer to a previous question that we would be prepared to explore every avenue and to talk to the Scottish Futures Trust and Transport Scotland about the funding issues after we come out of mediation and see where we are in relation to timescales and cost.

**Jamie Hepburn:** We heard earlier that Lothian Buses has been identified as the operator of the trams. When did that happen?

**Richard Jeffrey:** When the project was conceived, there was a separation between the project and Lothian Buses, and Transdev, which is a private sector transport operator, was brought in. Around the end of 2009 we terminated the contract with Transdev and in effect brought the operation back in-house. One of the reasons for that was that after discussions with the then management of Lothian Buses it was clear to me that the expertise to operate the tram existed in Lothian Buses. At that point we concluded that we no longer needed the services of Transdev.

Therefore, I guess that the idea was conceived—or, rather, acted on—at the end of 2009. Since then we have had a continuous process of working more and more closely with Lothian Buses, to ensure that when the trams are ready for operation the company is geared up to absorb them into its operation.

**Jamie Hepburn:** I do not represent the area and I do not have intimate knowledge of how Lothian Buses is structured, but am I right in saying that it is not owned wholly by City of Edinburgh Council but is owned by all the Lothians local authorities?

**Dave Anderson:** City of Edinburgh Council owns 91 per cent, and the balance of 9 per cent shareholdings is distributed across the three Lothians authorities, although not in exactly equal shares.

**Jamie Hepburn:** So it is virtually owned by City of Edinburgh Council. What has been the opinion of the other Lothians authorities on the prospects of Lothian Buses operating the trams?

**Donald McGougan:** Due diligence in relation to how everything will work has still to take place. It has been recorded again in public as recently as in the latest council report that the direction of travel is that Lothian Buses will take on the operation of the trams. A number of issues in relation to the governance of the operation and how it will be put in place are outstanding. That has still to be subject to legal due diligence. There has been some discussion with the other councils, who have small minority shareholdings in Lothian Buses, but no concrete proposals have yet been agreed with them.

**Richard Jeffrey:** There is logic behind the proposal and there are reasons why it is the right way forward. We have to consider the issue from the city's perspective and passengers' perspective. We have talked about integrated ticketing and integrated timetables, with a single fare structure across the whole combined tram and bus network and with the opportunity to integrate service patterns and so on. All those factors mean that the smart thing to do is integrate the tram and bus operations.

**Jamie Hepburn:** Mr Jeffrey said that the EARL legislation is still in place and that TIE has responsibilities there, but, on a de facto basis, EARL is not happening. Also, Lothian Buses seems to be the preferred operator for the trams. So the only project left to TIE—as was highlighted in the answer to Murdo Fraser's question—is the delivery of the tram project. So what is the long-term future for TIE? Once the tram project is delivered—whenever it is delivered—what will your role be?

**Richard Jeffrey:** As you can imagine, that is a conversation that I have with my team all the time—because they want to know the answer as well. However, until the tram project is delivered, there is really no point in thinking about the longer term for TIE. We have the one project and we have to get it delivered. That has to be our focus.

If, in the longer term, funding is available for other transport projects and it is deemed that TIE is the right organisation to take them forward, then so be it. If that does not happen, TIE's purpose ceases to exist at the end of this project.

**Dave Anderson:** The need for investment in public transport infrastructure in this city has not gone away. The city is growing and it will require investment in infrastructure in future. It will require a body that is capable of developing new infrastructure and of finding methods of financing

that new infrastructure. Whether or not that happens through TIE, the task will remain.

**Jamie Hepburn:** We could explore that point further, but I will not.

I want to follow up on a couple of points that Mr Jeffrey made in response to Shirley-Anne Somerville and Murdo Fraser. You have said quite clearly that you will not speculate on the total costs of the project. Does that not offer no reassurance whatsoever to members of the public who, in essence, are paying for this project? Are you not giving the impression that there is a bottomless pit?

**Richard Jeffrey:** The uncertainty of the costing programme is understandably a source of frustration for everybody—politicians, members of the public, the media and so on. That is why one of the things that must come out of mediation is certainty.

**Jamie Hepburn:** You were also somewhat reluctant to give any concrete forecast for when the project is likely to be completed. I was very interested to hear you say that you could make a forecast with a reasonable contractor working at a reasonable rate. I may be paraphrasing you slightly, but was that a backhanded criticism of the current contractor?

**Richard Jeffrey:** No, it was simply a clarification of the assumptions that would need to go into the calculation of any programme.

**Jamie Hepburn:** So the current contractor is a reasonable contractor working at a reasonable rate.

**Richard Jeffrey:** Our differences of opinion with the contractor have been well publicised. Earlier, Shirley-Anne Somerville talked about the need to build relationships. I am not sure that it is helpful for me, in a public environment, to express again views that have been expressed in the past. The focus has to be on building relationships and finding a satisfactory resolution at mediation.

**Jamie Hepburn:** We may read about it in your autobiography.

**The Convener:** This discussion has been quite wide-ranging and I am now going to draw it to a close. I thank the witnesses for coming to the meeting; I know that you were somewhat concerned about it because of the upcoming prospect of mediation. We appreciate your taking the time to come along.

It will be interesting to hear what Transport Scotland has to say. Because we are so near to the dissolution of Parliament, it will be difficult for the committee to go into the depth that it might want to go into, but I am sure that this issue will come back either to a future audit committee of

the Scottish Parliament or to a future transport committee. Thank you all very much for coming along.

Item 5 is no longer on our agenda so we move to item 6, which will be taken in private.

12:30

*Meeting continued in private until 12:37.*

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