The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

INFRASTRUCTURE AND CAPITAL INVESTMENT COMMITTEE

Wednesday 20 November 2013

Session 4

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INFRASTRUCTURE AND CAPITAL INVESTMENT COMMITTEE
23rd Meeting 2013, Session 4

CONVENER

*Maureen Watt (Aberdeen South and North Kincardine) (SNP)

DEPUTY CONVENER

*Adam Ingram (Carrick, Cumnock and Doon Valley) (SNP)

COMMITTEE MEMBERS

*Jim Eadie (Edinburgh Southern) (SNP)
*Mary Fee (West Scotland) (Lab)
*Mark Griffin (Central Scotland) (Lab)
*Alex Johnstone (North East Scotland) (Con)
Gordon MacDonald (Edinburgh Pentlands) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Peter Farrer (Scottish Water)
Ronnie Mercer (Scottish Water)
Douglas Millican (Scottish Water)
Mark Powles (Scottish Water)

CLERK TO THE COMMITTEE

Steve Farrell

LOCATION

Committee Room 6

Scottish Parliament

Infrastructure and Capital Investment Committee

Wednesday 20 November 2013

[The Convener *opened the meeting at 10:00*]

Scottish Water Annual Report and Accounts 2012-13

The Convener (Maureen Watt): Good morning, everyone, and welcome to the 23rd meeting in 2013 of the Infrastructure and Capital Investment Committee. I remind everyone present to switch off mobile phones and other devices as they affect the broadcasting system, although some committee members may consult tablets during the meeting because we provide papers in digital format.

Gordon MacDonald has given his apologies and Gil Paterson should be attending in his absence.

Agenda item 1 is Scottish Water's annual report 2012-13 and accounts. We will hear evidence from Scottish Water representatives.

Mary Fee, do you want to say something at this point?

Mary Fee (West Scotland) (Lab): I declare that my son works for a company that is involved in the Thistle Water consortium. He has no knowledge of and no involvement in the working of Thistle Water, but I thought it prudent to bring that to the attention of the committee and witnesses.

The Convener: Thanks very much, Mary.

We will hear later from Scottish Water on the strategic review of charges and its related draft business plan, but at the moment we will concentrate on the annual report and accounts.

I welcome from Scottish Water Douglas Millican, the chief executive; Ronnie Mercer, the chairman; and Peter Farrer, the chief operating officer. I also welcome Mark Powles, chief executive officer at Scottish Water Business Stream.

Ronnie Mercer, do you want to say anything at the beginning?

Ronnie Mercer (Scottish Water): Yes, I will make a few remarks if that is okay. I will get us warmed up and going and will give you something to ask us about.

We are very pleased to be here. It has been another quite good year for us. We must be one of the highest-performing water companies in the United Kingdom, and we think that we are getting better at offering value for money to our customers in terms of service and charges.

This is the fourth year of the five-year regulatory period, and I will list a few good things. We have outperformed our customer service target, which is good. The target is known as the overall performance assessment—OPA—and everyone measures against that. Our customer service is at record levels and we have the highest-quality drinking water that we have ever had in Scotland. We have managed a pretty big reduction in water leakage from pipes and we have reached the regulator's target a year early. I stress that we need to do a lot to stand still in that business and could go backwards if we did not do anything. However, we have got to that point a year early, which is good.

In continuing to support growth in Scotland, we have spent £487 million on infrastructure projects for water and waste water, which is delivering benefits for customers—that is what it is all about. Those projects support a lot of construction jobs at the same time.

We are also pleased that we are running at our highest level of new graduates and apprenticeship places in the business, both in house and through our supplier and delivery partners, whom we encourage to take people on to whom we then give work. That seems to be working very well.

Our average household bill is £54 per annum below the average bill in England and Wales and is pretty good value at just under £1 a day. We are quite happy about that, but we are never complacent, as we cannot be in our business. Recently, we have had large bursts in trunk mains at Maryhill Road and Bridge Street in Glasgow and at Colinton Road in Edinburgh. Those bursts were not geographically related, but they happened and caused a good bit of disruption to customers, which proves that there are still things that we need to pre-empt. We handled those incidents when they happened, but we would rather that they did not happen. Perhaps we can return to that when we look to the future.

Mark Powles from Business Stream is with me today. Business Stream has delivered a solid set of financial results in a year that has been economically challenging for business customers, as members will be aware. The market has also seen increased competition, as there are now 12 licensed providers operating in Scotland and another is about to appear. Business Stream has risen to the challenge and is delivering real benefits for 115,000 business customers, who are now paying less than they would have done without competition.

Even before we started to lose market share, the threat of competition made us better. Since there has been competition, more than £30 million has been saved by business customers, who are paying £30 million less as a result of keener prices. We have also saved £35 million through water and waste water efficiencies. We got the public sector bodies' contract, and they will have paid £32 million less over the life of the contract between 2011 and 2015, which will be renewed again—not necessarily with us, but with whoever wins it. Customer service satisfaction levels have reached a high for Business Stream at 81 per cent, and we had had a reduction of 35 per cent in complaints the last time that we counted.

Mark Powles is keen to keep working with customers, innovating and trying to get people to use less water and, therefore, pay for less. That is what we want to happen. We offer not only a good financial service but a good customer service. We are now active in England, helping customers with various solutions, and the English market is due to open in 2017. I shall say more about that later.

However, I sound a note of caution. Business Stream is a competitive business and is in competition with another 12 businesses. This meeting is being webcast, and people who are trying to take business from us might be watching. We shall answer your questions as best we can, but I will not say on camera something that I think would be to the advantage of a competitor. I would be happy to say such things off camera, if that is okay with you.

Alex Johnstone (North East Scotland) (Con): You can whisper. [*Laughter*.]

The Convener: Thank you for that brief introduction. Can Scottish Water continue to provide the cheapest water and waste water services in the UK while mantaining the necessary levels of investment in the water and sewerage networks?

Ronnie Mercer: It is our intention that our bills will remain in the lower quartile of bills in the country. I cannot say whether ours will be the lowest, as someone else might pass us from time to time, but we expect our bills to remain well below the average bill in England and Wales and to be among the lowest. Right now, they are the lowest, but we would not make incorrect decisions in order for them to stay there or for the sake of £1. Douglas Millican might want to expand on that.

Douglas Millican (Scottish Water): There are a number of different dimensions to the issue, which plays into the future discussion of the strategic review. Our plans for the future are very much informed by what customers have told us matters to them—their expectations of service levels and service improvements and what they want to pay. Our plans for the future are geared to delivering what our customers want. As Ronnie Mercer said, we expect our bills still to be significantly below the average and among the lowest, but they may not be the lowest. That is no surprise given the geography that we cover in Scotland compared with the geography that is covered by some of the companies in England. It is no coincidence that the company in England that has the lowest bill has probably the greatest concentration of customers in the English midlands.

The Convener: You mentioned that there have been recent bursts as a result of dry weather. Thank goodness that we have had dry weather for a change. Has that exposed pipework, so that greater investment is required to replace older ware and works more quickly? Is the pattern of investment such that you can keep the water flowing as it is, or would you like to increase the level of investment?

Ronnie Mercer: No, I do not think that we are looking for any more investment. It is really about clever investment. If it was just a case of repairing the oldest pipes, it might be easier to know what to do.

You are absolutely right, convener, that those three bursts were all old pipes. However, we have an awful lot of old equipment all over the country. I ask Peter Farrer to comment on that. We do quite heavy optioneering on where it is best to spend our money, but we hope that we are doing that in order of what matters and not just according to the age of our assets. We carry out tests, and something old will often last for a long time yet. When we had those three bursts, we thought, “That's a bit different.” The weather had been dry, and there can sometimes be a shift in very dry ground that makes a pipe crack.

Peter Farrer (Scottish Water): There is no real correlation between the age of our pipes and their performance or the number of bursts. In those particular cases, although they were all very old pipes, when we took them out to repair them they were all in very good condition.

We need to have sufficient resilience in our networks so that when something like that happens—in those three cases, dry weather and the ground drying out caused the problems—we can back-feed our customers through different routes, which will give us enough time to repair the pipes.

The Convener: As there are no further questions on pricing, we move on to Scottish Water International. According to your annual report and accounts, Scottish Water International has won contracts in Qatar, India, New Zealand and Poland. How do you see that part of the business developing?

Ronnie Mercer: I will ask Douglas Millican to say whether there are any plans for the future. We have found it quite an interesting thing to do, and it is making good use of our people. It is giving them a view of the rest of the world and getting our name known elsewhere, which is no bad thing.

We are trying to get a core of people whom we can call on if we need them, because we do not want people doing nothing. They are working at the moment, but if we get jobs elsewhere we can lift them into those jobs. People would have to leave home to do those jobs, so they have had to let us know whether they are prepared to do that. Douglas Millican can expand on that.

Douglas Millican: Last year was the first full year of Scottish Water International and it was quite a successful year. About 13 staff worked on location throughout the year, principally in Qatar. We also had a member of staff out in New Zealand on a fairly long-term basis and we had some shorter contracts elsewhere.

