

ENVIRONMENT AND RURAL DEVELOPMENT COMMITTEE

Tuesday 5 October 2004

Session 2

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ENVIRONMENT AND RURAL DEVELOPMENT COMMITTEE 23rd Meeting 2004, Session 2

CONVENER

*Sarah Boyack (Edinburgh Central) (Lab)

DEPUTY CONVENER

*Mr Mark Ruskell (Mid Scotland and Fife) (Green)

COMMITTEE MEMBERS

*Rob Gibson (Highlands and Islands) (SNP)
*Karen Gillon (Clydesdale) (Lab)
*Alex Johnstone (North East Scotland) (Con)
*Richard Lochhead (North East Scotland) (SNP)
*Maureen Macmillan (Highlands and Islands) (Lab)
*Mr Alasdair Morrison (Western Isles) (Lab)
Nora Radcliffe (Gordon) (LD)

COMMITTEE SUBSTITUTES

Alex Fergusson (Galloway and Upper Nithsdale) (Con)
Janis Hughes (Glasgow Rutherglen) (Lab)
Jim Mather (Highlands and Islands) (SNP)
Jeremy Purvis (Tw eeddale, Ettrick and Lauderdale) (LD)

*attended

THE FOLLOWING GAVE EVIDENCE:

Ross Finnie (Minister for Environment and Rural Development)
William Fleming (Scottish Executive Environment and Rural Affairs Department)
Ewen Milligan (Scottish Executive Environment and Rural Affairs Department)
Clare Morley (Scottish Executive Environment and Rural Affairs Department)
Andrew Scott (Scottish Executive Environment and Rural Affairs Department)

CLERK TO THE COMMITTEE

Tracey Haw e

SENIOR ASSISTANT CLERK

Mark Brough

ASSISTANT CLERK

Chris Berry
Catherine Johnstone

LOCATION

Committee Room 2

Scottish Parliament

Environment and Rural Development Committee

Tuesday 5 October 2004

[THE CONVENER *opened the meeting at 09:39*]

Interests

The Convener (Sarah Boyack): Good morning. I welcome members, witnesses, press and members of the public to this Environment and Rural Development Committee meeting and I ask everyone to turn off their mobile phones. We have received apologies from Nora Radcliffe and Alasdair Morrison, who I think will join us later.

Agenda item 1 is a declaration of interests. Last week, the Parliament decided that Richard Lochhead would replace Roseanna Cunningham as a member of the committee. I welcome Richard to the committee and ask him to declare any relevant interests.

Richard Lochhead (North East Scotland) (SNP): Due to lack of wealth, I have no interests to declare.

The Convener: Nothing on the record, anyway. Thank you.

Just as Richard Lochhead is joining us, Tracey Hawe, our clerk, is moving sideways to another committee. She worked with the committee before, when it was the Rural Development Committee. It is a real pity that we are losing her. As a new convener in this place, I found her support absolutely wonderful. She has been a brilliant support to all the committee and we officially record our thanks.

Subordinate Legislation

Ethical Standards in Public Life etc (Scotland) Act 2000 (Modification of National Parks (Scotland) Act 2000) Order 2004 (Draft)

09:41

The Convener: Agenda item 2 is subordinate legislation. We have three instruments before us, all of which are subject to the affirmative procedure, which means that we must formally approve them before they can either come into force or remain in force. There are three motions, in the name of the Minister for Environment and Rural Development, Ross Finnie, who is with us this morning, inviting us to recommend to the Parliament that the instruments be approved. I welcome Ross Finnie and his officials and ask him to address the draft Ethical Standards in Public Life etc (Scotland) Act 2000 (Modification of National Parks (Scotland) Act 2000) Order 2004.

I do not know how controversial the instrument is going to be. The Subordinate Legislation Committee considered the instrument but had no comments to make. I ask Ross Finnie to introduce his officials and to make some brief opening remarks on this piece of subordinate legislation. We will then move on to factual questions and points of clarification from members.

The Minister for Environment and Rural Development (Ross Finnie): Morris Fraser will stand in for now for the officials coming in behind us, who will give us support if we get into difficulties.

I do not think that the instrument will be controversial. Nevertheless, a difficulty has emerged in the fact that the Ethical Standards in Public Life etc (Scotland) Act 2000 and the National Parks (Scotland) Act 2000 are at odds with each other over the issue of a member declaring any interests at a meeting. This statutory instrument is necessary to resolve those difficulties.

The Ethical Standards in Public Life etc (Scotland) Act 2000 sets out the broad framework for securing the observance of high standards of conduct by councillors and members of public bodies. Along with the National Parks (Scotland) Act 2000, it was one of the earliest acts to be passed by the Scottish Parliament and it gave ministers powers to introduce codes of conduct for members of devolved public bodies. Both national park authorities were added to the list of bodies in schedule 3 to the Ethical Standards in Public Life etc (Scotland) Act 2000 and so were required to have in place their own codes of conduct for their

members, which had to take account of the terms of the model code of conduct that was approved by Parliament.

Section 5 of the model code provides for the circumstances under which members should declare an interest at meetings. However, in the course of the authorities' drafting their own codes, it came to light that the process that board members of national parks are required to follow under the National Parks (Scotland) Act 2000 when declaring an interest at a meeting is inconsistent with the provisions regulating the procedure that members of other public bodies are expected to follow under the model code under the Ethical Standards in Public Life etc (Scotland) Act 2000.

As things stand, members of a national park authority are required to act in accordance with the procedures that are set out in paragraph 18(1) of schedule 1 to the National Parks (Scotland) Act 2000, which states that any member who is in any way interested in a matter that is brought up for consideration at a meeting

"must disclose the nature of the interest"

and can take no further part in the meeting. The terms of that provision are clearly much narrower than those in the model code of conduct under the Ethical Standards in Public Life etc (Scotland) Act 2000, which states that a member can continue to attend a meeting and participate in both discussion and voting if they feel that,

"in the context of the matter being considered,"

their

"involvement is neither capable of being viewed as more significant than that of an ordinary member of the public, nor likely to be perceived by the public as wrong".

There is a clear inconsistency between the two procedures, which needs to be remedied. As things stand, members of national park authorities cannot bring their expertise to the table and that is unsatisfactory.

We have consulted the Standards Commission and the national park authorities from the outset and the organisations agree that the only sensible way to proceed is to remove paragraph 18 from schedule 1 to the National Parks (Scotland) Act 2000 in relation to members of national park authorities.

09:45

The Convener: Thank you, minister. That is a helpful outline of the statutory instrument's objective. As it is fairly straightforward, no member seems to have a point of clarification or a question and we move to the formal debate.

Motion moved,

That the Environment and Rural Development Committee recommends that the draft Ethical Standards in Public Life etc. (Scotland) Act 2000 (Modification of National Parks (Scotland) Act 2000) Order 2004 be approved.—[Ross Finnie.]

The Convener: Does any member want to make a statement?

Alex Johnstone (North East Scotland) (Con): This is a very sensible change. Too often in public life we disqualify those with genuine expertise in a subject from contributing to debate or discussion on those subjects on which they have expertise. In a small country such as Scotland, we can ill afford to take that route, so I am delighted that the minister has made the change, which I hope will be constructive for the national park authorities.

The Convener: The committee seems to agree broadly with those sentiments. There are no other comments, and there does not seem to be a need for the minister to wind up.

Motion agreed to.

Scotland Act 1998 (Functions Exercisable in or as Regards Scotland) Order 2004 (Draft)

The Convener: The Subordinate Legislation Committee has considered the instrument and its comments have been circulated to members. I invite the minister to introduce the next set of officials and to make any opening remarks.

Ross Finnie: I do not think that there are any new officials; we seem to have lost officials this morning. The satellite monitoring on which Richard Lochhead has said that he wants to question me does not seem to be working. I apologise.

The instrument is purely technical; there is nothing of substance or politics to discuss.

The Convener: I think that members have read their papers on this occasion; I see some members nodding in agreement. We do not usually put subordinate legislation through this quickly, but on this occasion it seems to be quite straightforward.

Richard Lochhead: If I ask a question, will the minister write back to me as opposed to having to answer today?

The Convener: Yes, but are you sure that your question is on the draft Scotland Act 1998 (Functions Exercisable in or as Regards Scotland) Order 2004?

Richard Lochhead: No. I am sorry.

Motion moved,

That the Environment and Rural Development Committee recommends that the draft Scotland Act 1998 (Functions Exercisable in or as Regards Scotland) Order 2004 be approved.—[Ross Finnie.]

Motion agreed to.

Fishing Vessels (Satellite-tracking Devices) (Scotland) Scheme 2004 (SSI 2004/379)

The Convener: The Subordinate Legislation Committee has considered the instrument and copies of that committee's comments have been circulated to members. As with the previous statutory instruments, I intend that members should ask for any clarification or raise any points directly with the minister before we move into the formal debate. I invite the minister to introduce his officials and to make any opening remarks before we move on to questions.

Ross Finnie: I am joined by Ewen Milligan from the fisheries division.

As members will be aware, the monitoring of fishing vessels' position using satellite technology has become an increasingly important aspect of fisheries management control. It was first introduced in 2000 for vessels of more than 24 metres and it is now to be phased in for all vessels of 15 metres or more in length.

Satellite monitoring underpins the control arrangements in many of our fisheries, including those in which geographic separation is important, for example the pelagic fisheries, and the cod and haddock fisheries in the North sea to which spatial management applies. However, experience of operating control systems here and elsewhere in the European Union has shown that they can be vulnerable to deliberate interference or manipulation. Consequently, under a revised European regulation that was introduced in December 2003, vessels must have a terminal fitted that does not permit the input of false positions and is not capable of being overridden.

As the new tamper-resistant terminals will have no function other than fisheries control, we felt that it was appropriate to provide 100 per cent grant funding for them. Grants will be available to cover the purchase and installation costs of terminals that are sourced from an authorised provider and will also cover the cost of a three-year warranty on the satellite equipment that is provided. The statutory instrument gives Scottish ministers the powers to implement the scheme, which is fairly straightforward and broadly similar in content to other fisheries-related grant schemes that the committee has seen in the past.

Richard Lochhead: I have no objection to the scheme as such and I welcome the 100 per cent grant, but I have concerns about the process that officials will follow if they decide that the scheme might have been breached and decide to try to recover the funds from the boat owner. The instrument says that the appeal process is limited to "making written representations". Is there a general trend in the Executive towards imposing

administrative penalties on fishermen who breach regulations? I understand that there is a lot of concern about that.

Ross Finnie: We have not taken a general policy decision on that. There are some pressures from the European Union in that regard, but we monitor the situation, because there are limits on the application of administrative penalties. As you are aware, one of the great difficulties with breaches of the law in fisheries regulation is that they take place at sea and it is often difficult, if not impossible, to obtain the corroborating evidence that is required as a test in Scots law. I regard that test as important, so I am slightly reluctant to move towards more management operations. We must bear in mind the relative costs and the severity of the penalty that might be applied, but we have come to no firm decision on the matter and must keep it under review.

