



The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

INFRASTRUCTURE AND CAPITAL INVESTMENT COMMITTEE

Wednesday 30 April 2014

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INFRASTRUCTURE AND CAPITAL INVESTMENT COMMITTEE
12th Meeting 2014, 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:

Professor Gordon Hughes (Water Industry Commission for Scotland)

Belinda Oldfield (Scottish Water)

Peter Peacock (Customer Forum for Water)

Alan Scott (Scottish Water)

Ian Tait (Water Industry Commission for Scotland)

CLERK TO THE COMMITTEE

Steve Farrell

LOCATION

Committee Room 2

Scottish Parliament

Infrastructure and Capital Investment Committee

Wednesday 30 April 2014

[The Convener opened the meeting at 10:00]

Decision on Taking Business in Private

The Convener (Maureen Watt): Good morning. Welcome to the 12th meeting in 2014 of the Infrastructure and Capital Investment Committee. I remind everyone to switch off mobile phones, because they affect the broadcasting system.

Item 1 is a decision on taking business in private. I seek the committee's agreement to take in private item 4, which is consideration of the evidence that we will hear on Scottish Water today. Is that agreed?

Members *indicated agreement.*

Strategic Review of Water Charges 2015 to 2021

The Convener (Maureen Watt): Item 2 is an evidence-taking session on Scottish Water's strategic review of water charges for the period 2015 to 2021. We will hear evidence on the review from three panels of witnesses today.

I welcome the first panel who are both from Scottish Water. Belinda Oldfield is regulation manager and Alan Scott is water service strategy manager. Would either or both of you like to make opening remarks?

Belinda Oldfield (Scottish Water): I have some opening remarks. First, I thank the committee for inviting us here today. Ronnie Mercer, our chairman, and Douglas Millican, our chief executive, extend their apologies for not being here—they have a previously arranged Scottish Water board meeting. Alan Scott and I are delighted to be here to speak on their behalf. They spoke to the committee in November, when they outlined our strategic plan for 2015 to 2021 and highlighted that we have been very focused on bringing customers into the heart of that process.

We will talk about the process for developing the plan, highlight how customers' views have been included and give the committee a bit of an overview. I think that that fits in with the committee's request to Scottish Water.

Essentially, we work within a statutory framework, with the Water Industry Commission for Scotland determining charges in light of the decisions that are made by Scottish ministers on aspects such as the length of the period, the principles of charging and the objectives for investment and any other guidance that ministers want to give us. That is our starting point.

Throughout the process, we work with the drinking water quality regulator for Scotland and the Scottish Environment Protection Agency to explore and identify priorities for investment that underpin the ministerial objectives.

We have been through quite an intensive process, and we have worked collaboratively to establish the investment programme and to enable WICS to set the level of charges for the forthcoming period. WICS introduced a number of changes to the price review process, one of which was to increase customers' involvement. In 2011, the customer forum for water was established and given the role of independently representing the views of customers as a whole.

During the development of the plan, we have worked closely with all our stakeholders on extensive customer engagement and research.

The research highlighted that our customers wanted us to ensure that we do not compromise existing service levels; it also highlighted that customers wanted further improvements in service but did not want large price increases—in fact, they wanted price stability. Those are the main objectives of our plan for the period 2015 to 2021.

In developing the plan, we developed service improvement reports for each area of service that we provide. Those reports set out the nature of the service; the current and future challenges; and the options and choices that are available to customers for meeting those challenges. Through a series of meetings with the forum on each of the service improvement reports, we identified customers' priorities for service improvements and investment.

We then produced our business plan and entered a period of quite intense negotiation with the forum. We reached agreement with the forum in January this year, after very real, constructive challenge from its members. We submitted our agreed plan to WICS, and it published the draft determination for consultation in March.

In summary, our plan is fully consistent with the draft determination that has been published and is available on our website. It is of course still subject to the final determination of charges by WICS later in the autumn, once ministers have finalised their objectives and principles of charging.

We have a plan that has been negotiated and agreed with customers and that we believe has legitimacy from a customer perspective in terms of both content and price. From our perspective, we have gained significant benefits from customer engagement and involvement in the process.

Alan Scott and I are happy to take any questions that the committee may have.

The Convener: That is fine—thank you.

Can you summarise Scottish Water's key objectives for the next regulatory period?

Alan Scott (Scottish Water): Yes. Our main objective is very much to build on what we have achieved in the current period. We are very proud of the fact that we have achieved most of the objectives that were set for us for the period 2010 to 2015. Some of them were achieved early on, which may not have been anticipated, and we now match the performance on service levels and efficiencies of the leading companies in England and Wales.

Our objectives for the next period are to build on that and deliver further improvements that align with customers' expectations on price and service, while meeting all of the ministers' legislative objectives.

The plan centres on the three strategic objectives that were set out in our long-term projections: providing continuous high-quality drinking water; protecting and enhancing the environment; and supporting Scotland's economies and communities to grow. As Belinda Oldfield said, we have undertaken extensive research to inform both the strategy and the plan, on which we consulted back in February 2012.

The research highlighted that we must not compromise existing service levels while improving in other areas, so that must be the starting point. Our customers expect a safe, reliable supply of water and that their waste will be taken away and properly dealt with. Customers want us to further improve services in areas such as reliability of supply and dealing with sewer flooding, and they want that managed so that they do not see large price increases. We have always had to balance the rate of improvement with affordability for customers.

From 2015 through to 2021, we will continue to deliver the high service levels that we have achieved in the current period and ensure that our water and waste water service is among the best that is provided by United Kingdom water companies. A high-level summary of the benefits of the plan is set out on page 4 of the draft business plan.

We are committed to having fixed annual household prices that will increase by 1.6 per cent for this year and in the first three years of the new regulatory period, with an expectation—with everything working favourably—that we will be able to continue that right through to 2021.

We will continue to deliver further efficiencies and keep charges lower than the average charge in England and Wales, and we will still invest more than £500 million a year to sustain and improve services. We will further improve customers' experience of service as measured by the new customer experience measure for household and business customers that we are introducing in line with the forum's view.

We are using many innovative and proven approaches to deliver the service and to improve compliance to give us, overall, the most effective cost for customers. We will continue to listen to the needs of the licence providers as the UK market for retail competition opens up. That will perhaps change some of our views as we see how it expands.

We have also committed to continuing customers' legitimacy in the whole process, including the annual review meeting on performance with the customer forum or whatever body follows it in representing customers. Overall, we aim to maintain a financial strength that is

appropriate for the company's governance structure.

That summarises the objectives in the plan.

The Convener: You said that the constraint has been set at 1.6 per cent. Are you satisfied that you can deliver on your commitments in the draft business plan given the financial constraints that are set out in the draft determination?

Alan Scott: We have set ourselves some very challenging efficiency targets that go beyond what we know we can definitely do. However, given the track record on outperforming that we have built up over the past 12 years, we are confident that we can deliver the balance of prices for customers and borrowing in the plan.

As I said, we are focused on delivering increased productivity, making service improvements and using innovative approaches. Innovation is an on-going aspect: we will find innovations and smarter ways to do things as we go through the period ahead. That has been very much part of the pattern in the current period.

A number of regulatory mechanisms are available to deal with any significant changes to the plan that may be needed; those mechanisms have been in place in the past two or three regulatory periods.

On top of that, we have the rolling investment review in 2018, which will take account of any significant change to priorities or any external financial impacts that might arise, and we can consider the balance between service improvement and prices at that stage.

The Convener: What input does the workforce have on determining issues such as efficiencies and productivity?

Belinda Oldfield: We work fairly extensively with all the management in the business and with team leaders to consider how we can stretch our activities and do more for less, and how we can build innovation into what we do. We have good engagement throughout the organisation in relation to meeting challenging targets—we have a history of that, and it will continue.

Mark Griffin (Central Scotland) (Lab): What discussions have you had with key stakeholders regarding the draft determination and possible alterations to the draft business plan?

Belinda Oldfield: We have been involved in on-going discussions with all stakeholders: the customer forum, the drinking water quality regulator for Scotland, SEPA, WICS, Consumer Futures, as was—its responsibilities have now passed to Citizens Advice Scotland—and the Scottish Public Services Ombudsman. All along, we have been involved with all those stakeholders.

You asked specifically about the draft determination but, actually, most of our engagement with stakeholders has been prior to the draft determination, in the lead-up to agreeing the plan.

I referred to the service improvement reports that we have produced. Critically, those were agreed with the drinking water quality regulator and SEPA so that there was absolutely no ambiguity about the statutory requirements before we took them to the customer forum to agree them. We have listened carefully to all the stakeholders and we have made changes to the plan with the customer forum, having looked at the extensive customer research that we undertook and having deliberated on the most reasonable and sensible approach. Throughout the process, we have engaged with our stakeholders and listened to them carefully.