Our whole model is very much to work in partnership with others. Consultancy is inherently a competitive, low-margin business, so we need to keep a close eye on not building up big overheads for that. Our approach, from a marketing angle, is to work in partnership with other major consultancies where there is an opportunity for them to leverage off our operational skills or our particular expertise in running a publicly owned water company. We are very much opportunity and market led, depending on the opportunities for our partners.

The middle east is one of the most attractive markets for us. In the current year, we have done a small piece of work in Oman that we hope may lead to something more significant. It is important to say that, from a scale angle, International will always be a modest aspect of Scottish Water's activities. We are looking to find those opportunities where we can leverage the most benefit from the perspective and expertise that Scottish Water can bring.

The Convener: I am trying to find out how much income International generated in its first full year. I cannot remember where I saw that.

Some people say that you are not developing that angle of the business at a fast enough pace and that there are many more opportunities out there for Scottish Water than you are currently grasping. Last year, you said that you were taking tentative steps and were well aware that that angle of the business could not be allowed to impact negatively on the core business. Are there other opportunities out there that you could be grasping but are not?

Douglas Millican: In terms of appropriate opportunities for us, I do not believe so. We actively scan many opportunities in different countries, and a number of those take a significant time to come off. There are also many parties that are keen to tap into our expertise without paying for it. The trick is to ensure that if we provide real value we get remunerated for it.

10:15

The Convener: How do you see the business developing in the next few years?

Douglas Millican: As Ronnie Mercer mentioned, in the past six months we have pulled together a pool of what we refer to as designated consultants. Those people have a day job in Scottish Water but are willing and keen to work with us in an international capacity. We have selected about 30 such people who have skills in areas in which we believe there might be a market demand. We are training them as consultants because more skills are involved in being a consultant than in being a technician or engineer. When opportunities come along, they will be ready to be released to provide support.

On potential market areas, my response is a bit like Ronnie Mercer's earlier reference to Business Stream—there are issues around commercial confidentiality. I am happy to talk informally about the specific opportunities that we are targeting, but I will not do so on the public broadcasting system.

Ronnie Mercer: It is important to say what we are not doing, convener. We are not into building, owning and operating something that we have paid for in the middle east. We are not doing that because it would be gambling with the public's money. We are supplying expertise to a project that is funded by someone else, and we are putting that expertise into it because we have it and we are using it here. Our work in Qatar is a classic example of that. Qatar has the world cup in 2022, but it does not really have a sewerage system, as you and I know, so we are helping to design one. We are not building things and then hoping to get paid for them—I want to be clear about that. We are a consultancy; we are not a build-own-operate organisation, and we do not want to be one.

The Convener: What is the split between helping with the design of things such as sewerage systems and dealing with water governance issues such as those that you are pursuing in India?

Douglas Millican: Most of the work that we have done that has generated value is associated with supporting Qatar's public waste water authority with the upgrading of its waste water management system and the delivery of customer service around that.

In New Zealand, we worked on leakage detection following the Christchurch earthquake. The work that we have done so far in the area of governance has tended to be of lower value because the pieces of work tend to be short lived and very much about senior-level engagement rather than working with people on the ground for months on end.

The Convener: Mary Fee would like to ask some questions on Scottish Water Horizons.

Mary Fee: Your annual report indicates that Scottish Water Horizons is withdrawing from the green waste and composting business. Can you give me a bit more detail about the reason behind that decision?

Douglas Millican: It was very much a function of market conditions and what we experienced last year. The sales value per tonne of waste that was available to the market meant that it was not economic for us to continue with that. We are therefore gradually withdrawing from that sector, although we are honouring the contracts that we have. Clearly, we will have the facilities and capability that mean that, if market prices rise in the future and it makes sense for us to get back into that business, the opportunity will still exist. When we are operating in a competitive market such as the waste sector, where there have been quite significant changes in the market prices over time, we absolutely have to respond to those market opportunities and threats to maximise our financial position.

Mary Fee: So was a loss made? Is that one of the reasons why you are withdrawing from that market?

Douglas Millican: Absolutely. Last year the prices that we were able to achieve in that market were not sufficient to cover our costs, so it did not make sense for us to enter into further contracts if we could not make an appropriate return.

Mary Fee: From what I hear, the green waste and composting business is growing. Has it become more competitive?

Douglas Millican: Absolutely. The tonnage that is available in the market is increasing, but so is the competitive activity, because the market has fairly low barriers to entry and it is easy for new entrants to come in or for existing businesses to expand. Over the short term, that has driven market prices down to a point that means that it is not economic for us to continue in the market at the current time.

Mary Fee: If you have made a loss, have you had to move funds from another part of the business to cover that? If not, how will you manage the loss going forward?

Douglas Millican: It is all covered by the financing within the Scottish Water Horizons part of the business, so there is absolutely no crossover into the core, regulated part of Scottish Water.

Ronnie Mercer: It is perhaps worth saying that Scottish Water is still involved in energy.

Douglas Millican: Absolutely. Scottish Water Horizons is very much focused on generating energy from hydro and wind, and from food waste. We have a food waste plant in Cumbernauld, which in itself shows the vagaries in the market, because market prices have fallen but they are now starting to rise again. We must just accept that such markets have both opportunities and challenges, depending on what is happening with market pricing.

Ronnie Mercer: The site that we use for waste energy is the same one that we have used for green waste, so we are still in the same place.

Mary Fee: Will you continue to operate in competitive markets that are not part of your core business, or will you gradually withdraw and just focus on your core business?

Douglas Millican: It is very much about being opportunity led. Our whole growth strategy is predicated on looking at the resources that are available to us and seeing where there is a market opportunity that will mean that we can add value to help customers and to make money.

Jim Eadie (Edinburgh Southern) (SNP): Mr Millican, I think that you said that there was no crossover into the core business of Scottish Water. Does that mean that there is no knock-on effect for customers and taxpayers?

Douglas Millican: Absolutely.

Jim Eadie: How much was the loss that was incurred? Can you put a figure on it?

Douglas Millican: The operating loss in Scottish Water Horizons last year was £1.6 million.

Jim Eadie: My colleague sought to understand what the impact of refocusing the business would be. How do you absorb that type of cost?

Douglas Millican: We generate surplus over time across the range of our non-regulated activities. It is in the nature of any business that there will always be streams that are profitable and some that can struggle. We must therefore build up reserves over time across the portfolio that can enable us to absorb any shocks that come along.

Jim Eadie: Does that impact on the profitability and commercial viability of the non-core business?

Douglas Millican: No. We expect that Scottish Water Horizons will be a profitable activity this year.

Mark Griffin (Central Scotland) (Lab): Mr Mercer, you referred in your opening statement to the difficult economic conditions that caused some non-payment difficulties, particularly for Business Stream. How is Business Stream supporting customers who are having difficulty in paying their bills?

Ronnie Mercer: The answer is that we are doing that in a lot of ways. I will ask Mark Powles to talk about them.

Mark Powles (Scottish Water): We recognise that the past few years have been difficult. We obviously have a responsibility to get payment for the services that we provide, but we try to be sensitive with customers where possible. For example, we can issue payment plans for them; if a reassessment can be done to move them from unmeasured to measured, we will support them in that; and we will sign customers up to direct debit where possible so that they have more visibility and regularity of payments. It is a difficult time for businesses, but collecting the cash for the services that we provide is essential for the viability of our business and to ensure that Scottish Water gets the wholesale charges that it needs.

Mark Griffin: Has there been a particular effort or exercise to identify companies that are connected to the water network but have not been identified by Scottish Water as having an account and are now being retrospectively charged for activities?

Mark Powles: The regulator has put in a series of incentives and penalties for the industry, which means that we have a responsibility to identify customers and bill them for services from the point of occupancy. In the main, that has generated charges for customers who were not on a database and customers who have not told us that they have moved into a property. That is one of the most difficult issues. If a customer tells us at the point when they move in, we can issue the welcome pack, start to bill them and ensure that they get maximum value. Unfortunately, not all customers do that, so we have to go and find customers who have moved into properties.

Yes, we are identifying properties, but other licensed providers in the market are doing exactly the same. We have an obligation to back bill from the point of occupancy. We are currently talking to the regulator and within Scottish Water about reviewing the back-billing policies. I cannot give you anything more than the fact that we are in discussions. At present, until we have gone through the review, we have put a freeze on for a lot of customers who would have been back billed. I would be happy to write to you afterwards and give you more details on that once we have reached an agreement.

Mark Griffin: Just to clarify, it is the regulator that imposes on you the requirement to back bill.

Mark Powles: We have to bill from the point of occupancy. When a customer moves into a property and starts to receive services and use water, I think that, in the main, it is fair that they should pay for that. The problem that we have is that, on quite a few occasions, customers do not tell us when they move into a property, so we have to go and find them, and then find out the point at which they moved into the property and bill them accordingly. We are reviewing the policy at present with the market, and as soon as we have agreement on that I will be happy to write and give you the details.