Richard Lochhead: I might pursue that later.

Mr Mark Ruskell (Mid Scotland and Fife) (Green): I seek clarification from the minister. When the Subordinate Legislation Committee considered the instrument, it seemed to uncover some circularity in how it will operate, which is reflected in another Scottish statutory instrument on fishing. My understanding is that the instrument gives officials powers to enter premises or vessels to find out information about how other officials have not been allowed to gain access to vessels or premises. How has the minister addressed that circularity? It is an outstanding issue to which we have been asked to give some attention.

Ross Finnie: I ask Ewen Milligan to address the technical aspect of the question.

Ewen Milligan (Scottish Executive Environment and Rural Affairs Department): The powers in the instrument—such as the power to enter into premises where documents that are relevant to the application might be held—are a fairly standard set of powers that would be found in any instrument that deals with fisheries matters. We do not accept that there is any circularity in those powers.

The Subordinate Legislation Committee's 33rd report states:

"Paragraph 9 obliges any applicant, or any employee or agent of any applicant, to give to an authorised officer such assistance as that officer may reasonably request in order for that officer to exercise the powers conferred by paragraph 10 ... Accordingly, should there be reason to suspect that an applicant failed to comply with a reasonable request from an officer for such assistance",

the officer may

"exercise any of the powers under paragraph 10 to ascertain whether ... the applicant failed to comply with the obligation imposed by paragraph 9."

It is not the person who is assisting the officer who is exercising the powers, but the officer who is empowered by the instrument. Anyone acting to assist the officer under the scheme's enabling provisions is not directly empowered by the instrument; it is the supervising officer who would invoke and carry out the powers available under the instrument.

The Convener: Is that helpful?

Mr Ruskell: Yes, that is helpful. It will be useful to see how the instrument works in practice. If it does not work, it will have to be reviewed.

Ross Finnie: If we drift to the person assisting, that does give rise to an interpretation of circularity. As Ewen Milligan has explained, it is the principal officer who is empowered, so the problem that you envisage would not arise in those circumstances.

Mr Ruskell: That is clear. Thank you.

Mr Alasdair Morrison (Western Isles) (Lab): I welcome the instrument, which I am sure every reasonable individual will support. I have three short questions on how the industry and fishermen will benefit. First, are there safety benefits for the crews of fishing boats? Secondly, what are the benefits for stock management? Thirdly, over a period of years, will the instrument help to give us a clearer picture of the process of determining the state of stocks and where exactly they are to be found?

Ross Finnie: There are no safety benefits as such. It is a sad fact that any regulatory procedure is brought about by a minority, not by the majority. Originally, we wanted to proceed with combined satellite instruments, with both a navigational use and a tracing use. Sadly, because their use was manipulated, not just in Scotland but elsewhere in the EU, a minority brought about the revised regulation, which then required us to have tamper-proof instruments for satellite monitoring purposes only.

The regulation is intended entirely for the benefit of stock management, to ensure that persons are not wrongfully and unbeknown in an area for which they do not have the appropriate licence or permit and are not carrying out fishing activities illegally outwith their own regulatory provisions.

In the sense that we are—*[Interruption.]*

The Convener: I am sorry, minister. Could somebody please switch off that mobile phone? Thank you.

Please continue, minister.

Ross Finnie: In so far as we will know more about other landings, and in so far as information about where vessels have been fishing is entirely accurate, I suppose that we will be helped in

building up data on stocks. However, I regret to say that the essential feature of the instrument is that it will provide a more accurate way of pinpointing that persons who are in the required areas at the required times are carrying the required permits to fish. That is another reason why we felt obliged to assist with the cost; that is the approach that we are taking.

The Convener: If there are no other questions or points of clarification, we move to the formal debate on the motion.

Motion moved,

That the Environment and Rural Development Committee recommends that the Fishing Vessels (Satellite-tracking Devices) (Scotland) Scheme 2004 (SSI 2004/379) be approved.—*[Ross Finnie.]*

Motion agreed to.

The Convener: We shall report to Parliament on the three statutory instruments.

10:00

Meeting suspended.

10:01

On resuming—

Petitions

Waste Water Treatment (PE517 and PE645)

The Convener: Item 3 is consideration of two petitions, PE517 and PE645, which relate to noxious odours from waste water treatment works. Colleagues will recall that we have debated the issue on several occasions. Most recently, on 9 June 2004 we took oral evidence from Allan Wilson, the Deputy Minister for Environment and Rural Development, and Mary Mulligan, the Deputy Minister for Communities. Following that, we decided that we wanted more information on a number of issues and that we would reconsider the petitions once the information had been received.

Members have in front of them a fairly lengthy paper, which is useful, because it gives them all the information that we have had back from a variety of organisations in response to a series of questions that we put. Members also have a draft code of practice on odour nuisance, which has just been issued for consultation by the Executive, which is also useful in the context of this discussion.

We have to consider the information that we have received and decide how to proceed. Members will have read the background paper. I found it useful reading given the different positions of the organisations that wrote in, in particular those of the local authorities, and the supplementary information from Scottish Water, the Scottish Environment Protection Agency and the Executive. We have moved a long way on the matter.

Members should also have in front of them a note from Susan Deacon, MSP for Edinburgh East and Musselburgh, who has taken a close interest in the Seafeld waste water treatment works. She acknowledges in her letter that she finds our new information to be interesting, particularly the draft code of conduct, and she welcomes the Deputy Minister for Environment and Rural Development's comment that he is keen to have some form of statutory underpinning for the draft code. She makes the point that she is keen to see progress

"at the earliest possible opportunity"

and hopes

"that the Committee will continue to pursue this matter vigorously."

It is over to colleagues on where we should take the matter next. The paper sets out three options. The clerks have done an excellent job in working

out how we can take the matter forward. Option A is to wait until we have research on the interaction between land-use planning and environmental regulation. The second option is to keep the issue going as we move to the stage 1 report on the Water Services etc (Scotland) Bill, which we will discuss with the Minister for Environment and Rural Development later this morning. The third option is to appoint a reporter to consider the issues, monitor developments in relation to noxious odours from waste water treatment plants and landfill sites, and report back to the committee. Those are straightforward ways to move forward.

My feeling is that we have a huge amount of information and the key issue now is what happens to it. Does it get taken on board by the Executive? Do we get statutory underpinning and, if so, how do we get it? Might we see the matter being advanced in the Water Services etc (Scotland) Bill? I am not sure that we want to monitor developments, because we know what has happened and now it is over to the Executive. My view is that we should address the matter in our discussions on the Water Services etc (Scotland) Bill, when we will also be discussing quality and standards III and the investment programme. That would be the ideal time to ensure that we complete our consideration of the petitions.

Do colleagues have strong views to the contrary, or would they like to add something?

Rob Gibson (Highlands and Islands) (SNP): You said that we should address the issue in our discussions on the Water Services etc (Scotland) Bill, which is about competition, but the issue is more to do with Q and S III. I am being technically correct, but what really matters is how the money is spent.

The Convener: We could debate how to provide a statutory underpinning of the process. We can have that discussion.

Alex Johnstone: My first reaction is similar to that of Rob Gibson. I have watched a lot of legislation go through Parliament over a number of years, and I am fairly happy to proceed on the proposed basis. We can decide during our stage 1 deliberations the appropriate way to address the issue, and by including it in our stage 1 report we can encourage the Executive to use its greater resources to consider it. I am perfectly happy with option B in the meantime, to see whether we can provoke some movement. If we do not succeed, we will have to consider one of the other options.

Mr Ruskell: I, too, am happy with option B. My only concern is that the Executive has not identified an appropriate legislative vehicle to deal with the matter. I presume that it will come at

some point in the future. We need to monitor that and keep pushing the Executive, so that it introduces an appropriate vehicle if the Water Services etc (Scotland) Bill is not the right one. Clearly, establishing a code of practice for the water industry is great, but we want it to be followed through with statutory underpinning. If that cannot be done through the Water Services etc (Scotland) Bill, it will need to be done at some point somewhere. We need to ensure that that happens, so that communities are assured that the issue will be tackled.

The Convener: That is helpful. We do not know what the legislative options might be. Clearly, the issue has been outstanding for a long time. I echo Susan Deacon's comments that we should address the issue

"at the earliest possible opportunity".

We might wish to go away and think about that, but I will put it to the minister later this morning.

It sounds like we all agree to option B, which means that we will conclude our consideration of the petitions by ensuring that the issues are addressed in discussions on quality and standards III—the investment programme discussions—and in the representations that are made to the Executive, and by considering the opportunities that the Water Services etc (Scotland) Bill might afford.

I see general agreement round the table. I thank members and the clerks. The issue has been with the committee for a long time. Part of the reason for that is the fact that the problems that communities in Edinburgh and Kirkcaldy are experiencing are severe. I know that many members of the public are keen for us to address the issue. I hope that people read the *Official Report* of our discussion today and view our decision as a step forward.

We will have a short suspension before we take evidence from the Minister for Environment and Rural Development.

10:09

Meeting suspended.

10:15

On resuming—

Water Services (Executive Consultations)

The Convener: Agenda item 4 is on Executive consultations on water services. Over the past few weeks, we have received background papers and have heard many comments from witnesses in taking evidence on the Water Services etc (Scotland) Bill. In this discussion, we will focus in particular on the Executive's consultations, "Paying for Water Services: A consultation on the principles of charging for water services", relating to the period 2006 to 2010, and "Investing in Water Services 2006-2014: The Quality and Standards III Project".

Members will be aware that, although the Water Services etc (Scotland) Bill will not change the principles of the charging scheme and does not deal directly with investment priorities, the consultations are being conducted in parallel with stage 1 of the bill. I propose to discuss the consultations first and then move on to agenda item 5, to enable the minister to address issues that we want to take up with him about the bill. A couple of weeks ago, we were given an informal presentation by the minister's officials, who outlined the main points in the consultations. For us, that was a useful backdrop to getting evidence from other witnesses.

Before we take evidence, I ask members to declare for the *Official Report* any relevant interests that they may have.

As members do not have any relevant interests to declare, I welcome back the Minister for Environment and Rural Development, Ross Finnie, and his officials. Minister, do you want to make any opening remarks about the consultations on Q and S III and the investment programme?

Ross Finnie: I will make some brief remarks only, as members have been given a presentation by my officials. It is clear that the investment programme is hugely complex—indeed, in recent months, we have all become much more aware of the extent and nature of that complexity. When my officials and I looked back at the consultation for the Q and S II programme, we found that nobody—with perhaps one exception—raised issues relating to development constraint as factors that would come into play. Similarly, on technical issues, members will find that even placing more emphasis on odour control did not feature in the earlier consultation. Therefore, in forming the £1.8 billion programme for 2002 to

2006, we were very much driven by a consultation that invited us to place almost the entire emphasis on drinking water quality, on matters relating to improving sewage outfall and on dealing with other regulatory processes.