Mark Griffin: Scottish Water has said that it aims to introduce a new customer service measure. Can you give the committee more information on that? Can you give us an assurance that we will be able to compare with previous performance to allow us to keep a watching brief on customer service?

Belinda Oldfield: We will introduce a new customer experience measure, which will monitor customer service. It has two main components: a quantitative component that is based on complaint volumes and negative customer contact; and a qualitative component that is based on satisfaction surveys in relation to resolved issues and independently conducted satisfaction surveys with customers. We are working on that with the customer forum. We have recently agreed heads of terms and a work plan with the customer forum, and we will have it in place later this year.

You asked how the committee will know how we are doing on that. That measure is a development of the service measure that is used in England and Wales, so we will be able to track how we are doing relative to companies in England and Wales, and we have assured the forum of that. Also, the measure will be developed for household customers as well as business customers, so it will be for the complete customer base.

Mark Griffin: How will the new measure allow us to compare not just with England and Wales but with customer satisfaction levels in previous years for Scottish Water?

Alan Scott: We will still have all the measures that are in place at the moment—they sit in the overall performance assessment. This is a new measure over and above those, and we believe that it will lead to even better performance. It is a broader measure that really gets into what drives satisfaction in customers. We will still have the

existing customer satisfaction measures in the OPA on issues such as contacts and response times. The new measure will be an extra, and we will still have everything that we had before.

The Convener: You keep talking about comparisons with England and Wales, but are England and Wales the best comparator? Do other countries deliver better performance for their customers in the provision of water and sewerage facilities?

10:15

Belinda Oldfield: We have been looking more broadly at customer satisfaction in different sectors, beyond the water industry. I should have said earlier that we will be adding in a high esteem test, which is built on the UK customer satisfaction index across all sectors—retail, utilities and everything else. We will be able to benchmark ourselves against John Lewis and Amazon—I think that Douglas Millican and Ronnie Mercer have talked about that—so that we get a feel for how we rank in relation to some of the household names.

Mary Fee (West Scotland) (Lab): The draft business plan requires Scottish Water borrowing of £120 million per year between 2015 and 2021. What discussions have you had with the Scottish Government on that issue? Are you confident that the loans will be made available?

Alan Scott: The business plan is based on borrowing of £120 million to finance the capital enhancement programme's delivery. That has been discussed with Government officials and is consistent with the indications that the Scottish Government gave us in its draft budget in September 2013. As Belinda Oldfield said, we expect ministers to confirm the borrowing during the next 12-week period, before the commission makes the final determination. We have no reason to believe that the borrowing will not be given to us. We have always had the borrowing that we have required.

Mary Fee: Are you exploring opportunities to generate cash from within the business if the borrowing that you anticipate does not materialise or is less than you expect?

Alan Scott: Yes. We always seek to outperform our business plans. We have a pretty good track record of doing that and we continue to seek innovation and improved productivity. If sufficient cash surpluses are yielded, a mechanism is in place to deal with them; the commission might talk about that later in the meeting. Our intention is always to try to deliver more for our customers, over and above the challenging efficiencies that we have set ourselves.

Mary Fee: The draft business plan says that forecast annual operating costs will fall from £354 million in 2015-16 to £350 million in 2020-21. How confident are you that operating costs can fall while you maintain service levels and continue to invest in the network?

Alan Scott: Those are the pure operating costs; they are not the capital maintenance costs, which are rising slightly. The primary reason why the operating costs are dropping is the on-going efficiency and productivity stuff that we are doing, on top of the investment that we are making in renewable energy and energy efficiency, which will help to bring down our energy bill.

We would describe the position as broadly stable; a drop of £4 million is not a big change, in many ways. We are pretty comfortable about our ability to hold that stable position, and we will seek to outperform on it. However, as we go through the period, we might find innovative approaches that mean that we spend more on operational costs and less on capital maintenance or capital enhancement costs. The mix might change over time, as we innovate; the number might not remain the same at the end of the day.

Alex Johnstone (North East Scotland) (Con): The draft business plan predicts that total borrowing will increase from £3.584 billion in 2014-15 to £4.184 billion in 2020-21—it does not sound like much if I say it quickly. Are you satisfied that the increase is manageable and that an assumed average interest rate of 4 per cent over the control period is sufficiently conservative to protect customers from a redetermination of charges?

Alan Scott: The level of borrowing is manageable. We have balanced customer revenue and new borrowing to provide financial strength that is appropriate for our governance structure, in accordance with ministers' draft guidance on the principles of charging.

On the interest rates, a reasonable amount of our debt extends over a reasonably lengthy period and is therefore secure. It would be wrong of me to say that I know what the economy will do in the next five years. I think that the commission said in its draft determination that 4 per cent was a reasonable assumption. I would say that that is not particularly conservative, but there is a balance to be struck between making overconservative judgments and locking up customers' money unduly.

We have to look at the business plan in the round. The interest rate is one of many assumptions in the plan—that one might go against us, but another one might go for us. We have highlighted all that in the part of the plan that covers risk and opportunity.

Alex Johnstone: The draft business plan includes the decision that

“investment plans will be updated on a ‘rolling’ basis at 3 yearly intervals”.

Can you explain the benefits of the rolling review process for customers?

Alan Scott: The primary benefit is that we will always have greater forward visibility of investment, and therefore our supply chain will be able to resource more efficiently. Consequently, our customers will get more efficient costs in the delivery of our capital programme.

Another benefit is that it will allow us to take account of changing priorities and emerging needs—new legislation, for example, or changes to assumptions about things such as the level of investment for growth or meeting new demand if the economy suddenly takes off and growth shoots up. The process will allow us to take account of changing assumptions that are not in the company’s full control.

Should any of the financial issues that have been alluded to happen, such as a change in interest rates, the process will give us the chance to reconsider the rate of investment and prices. With the commission, we will have another tool in our kitbag that will allow us to consider which decision to make at the time and to have a conversation with the customer forum or whatever customer body is in place.

Alex Johnstone: A lot of progress has been made on dealing with the problem of continuity. Will the rolling review process give contractors greater continuity and help to avoid the boom and bust situation that we saw in the Scottish Water’s early development?

Alan Scott: Fundamentally, the process should take that problem away. At the moment we have a plan that runs to almost 2022, with a tail of investment running from probably 2018 onwards. By 2018, we will add another £5 million or £6 million that will go out until 2024-25. In 2020-21, we will have almost three years ahead of us.

The other advantage of the process is that it will prevent us from locking in solutions too early and give us more opportunity for innovative thinking. It will give us the chance to reconsider things. There are some things in the plan that we know we need to do, and we have agreed that we will decide by 2018 what is the right thing to do. That lets us do a bit more study and investigation with the drinking water quality regulator, SEPA and any other parties to identify the right balance of risk and cost when we do something really innovative. If the thing does not work, we have the failsafe that we can still come back and do something else.

The review process definitely gives continuity; it gives a lot of other things, too.

Alex Johnstone: It will facilitate a more sophisticated approach to investment.

Alan Scott: It really will. It will make a continuum, rather than our taking a stop-start approach.

Gordon MacDonald (Edinburgh Pentlands) (SNP): The business plan outlines four new service measures—you have already touched on one—that will be developed for the next control period. What are they and how will they assist in monitoring Scottish Water’s performance?

Belinda Oldfield: There are a number of service measures. We have touched on the new customer experience measure. I do not think that we have four new service measures in the plan, but I am happy to talk about overall performance assessment, which Alan Scott touched on. We will continue to use that. It measures overall performance of various elements of our service.

The customer experience measure is new and the high esteem measure is also coming in. We will work on that with the forum. We will continue to use the overall measure of delivery, which measures the capital programme and whether its performance is still on track. All the investment will be monitored by the outputs monitoring group, which is chaired by the Government.

We are looking at a number of other individual items in the detail of the business plan and we will discuss those with the forum and work on them jointly as we go through the period.

Gordon MacDonald: I am happy to focus on the customer experience measure, on which Mark Griffin has already asked you a couple of questions. When Ronnie Mercer appeared before the committee in November, he commented on the overall performance assessment. He said:

“We have outperformed our customer service target, which is good ... Our customer service is at record levels”.—[*Official Report, Infrastructure and Capital Investment Committee*, 20 November 2013; c 2166.]

If that is the case, why do you need to introduce a customer experience measure?

Belinda Oldfield: Ronnie Mercer rightly highlighted that we have been outperforming our customer service target, which, at this point, is a very quantitative measure of customer complaints and how they are handled. We want to move to a position where we look more at customer experience and customer satisfaction. It is not just about ensuring that, when people have a problem with our service and complain about it, we address that very quickly; it is about ensuring that customers are generally satisfied with the service and that, if they have to phone us and contact us,

their experience of that is good. It is about capturing both the quantitative and the qualitative elements.