Mark Griffin: It would be good to hear about that. I have a couple of examples from my constituency: a charity-owned community centre and a church that occupies a building in the town centre have been back billed, and, as a result, the community centre has closed while the church is now struggling to pay its bills.

Mark Powles: Charities specifically are a difficult issue. As you know, an exemption scheme is in place, but the rules are fairly rigid. When we identify a charity that has not been paying for services, the first thing that we proactively encourage it to do is to look at the exemption scheme to establish whether it would be eligible. In some cases, we have been able to do that.

We recognise that the charitable sector is under pressure and that back bills can be very difficult. Again, the exemption scheme is currently being examined by the Government and a consultation document will be published shortly on a new scheme that will start from 2015.

We have put on hold any back billing for charitable customers at present until we have gone through the review and established the new rules, which I would hope would be sympathetic to charities.

Mark Griffin: My next question is on your plans to expand into the English deregulated market. Could you outline how you plan to progress that expansion and say whether there will be any impact on Scottish customers?

Mark Powles: First, to be clear, our focus at present is very much on serving Scottish customers in our core market. That has, as Ronnie Mercer said at the start of the meeting, delivered fairly significant benefits to customers. Almost 70 per cent of the market is now benefiting from lower prices. We have saved more than £35 million in consumption savings and developed a suite of more than 60 innovative added-value services that are reducing carbon impact and improving environmental things for customers.

We have built a suite of services that are now proving to be quite attractive to English customers. As the market evolves towards England opening up its competitive market in the same way as Scotland by 2017, we need to start to try to capture some of that market.

When an incumbent starts with 100 per cent of the market, the only way is down, if it is not careful. Our ability to continue to do great things for Scottish companies is almost predicated on our creating a viable growing business. We have taken baby steps—if members do not mind that phrase—into England. We have won a couple of customers down there by using a lot of our added-value services—our ability to help customers to use less water, treat waste more efficiently and identify economies in their businesses. We are starting to demonstrate our capability in that market. That certainly will not hinder the work that we do in Scotland; in many ways, it will help Scottish customers, by giving us more expertise, more capability and more services, which we can provide UK-wide and not just in Scotland.

10:30

The Convener: Why was the Scottish market opened up before the English market? Why do English companies find the Scottish market attractive to come into?

Mark Powles: I started at Scottish Water after the Water Services etc (Scotland) Act 2005 was passed to open up the market in Scotland. Perhaps my colleagues can answer.

Ronnie Mercer: The act was passed to open up the market in Scotland. I came to Scottish Water in 2006, when one of my first instructions was to make that happen. As per the regulatory compliance arrangement that we must follow, we separated out Business Stream. We have opened up the market and gone for it. England did not do that and it does not intend to do it until about 2017, so English companies can come here but we cannot really go there. Hardly any of the market there is open and none of it has really changed hands.

This is a timing thing. We must defend what we have and prepare for going into England. That is exactly what we are doing.

Mark Powles: The convener asked why people are coming up here. The success of the Scottish market has started to make the Westminster Government think that opening the market is a good idea, which is why the Water Bill is going through the UK Parliament to open up from 2017 the English market, which involves about 1.1 million customers and about £2 billion of income. In the knowledge that that is to come into the English market, a lot of companies are taking the opportunity to come to Scotland to learn about competition and how to be a retailer.

As our chairman said, the playing field between Scotland and England is a bit uneven, because the market in England will not be open in the same way as that in Scotland until 2017. The English market that is available today is not particularly attractive; customers must negotiate with the wholesaler to get a price, the margins are quite low, the services are for water only and not for waste, and the process is incredibly cumbersome. The opportunities to win business in Scotland are much more lucrative than those in England, which is why companies are coming here.

The Convener: Are the opportunities lucrative because companies do not have to do waste water or for other reasons?

Mark Powles: The opportunities are lucrative in Scotland and not very lucrative in England. Today, the market in England is open only to 27,000 customers—those that use more than 5 megalitres of water on a single site—out of 1.1 million. That market opened up in early 2003 and has had limited movement from customers switching suppliers.

The market in Scotland is open for all non-household customers, from corner shops to big industrial manufacturers and public sector organisations, and it is for all services. That model is very good, which is why a bill is being taken through the UK Parliament to open up the market in England in the same way.

The Convener: Post-2017, are the markets and the regulatory regimes likely to be the same? Are the profit margins in Scotland and England likely to be the same?

Mark Powles: It is fair to say that a lot of the policy is still emerging. It is important to make the distinction that we have two separate markets that are run by two separate regulators under two separate Governments. The challenge, which we are trying to meet, is to create a seamless customer experience. We want multisite customers that have cross-border branches and outlets between England and Scotland to be able to contract with one supplier, to get one bill and not to see the join between two separate markets. However, the characteristics of the English market are slightly different. Its price review process is through its regulator. That could have an impact on pricing and price structures. Where possible, we are trying to create a market in which the customer experience is seamless, but they are two separate markets.

Profit margins have not been revealed yet, so I would be guessing if I commented on that.

Ronnie Mercer: It is fair to say that Mark Powles is helping the English market. He gets to meet the Department for Environment, Food and Rural Affairs because we have been at it for five years and the English have not got there yet. We are trying to get our views across as best we can through him. He has an important role to play because, five years later, we know a lot more than we did and DEFRA wants to get every bit of information that it can to help the English markets to open up seamlessly. We are trying to influence it a bit so that it is as level as it can be.

The Convener: In your opening remarks, you said that Business Stream was helping people to use less water and, therefore, pay less. However, in my experience, that is not really true, because a company can have two people in an office using a kettle, the toilet and sink once or twice a day and pay a hell of a lot for its water. The cost is based on the size of the premises and the number of rones, downpipes and drains that they have rather than how much they use. Scottish Water does not repair the rones or the drains or even empty the drains. That is the council's job. Many people are very confused about how much they are paying for water when they know that they are using very little. Will you explain it in words of one syllable?

Mark Powles: I suppose that the easiest way is for people to understand the rules of engagement in the market. A wholesale price is created as the result of a negotiation between Scottish Water Wholesale and the regulator. That creates the price at which I have to buy the services for the customer. There is also a default retail price, which is the maximum that I can charge the customer for the services that we provide.

The wholesale tariff is my starting point with a customer and the maximum that I can charge them is also regulated. That has created fairly flat pricing for customers. Look at what happened in other sectors and you will see that customers have benefited from quite a level pricing structure over the past five years. However, as I said, 70 per cent of customers are now benefiting from lower prices than if competition had not been introduced. How do I define it? It means that they have come off the default retail tariffs. Within the rules of engagement—the wholesale price that has been created—our job has been to try to help customers to reduce what they pay from those default retail prices.

However, we have done a lot of other things for customers. The last thing that someone in a corner shop who is trying to serve their customers wants is to be talking to their water provider when there is a problem. We have created electronic bills and, through electronic means, enabled customers to communicate with us at a time and location that suits them. That reduces the time that customers have to spend using water.

Where possible, we have introduced smart meters for customers. That gives them access to real-time information on their usage. Many of the costs are fixed for smaller customers and their consumption is less, but the smart meters help a large number of customers in Scotland to identify when, why and how they use water. We can then help them to use less.

I would like to think that the solutions that we have created will help all customers, to differing degrees.

Ronnie Mercer: Mark Powles has an engineering solutions team that goes to sites—not to corner shops—and finds out how the companies could use less water and reduce their effluent discharges. That is for more commercial and industrial customers rather than those on the high street, for example.

Alex Johnstone: Mr Mercer, we heard in your opening remarks about the target for the overall performance assessment being exceeded—it is clear from the numbers that it has been exceeded comfortably—and you spoke about being in the top quartile when compared with English companies. Will you tell us more about where you are in relation to English companies and about the areas where you will need to make additional efforts to match the very top performers?

Ronnie Mercer: I ask Peter Farrer to respond, but we should remember that a body can slide backwards on the OPA. If, for example, a massive failure occurs at a big sewage treatment works, a body can find itself down the greasy pole fast. As a result, we have to work at keeping our place, but we plan to stay where we are and indeed catch up.

Peter Farrer: Mr Johnstone is right—this year, we achieved an OPA score of 368 against our delivery plan target of 338, which is a 9 per cent outperformance, and we made significant improvements in areas such as environmental pollution incidents. We got additional points for hitting our economic level of leakage target a year early. We also reduced the number of properties where burst pipes had interrupted the water supply and improved pressure to about 900 other properties. All those measures helped us to outperform this year's target.

It is worth noting Ronnie Mercer's comment in his opening remarks that our target for the coming regulatory period SR15 was to move to the upper quartile in performance and, as we move through this year, we are on track to hit that. That is particularly satisfying because we started the journey as the UK's lowest performer with costs that were among the highest. We are turning that round to become one of the highest performers at the lowest cost, and things are progressing this year in the same manner as they progressed last year.