In the consultation process, I have been, and I am, anxious that there should be a broader and wider understanding of all the elements that properly have to be considered in developing an investment programme and that there should be a better understanding of the hard choices that will have to be made in balancing regulatory requirements, issues such as development constraint and other matters that, in general, members of the public have properly pushed up their agenda. The water team and I have been at pains to conduct consultations and to hold seminars and meetings throughout the country to raise the level of understanding; we have genuinely invited wide participation in the process of bringing forward evidence about the elements that should be included in the investment programme.

There has clearly been a lot of misunderstanding about the basis for charging for water services. I have been extremely anxious that all facets of Scottish society should have the opportunity in the consultation to gain a better understanding of the principles of charging—how it impacts, the basis on which we seek to charge water customers, whether domestic or non-domestic, and how we would do that uniformly on a geographical basis. It is important to acknowledge that water plays a significant part in public health, so there are real issues in ensuring that those who are least able to pay are not debarred from access to water by virtue of their circumstances.

Those are a range of important issues on which we are genuinely consulting. I hope that the process has been much more open, transparent and thorough. We spent much more time on preparing the consultation documents prior to issuing them than we did previously. I hope that we have learned a lot of lessons from the situation that we largely inherited in 1999.

The Convener: The consultations are running concurrently. Is there a logic behind having both discussions together, rather than deciding what is needed and then working out how to pay for the changes?

Ross Finnie: We are not expecting to come to any decisions until well into 2005. Extending the length of time that the consumer had to consider these matters—given the time for an appropriate parliamentary procedure—would have been difficult. There might have been some logic to what you suggest, convener, but it would have been difficult, as the process would have been

overly prolonged. We have had good attendance at some of the seminars and meetings that we have called. I rather suspect that if we had had two separate bites at the cherry, we might not have had that same level of active participation in the process.

The Convener: The consultation has obviously concentrated minds. There is a huge amount of potential investment out there. I suppose that the issue is about working out the criteria by which you make decisions about what to put in quality and standards III. Quite a few of our witnesses have raised that issue.

Rob Gibson: I hope that we can establish that, in your role as Minister for Environment and Rural Development, you have some idea of the need for housebuilding in rural areas. You said that the fact that few consultees came up with arguments about development constraints in the last round has led us into difficulties. We all agree about that. However, in your role as the minister dealing with rural development, did you not have any inkling that there would be problems around extending settlements in rural areas?

Ross Finnie: I referred specifically to the evidence submitted by the planning departments of each of the 32 local authorities in Scotland, including those in rural areas. Although we are all conscious of development, the fact of the matter is that authorities' formal responses to the consultation in 1999 did not draw attention to the potentially serious situations in which we now find ourselves. My response to that has not been to go backwards; it has been to say, "This perhaps points to a flaw in the process in 1999." That is why, in my opening remarks, I made it clear that we undertook far more preparatory work with local government and other key stakeholders, even in preparing the material that is in the consultation documents. Aside from the factual matters, we sought to ensure that the consultation would have a much firmer foundation and that it would elicit a much more detailed response from the respective planning authorities.

Rob Gibson: The Scottish Water mechanism was new and SEPA's regulations were being tightened up, but people were perhaps not relating the two. Local authorities might have been slightly underpowered in responding to the number of consultations that were cropping up. Nevertheless, we find ourselves with particular projects being stopped in their tracks. For example, it might not have been possible to build sewerage infrastructure because there was not enough money or because other work needed to be done. Do you think that the backlog that has built up, of which you are well aware through your discussions with Scottish Water, can be tackled as part of the first work undertaken through Q and S

III, or will some of the backlog be tackled before that?

Ross Finnie: There are two difficulties. It is all very well being wise after the event but, as you and I both know, a capital programme does not just take place overnight. Scottish Water has more than 30 projects in the pipeline. Those projects were agreed in principle some time ago and they were worked up as engineering solutions in the relevant groups. Scottish Water has been seeking planning permissions for those developments. We are talking about months and months of planning problems.

I am well aware of the problem that you identify, but we have to be realistic. When we set a capital programme in train, as we have, we cannot just turn it on or off. The crucial thing is that the plan has to be underpinned with seriously good information. What has emerged—regrettably—is that the basic information underpinning the last investment programme was flawed. I am anxious about that. I must confess that I have been much more encouraged by the latest responses of local authorities and other persons who are engaged in strategic, regional and local planning, including those in the private sector. There has been a much greater understanding of the importance of getting the information for the planning process.

Looking forward, I believe that it is crucial that we strike the right balance in Q and S III. Scottish Water, SEPA and others are trying hard, where they can, to address the blockages that exist. In recent months, they have unblocked a number of projects. I am thinking in particular of a situation in Perthshire, which had seemed intractable, but for which a solution was in fact found.

We are not giving up on those projects; we are trying hard to accommodate them. It is extraordinarily difficult, however, to intervene in a capital programme. We cannot stop a process and suddenly turn on a planning permission or a detailed engineering drawing and make that the solution to a technical problem. These things are complex. That is why we must get the consultation process right.

Rob Gibson: So we can expect that some of the things that are blocked by Scottish Water at present could take several years to sort out. For example—

Ross Finnie: I am not into these pejorative terms. We agreed a programme of £1.8 billion. It is all very well to turn round now and say that we should not have done that, but on what basis? We have to move forward.

There are two elements in the capital programme. First, there is capacity, which is evidently an issue for Scottish Water, whether that is capacity in drinking water or in sewage

treatment plants. Secondly, some development constraints are not just about capacity; some of them are infrastructure issues and concern specialist developments in particular. One of the suggestions that is out for consultation—it is mentioned specifically in the charging regime booklet “Paying for Water Services” and it is alluded to in the investment programme documents—is that, as the infrastructure benefits are exclusively for the development, the developer should pay for part of them. If that general proposition were to be accepted as a consequence of the consultation, that would go some way towards unblocking one element of the development constraints from which we have come to suffer.

10:30

Maureen Macmillan (Highlands and Islands (Lab): When we were considering the Water Environment and Water Services (Scotland) Bill, I raised issues that had been raised with me by rural housing associations, which were concerned that they would not be able to develop more rural housing because of constraints on water supply and sewerage. I attended the rural and islands housing associations forum at the weekend. As you may imagine, all the housing associations were extremely agitated about the constraints that still exist in places such as Orkney, Shetland and the Western Isles.

Rob Gibson has gone over some of the general issues that the housing associations have raised; I would like to ask about some of the more focused issues that have been raised with me. First, there is the business of reasonable cost. I am hearing that, where there are small sewage works—say, in the Western Isles—Scottish Water will not take them over because it will not gain enough income from the system. I am talking about small, private works that have been put in by the local people. Might that be looked at?

Secondly, there is the whole business of modelling. In Orkney, for example, Scottish Water has been asked to undertake a modelling exercise to see whether sites can be connected to the present sewerage system. However, I am told that Scottish Water will not even do that, because it is not in the programme. Orkney Housing Association cannot get funding from Communities Scotland to commission a modelling exercise. Could greater flexibility be built into Q and S III so that people can at least plan what will be possible or needed in the future, rather than coming up against a brick wall?

Ross Finnie: I will make a couple of points about the general issue first. I understand that the issue in relation to any sewage works—in the Western Isles or elsewhere—is not about income.

I am pretty certain about that, although Andrew Fleming will check it out. We are pretty certain that the only reason why a works would not be taken over would be that it did not meet the required standard. There would be an issue of Scottish Water spending money to bring it up to the required standard. However, the only reason for a works not being adopted would be that it did not meet the required standard.

I am aware of the difficulties that Orkney Housing Association has had and I have been in correspondence with it. Sadly, there was no real, effective response to Q and S II. The issue is about trying to get greater flexibility under Q and S III. We have fixed the programme and have asked Scottish Water to produce and deliver it; we have not built into that programme a way of saying to Scottish Water that we want things done slightly differently. Therefore, we will have to do something in the next few years to try to get greater flexibility into how we manage things.

Maureen Macmillan: Another issue that the housing associations raised with me was the possibility that, if they could not get Scottish Water to deliver infrastructure, they could do so privately and have, for example, a septic tank connecting three or four houses plus a private water supply. How would that be viewed?

Ross Finnie: I would have to address the specifics of that. The issue of quality and standards is still imperative. If Scottish Water has a responsibility to pay for that work, that would have to be built in. The issue is not about not contracting out the work; it is about ensuring that, in the specific circumstances, both the drinking water quality standard and—especially in the case that you mention—the standard required by the sewage outfall and septic tank regulations are being entirely adhered to. Again, the issue is not about trying to be inflexible; it is about trying to maintain the standards that Scottish Water has to meet on a regulatory basis.

Maureen Macmillan: The other issue that has been raised is how we pay for getting to grips with the development constraints and whether that should be done by cross-subsidy or through general taxation. The consensus of opinion across the housing associations seems to be that it should be done through general taxation. What are your views on that?

Ross Finnie: The consultation paper raises the question of how we address the need for affordable housing as opposed to general housing developments. A clear differential is to be drawn in relation to affordable housing. We need to have a clear view of the way in which we can avoid burdening those developments with the cost of some of the infrastructure. Of course, some developments come in two parts, because it suits

the developer both to have some housing that is to be sold for an entirely commercial price and to make provision for affordable housing as part of the development. I have been in close touch with the Minister for Communities in an attempt to ensure that, when we finalise the consultation, due regard is paid to the need for a flow of affordable housing. We need to ensure that the system is not caught up because the business of ensuring that commercial developers pay their fair share of development costs is overly regulated.

Maureen Macmillan: I feel that I ought to leave some room for other members to ask questions on this subject.

Mr Morrison: Scottish Water talked about the need to have clarity about who is responsible for paying for new connections. Will that clarity be provided for in the bill?

Ross Finnie: No. When the consultation is concluded, we will make a statement about the level and the basis of the investment programme. The question whether commercial developers will have to make a contribution will be determined at that point. If there is any third element relating to affordable housing, that will have to be dealt with at that time, because that information has to be set out before the water industry commission first. We will set the objectives for Scottish Water from a political point of view and it will then be for the water industry commissioner to take a view as to how the publicly owned water monopoly can deliver those objectives at the most effective price. That clarity should emerge in the early part of next year.

The Convener: I am trying to see how all the elements join up. It would be a mistake to think of affordable housing as a separate issue, because there could be mixed developments that have affordable housing and private development. That is certainly the solution that is being considered in urban areas. I suppose that the issue relates to your comments about relative costs.