We might phone you and ask, "Did we respond to you quickly enough? Were you satisfied with the service? We appreciate that something went wrong, but did we make it right as fast as we could and to your satisfaction? Were you comfortable with that?" We will also contact customers who have had no problem at all with the service to make sure that they are content. We are not going to take it that, because they have not got in contact with us, they are generally content with the service either on a day-to-day basis or if we have had an outage. They may have been affected but, for whatever reason, did not contact us. We want to tease out how satisfied such customers are with the service that they get from Scottish Water. It is about going above and beyond where we are just now.

Gordon MacDonald: Basically, you are saying that there appears to be a level of dissatisfaction with the service out there and you are bringing in this customer experience measure to address that.

The written evidence that we have received from Citizens Advice Scotland states:

"we recommend that a regular and independent review of Customer Experience Measures is carried out. This will verify Scottish Water's score and will provide customers and stakeholders with assurance of Scottish Water's performance."

Why does Citizens Advice Scotland need that reassurance?

Belinda Oldfield: First, there is not a level of dissatisfaction with the service at the moment. Broadly, through a very deep bank of research that we have done with customers, we know that customers are telling us that they are happy with the service that they get and that, when they have issues with us, we respond to them fairly quickly. There will always be isolated issues and customers who, for some reason, are dissatisfied on some particular point, but our customers are broadly satisfied.

Secondly, we assured the customer forum prior to the transfer of responsibility to Citizens Advice Scotland that we would have a regular independent review. It is not about Scottish Water measuring itself and trying to tell everybody that everything is great; we are quite happy to have transparent public scrutiny of that independent review, and that is what we agreed with the customer forum. Given that the responsibility has been transferred to Citizens Advice Scotland, I am sure that it is echoing the welcome for that review. However, I do not think that it is born out of a level of dissatisfaction.

Gordon MacDonald: You have touched on the need to split the customer experience measure between domestic and non-domestic customers. If you find that there are different levels of satisfaction in those two groups, will you be in a position, over the review period, to refocus resources to tackle that issue?

Belinda Oldfield: It is likely that the levels of satisfaction will be different—they definitely will not be the same. The level of satisfaction will be higher among household customers than among business customers, or vice versa. Within the company, we are making sure that we take the customer experience to a new level, whether they are a household customer or a licensed provider—licensed providers interface with business customers—to make sure that the service that is delivered to business customers by Scottish Water wholesale also sits at a high level.

Gordon MacDonald: I seek clarification of the answers that were given to Mark Griffin earlier. You say that you will be able to continue to compare performance in future years with performance in previous years, but page 44 of the draft business plan says:

"We will replace our current customer satisfaction measure with the CEM"—

the customer experience measure. How does that work?

10:30

Alan Scott: Our current customer satisfaction measure is something that we use internally. We picked it up as being really important in terms of driving service higher. It is very close to the customer experience measure but, in discussions with the forum, we agreed a slightly different mix of the weightings of things and the factors to be taken into account.

The measures that are monitored in the business plan at present are all under the banner of overall performance assessment and serviceability targets. The customer satisfaction one is one that Scottish Water did of its own volition in many ways, but we have seen it as important in driving up the OPA and the overall service performance.

Going back to what Belinda Oldfield said earlier, I add that one of the key things about focusing on customer experience is to get us away from being just one of the best water utilities to being one of the best service providers in the UK. It is about putting customers at the heart of what we do and trying to understand the specific issues in different sectors of our customer base, and what we do to respond in each area will be different.

In this period, we found that customers are reasonably tolerant of something going wrong. They accept that, with the sorts of things that we manage, there can be asset failures. What they are not so tolerant of is repeats. That has driven a focus on trying to get out there and deal with recurring issues. Also relevant is some of the more proactive stuff that Douglas Millican or Ronnie Mercer might have mentioned before, such as the intelligent control centre that we are putting in, which will try to predict things and get the response out there almost before the event happens. That kind of indicator is probably driving us to the next level of service, which is beyond product services. It is more about how people feel about the company, how they feel when they interact with it, its value and the trust that people have in us.

Gordon MacDonald: My final question is on Scottish Water's carbon footprint. The draft business plan states, on page 34:

"Over the past 5 years we have reduced our carbon footprint by 10%."

The proposals in the business plan will reduce Scottish Water's carbon footprint only by 2 per cent. Is that sufficiently ambitious given the Scottish Government's climate change targets?

Belinda Oldfield: I think that it is helpful to put the matter in context. We have been steadily reducing our carbon footprint, but the increasing levels of treatment that are required to meet European legislation have increased our energy use. Over the past five years, we have managed to offset that increase through our work on leakage, the work that we do to increase efficiency where we do a lot of pumping, whether that is water pumping or waste water pumping, and investing in renewables.

Overall, in the past five years, the carbon footprint has been reduced by 10 per cent. We believe that it would have reduced by about 20 per cent if the quality and standards enhancement investment over the past 10 years had not taken place.

We are continuing to work towards reducing energy use, we are implementing investment to efficiently reduce consumption and we are exploiting more renewable energy opportunities. All of that is really to offset the increased standards that are coming through for water supply and the waste water collection system.

Gordon MacDonald: Thank you.

Adam Ingram (Carrick, Cumnock and Doon Valley) (SNP): I note that the briefing that we received from Citizens Advice Scotland, which took over the roles and responsibilities of Consumer Futures earlier this month, states that

Scottish Water does not do enough to protect those who are struggling to pay their bills and that a vulnerability strategy is required. Would you care to comment on those points?

Belinda Oldfield: As you are aware, Scottish Water does not deal directly with customers regarding their water and sewerage bills as that is done through council tax. Do we do enough to protect vulnerable customers? I think that the way in which charging is established through the council tax system has its own in-built protection mechanisms, such as the structure of charging, which is done in bands, and the number of discounts that are available. That is all in line with Government policy. Prior to the end of March, when Consumer Futures handed over to Citizens Advice Scotland, we met Consumers Futures and local authority heads of finance to examine what needs to be done to protect vulnerable customers. At Scottish Water, we are very happy to look at more customer awareness, more education and more campaigns to help where we can in that regard, but that will happen in a framework with local authorities and Citizens Advice Scotland.

Adam Ingram: You are not responding directly to the comments. I understood that the outputs monitoring group would be looking at the issue.

Alan Scott: We are working with the Scottish Government and other stakeholders, including the forum, to investigate what more can be done to provide support, but that must be done within the minister's charging policy. That work, which started about six months ago, is on-going. It is looking at what is achievable in the framework in which we operate because, at the end of the day, charging is for the minister to decide, so any change would have to be ratified by ministers.

The Convener: Mr Scott, you said in your opening remarks that one of your objectives was to increase activity in the Scottish economy. How would you do that? We have discussed the Procurement Reform (Scotland) Bill, so I am aware that Scottish Water does not fall within its scope. How do you engage with stakeholders and businesses to let them know what work is coming up, so that they can decide whether they are in a position to bid for that work? Sometimes, because of your long-term strategy, as Alex Johnstone mentioned, there may be only a few companies in the mix to get the work. How do you ensure that you get the best value? How do you give lots of companies the opportunities to bid for work?

Alan Scott: You are right that we have major frameworks and alliance arrangements for the bulk of our programme. However, we also commit to supporting local communities and local development through the use of our rural framework procurement approach. We have also had specific frameworks for requirements in the

islands as well as one for the north and Argyll regions, which use local contractors.

This is not my area of expertise, unfortunately, but I know that we recently held a market day with a lot of the local suppliers. If you want, we could provide more information about that from the procurement team in our written response.

The Convener: We saw Tayside procurement forum do what you are calling market days. Does that happen throughout the country?

Alan Scott: That approach will continue. As we work with our alliances, I am sure that they will want to use local suppliers where it is more efficient for them, too. They will probably see that the bulk of the work that it is efficient for them to do falls in the central belt, because that is where the majority of their resource will be. Therefore, they will probably seek to use similar approaches. However, those alliances are only being formed. As I say, that is not my area of expertise, but if you want more information, we can provide a written response.

The Convener: As no one has any further questions, I thank both the witnesses for their input, which has been very helpful.

10:39

Meeting suspended.

10:40

On resuming—

The Convener: We continue our consideration of agenda item 2, on Scottish Water's strategic review of charges. I welcome our next witness, who is well known in this place—proving that there is life after being an MSP. Peter Peacock is chair of the customer forum for water. Do you wish to make any opening remarks, Peter?

Peter Peacock (Customer Forum for Water): I was going to say that it is a pleasure to be here, but then I thought that I have not heard your questions yet. It is a pleasure to be here, in any case.