You asked about England and Wales. Our targets for 2010 to 2015 were based on benchmarking with the English and Welsh companies. However, they no longer measure the OPA in their performance measures and have moved on to something different. Although we have lost that link, we are focusing on the journey that we have been on and the fact that, if we get over 380 points, we will get into the upper quartile and be part of the leading pack. Our aspiration is to continue on that journey and to improve as we get to the end of this period and into SR15.

Alex Johnstone: Ministers set 12 targets that you have to meet by 2015. You have mentioned some of them but, broadly, what progress are you making against the 12?

Douglas Millican: We are generally progressing well across the range of targets and we expect to fully meet the expectations that ministers have placed on us. We are also outperforming in other areas. Some of the objectives that we were set required us to carry out significant study work to ensure that we understood the issues well before we made any investment.

For example, one of the major objectives in this regulatory period is to improve intermittent discharges in the Clyde and its tributaries and to alleviate sewer flooding incidents. That is a major programme of works and, to ensure that we design the most appropriate solutions, we have carried out study work and launched an investment programme of about £250 million.

Some of those works will be completed by 2015, while others will extend beyond that date, but that is absolutely consistent with one of the main objectives that ministers have set for us—it is another example of where Scotland is leading the way in the UK—which is of smoothing investment delivery across regulatory cycles to avoid any boom and bust in activity in the construction sector. Typically, in a regulated investment programme, some activity starts before the period in question, the bulk is delivered during the period and the rest is completed at the start of the next period.

Overall, we are absolutely on track to deliver ministers' expectations for this period.

10:45

Alex Johnstone: In his opening statement, Mr Mercer mentioned that the number of complaints is down by 35 per cent. The figure that I have extracted suggests that the number of written complaints is down by 34 per cent. Are we talking about the same figure?

Ronnie Mercer: I was talking about Business Stream.

Alex Johnstone: The figures are just similar; we must not get confused.

Ronnie Mercer: Yes.

Alex Johnstone: The number of written complaints is down by 34 per cent over the year. Are figures on written complaints difficult to compare? Has the number of complaints fallen across the board or are fewer people writing to you?

Ronnie Mercer: People write less and email more. I think that Peter Farrer can deal with what is meant by the term "written complaint".

Peter Farrer: The decrease in complaints is a result of our focus in this regulatory period on putting customers at the heart of everything that we do. We have put a significant focus on improving customers' experience of everything that happens in our business.

In the regulated business, the number of formal written complaints was down by 34 per cent this year. The figure represents less than 0.1 per cent of connected properties. It is satisfying for us that that journey is continuing. Back in 2006-07, when we started measuring complaints properly, we had more than 6,000 complaints. The current level of complaints is about 65 to 70 per cent less than when we first started measuring complaints, so there has been a big decrease.

Written complaints cover formal written letters and emails, so all are measured. We have a standard measurement, which we compare against English and Welsh companies.

Alex Johnstone: You are saying that written complaints include those coming in by electronic means.

Peter Farrer: Yes.

Alex Johnstone: There are no disguised figures simply because people do not write as often as they used to.

Peter Farrer: No. There is a correlation between those figures and the number of telephone contacts, which is down by 24 per cent this year. That indicates that we are doing things right in the business because, if we prevent problems from happening, customers do not need to phone us.

As I said, the number of telephone contacts is down by 24 per cent. In 2004-05, when we started measuring the figures in earnest, we had 850,000 calls a year to our contact centre. That figure is down to fewer than 350,000 calls. Again, that is satisfying for us because it indicates that we are doing things correctly and preventing problems from impacting customers in the first place.

Alex Johnstone: You mentioned the number of complaints that you receive. How many of them were satisfactorily resolved?

Peter Farrer: We put in place a new service review team a couple of years ago and we have increased the skills in that team to ensure that we deal effectively with customer complaints. Our measure of whether complaints are dealt with effectively is whether they are escalated to the Scottish Public Services Ombudsman.

The trend is encouraging. This year, 24 complaints were referred to us from the ombudsman, which was down from 44 last year. That trend is continuing into this year and, halfway through the year, only seven complaints have been referred to us. If we look back at the history, when second-tier complaints used to be referred to Waterwatch Scotland—it dealt with such complaints before the SPSO took on the role—there were 365 referrals. The decrease in numbers indicates that the service review team is managing complaints effectively.

Alex Johnstone: My final question was going to be the standard final one, about what Scottish Water is doing to further reduce complaints. However, against the backdrop that you have described, it must be difficult to reduce complaints further. What are you doing to try to achieve that difficult objective?

Peter Farrer: Our strategy for the customer experience and complaints is based on two main streams. The first is about being more proactive in how we operate and maintain our assets so that we prevent problems from impacting on customers in the first place. If we have no impact on customers, we do not get complaints.

The second part of our strategy is that, when things go wrong—given our asset base, with thousands of treatment works and many thousands of kilometres of pipes and sewers, things do go wrong—we will respond in a way that leaves customers with a smile on their face, even though there has been a problem. That is another big driver for reducing the number of complaints.

You are right that, as the number of complaints goes down, we have less to focus on. Our big focus now is on how we improve customer satisfaction with every experience that customers have of Scottish Water. We measure that regularly. For every contact that involves a customer having a piece of work done, we survey the customer to find out how satisfied they were with the experience from Scottish Water. We have seen a significant increase in satisfaction over the years. A few years ago, we were at 63 per cent satisfaction with the response that we gave customers when they required a piece of work, but we are now up to 90 per cent satisfaction.

Even though we are at 90 per cent, we do not rest on our laurels, as Ronnie Mercer said. That is a high level of performance. In comparison with the utility sector and public services, we are right at the top. In the future, our focus will be on targeting the levels of experience that customers get in other sectors. The online retail sector and the retail sector more generally have the highest levels of customer satisfaction. We do not want to be the best of the worst, which is where the utilities and the public sector sit; we want to target the best. We are setting that out in our plan for the future. We want to get our customer experience levels up to the levels that customers expect from other sectors.

The Convener: As there are no more questions on that subject, we will move on to climate change and sustainable development.

Mary Fee: In the past five years, Scottish Water's operational carbon footprint has decreased by about 10 per cent, and carbon emissions are reducing. How do you intend to further reduce greenhouse gas emissions in the coming years?

Douglas Millican: It is worth giving a bit of context on the drivers of energy use, which is the principal driver of carbon emissions in our business. In the water system, we have the lowest carbon intensity of any water company in the UK. In part, that is down to the work that we have done on reducing leakage, but it is also because of our good fortune that those who preceded us laid a lot of gravity-fed water supply systems, which mean that we have less pumping to do than is required in England.

Conversely, we have one of the higher intensity waste water services, although not the highest. That is a function of Scotland's geography. We have 2,000 treatment works, which all serve local communities. Quite a lot of energy is involved in pumping waste water to those treatment systems. Those are the drivers of energy use in our business.

Over the past 10 years, one factor that has inherently caused an upward demand for energy and has therefore increased carbon emissions is the enhanced treatment that has been required. That applies partly to drinking water quality and particularly to waste water treatment. It is worth the committee understanding that, in our drive to improve the quality of discharges to the aquatic environment to meet European Union standards as reflected in Scottish law, where previously there was no treatment or minimal treatment, we now have much more sophisticated treatment, which consumes carbon. We have been fighting an upward trajectory.

Nonetheless, as you highlighted, we have taken some really good steps. We have made a 10 per cent reduction in carbon consumption in the past five years, which has been largely down to the work that we have done in reducing leakage in the water system. In many cases, we have changed the equipment that we use—for example, pumps and motors—for more energy-efficient equipment. All the time, we are looking at how we can optimise the way in which we treat our waste water to give a double benefit of reducing energy and carbon usage and reducing costs and customers' bills.

When we look ahead, our first challenge is to minimise the upward demand on energy for, say, future waste water treatment. Beyond that, we will fully explore the potential for using the most energy-efficient pumps and motors; and we will look at where we can vary the speed at which motors drive and, therefore, the power that they consume. We also try to take full advantage of the opportunity to generate renewable energy, and the most efficient way of doing that is to generate energy for use on site, which displaces energy bought from the grid. That provides the biggest benefit from a carbon angle. There are a number of strands to our future intent.

Mary Fee: You talk about minimising the energy that is used in treating waste water. What is the impact of that on the customer? Does that provide better service?

Douglas Millican: The primary benefit of the upgrades that we have made in waste water treatment is a huge benefit in the quality of waste water discharges to the local environment, whether to local burns and rivers or—as in the case of Edinburgh—to the Firth of Forth. That benefits the whole marine environment, and it is a benefit to customers as users of rivers and beaches.

Mary Fee: In your annual report, you say that your carbon footprint is being reduced despite investment to meet statutory quality enhancements. You have talked a bit about that. Is that a constant battle? Do you use a lot of energy to produce those enhancements? Are you balancing those high emissions against lower overall emissions?