What is the next stage after we have gone through this process? At the end of the consultations on the quality and standards III programme and the principles of charging, you will have a series of bids from local authorities, which will be based on their structure plans and local plans. How will you decide between the bids of local authorities? If a bid is not accepted or if investment for the future is not accepted, will the local authorities be under any obligation not to give development approval for projects that do not have investment coming along behind them? I understand that some local authorities have refused development on the basis of a lack of water and sewerage capacity, whereas other authorities are letting proposals through without any prospect of investment by Scottish Water.

Again, we are talking about clarity and certainty for the future and how these issues slot into the forward planning process, which, historically, has been where decisions about future capacity are taken and where local communities and councils take decisions on the relative merits of projects. What will happen in the future? After the investment framework is established, what happens next? That is a fundamental question.

Ross Finnie: I agree. If you read the relevant consultation point in “Investing in Water Services 2006-2014”, you will see that that issue is referred to specifically. Notwithstanding the need for us to have a view about what is manageable and affordable, we point out the real concern that, in determining the bigger picture, we have to settle issues of strategic economic planning and modelling in and across local authorities. We are conscious that in some cases an appropriate amount of economic modelling has not been carried out between adjacent local authorities, particularly on the boundaries. As I said, we refer explicitly to that issue in the document. We are looking to Scottish Water and the local authorities to show a better method of doing that.

A difficult balance needs to be struck in relation to the scale of development. We need to optimise the amount of total investment, to ensure that efficiencies are brought to bear and, in purely commercial developments, to make use of the call on the developer to pay a proportion of the costs, if that is the result of the consultation. After balancing all those considerations, we return to the question what the respective customer can afford.

On the point about priorities, all that I can say is that they will have to be determined some time before we finalise the programme. Although we will give the broad parameters to the water industry commissioner in the early part of the year, it will be some months before we will have the detail of the consultation—in particular, the detail on developments between the local authorities and Scottish Water. By that time, all that we will have done is to narrow the focus slightly; we will not be at the detailed end of the process—the calculations are complex.

Maureen Macmillan: The point that I was trying to make on modelling was that, if you want to know what is needed in Q and S III, you should be doing the modelling now, but it seems that Scottish Water, Communities Scotland and the local authorities will not do it. How will the modelling be done? Surely it needs to be done before we know what is needed.

Ross Finnie: Some of it is being done. However, I agree that the examples that you cited where it is not being done are disappointing. The local authorities and Scottish Water have a mutual interest in the process. At the end of the day,

however, it is the local authorities that grant the planning permissions and development programmes for new housing. We asked Scottish Water to include modelling as part of its costing process. We do not want a repeat of either Scottish Water or the local authorities saying, “It’s no us.” We want to encourage Scottish Water to build into its costings the need for some kind of modelling process.

The Convener: It is useful to have that on the record. Over the past few weeks, we have all heard a variety of witnesses say different things in public and private. It will be interesting for us to follow up on that.

Mr Ruskell: A couple of weeks ago, we had a useful presentation from your officials about the two consultation processes. However, I came out of it with the distinct impression that, beyond pure compliance with EU environmental regulations, there are no real policy drivers driving sustainable development. Leakage is not really an issue in Scotland because water is relatively plentiful. To what extent are you using the Q and S process to find out how sustainable development indicators—in particular, odour nuisance, water poverty as a proportion of household income, leakage and energy usage—might be barometers of your policy’s progress?

At the briefing, I learned that a large amount of money needs to be invested in our infrastructure to deliver the different sustainable development priorities. However, although the first two indicators involve investment, the final two are about saving money in the long term. I wonder about the extent to which you are working to those indicators to deliver your policies, which I must say do not seem to have been made explicit in the consultation process.

10:45

Ross Finnie: I am sorry if they have not been made explicit. Section 51 of the Water Industry (Scotland) Act 2002 places a very clear obligation on Scottish Water to act and operate in a way that is entirely consistent with sustainable development. Given that Scottish Water has to adopt the plans and that it is obliged under the terms of the act that set it up to operate with due regard to sustainable development, energy savings will be made.

We must remember that there is an enormous range of competing demands, which in many areas are driven by sustainability and requirements under the Water Environment and Water Services (Scotland) Act 2003, which seeks to deliver the water framework directive. As a result, Q and S III has to operate within a very robust framework. It might well be that the

headline priorities head towards removing development constraints, although I should say that there is a mutual interest in tackling odour nuisance. The consultation document "Investing in Water Services 2006-2014" covers major elements such as how we develop within the water framework directive, which itself contains a robust series of sustainable aspects that govern developments.

Mr Ruskell: I appreciate all that. However, I suppose that my question is about how you set, see through and monitor priorities. We might be able to follow things through if, for example, the indicator on development constraint were made one of your priorities. How do you set your priorities? I know that it is not an easy task.

Ross Finnie: It is not easy. The priorities will be set by the policy framework for Scottish Water. That framework has two key elements, one of which involves the overarching provision in section 51 of the Water Industry (Scotland) Act 2002. Under that section, in whatever Scottish Water does, it must have due regard to the impact on sustainable development. Moreover, the organisation must also meet a number of clear regulatory requirements with regard to drinking water quality and sewage outfall and disposal. Those aspects make the task of checking regulatory requirements and the time by which those requirements should be met slightly easier, because it is possible to see a phased development. After that, there is a different order of more economically and socioeconomically driven priorities with regard to, for example, affordable housing.

We must ensure that in delivering the whole programme we have due regard to the overarching concept of sustainable development. I do not decry that suggestion at all. The question is about how we get the various huge building blocks into the one mix and make sure that each element goes to make a cohesive whole in meeting the objective that it has been set.

Mr Ruskell: Do you see a role for indicators in that framework?

Ross Finnie: Yes, but again I have to be careful about who does the monitoring and how it is carried out. Leakage is a nightmare that Scottish Water would dearly love not to have, because not only is it an environmentally non-sustainable use of the resource, but it places a severe economic restriction on Scottish Water. It is not about an indicator for Scottish Water; it is about an engineering resource that has to be devoted to elements of the network that are not well mapped. For example, there are one or two areas in which Scottish Water has renewed lengths of the carriage only to discover that although the water flows better when the carriage does not leak, the

amount of leakage increases when the pressure is increased a few miles down the road. Parts of the network are in such poor condition that for every bit we do better, there is a downturn on the other side. It is not as if Scottish Water is not trying, but there are areas throughout Scotland where the consequence of renewing piping has an impact further down the chain. It is not about not having enough resources; it is about getting a handle on a water network that has suffered from huge underinvestment.

The Convener: I want to follow up Mark Ruskell's point about odour issues, on which we took evidence earlier today. The consultation does not estimate the cost of dealing with odour problems at sewage works. We have done a fair amount of consultation on that while following up some petitions that have been presented to the committee. Will you have those costings in front of you when you make the decisions on investment priorities, given the need to invest both to comply with environmental legislation and to maintain the network and to balance that work with an affordable investment package? How will you make that calculation to deal with investment to address the odour problems that have been forced on the committee's attention?

Ross Finnie: In my opening remarks, I acknowledged that during the past three to four years, people's expectations of sewage outfall works have risen and so have their expectations that odour nuisance would be addressed in a more satisfactory way. That is why we make that comment in the investment programme.

On the responses to the consultation, we do not have the detailed costings but we are working on them so that before we make a decision we will have a view on the overall level that might be required as part of the quality and standards III programme.

Richard Lochhead: I am sure that the minister shares the objective of ending the situation in which many people, particularly young people, cannot get access to housing in their local community and so have to leave. One of the biggest priorities that I am sure the committee will have identified is that of development constraints. How do you balance the different priorities in your two portfolios? Surely if you want to help rural Scotland, you have to increase the supply of housing so that the value of property comes down. That means giving access to land and water and sewage infrastructure. How will you determine your priorities between your rural development portfolio and your responsibility for water?

Ross Finnie: It does not matter whether a minister holds two portfolios or one, as the Executive has to balance those priorities in any event. All that I can say is that I might be more

acutely aware of the differentials that have arisen in rural areas as a consequence of the historic underinvestment in water. I do not see that there is a conflict.

I readily acknowledge that determining the balance of the Q and S III programme will be extraordinarily difficult. Some of the numbers in the consultation document are frightening. That is why responses to the consultation have been helpful and important, as will be the committee's report. That information will give us a much better handle on the priorities—including the geographical priorities of different local authorities—before we have to come to a decision. That is why we are engaged in this very full consultation.

Richard Lochhead: To what extent are you working with the ministers responsible for housing and planning? Last week, after the spending announcements, the minister responsible for housing announced that several thousand houses were to be built over the next three or four years. Clearly, those houses can be built only where water and sewerage capacity exists. What is the Executive's strategic plan? Where will those houses go? That decision will surely be influenced by considerations of where infrastructure exists. How do such considerations affect investment decisions?

Ross Finnie: All the Executive's work in relation to housing involves close collaboration between the minister responsible for housing, housing officials and planning officials. No one in the Executive wants to work in a separate compartment.

When considering the money available to develop more affordable housing, we have to get the balance of investment right in Q and S III, to ensure that as many affordable houses as possible are built. We also have to consider—this may not have received enough attention before—the priority given to developments to ensure that we have the double benefit of meeting regulatory requirements and meeting development constraint requirements.

Richard Lochhead: Maureen Macmillan spoke about the campaign to use taxation to put in new infrastructure, especially in rural areas, to try to prevent depopulation and the loss of young people. Many parts of Scotland are becoming exclusive to wealthy retired people. The only way of giving such areas an economic future is through Government intervention.

Did the spending review process have any influence on investment in water infrastructure? It may be that more announcements are to be made. Have you sought any subvention from general taxation or the Scottish block to address this urgent situation, which has been neglected for

decades? Simply listening to the local authorities that shout the loudest may not work; we have to consider where the real need is and get the cash there as soon as possible.

Ross Finnie: I wholly agree that development constraints are way up on our list of priorities. Richard Lochhead talks about using general taxation, but I am not sure that this is entirely a funding problem; it is more a capacity problem. We have to consider the availability of cash and the availability of expertise to work up the capital investment programme to deliver the volume of investment required. Let us consider the target set for Scottish Water even in Q and S II. When I have attended this committee before, I have referred to the difficulties that Scottish Water encountered in its inheritance from North of Scotland Water, West of Scotland Water and East of Scotland Water. As we speak, Scottish Water is delivering £40 million-worth of pipes and so on a month. We think that the annual figure will be some £500 million. If that happens, it will mean that Scottish Water will be delivering a higher level of water infrastructure investment than any other company in the United Kingdom. I say that not just to pat Scottish Water on the back, but to try to put the scale and nature of the problem into some perspective. It is not only about money but about managing the way in which we raise the level of investment in Scottish Water efficiently, effectively, cost-effectively and qualitatively. There are other issues besides money; it is also about management.