I will say nothing by way of introduction other than that there are two distinct aspects to the matter. The first relates to the detail of the draft determination, based on the agreement that Scottish Water and the customer forum came to. Secondly, there are issues around the process, which is innovative and new and which has attracted a lot of interest. When it comes to involving customers in regulation, the process has broken new ground not just in Scotland but much more widely. Indeed, people are showing interest at an international level in what has been going on here.

I am happy to go straight to questions.

The Convener: How do you go about collecting the views of Scottish Water customers? How do you represent those views to the key stakeholders?

Peter Peacock: That is the absolute key to what the forum is about. In a sense, your first question to Scottish Water was about its objectives and the objective of the plan. I guess that the forum's objective, first and foremost, was to find out what customers thought about Scottish Water's services, where they wanted improvement and where they were concerned. Without that, the forum would not have had any legitimacy. We were just eight people who had been selected for the purpose of putting ourselves in the place of customers and thinking what they might want. Unless we find out things in detail, we cannot do that.

A huge amount of effort was made, jointly by Scottish Water and the forum, in trying to find out what customers thought. Extensive focus group work was done; there were about 1,000 stated preference interviews with household customers, 500 interviews with business customers, online panels and so on. In addition, the forum carried out independent work on customers' attitudes towards willingness to pay and affordability, around which there were particular concerns. We ran a series of interactive focus groups on those issues.

We commissioned a couple of bits of work. One of those, which was undertaken by representatives of CAS and the Child Poverty Action Group, considered changes in the benefits system, tax credits, pensions and so on. From their experience of dealing with people at their bureaux and more widely, they told us what they thought the impacts of those changes were on household disposable income.

We had further work done by academics on the effect of the recession on household incomes; that work addressed things such as the impact of part-time employment on disposable income in households. The academics also gave us advice on the difference between the consumer prices index and the retail prices index in the measurement of inflation, as we had become interested in that distinction.

As well as doing all that, we spoke to the Convention of Scottish Local Authorities about some of the issues that it had, and we spoke to developers and big businesses about issues that they had. We had some representation from business on the forum. There was a wide range of ways in which we sought to get the information, and a lot of that was done with Scottish Water.

Having come to the issue cold, and not really knowing Scottish Water, I have become hugely impressed by its commitment to finding out that information. Once we had obtained all the data, we sat down with the Scottish Water representatives at one session and asked them about what the review meant to us and whether we could agree on what it meant in terms of investment priorities, potential pricing and so on. From that, we reached an agreement about what the investment priorities should be. That was fed into all the service improvement reports that were mentioned by Scottish Water as one element of the consideration about different aspects of service. Those reports included a section that outlined what customers had said about various parts of Scottish Water's service.

A huge amount of effort went into that, and that helped to inform us. We saw our role as taking that information to the heart of the decision-making process and continuing to assert a customer perspective. Scottish Water was more than willing to hear that. It is clear to me that Scottish Water has come to recognise that it can improve its services by really listening to its customers and being informed about how services can be improved.

That is a broad explanation, if it helps.

10:45

The Convener: What were the key issues that were raised by customers during the strategic review? Was there much of a difference between domestic customers and business customers in that regard? As an MSP, I do not get many domestic customers complaining to me about services from Scottish Water, but I get quite a few complaints from businesses. What did you discover?

Peter Peacock: The first really revealing thing that one discovers when one starts probing matters with customers is how little they understand about water and Scottish Water. We observed quite a number of the focus groups—or rather, we watched the meetings go on from behind a two-way mirror. It is fascinating to hear people talk about things. People are largely unaware of Scottish Water—they do not think about it. That is probably quite a good thing, because if they thought about it constantly, that might be because they had a complaint about it. People are not hostile towards Scottish Water.

People tend not to know what they pay for water—when they are asked, they give figures that range from £30 to £300. That is probably because their water bill forms part of the council tax bill. They are largely unaware of Scottish Water, but when one probes deeper, one finds that there is

no hostility towards the organisation. People are quite proud of what they receive when they turn on their taps or when they pull the plug in the sink. Things are taken care of; it is a good-quality service. The issue is not front of mind for people.

On digging deeper, one finds that people want to maintain the current levels of service. One of the consultants who did quite a lot of the research work commented on an interesting phenomenon whereby there appears to be a high degree of altruism among Scottish consumers, in the sense that, although they might have a good and extremely reliable service, as soon as they discover that not everyone gets such a service all the time, they are more than willing for those problems to be addressed for other customers, even if that will have a marginal effect on their bill. We tested that idea a bit further, because we were not entirely convinced about it, but it seemed to hold true.

People say things such as, “We want our water quality to improve, if that's required.” They expect Scottish Water to deliver to the environmental standards in terms of both water quality and environmental discharges. They get pretty angry when they see water running down the street. Understandably, they do not like that and they want it to be dealt with quickly. They regard sewer flooding as simply unacceptable. Even if their property is not surrounded by such flooding and they do not have it internally—internal sewer flooding is even worse—they view it as simply unacceptable that anyone should be in that position. There is a high degree of recognition of that, and a desire to do something about it.

People want continuity of supply. In other words, they want as few interruptions as possible. When people are questioned about the effects of climate change, such as more drought and more flooding, which could cause greater uncertainty in service delivery, they still want continuity of supply. That implies that there needs to be much more resilience in the system than there is at present.

We discovered that, notwithstanding the fact that the technical standards for water pressure tell us that far fewer than 1 per cent of people should have any concern about water pressure, in survey work up to 15 per cent of people think that they might have a problem with water pressure. We are looking into why that is the case in much more depth and investigating whether the technical standards are too low in relation to what people want to experience. People also raise the issues of taste and odour, but the number of occasions on which they do so is pretty small in comparison with the incidence of the other issues that I have mentioned.

That is what householders tell us. Largely, businesses say the same things, although they

give leakage problems a higher ranking—they are more strongly of the view that it is wasteful if there is water running down the street. They are also much more hawkish about what they pay for water. They want to have complete justification for any increase in costs to them because, in their business environment, they have to manage pressures on their other costs and it is often the case that they simply cannot pass on increases in water charges to their customers.

In addition, there are recurrent issues. From smaller businesses, in particular, we picked up a feeling that they could not control what they considered to be a pretty high fixed cost to them. In fact, they viewed it more as taxation than as a charge—that might be oversimplifying things, but it characterises how they feel. Therefore, there are differences between the two sectors, which I have tried to summarise.

The Convener: How satisfied are you that the key stakeholders—not just Scottish Water, but everyone who is involved in the provision of water—are taking those issues on board? You said that Scottish Water is keen to do that, but what about, for example, the companies that provide services for Scottish Water?

Peter Peacock: There are a number of stakeholders. We have had some contact with people in the supply chain for Scottish Water—those who are on the ground, building and maintaining things. There are varying views about Scottish Water in that sector. People feel that they have been required to deliver significantly more efficiency to help Scottish Water deliver its efficiencies, and they feel that Scottish Water has been pretty tough on them at times. However, there are benefits to be gained from that in terms of price and so on.

We have had a lot of contact with SEPA and the drinking water quality regulator. For the most part—thankfully—the objectives that they are pursuing with regard to environmental directives from the European Union are much in line with customers' priorities, because they relate to water quality, environmental discharge, improving bathing water quality and so on. We are all pretty much in line in that respect, which is helpful.

There was a point during the process at which the drinking water quality regulator and SEPA were probably a bit—to use the word “anxious”—would probably be an overstatement, but they certainly wondered what the customer forum was going to examine. Their concern was to do with whether we would focus on price issues and whether our attempts to get a good price would reduce investment in a way that would affect their plans. As it transpires, there has been no need to do that. In fact, I went out of my way to reassure

them at one point that we were not trying to undermine their wider interests as stakeholders.

Jim Eadie (Edinburgh Southern) (SNP): On 30 January, on behalf of the forum, you signed a minute of agreed modifications to Scottish Water's draft business plan for 2015 to 2021. What are the key outcomes of that agreement, and what benefits have been delivered on behalf of customers?

Peter Peacock: Signing that minute was a significant moment. Because of the process that we had been through, there were not a huge number of surprises in the draft business plan on the investment side. Nonetheless, we had about 12 hours of detailed discussion with Scottish Water to thrash out a lot of detail that is now in the minute of agreement. The forum and Scottish Water regard it as quite an achievement that we got to the point at which we could agree, as we had been asked to by the regulator. I note that in passing.

From the customers' point of view, the business plan maintains the investment programme of roughly £500 million a year of capital investment. That allows us to address some of the issues that I said had arisen in the research, such as issues around sewer flooding, water quality and environmental discharges. That not only maintains service levels, but seeks to improve them.

The other big area in which we made a lot of progress concerns issues that the committee discussed with the first panel of witnesses. The performance measures that we now have are much more comprehensive than they were in the past. You questioned Belinda Oldfield about the customer experience measure in particular, with regard to qualitative aspects of service delivery. We now have an overall performance assessment that enables historical comparisons to be made, which is important. Those comparisons can be made with previous years in Scottish Water's history and with the performance of companies down south.