Douglas Millican: There are three things to mention from a historical perspective. First, there is no doubt that upgrading the quality of our treatment—particularly our waste water treatment—inherently drives a big increase in our energy demand. However, when we are faced with a scheme to upgrade in a community, we endeavour to find the most sustainable way of delivering that scheme in all its various dimensions, which includes minimising the use of energy and therefore the scheme's carbon emissions. We try to mitigate the upward pressure on energy demand.

Secondly, once a scheme is up and running, we look at whether we can optimise further the way in which energy and chemicals are used at the site, as chemicals are a further driver of carbon emissions. Thirdly, across all our existing asset base, we continually wrestle with how we can drive reductions in energy usage and therefore carbon consumption through radical changes or fine tuning.

Mary Fee: I want to talk a bit more about leakage. You state in your report that you have

"reached the Economic Level of Leakage"

in your network. That still means that over a billion litres of water leak from your network on a daily basis, and I struggle to understand how a leak of a billion litres of water can be economic. How are you going to manage leakage going forward?

11:00

Douglas Millican: I will explain the context and then let Peter Farrer give you the specifics of how we are going to do that.

The economic level of leakage is a calculation that can be done at any point in time, and that level can change over time. It represents the optimal point at which it would cost more to fix leaks than the value of saving that water. In a zone in which there is an abundance of water supply, it is very much about just trading off the cost of finding and fixing leaks and the cost of the water that is saved in the water production. However, in a zone in which the capacity of the treatment plant or the water supply is more up to the limits, the economics of driving leakage lower can be very different, because a major capital upgrade can potentially be saved.

If we look on a longer-term basis, the calculation changes, because it is clear that supply and demand in a particular zone can change over time as a result of, for example, new economic development or housing growth. They can also change as a result of changes in energy prices. Broadly, we would expect that, over time, the economic level of leakage will drop as energy prices rise—most forecasters expect that they will rise over time—because energy is the single biggest driver of the cost of treating water.

I will hand over to Peter Farrer, who will explain what we will do practically to drive down leakage.

Peter Farrer: It is worth putting the matter into context. Mary Fee is right that we have reduced leakage, by another 54 megalitres per day in 2012-13. The figure of a billion litres that she mentioned is not correct—that was where we started the journey. The leaked water target is between 570 and 600, which is the economic level, and we have outperformed that.

We have reached that position in six years, which is good in relative terms. It took the English and Welsh water companies 15 years to get to their economic level of leakage. We are, of course, learning from some of the things that they did in the early stages. They have helped us, but we are pleased to have got there as quickly as we have.

As Douglas Millican mentioned, the economic level of leakage will change. We have already considered a refresh of the level. As the marginal cost of water goes up because of energy and chemical prices, and the cost of our finding and fixing leaks goes down as we get more innovative, smarter and productive at doing that, the economic level will reduce. It is likely to come down a fair bit from the 600 figure.

The things that we are doing to focus on achieving that economic level include pressure management, which is a good way of reducing the pressure in the network. It stops leaks and has the added benefit of preventing burst pipes. That prevents interruptions to supply for customers, so it has significant customer benefits.

We are looking at more innovative detection methods to find leaks. As time goes on, people in the industry are finding new ways of using equipment to find underground leaks, and that will continue to drive our reducing levels of leaks.

Those are the main things that we are doing. It is a matter of working on the use of equipment, finding leaks more effectively, pressure management and reducing the economic level of leakage.

Mary Fee: You said that 600 is the correct figure for the economic level of leakage. Six hundred what?

Peter Farrer: Megalitres per day.

Mary Fee: What is a megalitre?

Peter Farrer: A million litres.

Mary Fee: That is fine. I just wanted to be absolutely sure about that. That is what I presumed it is.

Peter Farrer: Since we started on the leakage journey, we have reduced the amount of leakage by around 500 megalitres per day. To put that into context, that is the equivalent of the volume that is supplied to the whole of Glasgow and greater Glasgow on a daily basis. Back in 2006, that amount of water was leaking out of our pipes. We have now stopped that leakage throughout the country.

Mary Fee: I imagine that you have a rolling programme of upgrades and maintenance, but it sounds as though the system is leaking like a sieve. Do you fix a leak and another leak appears, or are things not as simple as that?

Peter Farrer: They are not quite as simple as that. That sometimes happens, but it depends on a number of things. Pressure management is the key. If a system is under stress and a leak is fixed, that can increase the pressure because it blocks something that was naturally reducing it. Therefore, we have to carry out find-and-fix activities and pressure management at the same time. As we find more leaks, we can use the pressure-reducing valves to reduce the pressure in the network to get a calm network. It is complex. We have more than 200 leakage zones, and every zone has different anomalies—there are different things that we would look at for each zone.

Ronnie Mercer: As well as leaks, there are weeps and seeps. Weeping and seeping at joints are not things that we can necessarily see. You might imagine that we would be floating away, if you say it quickly. It is a good question, and it is difficult to explain, which is why my colleagues are explaining it, not me.

Mary Fee: I know that this does not happen often in Scotland, but we are occasionally told not to water our gardens or wash our cars, and to be careful with the amount of water that we as customers use. What impact does the amount of water that we use and the amount of water that leaks from your system have on the price that we pay?

Douglas Millican: In the short term, it is quite a limited impact. The principal reason is that, if we drove down leakage significantly below the economic level of leakage that we are now at, paradoxically, that would start to increase costs rather than reduce them. We would be spending more on finding and fixing the leaks than the value of the water saved.

The real benefit of pursuing water efficiency is the savings that customers can make in their energy bills. It is estimated that about 25 per cent of the energy that is used in the home is to heat water. If customers think more about using water wisely, there is a saving in the amount of water that we need to produce, and there is a direct personal saving to the customer in their energy bills.

Mary Fee: I accept that. I am sure that you must also accept that, given the amount of leakage every day, it is a bit galling to customers to think that our bills are X, and we are doing what we can, yet you are leaking all that water from your system on a daily basis.

Douglas Millican: We are trying to take a customer-centric approach. Leakage was one of the areas that we explored in depth with customers as part of our customer research activities for the 2015 to 2021 period. Typically, we got a group of customers together in a room for sessions that were independently facilitated and exposed them to all the different dimensions around leakage, just as we have done in the past few minutes.

Two different things came out of that. Generally, once customers understand the concept of the economic level of leakage, they do not want us to pursue something that might add to their bill. It came out strongly that customers are intolerant of visible leakage such as a burst that results in water lying on the streets. They can see that—it is a visible waste of precious resources. The message that our customers have given us is that we need to get faster at fixing the visible leaks. However, they understand the economic point about the system as a whole.

Mary Fee: So ignorance is bliss—if we do not know about it, it is all right.

Douglas Millican: Absolutely not. We have teams of people who are working all the time to find and fix leaks and to ensure that we are operating the system as economically as we can in the interests of customers.

Jim Eadie: I promise that my question will be much gentler than the previous round of questions. Parts of the Water Resources (Scotland) Act 2013 are now in force. I am interested to explore what steps you are taking through your various businesses and working in co-operation with your partners to implement that act and to achieve the Scottish Government's hydro nation agenda.

Douglas Millican: The hydro nation agenda goes much broader than Scottish Water. We must play a key part in it, but it is important to remember that it is an agenda for the whole of Scotland.

There are three or four dimensions for Scottish Water. We have covered a couple of them already, including the work that we are doing to maximise the development of renewable energy. An aspect that we have not spoken about so far is what we are trying to do in partnership with major energy developers where we have landholdings on which it makes sense to generate wind. We are working in partnership to promote such schemes, some of which are up and running and others are in development. We are also doing a lot of work to maximise the scope for hydro, solar and food waste generation within our asset stock.

Jim Eadie: I have a specific question on that. You referred earlier to displacing energy from the grid. Is that work at an early stage? Can you give us numbers for what that represents in terms of energy generation and income saved to the business?

Douglas Millican: There are a few dimensions to that. There is energy that we generate on site that can displace bought-in energy and there is renewable energy that we might generate in our asset base but which we do not need to consume at that point, so it gets exported to the grid. If we combine those two elements, they amount to about 22 gigawatt hours of renewable energy that is currently being generated. Our expectation is that over the next two to three years that will broadly double. By the end of the 2015 to 2021 period, depending on where we get to in agreeing our business plan, we hope to increase our overall self-generation capacity to about 75 gigawatt hours, which will be about 15 to 17 per cent of the energy that we need to consume.

Jim Eadie: That is a helpful clarification. What time period do you envisage for that shift?

Douglas Millican: We hope to be up to 75 gigawatt hours by 2021.

Jim Eadie: Thank you. Sorry, I did not mean to interrupt you, but it was useful to clarify that point.

Douglas Millican: No, that is fine. In terms of the total quantum of energy generated, the biggest step change is what can be done from wind. For example, we have a scheme in which land was made available for wind generation, which is already generating 350 gigawatt hours. I hope that, by the time that we are here again next year, other such schemes will have obtained approval. However, I am sure that the committee will understand that that can be quite a long and complex process in which success cannot be guaranteed.

Jim Eadie: On implementing the 2013 act and the wider agenda, do you have anything further to share with the committee?