11:00

Richard Lochhead: I ask for a specific answer to my question on whether the budget that was announced last week has had any direct impact on the level of investment that is available for the water industry.

Ross Finnie: Within the settlement, we have secured access to borrowing levels that we believe will be sufficient to enable us to carry out a programme under Q and S III.

The Convener: We have spent most of the morning so far talking about quality and standards III and what we want to add to the list of future development, and it strikes me that we have not spent much time considering the consultation on the principles of charging. However, Alex Johnstone wants to ask about development constraints.

Alex Johnstone: I am surprised that some members who are present believe that huge infusions of public money are the only solution to the problem of development constraints; I will explore another potential route and the possible impact of legislation on it. I am aware that there are different priorities in different areas to facilitate

the development of housing, but in the area from which I come, there are huge constraints, and there seems to be a willingness among developers to become involved in financing the necessary infrastructure to facilitate the developments with which they would like to proceed. My concern is that the opportunities that are afforded by that approach are constrained by the proposals in the Water Services etc (Scotland) Bill to prevent the principles of common carriage from becoming the norm in Scotland. Could we not, by allowing Scottish Water to permit common carriage in certain circumstances in which public benefits could be achievable, allow developers to make investments and become involved in the provision of capacity that could, ultimately, facilitate housing in some of the areas in which development constraints are in place?

Ross Finnie: There are two separate elements to that matter, which calls for some judgment. First, access to carriage is a question of competition, but it is not necessarily the same as increased capacity. Secondly, if we did not use the provisions in the bill but permitted private developers not only to have access but to undertake developments of their choosing, we would have two separate problems because, genuinely and simply, we would be going into open competition in access and carriage. In that case, we would end up with development by private developers and access to carriage by private operators, which takes us back to the circumstances that might have obtained had we not created Scottish Water. There is an insufficient number of customers in the north, the Highlands and Islands, the south and the south-west of Scotland to sustain a water company with an investment programme, so we would be cherry picking and would put at risk the ability to supply a Scottish water service throughout Scotland.

Alex Johnstone: The minister has answered a question that I did not ask. I am trying to examine the opportunities for co-operation between private developers and Scottish Water where development constraints exist and the will exists among the developers to become involved in the provision of infrastructure.

Through the Water Services etc (Scotland) Bill, we are building a system in which decisions on where investment will take place will, in effect, be made centrally. If Scottish Water was granted the power to become involved in joint projects in which the provision of the necessary infrastructure was, in certain cases, the financial responsibility of the developers and the principles of common carriage were employed to ensure that the developers and Scottish Water worked hand in hand to make sure that such provision was made available publicly as well as to the private developments, is there not a way in which we could exploit—

Ross Finnie: As I have already indicated, one must draw a distinction between infrastructure that is required exclusively for a development and infrastructure that is capacity in a sewage disposal works or a drinking water supply works. The consultation on charging suggests that, with infrastructure that is just for a development, we should move from a position whereby all such infrastructure is provided by Scottish Water. The consultation also sets out the proposition that, where infrastructure is required exclusively for a development, there is a strong case for the developer who provides that infrastructure to link it to the Scottish Water network, provided that the development meets the construction standards that are set out in the relevant water industry regulations. My view is that there should be no obstacle to that, but a difficulty arises when there might have to be joint expenditure on capacity for the network in a sewage works or a water supply works because, at that point, a decision would have to be made that might affect the meeting of some other priority or objective in another area. The consultation suggests nothing that would prevent private developers from building the infrastructure for a specific development, provided that there was capacity further down the line.

Alex Johnstone: In many circumstances, that remains the limiting factor.

Ross Finnie: That means that you are talking about joint ventures, because the new infrastructure would not be used exclusively by the developer. In the general framework of Q and S III, choices would have to be made about what priority to give a particular piece of infrastructure. However, there are developments in relation to which the developer could provide the necessary infrastructure.

Alex Johnstone: I will have a final stab at explaining what I am trying to get at.

The Convener: As long as it is a brief stab, because we will come back to the issue when we move on to our stage 1 consideration of the bill.

Alex Johnstone: In relation to such downstream provision, is there not an argument that if the principles of common carriage were employed, they could allow the direct charging of developers for the use of services? In other words, could developers buy the services that they required on a commercial basis?

Ross Finnie: No, because a developer who is not adding to capacity but is only buying services commercially would have to buy them from Scottish Water.

Alex Johnstone: But is the developer not facilitating development over time by providing the necessary money?

Ross Finnie: No. I think that you slightly misunderstand what would happen in such circumstances. There is a distinction between using private money to invest in a specific development and seeking to influence a development priority elsewhere. A developer will certainly not pay 100 per cent of the cost of a shared facility. What you are talking about would involve changing the order of priority in Q and S III. I do not think that one could order priorities according to who was paying the most money.

Alex Johnstone: I think that the minister understands what I was after.

The Convener: We have teased out that issue. Other members might want to read the *Official Report* to make sense of parts of that exchange.

I remind colleagues that, so far, we have dealt pretty exclusively with the quality and standards III consultation paper. We have highlighted the fact that the improvements will cost more, but we have not focused on who will pay for them. That is dealt with in the consultation paper on the principles of charging, which we should consider before moving on to discuss the bill. Other witnesses have put to us a checklist of issues, including charitable relief, cross-subsidies and local government finance.

The charitable sector made quite a few pleas that the water charge relief scheme is too complex and too onerous for charities. The sector believes that charities do not benefit from the charitable relief scheme because of the way in which the scheme operates. It was put to us directly that the number of charities that benefit is significantly lower than was initially estimated when the scheme was set up. Does the minister agree that the scheme is not operating as intended, or does he have a different interpretation?

Ross Finnie: I do not wholly agree. The scheme was intended to grant relief to smaller charities and voluntary organisations that were in receipt of relief as a consequence of the previous involvement of local government. We have now made it clear that the regime that will be in place will exempt a range of organisations from charges until 2010.

The consultation seeks views on the slightly broader question of to whom exactly we should provide relief and whether it should be up or down that chain. Like the committee, I have received representations from charitable bodies, some of which have asked that the scheme be extended to cover all charities. One difficulty that I have with that request is that although certain charities could undoubtedly do with additional assistance, many of them have a relative state of income that is no better or worse than that of some private individuals. I am concerned lest we end up not directing the benefit to those who are least able to

pay. There are also issues with how water costs should be measured and therefore with the burden that any person should be asked to pay.

Extending the scheme would simply mean that someone else would need to pay. We have considered the operation of the scheme. We know that some people are agitated because they feel that they should be included in it, but we have tried to be fair to charities that already benefited from the scheme by indicating that, whatever else we do, they will remain exempt from charges until 2010.

The Convener: The other issues that arose from the consultation paper on the principles of charging were water poverty and cross-subsidies. We received representations on the need for an agreed definition of water poverty, just as a definition exists for fuel poverty. Has the Executive considered whether the assumptions that the Department for Environment, Food and Rural Affairs makes on water poverty should be debated? Also, the consultation paper says that the Executive, Scottish Water and the water industry commissioner are conducting research into cross-subsidies. When might that research be completed and when is it intended to be published? Where is the Executive going on those two issues and how will they fit into the outcome of the consultation process?

Ross Finnie: On the latter point, we anticipate that the work that we have asked economists to undertake will come to a conclusion just before the end of the year. Prior to the consultation process, evidence was put to us that suggested that Scottish Water's structure still provided a cross-subsidy from the non-domestic sector to the domestic sector. However, that evidence was sketchy at best, which is why we have brought people in specifically to look at that. Whatever their conclusion is, there is no question but that we will have to look carefully at how we can try to unwind those subsidies. It is not something that we would contemplate doing overnight if it was going to have a serious effect on a specific sector.

There are two elements to our looking at and targeting support towards water poverty. I will ask Andrew Scott to comment on the DEFRA scheme in a moment, but there is also the issue of where the support ought to be targeted. At the moment, we use the local authority banding system for partial remuneration, and there are other schemes in the consultation document. We talk about being much more specific and targeting those who are in receipt of benefits. We are trying to concentrate the support very much at the bottom end. Perhaps Andrew Scott can comment briefly on the operation of the DEFRA scheme.

11:15

Andrew Scott (Scottish Executive Environment and Rural Affairs Department): It is hard to find an absolute definition of water poverty, but, as a rule of thumb, people who spend more than 3 per cent of their available income on their water bill experience some kind of water poverty. We do not operationalise any definition like that in our paper, as it is quite hard to justify any particular definition. However, the proposals that we set out in the paper are about taking the help that is currently spread across 900,000 customers, which is worth about £75 million, and concentrating it on roughly half that number of customers.

The Convener: I could not hear that. Whom did you say the help is proposed to be concentrated on?

Andrew Scott: The help that we give at the moment is worth about £75 million, and it is generated by recycling charges from affluent houses to less-affluent houses. About 900,000 houses receive that help. The proposal is that that volume of help will be concentrated on about half that number of households in the future.

The Convener: So, some people would be less subsidised and some people would be more heavily subsidised.

Andrew Scott: Yes, that is right.

Ross Finnie: Without a definition, the rule of thumb would be that those who are in receipt of benefit for council tax purposes would be regarded as being most susceptible to water poverty.

The Convener: So, in a sense, there will be winners and losers but a more aggressive targeting of people at the lower end of the income scale.

Ross Finnie: Yes. That is what is proposed in the consultation paper, but we have not finalised our view.

Mr Ruskell: That does not take into account the fact that some people are in waged poverty. They might not be on benefits, but they are on low incomes. The council tax banding system, similarly, does not address the problem of people who are in waged poverty.

Ross Finnie: Someone on a wage can be on council tax benefit. Sorry—I referred earlier to the local authority banding system, but I am talking about council tax benefit.

Mr Ruskell: A water poverty indicator level would pick up not just the people who are on benefits, but those who are in waged poverty. There would be advantages to having a water poverty policy.

Ross Finnie: I do not necessarily disagree with you. However, there are people who are waged but who are in receipt of council tax benefit. I am not suggesting that that system is the perfect model, and I would be interested in alternative views. Nevertheless, that calculation includes people who are in receipt of income but who, without any shadow of doubt, are deemed to be at the lower end of the scale. That is the group that we suggest should be targeted.

The council tax benefit system is not perfect. As we suggest in the paper, however, using that system would, without reinventing wheels, be a method of capturing a class of people who are already regarded as susceptible to poverty and who will clearly be susceptible to water poverty. I would welcome any refinement of, or alternatives to, that suggestion.

The Convener: That is useful, thank you.

Rob Gibson: Our current pricing structure includes a high standing charge. Domestic water charges are based entirely on a fixed charge and charges for larger users have a significant fixed-charge element. The committee has heard that that structure acts as a disincentive to water conservation. Would it be possible for water charges to contain a bigger volumetric element but for us still to protect the social objectives by having a lower unit price for those on the lowest incomes?