The customer experience measure involves not only the quantitative issues that affect household customers, but the qualitative issues. It probes people about their experience and goes beyond those who have contacted Scottish Water. Scottish Water and the forum agreed that, if a place has experienced an incident—a big flood as the result of a burst pipe, or something else that might be seen on the evening news from time to time—the customer experience measure will not only involve the opinions of the people who were directly affected by the flooding but will consider the impact on the wider community, taking into account the opinions of people who were held up in traffic or those who could not get to work or were unable to get into a shop because it was

closed. The measure will examine how well Scottish Water dealt with those people who did not feel quite strongly enough to get in touch with it, but who were nonetheless affected by the incident. It will go to a much deeper level.

The convener asked earlier about the experience of business customers. That has not been looked at in the past, and the customer experience measure will give Scottish Water a better idea of that and of how it can improve. Other measures include the high esteem test. There is a much broader suite of measures against which Scottish Water's performance will be judged, and that will allow Scottish Water to dig deeper into what people feel. That can only bring benefits in tailoring services for customers in future.

The other big area is prices, and the impact on customers of the price arrangements that the draft determination from the commission suggests should be set after consultation. That is based on the agreement to which you referred; in real terms, the agreement is lowering prices—not relative to the RPI, but relative to the CPI, which is the lower inflation measure. That was quite a significant development from the discussions between the forum and Scottish Water. We said to Scottish Water quite early on that the RPI does not mean a lot to people if their benefit or pension goes up only by the CPI, so we should be thinking in terms of the CPI rather than the RPI. A consensus was reached between all the parties around that.

The level of fixed nominal increase was 1.6 per cent; I note that the CPI has dropped to 1.6 per cent, so that looks less good than it was three months ago. Nonetheless, the important thing about the 1.6 per cent—this is where Scotland is breaking new ground in the regulatory process—is that it has been set not just for one year, but for three years. In fact, including this year, it is a four-year period, with the indicative intention of keeping it going right through to 2021. That is important for customers, because it gives a reasonable price increase relative to achievement of the objectives. There is also stability for the customer and people have clarity around what they will be paying for each of the next three years, and possibly up to six years. Scottish Water agreed in the end that that is important to customers.

There is also a CPI safety net, if I can put it that way. If inflation keeps falling at the CPI level over the six-year period of the settlement, whatever the annual rate of the CPI, the price has to end up in aggregate at 1.8 per cent below the CPI. There is a safety net if inflation falls, and that is important to customers, too. The other side of the equation is wholesale customers' prices being kept at 0.3 per cent below the CPI each year.

There are a lot of helpful things in there for customers, I hope, and that is why the forum felt able to sign off the agreement. I stress that we have all agreed to the business plan. It is not a question of our having beaten up a reluctant company, or of its having lulled us into a false sense of security. We reached an agreement after a lot of detailed discussion that helped to deliver those decisions.

Jim Eadie: That was a helpful and comprehensive answer.

In a previous answer to the convener, you outlined the extensive level of engagement with customers and the academic research that the forum commissioned on, for example, the recession's impact on household incomes.

The committee has received evidence from CAS, which states, in relation to water and sewerage household debt:

"we believe that existing processes, both legislated and practiced, prioritise and incentivise the maximisation of revenue and do not do enough to protect those struggling to pay their bills."

Do you have a view on that? Could Scottish Water do more to support those customers who are in debt and struggling to pay their water and sewerage charges?

Peter Peacock: First, I want to make it clear that the forum was asked to operate within existing Government policy and within the existing regulatory framework. We do not have an advocacy role for the change of Government policy or the change of that framework.

Having said that, we raised issues about vulnerable customers partly because of the research that we saw, and partly because of the wide-ranging impacts of changes in benefits and tax credits. Those were not narrow phenomena that affected quite small groups; they were quite wide ranging. We were aware that even if someone received full council tax credit, their water bill would receive only a 25 per cent rebate and they would still have a debt, even if the remainder of the council tax was being paid. That came as shock to customers, because they thought that they did not have a debt and suddenly found that they did, which had impacts.

11:00

We had discussions on the issue with the Scottish Government, and I had a discussion with the chief executive of CAS. To cut a long story short, we found that what happens fits within the framework of the Government's policy on pricing, and that the council tax system is of itself shifting resources from the better-off to the less-well-off, if

you believe that that is related to property values, and that therefore it is progressive in that sense.

In money terms, there is quite a lot of additional help in Scotland, because if someone is on full council tax benefit they can get up to 25 per cent off their water bill. However, beyond that, the question was still being raised whether more could be done. Scottish Water said to us that if things could be done within the framework of Government policy—it is not Scottish Water's job to change that—it was happy to look at that. As part of the minute of agreement, it has been agreed that work will be done on vulnerability in order to probe it a good deal more and see what the relationship is between a customer in vulnerable circumstances and their water and waste water charges, and to see what might be the art of the possible.

My personal hope is for that to be done collectively between Scottish Water, the Scottish Government, local authorities and Citizens Advice Scotland in its role in representing customers. Alan Scott mentioned that in his evidence. We can see where that can take us and whether there is more that can be done.

Jim Eadie: That is helpful. CAS suggested that there could be a comprehensive vulnerability strategy that would allow consideration of those issues and, in particular, what more can be done to protect customers in vulnerable situations. What you describe sounds like a positive development. Do you have any information on timescales?

Peter Peacock: No, other than to say that we are trying to sort out with Scottish Water the work programme that will flow from the minute of agreement. One of the things that will be considered at some point is vulnerability and, from what you have said, I am sure that CAS will push pretty hard on that issue. My experience so far is that, although there are people who are willing to listen, there are constraints in the process and within Government policy. We therefore have to think about the whole thing in the round.

Jim Eadie: You mentioned the customer experience measure, which is one of the innovative developments to arise from the constructive engagement between Scottish Water and the customer forum. My understanding is that that measure will provide a direct feedback mechanism for customers. However, it is still at the theoretical stage and has not been implemented. If you were to return to the committee in six months or a year, what would you hope to be able to tell us about how the measure had been implemented?

Peter Peacock: You are right to say that we have got agreement that there should be a customer experience measure. The heads of

agreement on that are that the measure should have quantitative and qualitative aspects, some of which are about the experiences and perceptions of customers who have been in touch with Scottish Water. There are also dimensions on business customers, licence providers and developers, to try to find out their views.

We had a meeting with Scottish Water last week and we will now sit down and try to work out in fine detail what all that will mean for implementation in 2015. Scottish Water is out doing quite a lot of surveying. It has commissioned survey work and has just increased its sample size. It has discovered that there is more to be considered when the satisfaction data is disaggregated for the different dimensions. It has begun to see that customers who have not contacted Scottish Water with a complaint have different perceptions of the organisation, so it is probing that.

My hope for the process overall is that Scottish Water, and all the stakeholders in what is a vital industry in Scotland, will get a much more sophisticated feel for where customers stand on a range of questions. That is important. From working closely with Scottish Water, I have learned that it is very keen to find out that information because it knows that it can then improve. Scottish Water is heavily driven by its desire to improve the customer experience.

Scottish Water has said—perhaps rashly, with the benefit of hindsight—that it wants to be Scotland's most valued and trusted company. We have quoted that back to it a number of times. If a company actually believes that, who does it want to be valued and trusted by? The answer should be not just by the decision makers in society, but by its customers. To do that, a company must understand where its customers are and it must be close to them, and the only way in which it can find out is by doing it very deliberately. That is what the new measure will help to achieve.

Gordon MacDonald: I have a quick question about the existing overall performance assessment. For the past three years, the OPA has exceeded the target by, on average, 10 per cent a year. In March 2013, when the most recent figures were reported, it stood at 368, with two years of the current period still to be reported. What is your view about the OPA target of only 382.5 that has been set for the new review period?

Peter Peacock: That was the subject of a lot of debate in the final phase of discussions between the customer forum and Scottish Water. That has resulted in a much better understanding of the objectives between the forum and Scottish Water.

The OPA is really the only objective scientific measure of levels of service, so it is very important. From a customer point of view, it is

quite important that Scottish Water is seen to continue to try to move that score up. Otherwise, it gives the message that it is settling at 380. Is that fine? No. Scottish Water does not think that it is fine—its aspirations are much greater.

I guess that Scottish Water would be anxious that if, on paper, in a formal agreement, it sets the level too high, the level will be unachievable, or potentially very challenging. That has implications for how it motivates its staff in the company and so on. Scottish Water uses the OPA to try to drive improvements. It wants to see a gradual improvement. The figure of 382.5 that Gordon MacDonald mentioned is the average guarantee. Scottish Water wants to get up to 385, which is equivalent to about 387 in today's terms. There is a technical adjustment, so the figure is slightly higher than it first appears.