Douglas Millican: The other main area to highlight is our consideration of what we can do to give further support to sustainable rural communities. We talked earlier about the high energy intensity of some of our activities, particularly the waste water side. There can be a lot of cost and energy associated with supporting a local community. We are doing quite a bit of research work in partnership with others to see what we can do to support sustainable rural communities and whether there are ways of having more local generation of energy and local supply of water and waste water that is consistent with the hydro nation agenda.

One of the broader themes of the hydro nation agenda is how we work in partnership with others. We are increasingly going in that direction of travel. A few years ago, we were very much about what Scottish Water would do as a self-contained business. We will probably discuss this when we look at plans for the future, but our approach is increasingly about how we engage with third parties to deliver the most sustainable solutions for people in Scotland.

The Convener: Finally, as we have you here, I think that the interested public would find it remiss of us if we did not mention the publicity that you attracted earlier this week in terms of oil and water. We know that they do not mix—sorry about the pun—but what is your take on the situation with the pipe from the Kirriemuir sewage works to the River Dean and the BP Forties pipeline?

Douglas Millican: The scheme is being developed to upgrade the quality of waste water treatment and discharge in the Kirriemuir area. One dimension of the scheme, which we have experienced on many previous occasions, is that the path of the sewer needs to cross major national infrastructure such as oil and gas pipelines. In that situation, we need to agree with the relevant energy companies the method by which we will cross those pipelines and the way in which they will supervise the crossing. That is all wrapped up in a pipeline crossing agreement, and we are basically there. All the method statements have been agreed, and the work when it happens will be supervised by engineers from the energy companies. The pipeline crossing agreement is effectively ready for signing.

The Convener: Will there be any loss of assets or money because of the delay in the scheme?

Douglas Millican: Absolutely not. All the preliminary work that is necessary for the scheme to progress has been done. We now need to get the bit in place where the sewer crosses the oil and gas pipelines.

The Convener: Has that involved lawyers fighting it out?

Douglas Millican: We have not had any lawyers fighting it out. We have been dealing purely with the major energy companies, as you would expect us to do, to ensure that we protect our interests while they seek to protect theirs. The crucial element is to agree the technical details and technical method statements with regard to how the pipelines will be crossed in a way that safeguards that important national infrastructure.

Ronnie Mercer: It is true to say that we have been doing this for years. I could not give you a number, but we have dealt with hundreds and hundreds of similar situations. Sometimes, events change attitudes a wee bit, and the BP Gulf of Mexico incident has perhaps made us take a harder look now—that is real life. We have to take that into account, which we have done, and we are now proceeding.

The Convener: Are you saying that the time that has been taken is normal?

Ronnie Mercer: No, I would say that the time taken on the scheme has been a wee bit longer because there was a bit more difficulty in getting agreement due to events elsewhere. That is now done, and we are proceeding.

The Convener: Thank you. As there are no more questions on the annual report, we will take a short pause before we move on to questions on the strategic review of charges.

11:17

Meeting suspended.

11:22

On resuming—

Water Charges and Procurement

The Convener: The second item of business is further evidence from Scottish Water representatives, this time on the "Strategic review of charges 2015-21". The session will include questions on Scottish Water's engagement in the process, including its related draft business plan from 2015 to 2021.

We will also take the opportunity to ask Scottish Water about its procurement activity, given our current scrutiny of the Procurement Reform (Scotland) Bill.

I again welcome Douglas Millican, chief executive; Ronnie Mercer, chairman; and Peter Farrer, chief operating officer, from Scottish Water; and Mark Powles, chief executive officer of Scottish Water Business Stream.

Perhaps Ronnie Mercer would like to make a short statement.

Ronnie Mercer: I will take just a couple of minutes—thank you, convener.

Scottish Water is very keen to build on the successes of our unique public sector model and to progress the interests of our customers within that. The model is largely different from the model in the rest of the UK, but we think that it is working quite well.

We are trying to embed in the business the efficiencies that would be made in a private company; the productivity that we want and the commercial edge that we need when we spend the money that we do; and the customer service that our customers deserve.

At the same time, we are trying to achieve the outcomes set by our owner, which is the Government, to meet all its directives, and to recycle any gains that we make in the business from beating the regulatory contract back into the business instead of sending them off somewhere else. We are really keen to make that work.

We have just held our largest ever consultation, "Your views count: shaping the future of water and waste water services", to decide what our strategic projections might be and what those services will look like over the next 25 years.

We have conducted pretty extensive research, we have been heavily influenced by customers, regulators and stakeholders, and we have a customer forum. Peter Peacock, lately of this parish, is heading that. I met him a couple of weeks ago at a seminar and he asked, "What's keeping you busy, Ronnie?" and I said, "You are, Peter." His forum has had a big input, but that is what we wanted, and I hope that we will make that work for us.

We have recently published the strategic projections for what might happen over 25 years, and we have just produced a draft business plan for the six years that you mentioned in your opening remarks, from 2015 to 2021. I am now focused on what we are going to do about that, and we are due to meet the regulator at the beginning of December to start the process. The process will be quite long as a lot of discussion will be required before we eventually agree a final plan, which should serve the best interests of the customers and the long-term requirements of the industry with prices that are affordable.

What are the key messages that we get from customers' input and from the customer forum? First of all, they tell us that we cannot compromise the existing service levels; nobody is going to accept anything going backwards. They rightly expect that they will always have a safe and reliable supply of water and that their waste water will be taken away and dealt with properly, so that is a given. They are looking for further improved services, but they do not want large price increases to go with that, so we must ask what we can do for fairly modest increases.

We have looked at that input, and we think that we can commit ourselves to reducing charges in real terms and limiting further charges to less than the rate of inflation for the six-year period that has been mentioned. That is where we have started as the basis for the plan.

Looking to the future, we want to be operationally proactive on preventative measures. We have just opened a new intelligent control centre, which takes in messages from all over Scotland using telemetry, alerts and alarms, and tries to seek out and prevent problems from happening rather than merely responding—although of course we have to be responsive if something happens.

We expect that capital spending will remain at around £500 million, at 2012-13 prices, to cover increased capital maintenance and to invest in services. That includes investment to address flooding from the sewers. There will be a bigger emphasis on that issue, as it is one of the things that customers stress heavily to us.

Improved resilience in the water network is something that has already been asked about. It is strange that in a country where it rains a lot we sometimes have to issue warnings about not washing cars, but that happens. We have to manage or move water resources more effectively, even in Scotland, to meet customers' needs.

Based on our partnering experience in Glasgow, via the long-named metropolitan Glasgow strategic drainage partnership—not an easy trip off the tongue—where £250 million is going to be spent, we can achieve better outcomes at lower costs. Significantly, the best £10 million of that £250 million was spent before we started, on measuring, modelling and studying all the things that happen, so that we did not waste money by starting and then realising that there was input somewhere else in the system. That work is all being done, so we can build on it.

What I have just mentioned is to do with Scottish Water. For Business Stream, we anticipate increased competitive pressure; that is a given. The Westminster Government's new legislation and reforms are going through, and there is a significant opportunity for Business Stream, because there is a £2 billion market that we can try to get a bit of—and we would like to think that we can do that. Mark Powles has already said that the situation is not quite level at the moment; we have an open market and England and Wales do not, but that will change and we must try to hang in there until it happens.

Business Stream has created a pretty strong brand. The strategy right now is to defend it up here and to get into position—we could have a first mover advantage, having been in the market for years before everybody else, which I hope will work for us—while trying to maintain the customer experience. That is generally what Business Stream is trying to do.

I hope that those comments give members some insight into the future of both Scottish Water and Business Stream and what they will try to tackle over the next six years of the plan.

The Convener: Thank you. Jim Eadie will start off the questions.

Jim Eadie: Let me say at the outset that I represent an Edinburgh constituency and my experience confirms what Ronnie Mercer has just said about Scottish Water being influenced by its customers. Mr Farrer is aware of the background to the issue, and I put on record my appreciation for the constructive discussions that we have had, which I think will deliver a very positive outcome for my constituents very soon.

Let me ask about the timeline for the strategic review. When between now and April 2015 can we expect new charges to take effect?

11:30

Ronnie Mercer: The new charges will start in April 2015 and we give ourselves the next year—2014—to prepare, although we hope that we will not need as long as that. It will be a bit of time, but I am not quite sure how long at the moment. What do you think, Douglas?

Douglas Millican: We issued our draft business plan at the end of October, which has gone to all stakeholders to consider, but primarily to the Water Industry Commission for Scotland, the quality regulators and the customer forum.

We hope to agree a business plan with the customer forum by February 2014. If we manage to do that, or even if we do not, in April 2014 the Water Industry Commission will issue its draft determination of charges, which will be its view of charges. That will be open to public consultation until June. Over that period, we expect the Scottish ministers to confirm their investment objectives, their charging principles and the level of available borrowing.