Ross Finnie: There are two issues. First, the practical issues relating to the delivering of water mean that the major costs are of a fixed nature. Secondly, the practical problem with moving to a volume-based system would be that we inherited a non-metered domestic sector. Changing to a volumetric model, therefore, would not be quickly achievable. I am not disagreeing with you philosophically; I am merely pointing out a practical difficulty. There are few domestic customers who have meters.

Rob Gibson: We heard that it would cost a lot of money to put meters into domestic premises. However, are you considering moving further towards a system that would allow volumetric measuring or will you continue with the high standing charges approach?

Ross Finnie: As we have said, a huge number of challenges face Scottish Water. It would be lovely to be able to say that, at the same time as meeting those challenges, we could move towards an entirely metered system. For different reasons, the non-domestic sector is keen to move towards greater metering.

At the moment, Scottish Water is unable to work out what the impact of metering would be. I get somewhat exercised about the conservation aspects of metering, but that might lead me to place higher priority on bringing greater metering

to non-domestic customers than on doing so in relation to domestic customers.

Another issue relates to simply rearranging the total amount that is being charged in an attempt to address the amount that low users are being charged, notwithstanding the fact that the delivery of water—actually getting it to your tap—is the highest part of Scottish Water's present cost structure.

Rob Gibson: So the matter will not be dealt with in the bill. I suppose that it is more of a matter for the quality and standards III exercise.

Ross Finnie: Yes.

I should point out that the drivers are going in the direction of metering. One such driver is the issue of conservation and use; another is the need to find, over time, a way of more equitably distributing cost. The difficulty is that we do not have the meters.

The Convener: In all the discussions that we have had with witnesses, it has been clear that people think that this issue needs to be addressed. However, it will not be addressed in the bill. If we say that we are going to introduce water metering in five years' time, we are talking about a phenomenal cost without knowing what the benefits would be. The issue is to do with finding ways of getting people to use water conservation methods. There are all sorts of ways to conserve water and it is important to get them on the agenda.

The water framework directive allows for water charges to be used as an incentive to encourage people to use water resources efficiently. However, the costs and benefits agenda does not seem to have got past water metering. It is important to remember that there might be another way of moving towards volume-based charging. Perhaps we could all reflect on that.

We have just about exhausted the topic of the two consultation exercises. I suggest that we take a comfort break.

11:25

Meeting suspended.

11:33

On resuming—

Water Services etc (Scotland) Bill: Stage 1

The Convener: We come back fresh to item 5, which is our fifth day of evidence on the Water Services etc (Scotland) Bill. Witnesses have raised a range of issues with us over the past month, of which we have a running checklist that we wish to raise with the minister. This morning is our last evidence session, so we will see how far through our checklist we get.

I welcome the minister and pretty much the same team from the Executive. Minister, do you have any brief remarks? I draw to my colleagues' attention the fact that we have a letter from the minister on the water customer consultation panels, which everyone should have received yesterday. That is the only extra information that members need for the discussion.

Ross Finnie: The phrase "pretty much the same" rather understates Clare Morley's appearance at the committee. She is in charge of the bill team. She was sitting behind us, although she is now at the table.

I want to put the Executive's position on record. The bill is about strengthening Scotland's water industry. We believe that it takes prudent, precautionary steps to ensure that competition will not disrupt the supply and distribution of water, and to protect vulnerable customers from the potential impact of retail competition in this essential service. We believe that the bill strengthens the regulation of the industry, ensuring that it serves the customers' interest in a robust, transparent and accountable way.

The bill achieves those objectives in several ways. It clearly prohibits common carriage and retail competition for domestic customers. Without those prohibitions, accountability for public health would be undermined and support for vulnerable households could not necessarily be continued. The bill reforms the charge determination process. It defines with new clarity ministerial responsibilities for policies that shape the water industry, and it strictly defines the economic regulator's role, which is to price the ministerial investment and charging policies that Scottish Water must deliver. I have indicated that we will balance the water industry commission's charge determination powers with a right for Scottish Water to appeal to the Competition Commission. That possibility will provide the rigour that the system requires. There will be independent expert investigation of determinations.

This committee recommended the creation of the water industry commission. I believe that that will greatly improve economic regulation. Being led by a body corporate will offer a more accountable and transparent decision-making process. It is essential that the commission can understand and measure ministerial policy objectives and Scottish Water's functions. It will not be the commission's job to interpret or judge between the two. The bill makes a clear distinction between setting policy and objectives for the industry—which are for ministers and the Parliament—and the commission's duty to calculate the resources that those require.

I know that the committee has heard much evidence on the requirement for due regard to be paid to sustainable development—a point that Mark Ruskell raised earlier. I can only repeat that this bill in no way overrides the requirements of the Water Industry (Scotland) Act 2002—it is subsidiary to that act. The act requires Scottish Water to

“act in the way best calculated to contribute to the achievement of sustainable development.”

As the convener said, I wrote to the committee yesterday to outline changes to the functions of the water customer consultation panels that I am minded to propose at stage 2. I apologise that those changes were not incorporated in the bill as introduced. However, it has been necessary to reflect on the implications of the bill for the customer panels, and also to listen to stakeholders' views. I believe that my proposals will offer a coherent strengthening of the customer voice. They will ensure that the panels have a specific input to the ministers who are setting objectives for the industry, and that the panels—representing households and businesses as users of public water and sewerage, and taking on complaints handling and a stronger reporting function—will offer a right of reply. Panels will be able to speak directly to and for customers.

The Convener: I should have said that the committee also has a report from the minister on equal opportunities and the bill, and one from the Finance Committee on the financial memorandum. That information will help us in the preparation of our own report.

Mr Ruskell: Thank you for your statement, minister. You will be aware that the water services regulation authority, which will replace the Office of Water Services in England and Wales, is under an obligation to carry out its duties in the manner which it considers is best calculated

“to contribute to the achievement of sustainable development.”

That is a quote from the Water Act 2003.

We have heard a lot of evidence on the water industry commission's role and powers, and it was

said many times that the commission should have a statutory responsibility for sustainable development that is similar to that of its equivalent in England and Wales. Why did you decide not to give the commission that responsibility?

Ross Finnie: That was done because I believe that any operation of the water industry is regulated by the Water Industry (Scotland) Act 2002, and that any policy decision that is taken by ministers and guided by the Parliament on how Scottish Water should operate must be taken within that framework. Delivering sustainability is a policy matter and is not necessarily for a regulator, who should monitor the performance—and particularly the economic performance—of the industry. It is not the function of the commissioner—or the water industry commission, as it will be—to deliver on wider policy objectives. Rather, the commission has a clear role to play in the delivery of economic performance and investment, as set out in the particulars. Policy objectives are a matter for ministers and in setting them ministers must have regard to obligations under the act. There is a distinction. Giving people a job that they are not necessarily qualified to do will not improve matters—indeed, doing so might confuse matters, as it would then be suggested that there are policy objectives that ought properly to be for the commission. I do not believe that that should happen.

Mr Ruskell: I understand what you are saying. It is appropriate that you, as the Minister for Environment and Rural Development, should set the policy direction for the economy regarding water services, the environment and social justice. Those are the three elements of sustainable development that you must put in place in setting a direction. The problem is that the proposed water industry commission will not work to that policy framework. It will work to a policy framework that is about lowering costs to consumers. Therefore, there is a mismatch.

Ross Finnie: We all understand that there is a water industry commissioner because Scottish Water is a monopoly body. Therefore, it is not open to consumers to bring pressure to bear on that body to gain the advantages that they might in an open market. There are good policy reasons for that being the case. It is for the water industry commissioner—among other things—to set objectives within the policy framework to ensure the delivery of a service to a prescribed quality, to deliver quality in other policy objectives and to ensure that, in delivering its investment programme, the body works within efficiency parameters that make it comparable with other operators. Historically, the water industry commissioner has used the operation of similar sized companies in England and Wales as a benchmark.

Mr Ruskell: So you are saying that the water industry commission will work within a sustainable development framework because that framework is set by you.

Ross Finnie: I am saying that if objectives that are handed to Scottish Water are set by ministers and Scottish Water must then develop its plans and programmes on how it will deliver those objectives, Scottish Water—as you pointed out, and as we discussed earlier this morning—will be under an obligation to deliver those objectives with due regard to sustainable development. No matter what pressure the commissioner brings to bear on Scottish Water to perform in an effective and efficient way, that will not relieve Scottish Water of its obligation to meet the requirements of section 51 of the Water Industry (Scotland) Act 2002.

Mr Ruskell: But to use your own words, minister, the pressure that is coming to bear is coming from a different policy framework. It is coming not from a sustainable development context, but from one of lowering the economic price and working within a competitive framework. Surely it is better to place the duty to promote sustainable development on the water industry commissioner, so that he can bring pressure to bear on Scottish Water, while being mindful of the sustainable development policy framework that you are pushing. Scottish Water must work to it and the regulator should be mindful of it as well. Surely we need to join up the three areas.

11:45

Ross Finnie: But they are joined up. Maybe we are just not going to agree on this. In assessing the financial requirements of Scottish Water, the water industry commissioner cannot disregard the fact that Scottish Water has a clearly stated objective, as set out in section 51 of the Water Industry (Scotland) Act 2002.

In setting the financial framework for efficiency and effectiveness and, more particularly, comparability—because there is no ability to buy out—the commissioner cannot suddenly say, “I want you to be more efficient and more effective and, by the way, I see you’ve listed all these issues. Why are you dealing with them?” “They are sustainable development objectives, and they are set out in your requirements.” “I’m not funding them.” The commissioner cannot do that. He is required to produce financial parameters that bear down on Scottish Water in terms of reasonable efficiencies in comparison to other operators. He is also required to allow Scottish Water to operate a budget that enables it to deliver the objectives that are set by ministers and fulfil the functions that are specified in the overarching act. You cannot allow the commissioner to decide on his own which policy objectives he will feed into the process. He is setting economic parameters for Scottish Water.

The first of your complaints may be that you are not yet satisfied that Scottish Water is delivering fully on its obligations under section 51. I am not going to debate that with you this morning. However, it is under section 51 that sustainable development obligations ought to be raised and addressed within Scottish Water’s programme. It is not the function of the water industry commission to impose them.

Mr Ruskell: We have probably taken that subject as far as we can. The policy framework that is being adopted by Scottish Water, your department and the commission is not coherent. I cannot see why it has been adopted. There is a coherent framework for England and Wales in the Water Act 2003, but not here. I do not see why there is an objection to putting sustainable development in the bill, given that you are saying that the commission will work in due course—

Ross Finnie: It may be that with a privately owned water body you need someone else to impose public policy. We actually have a means of imposing public policy. We have a commissioner operating a publicly owned body, but I would not want there to be confusion between policy objectives and regulatory functions.