The aspiration that is quite clearly stated is to get up to and exceed 400. The forum was content to say, "Okay. We're on the move on this and we're continuing to see progress." Very few companies in England—that is the comparison, because they use the same measure—have continuously exceeded 400 points. Doing that is quite a challenge. Scottish Water is already achieving about 100 per cent on quite a number of the 17 scores, so it cannot improve on those measures.

Within those broad parameters, the agreement is reasonable and we and Scottish Water were happy to agree to it. It keeps performance moving forward, the aspiration is clear and I am pretty confident that Scottish Water will move up there—I know that it wants to move up there, because it wants to be the most valued and trusted company in Scotland. It genuinely wants to be able to demonstrate that, partly through the hard measures that the OPA represents.

Alex Johnstone: The proposed changes to the exemption scheme for small third sector organisations have caused a bit of concern among some organisations, especially churches. Have you taken those concerns to the Government?

Peter Peacock: The short answer is no, but let me explain that. As I mentioned in response to an earlier question, we were asked to operate within current Government and regulatory policy, and we regarded that as a matter of Government policy. The Government of the day introduced the scheme and it is for the Government of the day to decide whether to have it. We knew that it was also subject to a separate consultation, which was going out directly to those parties that were affected by it, so we did not take a position on the matter. Having said that, the forum touched on the matter informally, first to decide whether to take a position. That was our conclusion. It is not really our business to address those concerns.

This is not a formal position, but it is interesting that we are talking about a scheme that I think comes to £3.6 million to £4 million annually, in a business that is—we are looking at the draft determination today—an £8.5 billion enterprise over the six-year period, so it is a tiny part of the overall cost. There is a cost, because the money for charitable exemptions is not available to be invested or to reduce prices, and it is part of the non-domestic side of the equation. However, in the great scheme of things, the scale did not seem so great to the forum that it would be worth our commenting on. Our view is that the matter is clearly for Government policy.

Alex Johnstone: I see what you mean when you describe the cost as small, but concerns have been brought to MSPs. Do you suggest that, if we want to influence the Government's policy, that is our job and not yours?

Peter Peacock: The matter is entirely political.

Alex Johnstone: I will take that to heart and take up the issue.

Mark Griffin: Does the customer forum have any concerns about the non-charging aspects of Scottish Water's business plan or the WICS draft determination?

Peter Peacock: No. The important point, which I have referred to, is that what we have is what we agreed. By definition, we are content with that. In any negotiation between two parties, neither side gets everything that it wants, but that is the nature of negotiation. A lot of progress is being made on a wide range of fronts. Some of that is more about customer experience stuff and some of it is about the hard delivery of new services to reduce sewer flooding and improve water quality. The overall package is very acceptable.

Mark Griffin: Will you pursue in future agreements a particular aspect that has not come through in the current round?

Peter Peacock: The package makes a lot of progress on a lot of fronts but, inevitably, it does not solve every problem. The work programme includes looking at things that are emerging. I do not remember whether Mr MacDonald or Mr Johnstone asked about the investment review 2018 process, which occurs halfway through the settlement period. From a customer point of view, it is important that there will be time over the next few years to look at issues that have not yet been resolved and which are rising up the agenda. There is a mid-point when a decision to take action might be taken.

The minute of agreement mentions some obvious things. It is clear from Scottish Water's business plan that issues are arising about connecting private supplies to the public water

supply. Does that or does that not involve the art of the possible? A lot of that concerns rural Scotland and huge costs are involved. Are there alternative ways of dealing with that? A bit of work will be done on that in the coming period.

Questions are arising about whether we can go beyond statutory standards for lead in water and remove more lead. Work will be done to look at all that.

There will always be issues to look at. Vulnerability is another such issue. However, the good thing about the rolling investment review process is that it provides a chance to look at issues in a reasonable time. If there is a case for moving some such things forward, that will be considered under that process. The voice of customers will be at the table at the same time, in the same way as the process has operated until now. I hope that that answers Mark Griffin's point.

Mary Fee: This is the first time that the customer forum has been involved in the review of charges process. How beneficial has your involvement been? What value has it brought to customer forum representatives? How beneficial has your involvement been for Scottish Water?

Peter Peacock: It is difficult for me to say what value the forum has added; that is for others to comment on. An independent evaluation of the process is being done by Professor Stephen Littlechild, who is a well-known expert in the field internationally. That will help other people to decide whether the process has been of value.

I can say that Scottish Water told me that it found the process to be of great value and challenging at times. We have found it challenging and we have had to learn a huge amount. We have had to learn to balance customers' short-term and long-term interests; nothing that is done in the short term should threaten long-term interests.

11:15

Scottish Water has felt that it has been asked to do a lot. It has had to think afresh about some things. There must have been times when the Scottish Water officials left our meetings pulling their hair out and thinking, "What do we have to do to convince these people?" because some quite straight-from-the-shoulder, hard messages were given to Scottish Water about how it was doing things. Scottish Water officials have told me subsequently—if they were feeling bad about it, they certainly did not let it show and were very professional—that those were hugely important conversations because, for the first time, they looked at problems from a different point of view. Rather than looking at them from a technical or professional point of view, or from an

environmental standards point of view, and having that drive their behaviour, they started to look at problems from a different perspective because of the thoughts that we were putting to them. They have found the process valuable. There is a lot in the detail of the settlement—Mr Eadie was probing about that—so customers have got a lot out of the process, too.

You should not underestimate how innovative the process has been. Very few people in the world have tried it for making regulatory policy. There are some examples of it in America, but it tends not to involve bodies of retail customers; it tends to involve wholesale customers who are acting together. The Water Industry Commission has been inspired in this and has been thinking hard about how customers can be empowered more within the regulatory framework. The powerful thing that it did was ask the group that was acting on behalf of customers and Scottish Water to agree on the basis that, if they agreed, it would be minded to accept that agreement. That is a pretty powerful statement.

That gave the forum enormous scope and latitude. Equally, the commission—with which there were a lot of conversations throughout the process—set out parameters for us to operate within. There was no point in our discussing things that were never going to be acceptable to the commission, so it set clear parameters, within which there was a lot of scope. The clever bit about that was that the commission was giving scope and latitude to customers but, as the regulator, it was not giving away any power. I know, because I have been party to discussions in the south, that not every regulator would have behaved in that way. A lot of regulators would have thought that they were being asked to cede power in some way to the customer group. The clever thing about what the commission did is that it gave latitude and scope for detailed customer involvement without giving up any power. Although the commission would be minded to accept any agreement, it was clear to me throughout the process that there was no guarantee that it was going to accept it, because it has a statutory responsibility to fulfil.

The commission has been true to its word. It has checked out everything that we have done. It has checked out the agreement and made sure that it satisfies all the requirements that it has as an accountable public body, and it has embedded the agreement within the draft determination. That is very empowering for customers. There was one moment in a long day of discussions that we had with Scottish Water—I do not want to mischaracterise the discussions, which were conducted professionally and constructively—when the chief executive looked into my eyes and said, "Are you really serious about the figure of 1.6

per cent?" I looked back and said, "I'm deadly serious about it," and we came to an agreement. We felt empowered on our side of the table at that moment. That was enabled by the framework that the commission has created. At the same time, however, we knew that we had to behave responsibly and sensibly, not compromise the long-term interests of the company, and that the commission would check everything out.

It was a powerful process, and many people are taking an interest in it—not just for what it has done here but because of the implications that it might have for energy policy, the railways and other regulated sectors. Are there wider implications for empowering customers in new ways? I take my hat off to the commission for the way in which it has dealt with the forum. It has been very helpful and supportive. I am also grateful to Scottish Water for the way in which it responded. Returning to your original question, I think that the process has allowed it to hear perspectives that it did not hear before.

The process also meant that Scottish Water had to think about things earlier in its business planning—up to a year or 18 months earlier than it has ever done in previous business planning cycles. Why? Because it had to come and explain its plans to a group of laypeople and try to justify its proposals. That meant that Scottish Water had to think things through very carefully earlier. I know, from speaking to Scottish Water, that in going through that process it rethought a number of things in its business planning, so the process brought more transparency and earlier planning.

Mary Fee: Thank you for that very thorough answer. I had an additional question, but you have answered it, so thank you.

Peter Peacock: That is exactly what I like to hear.

The Convener: Throughout the session, you have said that some things are not part of your remit or are not within the framework within which you have to operate. If, as a result of the evidence from today's three panels, we write to the cabinet secretary with recommendations, what changes would you like us to recommend to the framework or parameters within which you operate?