The Water Industry Commission will then be able to take all that into account, including the consultation feedback on the draft determination, to produce a final determination of charges that will be published in November 2014. As Ronnie Mercer mentioned, charges will apply from April 2015 onwards.

Jim Eadie: I will come to the detail of the business plan, but I will stay on the process for the moment. Has there been any input on the development of the business plan? I know that you are saying that you are about to consult and engage in an extensive consultation period. However, have the Water Industry Commission for Scotland and the customer forum been involved at the initial stage?

Douglas Millican: There has been huge involvement from many parties. It may be worth me taking a couple of minutes to explain what has happened.

The first step was that the Water Industry Commission launched a review of how regulation of the Scottish water industry could be enhanced. It focused on three themes. First, did the commission need to review how incentives operated on Scottish Water and the parties in the industry to drive the best outcomes for customers? Secondly, how could much greater levels of innovation be brought into the plans that Scottish Water comes up with? Thirdly, how could customers be much more involved in creating the future of water services?

That three-pronged approach has driven a major programme of work. The first stage was to produce a draft of the strategic projections, which was published in October last year. The production of that draft was very much informed by working with the customer forum and other stakeholders. The draft went out to public consultation. We also had the your views count exercise for customers that Ronnie Mercer mentioned, through which we received a lot of feedback in the period to February this year.

We then worked extensively with the parties that you mentioned, particularly the customer forum, when we were shaping up the draft of the business plan that we published. For example, over spring and early summer this year we produced a series of service improvement reports that set out, for an area such as drinking water quality, the nature of the current service provision, the nature of future challenges and the options that are available for meeting those challenges and the degree of choice that customers have over them. That has informed very much our drinking water quality improvement plan, which is partly about meeting statutory requirements but also about meeting customers' expectations for and trust in the reliability of the drinking water service.

The plan absolutely reflects the huge amount of feedback that we have had from stakeholders and the extensive customer engagement programme that we have carried out.

Jim Eadie: That is very helpful.

How have you involved Scottish Water customers when developing the plan and do you intend to continue to involve them as the plan is rolled out? I am thinking specifically of the investment plan, which will be updated on a rolling, three-year basis.

Douglas Millican: There have been many dimensions to our involvement of customers. I draw the committee's attention to the draft plan on pages 5 to 7, particularly page 5, which sets out a summary of all the dimensions that we have used. They range from having groups of customers sitting in a room for a two-hour facilitated conversation, through to having surveys done in which customers can engage online.

We have built on the extensive feedback that we get from customers as part of their normal engagement with us on services. The customer forum has done its own validation of that research. We have a multiplicity of channels.

It was encouraging that there was a huge degree of commonality of views in our research, which was validated by the customer forum. It was really helpful for us that the forum held the lens up perhaps slightly differently. For example, we might have said, "Our research shows that customers are willing for prices to rise by a little." The forum said that, while it had come to the same basic research conclusions, it had a slightly different take on them. It did not think that the issue was so much that customers were willing for prices to rise; it was more an acceptance—maybe a slightly reluctant acceptance—that to get the improvements that customers wanted prices would probably need to nudge up a bit. It is because of such nuances of customer feedback that we are really beginning to understand what matters to customers. That is for now.

For the future, and the investment review update in 2018, we believe that we have a pretty good understanding of what some of the key areas of investment focus will be, but we will engage with customer groups, the forum if it continues and the consumer representative bodies as well as customers directly, to understand whether we need to adapt those plans, depending on what happens over the next three or four years.

Jim Eadie: That is very helpful.

Finally, will you share with the committee what you see as the key challenges facing Scottish Water across the range of issues that you are engaged with, as set out in the business plan?

Douglas Millican: At the very highest level, one of the challenges will be to meet customer service expectations for the lowest possible cost. That is the crux of it. As Ronnie Mercer mentioned in his opening remarks, customers take for granted the reliability of the service, and we need to invest to maintain that basic service provision.

There are a number of areas in which customers would like us to make improvements to deal with issues such as sewer flooding, drinking water quality and improving the resilience of the system so that they will never have to suffer an extended period of supply interruption. However, they want us to do that in a way in which price changes can be held below the rate of inflation.

Jim Eadie: On the increased competitive pressure that you spoke about earlier, what do you see as the key threat or challenge facing Scottish Water?

Ronnie Mercer: Scottish Water Business Stream now has 12 more competitors. There is nowhere else to go at the moment except here, because the market is not really open in England and the little bit that is open has no margin. That is why nothing is changing hands.

If I were the English water companies, I would be up here learning so that, when the market opens there, I can defend my own patch and maybe try to attack someone else's. We are getting them flooding in—to use a pun—because they are looking both to get some business up here and to get used to the whole idea.

Would you like to add anything to that, Mark? You are having to defend it all.

Mark Powles: That is what competitive markets are all about. If the service is not very good, the customer will go elsewhere. As Douglas Millican said, in the core business it is about service and price, and—I would add—innovation. A lot of customers make a price decision and others make a decision based on service. However, others make a decision based on how proactive and innovative a business can be in solving their problems.

What we have tried to do over the past five years is to recognise customers and their individual needs. For example, the needs of a multisite retailer are very different from the needs of a council. We are starting to tailor services to customers.

There is nothing like the fear of losing a customer to get you to raise your game. I spend most of my time looking over my shoulder wondering whether somebody is going to do something that we have not thought of. That drives us to try to do more.

The benefit for Scottish customers is that we stay focused on doing great things for them, and another benefit is that we can take those propositions into new markets as they emerge. The fear of losing a customer is a great motivation for us to wake up and be on our game in the morning.

Adam Ingram (Carrick, Cumnock and Doon Valley) (SNP): I am sorry that I missed your initial presentation, gentlemen, but I have been very interested in what you have had to say. I will ask about some of the financial issues. Given the investment needs that are set out in the draft business plan, I would be grateful if you could specify exactly what the plans that you have talked about to limit household bill increases to less than inflation mean.

Douglas Millican: Historically, utilities across the United Kingdom have referenced inflation using the retail prices index. One dimension that came from our customer engagement, particularly the customer forum, was a recognition that, for customers, it is no longer the RPI that is recognised, because things such as benefits and the state pension are now linked to the consumer prices index. Our commitment on prices relates to below-inflation increases relative to the CPI, which is a first in the utilities sector. If we looked at the issue in the traditional utility way—relative to the RPI—the price increase in our draft plan would be about 6 per cent below the RPI across the six-year period, whereas it is just a little below the CPI.

On the affordability of the plan, we have tried to work on an iterative basis. We have tried to understand what matters to customers on service and price, and we have looked at the likely borrowing that will be available from the Scottish Government. We have tried to come up with what we believe is an optimum package and to find the optimum point between expectation for service improvement and what customers say that they are prepared to pay. The plan is in draft form, and we will discuss it with the customer forum. Ultimately, we might come out with a slightly different answer.

Adam Ingram: My understanding is that the draft business plan requires £720 million of new borrowing from the Scottish Government. You have mentioned the importance of that borrowing. How does that compare with the current control period, and what discussions have you had with the Scottish Government on the subject?

Douglas Millican: In the current period, which is a five-year period compared with six years for the new period, we started with an expectation that we would require £700 million of borrowing. Due to a combination of three factors, that has now reduced to, I think, £485 million. First, there have been beneficial factors in the broader economic environment, such as reduced construction prices. Secondly, there is our performance improvement beyond the targets that were set in the regulatory determination. Finally, because of the practical phasing of delivering our big improvement programme in Glasgow, it will tail into 2017, which means that some of the resources for that will be required in the 2015 to 2021 period.

Broadly, in the current period, the average is about £100 million per annum. In the next period, that figure will rise slightly to £120 million per annum. We had discussions at official level with the Scottish Government, which agreed that that is a reasonable planning assumption to use, and I think that that was reflected in the draft budget that was published back in September.

Adam Ingram: I seem to recall that, in a previous budget, the Scottish Government took back from you money that you did not need. What happened there?

Douglas Millican: The borrowing allocation was reduced on a number of occasions over the period. That has taken us from the £700 million that we started off with to the current £485 million borrowing amount. That decrease is a function of the three factors that I mentioned in answer to the previous question.

11:45

Adam Ingram: Okay. That is fine. The review of charges will have implications for the charges that are levied by Business Stream. How has it engaged in the review and how is it planning to deal with the eventual outcome?

Mark Powles: We do a lot of on-going research with our customers to understand their views and attitudes. We analyse customer contacts to look for any areas where they are having problems or in which they want investment, and we feed that into the process. In addition, one of my board members sits on the customer forum and he not only feeds into the plan but consults and challenges Scottish Water on the needs of business customers.

Like you, I am interested to see the outcome of separation and the impact that it will have on business customers, but we have been actively engaged throughout.

Douglas Millican: We have been seeking to understand the views of all licence providers. From our perspective as a wholesaler, the 12 intermediate licence providers are important customers. Business Stream is one of those providers, but the other 11 are important, too. It is also important to understand the views of the ultimate end customers or users of the products that we supply.