The Convener: The question arose from evidence that we received that in England and Wales the regulatory body has that function, whereas our body will not. We can go back to the *Official Report*, read the evidence and reflect on it.

Ross Finnie: Indeed. We are not comparing apples with apples. We are talking about a body, the policy objectives of which are set by ministers and the Parliament. I am not sure that the situation is comparable with that in England, where the water industry is privatised. I have no intention of going down that road.

The Convener: We are talking about the regulatory function.

Ross Finnie: You may desire to impose a regulatory function because you cannot have it at parliamentary level, but that does not suggest that you need to do it. We have opportunities to set objectives at ministerial level, and to ensure that Scottish Water has a requirement to meet them. I humbly suggest that in such circumstances there is no advantage in confusing a policy objective with the role of the regulator.

The Convener: We will think about that. It was described to us as a bean-counting process. We will want to take a view on whether we think that that should have a wider objective.

Ross Finnie: If you do, you will have to look at wider policy objectives. I do not see why you would narrow the field. That is why I have an objection—

The Convener: I do not think that we see it as a narrowing of the field: we see it as ensuring that all the objectives that have been set are properly addressed. We are talking not about focusing down on one issue, but about the kind of trade-offs that we have talked about before in terms of sustainable development.

Ross Finnie: It is for you to decide, convener, as long as you look not only at the role of the commission, but at the role of Parliament, which has no bearing on the water industry in England and Wales. I think that we have a different structure in Scotland.

The Convener: We will think about that.

Karen Gillon (Clydesdale) (Lab): We got your wee letter this morning, minister. I am interested in where this has come from and where the evidence is. I am particularly interested in where we will take evidence on these changes. I do not know whether we have taken evidence on the kind of changes that you are suggesting. I am concerned that, if the proposals in your letter are carried through, we will give considerable powers to an unelected, unaccountable body. Why have you made that decision?

Ross Finnie: In representations to us from time to time, we have received requests on two grounds. We have heard, first, that the water consultation panels are slightly ineffective and that, secondly, given the fact that the customer base is both domestic and non-domestic, it does not make sense for us to draw an unnatural distinction between the two. We have been asked why domestic and non-domestic customers should not both have access to those panels.

We have also been asked whether a clearer view could be given of the process of the receiving and delivering of a complaint and of the requirement of the commissioner—and, indeed, of Scottish Water—to be seen to be dealing with the complaint. There is a general wish, not necessarily for us to give powers and take away from any parliamentary scrutiny, but simply for us to give the customer an opportunity to ventilate through a proper process and be assured that they can deal with a consultation panel that has statutory backing to ensure that they are going to get an answer. They want us merely to firm up the panels in what is very much a public body.

Karen Gillon: You are giving the panels quite serious powers to deal with complaints, yet they are appointed by ministers and are unaccountable to the public. Or are they elected? How do the panels become accountable to the people whom they are supposed to represent if they are not elected by them?

Ross Finnie: Well, I suppose the same problem is faced by the water industry commission. That is a difficulty.

When we established Scottish Water, we tried to create a structure whereby, instead of the customer feeling that they had to deal directly with the board, which was employed by Scottish Water, there would be groups through which the customer could ventilate either a specific complaint or a range of connected complaints that might be better addressed together and put to the board and senior officials in Scottish Water in a more coherent way. That was the whole purpose of customer consultation panels at the outset. The intention was never to create a different democratic process, but simply to give the individual customer dealing with a range of local complaints a different method of gaining access to Scottish Water. The democratic control of Scottish Water rests with the Parliament.

Karen Gillon: I am slightly concerned by the issue and think that we will have to return to it before stage 2.

Ross Finnie: As a matter of courtesy, I am giving the committee my latest thinking on the issue, and I am happy to give evidence on that.

Clearly, when we present the proposals as amendments at stage 2, there will be opportunities for you to consider them in detail. I know that you have only recently had the letter, but I hope that there will be ample opportunity to consider the proposals. I am certainly not trying to impose them and rush them through, but merely to give an indication of our thinking at as early a stage as I can and to develop the role and powers of the water customer consultation panels.

The Convener: We understand where you have got to in that process. The difficulty is that, when we took evidence on the bill and considered complaints, neither the water industry commissioner nor the water customer consultation panels expressed any enthusiasm for the proposals. We must think about how we take evidence on this point, because we have a tight stage 1 timetable and the Department of Trade and Industry is undertaking parallel consideration of the issue.

There are differences in the energy markets, and you have already made the point about Scottish Water being public, but we are conscious that the bill will set up a different system. We have taken evidence that there may be a need for a complaints process for domestic customers, but there may equally be a need for a complaints process for non-domestic customers, so we might want to take written evidence on that before we hit the stage 2 consideration. Once we are into the detailed discussion of the bill, there will be no opportunity for the committee to come up with amendments that it prefers as a way to solve the problem, so we want to take a step back rather than be rushed into a particular outcome.

Ross Finnie: I am happy with that; I am entirely in your hands. I would, however, like to clarify something: I think that you suggested—I do not want to put words into your mouth—that the water customer consultation panels do not want to move in the direction in which I am moving.

The Convener: No. As I recall, we took evidence from the water customer consultation panels that they were not enthusiastic about being a repository for complaints.

Ross Finnie: I take your word for that and do not dispute it, but that comes as a surprise; we have had discussions with the panels, and the convener of the water customer consultation panels indicated quite a different view to us. In fact, he supported a development in the proposed direction. I am not suggesting that he agreed with every detail, but he did agree with the general thrust.

The Convener: That evidence is in the *Official Report* of the discussions that we have had over the past few weeks with a range of people.

Rob Gibson: To come back to the consumer's point of view, some witnesses have argued that ministers should not introduce a bill to regulate competition, but should simply be prepared to defend Scottish Water against any legal challenge. In other words, they argue that its services qualify for exclusion from competition for compelling reasons of public policy. Why, minister, have you not chosen to defend your objectives for the industry by that route?

Ross Finnie: On a reading of the Competition Act 1998, it was my view that it was necessary to set out with total clarity and in legislation the precise way in which Scottish Water would operate and not simply await a challenge. I am not clear that, in such a challenge, I could point to the statutory framework within which Scottish Water operates and show why it meets the minimum standards of opening up competition under the Competition Act 1998. I understand the view that we should simply wait for the challenge, but the Water Industry (Scotland) Act 2002 does not indicate that we are compliant with some of the requirements of the Competition Act 1998.

Rob Gibson: We are dealing with an organisation that has hundreds of different sources of water and it is not really comparable to many of the other water companies to which the Competition Act 1998 applies. At this stage, the industry is merely settling down into a structure that might be workable. In other words, this is a catch-up phase. Is that not reason enough to argue that the Competition Act 1998 does not apply in this case?

12:00

Ross Finnie: No, I simply do not agree. With all due respect, although our detailed knowledge suggests that Scottish Water is still settling down, that is not relevant in this regard. It is in being and has a constitution and a structure. However, the fact that it falls broadly within the mischief of the Competition Act 1998 is a matter that we must address. The best protection for Scottish Water as a publicly owned company is to make its obligations clear in statute and to outline how it as a corporate body proposes to address the requirements of the 1998 act. That clarity will make it difficult, if not impossible, for anyone to challenge its operations or its compliance with that act's requirements.

Rob Gibson: Finally, is it the fact that the kind of challenges that might come would be from potential competitors for the delivery of parts of the service? It is unlikely that another Government body would challenge the act. Indeed, it is the people who wish to cherry pick who might question the response that you have given to the Competition Act 1998.

Ross Finnie: They might. There are two points at which such a challenge might be made. Without this bill, a potential competitor, cherry-picker or however you might wish to describe them could raise a challenge, because Scottish Water's constitution and regulatory framework is otherwise silent on the issue of competition under the Competition Act 1998. I have made it clear that I believe that Scottish Water would be vulnerable to such a challenge in the absence of the bill. Introducing the bill and making it clear that it complies with the minimum requirements of the Competition Act 1998 will greatly strengthen Scottish Water's position. Under the bill, it will be extremely unlikely that anyone would challenge Scottish Water, which means that we will avoid unnecessary legal and other expenditure defending such actions.

Alex Johnstone: How do you see the role of competition in the supply of water services in Scotland?

Ross Finnie: Politically?

Alex Johnstone: Yes.

Ross Finnie: I do not see any role in that respect.

Alex Johnstone: Do you not see any role for competition at all?

Ross Finnie: We are talking about a publicly owned body that I want to operate at the maximum possible efficiency in order to deliver the highest-quality water and sewerage service at the most efficient price. I appreciate that we face huge hurdles and difficulties in getting there; in any

case, I do not think that you and I are ever going to agree on this matter.

Alex Johnstone: Have you targeted the bill to minimise any interference from existing legislation in how it frames water services in Scotland?

Ross Finnie: To fulfil my clear, unambiguous and public intention of having a publicly owned water company, I have sought to read, interpret and give effect to the Competition Act 1998 in such a way as to minimise potential competition against Scottish Water. I have no need to apologise for that stance, because it is entirely consistent with my public policy objective.

Alex Johnstone: Are you content that the water industry commission, as defined in the bill, will ensure that the water industry in Scotland offers a pricing policy that is competitive with that of comparable organisations south of the border?

Ross Finnie: Yes.

Alex Johnstone: Is that the only provision in the bill that matches your aims with regard to water service provision with the operation of the more competitive marketplace elsewhere in the UK?

Ross Finnie: That is indeed the whole purpose, as I indicated to Rob Gibson. Where there is a monopoly, the consumer is at risk. There might be several ways in which the customer might benefit from public ownership, but one of the risks is that the fact that the service provider is not subject to a degree of competition might ultimately affect the price at which the service is delivered. The purpose of the water industry commission is to bring to bear on the operations of Scottish Water comparative evidence from other similar bodies, in this case mostly located in England and Wales. Scottish ministers, in consultation with Parliament, deliver the policy objectives to Scottish Water. Scottish Water then produces its detailed plans and programmes, which are subjected to critical analysis by the water industry commission to ensure that they are delivered within the policy framework, while meeting all the objectives that are set out and coming in at the most competitive price. That seems to be a perfectly fair way of delivering a public policy objective.

Alex Johnstone: Is that concept of competitive price the only criterion by which water services in Scotland are measured against a more liberated marketplace?

Ross Finnie: No. Most of the other matters that affect and are crucial to the consumer, such as drinking water quality, environmental requirements, and sewage discharge consents, are covered in statute. Scottish Water still has to meet its requirements to have regard to the best interests of the consumer and to public health, and other regulators deal with that. The drinking water

quality regulator has a statutory duty to ensure that Scottish Water complies with its requirements with regard to drinking water. SEPA is a regulator with the specific responsibility of ensuring that Scottish Water meets its regulatory requirements. Consumer protection comes from several sources, one of which is the operation of the water industry commission.