Peter Peacock: That is an interesting question. To be frank, I have not thought about that in sufficient detail to give you a solid answer. I guess that, now that we have got through this process, careful thought has to be given to whether it could be exactly replicated next time. We have to keep the process fresh and dynamic, so we have to think about how to do that. Do we want to keep customer involvement empowered at the heart of Scottish Water? Absolutely, yes. I suppose that there are a variety of ways of achieving that.

Scottish Water invested a huge amount of senior management time in talking to the forum, and I guess that it does not just want to write that off. In fact, I know that, because we have just set up arrangements for that. Scottish Water wants access to forum members so that it can bounce ideas off them and say, "From where you sit, how does this look?" There needs to be a powerful customer voice at the heart of it.

From my experience, part of the reason why Scottish Water opened up to us, behind closed doors and in an honest way, about the issues facing the industry was, I think—this would have to be confirmed with Scottish Water—because we did not have any statutory powers, and we were not consumer advocates against policy. To overstate the situation a bit, Scottish Water knew that it could tell us anything without ending up with us putting out placards arguing for a change of Government policy. It was a secure environment.

In future, it will be important to maintain a group that sits within regulation policy and is not there to challenge it. The role of challenge of the wider policy now falls to Citizens Advice Scotland, in taking over the role of Consumer Futures. It is important to draw that distinction.

I absolutely urge the committee to recommend that a customer dynamic should be retained at the heart of the process.

The Convener: You said that other bodies are interested in the same type of customer engagement. To put it bluntly, some parties in the Parliament would like Scottish Water's status to be changed so that it is not a public body, as it is currently. For private water companies in England, for example, some of which are looking at what we are doing here, would it be difficult to replicate the process because those bodies are private rather than public?

Peter Peacock: I have thought about that. A few weeks back, I went to an event in London to hear Professor Littlechild talking about regulation and customer involvement to a broad international audience. One of his points was to draw a distinction between what happened in Scotland and what happened in an analogous process south of the border in which water companies were asked to set up challenge groups of customers within the company framework. The regulator down south, Ofwat, said that if a customer challenge group and a company could agree the business plan in broadly the way that I have described—although not quite the same way—the regulator would fast-track the company through the regulatory process. It turns out that all the companies agreed but only one has been fast-tracked through the process. That is unlike how the commission handled things here, and pretty

fundamental questions are being raised down south about whether that approach will work.

Another key difference is that the companies in England are privately owned. Because the question has been put to me previously, I have thought a bit about whether the same approach could work in a private ownership setting. In principle, I do not think that it would be any different. It is about injecting a new dynamic, and the powerful thing is asking the companies to agree—that is the real power at the heart of it. Where they have perhaps erred down south is that they did not stick to what was agreed.

In the Scottish context, there is a Government dynamic because of the ownership of Scottish Water that does not exist with the companies in the south. In one sense, that simply changes the private shareholders' interest for the Government interest. Those are not entirely the same but, nonetheless, we have to account for Government policy and think about all that. Down south, people are not thinking about that anywhere near as much, but they are thinking about shareholder interest. However, would it not be a good thing to apply some customer pressure on shareholder interest?

The Convener: As there are no further questions, we will leave it at that. Thank you very much, Mr Peacock.

11:25

Meeting suspended.

11:28

On resuming—

The Convener: In our final panel this morning, I welcome Professor Gordon Hughes, chairman, and Ian Tait, director of investment, from the Water Industry Commission for Scotland.

Does either of you want to make any opening remarks?

Professor Gordon Hughes (Water Industry Commission for Scotland): I have not prepared an opening statement, but we thank the committee for the opportunity to answer questions. I would like to make a couple of clarifications in response to questions that came up earlier because it may be helpful for the committee.

First, there was a discussion about whether the procedure that WICS followed in Scotland might have been possible down south with a different ownership structure for the industry. It so happens that we had a meeting with Ofwat yesterday evening, and this morning it announced that two companies have gone through its enhanced

procedure and have essentially agreed draft business plans and therefore draft regulatory agreements with Ofwat as a consequence.

In fact, there is a great deal of similarity between what we have been doing and what those companies down south have been doing, and I am confident that Scottish Water would have acquired an enhanced status and would have been treated in roughly the same way that it has been up here. That is testament to the fact that Scottish Water stands out as being among the best when compared to the companies in England and Wales generally.

11:30

That brings me to the second point that I want to allude to. A question was asked about making comparisons outside England and Wales, rather than just looking at Scottish Water with reference to the rest of the UK. It is very difficult to make comparisons outside the UK, because we do not have a common information base, in the way that information is either collected or interpreted. However, one can say with a considerable degree of confidence that, at least as far as costs are concerned, Scottish Water is among the best in the UK and worldwide.

It is much harder to make that judgment about customer service, so we have used a broader set of international comparators in Europe, Australia and elsewhere to conclude that generally Scottish Water's performance on costs is very good. However, it may have further to go to match the best level of customer service.

Thank you for the opportunity to make those clarifications, which I hope are helpful. I am happy to answer any further questions.

The Convener: Can you set out details of the charge caps for household and wholesale customers and tariffs levied by licensed retail suppliers that are set out in the draft determination and say what they might mean in practice for customers?

Professor Hughes: As previous panels said, there are two components to the household charge cap. For the first three years, the increase in prices from one year to the next will be 1.6 per cent. Indeed, that was the case for the current revision of tariffs that came into effect at the beginning of April. For the longer period, there is also a cap of CPI minus 1.8 per cent cumulatively over the full six years.

As everybody up to now has been used to making comparisons with RPI, it may help to compare the last regulatory period with the current one in terms of RPI, from the point of view of households. Our draft determination, based on our

expectation of the difference between RPI and CPI, is equivalent to an overall charge cap of RPI minus 1.05 per cent a year, which is almost identical to what we set in 2010, which was RPI minus 1 per cent a year for five years. In essence, the charge cap over the full period of the review is very similar to the previous one.

For non-household customers—business customers—it is, in essence, the same. However, we expect the default tariffs to remain constant in nominal terms for the full period. That means that what we call the retail margin—in other words, the difference between wholesale charges and default retail charges for business customers—will narrow gradually over time, because the default retail charges are going to be held at their current value for the next six years.

Adam Ingram: What impact can the charge caps have on the plans and proposals that are set out in Scottish Water's draft business plan?

Professor Hughes: We believe that the resources that the charges will provide will enable Scottish Water to complete the programmes that it has outlined in its draft business plan and do one or two extra things as well, which I am certain were in the draft business plan and have been clarified as a result of the intensive discussions that have taken place with the customer forum, the Scottish Government, SEPA and the Drinking Water Quality Regulator.

In essence, provided that Scottish Water meets the efficiency targets that we believe are reasonable and achievable, it can fully finance its plans. Indeed, Scottish Water produced a revised business plan very recently—I think that it was about a week or 10 days ago—which incorporated all that and is fully compatible with our draft determination and the agreement, which you have heard about, between the customer forum and Scottish Water.

Adam Ingram: So there are no areas in which the two are at odds with one another.

Professor Hughes: We believe not. However, we must remember that all this is subject to the Scottish Government confirming its objectives for Scottish Water over the next regulatory period, which we expect it to do by the middle of the summer. Changes could arise because of changes that the Scottish Government introduces as a consequence of reviewing all the discussions and the agreements that have been arrived at.

Adam Ingram: Consultation on the draft determination closes in June. How do you intend to respond to issues raised during the consultation and what impact might that have on the final determination?

Professor Hughes: We can explain the process rather than the content of the piece, which will depend on the nature of the comments. We will consider in detail all the items that are provided. It is likely—I believe that it is standard practice—that we will publish the comments that we receive and then produce a revised final determination, in the light of the consultation, with, as appropriate, an indication of how we have responded to the concerns that have been raised up to then.

We have tried to take account of a wide range of interests and concerns from a very large set of stakeholders, so we hope that the comments will be—how shall I put it?—relatively minor in comparison with the intensive discussions that have already occurred, but we will see.

Ian Tait (Water Industry Commission for Scotland): It might also be useful to add that the final determination will take account of finalisation of the minister's objectives and principles of charging, which is due at the end of June, as well.

Adam Ingram: I take it that it is too early in the consultation process for themes to have emerged.

Ian Tait: It is early in the process, but a theme that has been touched on is consideration of rural provision. The finalisation of the minister's objectives in that area might bring some additional requirements that we would need to consider for the final determination.

Adam Ingram: So, we might have to have you back.

Professor Hughes: Draft determinations are called "draft determinations" because they are not final.

Adam Ingram: Thank you for pointing that out. *[Laughter.]*

The Convener: Are you satisfied that Scottish Water's assumptions regarding interest rates, the availability of borrowing and total debt are sufficiently robust to protect customers from an unexpected rise in charges later in the control period?