The customer forum is made up of members who are there to act on behalf of householders' interests, but in addition two members act on behalf of licence providers—Mark Powles mentioned the member from Business Stream, and another major licence provider is also represented. They make sure that the voice of business is heard as well as that of householders.

Adam Ingram: How do you intend to take the long-term strategy forward? How will you monitor and review the implementation of your long-term plans?

Douglas Millican: As a business, it is fundamental that we make investment decisions for the long term. Publishing a 25-year strategic projection is a major step forward to make sure that, as far as one ever can, we have the best possible understanding of the longer-term context and the opportunities and challenges over that time horizon so that, when we are making nearer-term investment decisions—typically on pipes and assets that might last for 20, 50 or 100 years—they are rooted in the best possible understanding of that longer-term context. That is why we did the 25-year plan.

It will be important that we keep our forward scanning up to date so that when, for example, we come to our investment review in 2018 and particularly the price review in 2021, we take a fresh update to the strategic projections and roll those forward for 20, 30, or 40 years beyond 2020. There are so many uncertainties and opportunities over that time horizon. The only certainty is that a lot of our assumptions will be wrong. However, that thought process gives us the best possible chance to have a really good understanding of the future and improve the chance of making the best possible investment decisions for the long term.

Adam Ingram: Do you have anything to add, Ronnie?

Ronnie Mercer: I will add one thing. England and Wales will go through the same process at the same time. In the past, some of the providers have had inflation-plus plans. We get good constructive feedback from the people we talk to about what we have put in, such as the regulator and Peter Peacock's team. They do not just give us a view on what they want; they also give us a firm view on what they do not want.

You may have seen recently that the biggest company in England tried to increase its prices so that it could build a big tunnel, but it was told that it could not have that. I think that it will go into an inflation-minus set-up as well, which will be different from before. Another aspect is the public mood, as it is clear that utility bills are a big part of people's spend. We do not see whether those companies have detailed plans, but we are keeping an eye on what they are doing, and that is where they are.

Taking a step back from all the work that is being done, I am comfortable that we are in the right place. No doubt there are several months of debate and negotiations to come, but we should not be out of kilter with what they might be encouraged to do—I was going to say "forced into doing"—down there.

The Convener: That is helpful. The committee plans to hear the views of the customer forum, WICS and other stakeholders in the spring, once they have made known their views on your business plan. We will find an optimum time to do that, but it will certainly be before ministers move to make their final decision.

You will know that the Procurement Reform (Scotland) Bill is before us. Scottish Water, in common with other utilities, is subject to a different procurement regime under the European utilities directive and corresponding Scottish regulations. Can you explain why utilities come under a separate regime?

Ronnie Mercer: We have in recent times won a UK award for excellence in our procurement, and we have tried to help with the formation of thinking in that regard. We have what we have. I ask my colleague to give a bit more detail on that.

Douglas Millican: On the question why utilities have a different regulation regime, the arrangement was clearly born out of measures to ensure that the procurement activities of utilities are regulated right across Europe. For as long as Scottish Water has existed, we have had to comply with all those obligations as set out in the legislation that you mentioned, convener.

Beyond that, we have endeavoured to adapt our whole approach to procurement to ensure that it best meets the needs of our customers throughout Scotland, and that it supports cost-effective and efficient delivery of our services in a way that also supports the local contractor base in various parts of the country.

The Convener: Specifically, how has it emerged over time that utilities fall under a different procurement regime from other areas?

Douglas Millican: Additional obligations are placed on utilities. I am not personally familiar with the history of that arrangement in an EU context, but I would imagine that it is about ensuring that, because utilities are there to serve the customers and the broader public through particular activities, the public interest is kept in mind.

The Convener: We have had representations to suggest that Scottish Water should be covered by the Procurement Reform (Scotland) Bill. One of the reasons is that it is publicly owned. What is your take on that?

Douglas Millican: That would clearly be an option but, from what I understand of the Scottish Government's thinking in preparing the bill, it recognises that, because we are already covered by a statutory framework and procurement obligation, there would be an inherent danger or risk of conflict—often at quite a detailed level—if two distinct pieces of legislation applied to us.

The Convener: As you know, the bill places a number of duties on contracting authorities, which include compliance with a duty of sustainable procurement, imposing community benefit requirements on certain contracts and producing annual procurement strategies and reports. Is Scottish Water already doing some of those things? Is there any reason why you should not do more of them?

Douglas Millican: Without looking at a checklist of every dimension, I can say in broad terms that we are doing those things. We continually look to evolve our procurement. As Ronnie Mercer said, we have been recognised as having a world-class approach to procurement. We have been awarded gold certification by the Chartered Institute of Purchasing and Supply and I understand that we are the first organisation in Scotland to have achieved that standard.

However, as with everything else to do with Scottish Water, we will never rest on our laurels and we will continue to look at how we evolve our approach. For example, we have done a lot of work to ensure that our approach to procurement supports the youth employment agenda. More than 100 apprentices are now employed in our supply chain. We also look at how we support the local contractor base. We are increasing the use of local framework contractors in more rural areas, because that is the right thing to do to support sustainable local communities and efficient service delivery.

The Convener: That point is interesting. We have heard—I do not know whether this is anecdotal—of contractors in the central belt getting contracts that cover Dumfries and Galloway and the Highlands and of people running up and down the country in white vans because they have forgotten the right bit of equipment. What you say about using local contractors is interesting. Will you confirm that that is the case? I think that a recent round of contract awarding has made things a bit more centralised.

Douglas Millican: We can look at what has happened over the years. I can look back at times when things became centralised and we awarded a lot of national contracts. That delivered a lot of efficiencies, but we also found that it created the situation that you highlight, in which a vehicle might go from the central belt for a fairly small job and more time might be spent on travelling than on fixing the issue.

The Convener: That is not sustainable.

Douglas Millican: Absolutely. As is consistent with our theme of learning and evolving, we have and will continue to put in place more rural frameworks. I will give some specifics. We now have framework agreements in the islands, as well as the north and Argyll. We are looking to roll out that approach into the Borders and the north-east. The position is continually evolving. We absolutely recognise the point that you made.

The Convener: We congratulate you on the procurement awards that you have won. What lessons have you learned from your procurement activity that might be valuable for the rest of the Scottish public sector and which we could recommend in the bill?

Ronnie Mercer: I will let the experts give the detail, but I will explain part of the reason for Scottish Water's success. There are another 10 big water and sewerage companies in the UK—nine are in England and one is in Wales. We have used them as comparators to drive costs down and service up. That is all measured by the overall performance assessment, which we have talked about, and by what the bill is.

Procurement is not very different. We drive cost per metre and cost in what we do in laying pipes and building infrastructure against what others in the industry are doing, which is a good comparator for us. If you asked me to choose, I would choose to stay in the utility comparator bit, because we are comparing our procurement not with the rest of the public sector but with Thames Water, Wessex Water, Northumbrian Water and so on. I prefer that, because I know what that is about. I can ask, “How come they are doing that for less than us?” or whatever.

However, there is no reason why we should not do most of the common activities that you mentioned—there is no doubt about that. Joe Rowan was asked to speak to the Government about what we do on procurement because of the award that we won. We tend to share heavily what we think that we are doing well.

Douglas Millican: We have done that over the years. One example is from our approach to energy purchasing. Energy is one of our biggest costs—we spend more than £40 million a year on purchasing electricity. The approach that we have taken to that for a number of years has been shared with the Scottish Government and I understand that it is now used broadly across the Government.

A lot of the procurement principles are no different from anything else in business—they involve listening to and engaging with the supply chain, working out how we can best align what we need with what suppliers need to drive out value and giving suppliers predictable demand, so that they know exactly what to plan for and can have resources at the right levels for delivering efficiently. That is about planning and prediction as much as anything.

The Convener: No one has any final questions. That has been a fair session, gentlemen. Thank you for your time. The session has been most useful for us in a variety of areas.

I suspend the meeting to allow the witnesses to leave the room.

12:00

Meeting suspended.

12:02

On resuming—

Subordinate Legislation

Road Traffic (Permitted Parking Area and Special Parking Area) (East Dunbartonshire Council) Designation Order 2013 (SSI 2013/311)

Road Traffic (Parking Adjudicators) (East Dunbartonshire Council) Regulations 2013 (SSI 2013/312)

Parking Attendants (Wearing of Uniforms) (East Dunbartonshire Council Parking Area) Regulations 2013 (SSI 2013/313)

The Convener: Our final item is consideration of three negative statutory instruments on parking matters in East Dunbartonshire. Members should note that no motions to annul have been received.

As no one has any comments, does the committee agree that it wishes to make no recommendation on the instruments?

Members *indicated agreement.*

The Convener: That ends today’s business. Our next meeting will be on 27 November, when we will take evidence from two panels on the Procurement Reform (Scotland) Bill.

Meeting closed at 12:03.

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e-format first available
ISBN 978-1-78392-153-9

Revised e-format available
ISBN 978-1-78392-166-9

Printed in Scotland by APS Group Scotland