Professor Hughes: As Scottish Water has explained, it has a relatively long maturity period for its debt. The interest rates on much of its debt are therefore fixed, so it would require an extremely sharp rise in interest rates for an unexpected rise in charges to occur. We have provided for an increase in interest rates over the period, and we think that the assumptions are robust.

Both Scottish Water and the customer forum indicated that we defined reasonable ranges for the discussions. Scottish Water's interest rate assumption is within the range that we regard as

being reasonable, given the information that we have and the fact that none of us has a crystal ball to see what will happen to interest rates.

Gordon MacDonald: What is your view on the need to develop a new customer satisfaction measure and why has the measure not been finalised by this late stage of the review process?

Professor Hughes: We believe that that step is very important, to move on from what in the OPA is fundamentally a complaints-based measure of customer satisfaction; in other words, it is a measure of whether the company responded promptly and adequately to complaints. As you have heard, that straightforward current measure is a long way from presenting a complete picture of business and non-business customers' views of Scottish Water's performance, so it is important to go beyond that to a measure that is much broader. As you also heard, the new measure incorporates the high-esteem target, which shows Scottish Water's desire to flag itself as a company of outstanding reputation and performance for everyone in Scotland, practically all of whom are affected one way or another by how Scottish Water does its job.

Gordon MacDonald: How will the new customer satisfaction measure relate to and affect the calculation of the overall performance assessment index?

Professor Hughes: It will not change the way in which the OPA is calculated. We want to retain that as a standard benchmark so that we can compare wherever Scottish Water reaches at the end of the current period with where it goes thereafter, and ensure that it maintains its performance and does not slip back on what has happened in the past five years.

In essence, we are broadening out and adding to the targets that we expect Scottish Water to meet. Inevitably, that is not an easy thing to do, so we are concerned not to overload it with the creation of more and more targets, which is why I did not fully answer the question about why the new measure was not ready for the draft determination. We believe that we must spend time piloting the measure in order to get one that is satisfactory, that customers believe and that reflects fully the views of the customer forum and society at large.

Gordon MacDonald: On the OPA, in the Water Industry Commission for Scotland's report "Scottish Water's Performance 2010-11" you said:

"Scottish Water plans to achieve a score of ... 380-400 by 2013-14".

Given that in March 2013 the OPA stood at 368 and that the 2013-14 figures will not be published until December 2014, is the new OPA target of

382.5 on average over the next five years ambitious enough?

Professor Hughes: We believe that, as of the end of 2013-14, Scottish Water has actually exceeded the 380 target—by how much, we have yet to confirm, but we expect that it will be significantly above that.

Is the new OPA target ambitious enough? It has to be seen in the context of the fact that the maximum possible OPA score is about 405 to 407, so we are talking about a very narrow band. Our main concern was that Scottish Water should not slip back; in other words, that it should maintain the level of performance that it has already achieved and turn its efforts to other things, in terms of the new customer experience measure.

Our belief is that Scottish Water is getting to the frontier of what it can possibly achieve on the OPA. We now have to challenge it to do better on customer service.

11:45

Jim Eadie: The draft determination, which was published in March, states:

"There would be no increase in the maximum charges payable by a non-household customer unless there is a substantial increase in inflation."

What do you consider to be a "substantial increase" and what process would have to be followed before any such increase took place?

Professor Hughes: We are trying to say that we would be very reluctant to increase charges. There would have to be a very substantial increase in inflation.

The context is that over the past five years RPI has varied between being negative and a maximum of 5 per cent a year. I do not seriously believe that the level of the default tariffs could remain constant if inflation was 5 per cent a year for more than a very short period.

Beyond that, the process would be one in which we would receive representations from Scottish Water as well as other parties. We would draw up our proposals and put them out for consultation, then respond to the views that were expressed.

The approach has to be seen in the overall context of Scottish Water and the retail market. We have introduced a mechanism that we refer to as the "tramlines". In other words, if Scottish Water's financial strength declines below a low threshold, there is a procedure that we have outlined for reviewing tariffs in general and for asking whether revision of the investment programme or the level of tariffs is required. The same is true if there are performance

improvements above a threshold. We view the approach as part of that tramlines process.

Jim Eadie: That is clear.

We heard earlier from Ms Oldfield that the customer forum presented a number of constructive challenges to Scottish Water. Are you satisfied that the forum has adequately represented the views of Scottish Water customers during the review process?

Professor Hughes: Yes, we are. Mr Peacock explained that the customer forum gave Scottish Water a pretty hard time on a number of issues. Our perception is that the forum very ably represented customers' interests and provided a very important and rather different perspective to the perspective that Scottish Water was getting from, for example, its market research inquiries. The forum's contribution to the process as a whole was enormously valuable.

Jim Eadie: In a previous evidence session, my colleague Alex Johnstone asked about the review of the water and sewerage charge exemption scheme. Do you have a view on that, or is it outwith your role?

Professor Hughes: Are you referring to the charities exemption scheme?

Jim Eadie: Yes.

Professor Hughes: We regard that as a matter of policy to be decided by the Scottish Government in the light of representations that it receives. Once the Scottish Government makes a decision, it will be our job to implement the consequences of it in respect of how we set charges and the overall level of charges.

Jim Eadie: For clarification, is it the case that you would not consider that issue as part of the consultation in which you are engaged between March and June this year on the draft determination?

Ian Tait: That would form part of the final objectives that the Government will set at the end of June.

Professor Hughes: Exactly. If the Government was to outline a different set of principles for charging based on that, naturally we would take account of it. That is the mechanism and that is the role of the principle of charging in the process that we are expected to go through.

Jim Eadie: Finally, do you have any views on how the strategic review process could be improved for the next control period?

Professor Hughes: Every strategic review process builds on what has gone before. Scottish Water might believe that in previous reviews the Water Industry Commission has tended to beat it

up over costs and has tended to look at a variety of challenges, which presented Scottish Water with a large agenda of issues to address. Generally Scottish Water has made excellent progress in responding to those challenges. We are now posing it a new set of challenges on the customer side.

We will review how the current strategic review has gone. We will think about it and look at what seem to be the emerging problems that will define how things have to be looked at in both the interim review in 2018 and the full strategic review in 2021. When we see where that is going, we will either tweak or make more major changes to the strategic review process. However, having just come out of one strategic review, I cannot say what the direction of change is likely to be in three or four years.

The Convener: The name of your body is the Water Industry Commission for Scotland. The non-domestic markets in Scotland are going to open up and other companies will come in, which will mean that companies will need to be made aware that there will be more competition in the industry. Have you considered how that will affect Scottish Water and was that taken into account when the review period was determined?

In addition, will you comment on the opportunities for Scottish Water to enter the market down south?

Professor Hughes: The market in Scotland has already opened up gradually over the past several years, and competition is becoming a great deal more real. We have 14 licensed providers, including Business Stream, which is a subsidiary of Scottish Water, and a number of other entrants, which are gradually taking market share from Business Stream.

We are required to ensure that the rules for the market do not operate to the detriment of Scottish Water's main household customers. That is done by ensuring that either the level of wholesale charges or the level of household charges properly reflects the costs that are incurred in those parts of the business.

We do not believe that the opening up of the markets in Scotland will represent a detriment to the regulated business side of Scottish Water, but the non-regulated side—Business Stream—is going to face an increasingly tough environment, in which it will have to compete with a range of competitors offering different services, with potentially different costs. However, Business Stream is fully aware that the Water Bill down south has almost received parliamentary approval, and it will have the opportunity to enter the market in England in 2017 or sometime after that. It is gearing itself up to build on its experience, skills

and all that it has learned in Scotland in order to offer an attractive package to the people who will have a choice in England. We hope that Business Stream will be successful in that, but that is up to Business Stream.

The Convener: There is a lot to think of in the future. Thank you very much, gentlemen.

11:54

Meeting suspended.

11:55

On resuming—

Subordinate Legislation

Road Traffic (Permitted Parking Area and Special Parking Area) (Argyll and Bute Council) Designation Order 2014 (SSI 2014/84)

Parking Attendants (Wearing of Uniforms) (Argyll and Bute Council Parking Area) Regulations 2014 (SSI 2014/85)

Road Traffic (Parking Adjudicators) (Argyll and Bute Council) Regulations 2014 (SSI 2014/86)

The Convener: Agenda item 3 is, as is detailed on the agenda, consideration of three instruments that are subject to negative procedure the purpose of which is to introduce a decriminalised parking regime in the Argyll and Bute Council area. The committee will consider whether it wishes to raise any issues when reporting to Parliament on the instruments. Members should note that no motions to annul the instruments have been lodged.

Members have no comments, so does the committee agree to make no recommendations on the instruments?

Members *indicated agreement.*

The Convener: Thank you. That concludes our business in public; we will now consider in private the evidence that we have heard on the strategic review of water charges 2015 to 2021.

11:56

Meeting continued in private until 12:01.

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