Alex Johnstone: The concept of a free—or more liberated—market has the potential to deliver several benefits and competitive pricing is one of them. I understand that you have explained clearly several times this morning that that will be tested against the views of the regulator and compared with other parts of the country. The most basic provision that a marketplace delivers within a market is the matching of supply and demand. Does the regulatory structure make any attempt to mimic that part of a market economy within the water industry in Scotland?

Ross Finnie: No, because demand in Scotland comes from people in the north of Scotland who want to have a public water supply and if it was left to the free market, there would be no such supply. In the south and south-west of Scotland, Scottish consumers demand a water supply and if it was left to the free market, again there would be no such supply. I am not in the business of defending the fact that Scottish Water does not meet the perfect model of supply and demand. I am suggesting that it is in the interests of the Scottish people to have their own water company to ensure that in a country that is 85 per cent rural, those people who live in rural areas are served just as well and to the same standards as are those who live in the conurbations. That is one of the aims of having a publicly owned water supply and I am happy to defend it.

Alex Johnstone: Of course, we are—

The Convener: Just a second, Alex. I do not want to hear a dialogue between you and the minister.

Ross Finnie: We can all join in.

The Convener: No, we cannot all join in. It should be one at a time. We could go on about this endlessly.

Alex Johnstone: I have one final point.

The Convener: It will have to be a short final question.

Alex Johnstone: The minister is telling us that instead of pursuing demand-led provision, he is going to pursue policy on matching supply with demand and on water service provision including sewerage.

Ross Finnie: I do not think that that is true at all. What I am saying is that I am driven not by a

purely economic model but by a socioeconomic structure that requires Scottish Water to ensure that, ultimately, it is able to deliver a uniform quality of water supply and sewerage service throughout the whole of Scotland, irrespective of whether the supply would be supported in an ordinary economic model.

I have no hesitation in saying that that is for the benefit of Scotland. The fact of the matter is that even the publicly owned North of Scotland Water Authority could not have survived much longer. Its customer base was so low that it was financially impossible for it to meet its investment and other requirements in the kind of free-market model to which you allude.

Alex Johnstone: But—

The Convener: No, Alex. I am sorry, but I want to move on. If you have other issues to raise, I am happy to put them to the minister. We have the Finance Committee's report on the financial memorandum which, at the very least, should surface in public before we consider our report. That committee raised a number of major concerns and I want to give the minister a chance to say something about them before we reach our own conclusions on the subject.

I have two points to raise on the Finance Committee's report, the first of which concerns the cost of introducing competition into the Scottish Water set-up. The Finance Committee reported that it had had sight of independent research suggesting that the cost of introducing retail competition could be significantly more than the financial memorandum outlines. That committee is extremely concerned about the issue and seeks as a matter of urgency further information by way of a reconciliation because the figures are totally at odds with those in the memorandum. Do you have confidence in the initial estimates in the financial memorandum?

Ross Finnie: I am well aware of the issue. I appeared before the Finance Committee shortly after it received the information. It was based on independent work that was done by a third party in estimating the costs, particularly in relation to the costs of a switch engine, metering costs and other costs. I regret to say that, as we speak and despite my request—I do not know what has happened and I do not want to blame anybody—we have not received the detail of the independent report. Essentially, I am still operating on the information that we discussed with Scottish Water at the outset, which is the information that we discussed with the water industry commissioner and applied in respect of the cost estimates that are set out in the financial memorandum.

Our view was that it would be fairly simple to estimate the water retail market, particularly by

comparison with the electricity market in which retailers need to estimate and balance usage every half hour, 24 hours of the day and 365 days of the year—a process that involves over 17,500 usage figures.

We took the view, the commissioner took the view and we understood that Scottish Water initially also took the view that the water sector was a simpler operation than other utilities. Until I have sight of the new evidence, I regret to say that I am unable to comment on it. I am happy to write to the convener on the subject, however.

The Convener: That is helpful. It does not answer the question, but it shows that you are aware of the issue and will come back to us on it.

Ross Finnie: I am deeply concerned that this gap has arisen. I must also confess that I am puzzled about it. Given our close examination of the issues and the non-comparability of the water sector and other utilities, I am left in some doubt as to how the gap has arisen.

The Convener: That clears up the matter for the moment. My other question concerns the regulatory impact assessment in the bill. Estimates of the retail gross margin for the average business customer are given in the region of 15 to 20 per cent of the total bill. However, a series of very different estimates was put in front of the committee. Some witnesses put the margin at between 4 and 8 per cent and others cited the work done by Ofwat, which put the average margin for English and Welsh water companies at 9.6 per cent. That is obviously important information for determining the accurate level of wholesale water charges and an important factor in terms of retail competition, but it is also an important factor in apportioning costs through Scottish Water. If the right margin is not set, domestic customers might have to pick up the tab. Those figures are quite at variance. Could you comment on them?

12:15

Ross Finnie: There are two aspects to that. The question of the different estimates is quite difficult, because they are estimates and no one has done detailed work on that. I concede that, but what are much more important are the points that you made in the latter part of your statement. Before the regime is ever established, it will be critical that both Scottish Water and the water industry commission are in possession not just of estimates—that will not do—but of detailed information. As you say, an inappropriate allocation of cost could have a serious bearing on the situation.

I shall ask Clare Morley to comment on that. You have given a good deal of thought to the nature of

the regime, and broadly we do not disagree with you, but our concern is not so much about differences in the estimates but about the point at which cost allocations are fixed and the impact that that could have on Scottish Water having to recover those costs. In our view, those are the critical factors.

Clare Morley (Scottish Executive Environment and Rural Affairs Department): Getting that allocation of the retail gross margin wrong could have a serious impact on the wholesale price, and we have said that there will be a right of appeal to the Competition Commission for that to be challenged. However, it is important to remember that the water industry commission will be setting charge limits. It is possible that the wholesale price that is set will have to be challenged, but as price limits will be set for all customers, including domestic customers, there will be no room for reshuffling within customer categories by Scottish Water if the charges are wrong. If the charges are wrong, they will have to be contested with the Competition Commission. Increased charges cannot be imposed on domestic customers in an attempt to balance the books. We believe that the bill protects customers—domestic customers in particular—from any adverse impact.

The Convener: I had understood that it would be the domestic customers who could suffer if the margins were set at the wrong level. That is the evidence that the committee heard.

Clare Morley: If the margin was set too large, so that Scottish Water was left bearing more costs than it felt it could, it would be Scottish Water wholesale that would be left short, but it would not be open to Scottish Water to try to make that up through domestic customer bills. It would have to seek an interim determination or challenge the initial determination to get more resources.

The Convener: Would that not undermine Scottish Water's effective operation as a company?

Clare Morley: Getting the margin wrong would undermine Scottish Water, but there is access to the Competition Commission to appeal that.

The Convener: I am just concerned that there is disagreement at the outset as to where you set the levels. One of the witnesses suggested that Scottish Water was being set up to fail, which was vigorously denied by Scottish Water. However, there is clearly some nervousness about getting those figures right at the outset so that we do not have an unstable organisation. You have, quite rightly, outlined the Government's objectives and why you are setting out the framework in the bill, but if the figures are wrong, it could become a very difficult issue to resolve.

Ross Finnie: I have to go back to my opening remarks. The estimates are just that. If the bill is passed, the commission, Scottish Water and others will have a considerable amount of work to do not to deliver an estimate but to deal with actual figures. I can understand people perhaps making a speculative comment based on a range of margins, but I do not agree with the comment that Scottish Water is being set up to fail. Nevertheless, people may say, "Ah, well, you just picked one of those numbers." That is not how the process will work. The commission and Scottish Water will be dealing with numbers. Of course the commission will then be under a slightly different pressure once the bill goes through. Previously, no one with any particular expertise would necessarily be challenging it but, by the time the bill goes through, Scottish Water will have access to the Competition Commission, which will put real pressure on the water industry commission to get things right first time.

The Convener: I am just worried that it will not. It has been suggested that the commissioner's estimates are out at the moment.

Ross Finnie: They might be, but estimates are estimates. I am suggesting that the commissioner has not spent the amount of time with Scottish Water that will be required to get the allocation right once the bill is through, which I think he would acknowledge, because the process will be different.

The Convener: So what you are outlining will happen after the bill has been approved.

William Fleming (Scottish Executive Environment and Rural Affairs Department): Yes, the commissioner is engaging consultants whose task it is to help him to prepare a means of having better regulatory information for his accounting purposes. That work is in hand. It will enable him to have a much more robust grip on the figures when it comes to doing the proper allocations.

The Convener: The Finance Committee has expressed concern that the water industry commissioner and Scottish Water have different views of Scottish Water's efficiency. Do you have a view on how that might be resolved?

Ross Finnie: They have disagreements, but I suppose that that is always going to be the case. There is no question about it: Scottish Water after two years is very much more efficient in absolute terms than it was and it feels strongly about that. That is slightly different from the view of the water industry commissioner, who is constantly updating his comparator with reference to the performance of other companies. He might take a view that in relative terms there is still much to be done and he will be redefining his targets. I do not regard it as

entirely alarming for Scottish Water to have a view that it is making real progress and improving its efficiency, while a regulator, looking at the comparative model in order to bring pressure to bear on Scottish Water, takes a slightly different view. I do not regard that as either necessarily unhealthy or something about which we should be too surprised.

Maureen Macmillan: The bill neatly divides customers into domestic and non-domestic. Given that the Justice 2 Committee—the other committee of which I am a member—is considering the Fire (Scotland) Bill, I realise that there is also the fire brigade to consider. We took evidence from fire brigades and it seems that they are responsible for the upkeep of hydrants and maintenance of ring mains, which are maintained by Scottish Water, which then charges the fire brigades. The fire brigades are not terribly keen on that arrangement. Are there other special arrangements with other public services that do not fit into the bill?

Ross Finnie: We are not aware of any. The fire brigades provide an essential service for which hydrants have to be provided. One of the major issues, which I am sure you have heard about in evidence, is the enormous cost of vandalism to hydrants. I might have to check my figures, but I think that in the Glasgow area last year it cost something in the order of £1 million just to repair fire hydrants that had been vandalised.

Maureen Macmillan: Yes, and that cost falls on the fire brigades rather than on Scottish Water, which is presumably why the fire brigades are not terribly keen on it.

Ross Finnie: I rather suspect that Scottish Water would not be too keen to take on the fire brigades.

Maureen Macmillan: I suspect that we have to sort out the vandals.

Ross Finnie: Indeed.

The Convener: Rob Gibson has a brief follow-up question.

Rob Gibson: It is on the same point. The servicing of hydrants has to take place regularly. How often does servicing take place in areas in which there is no vandalism, such as rural areas? Can the fire service rely on the hydrants in areas in which usage and servicing is minimal? You might not be able to provide an answer just now.

Ross Finnie: As Maureen Macmillan said, financial responsibility for hydrants rests with the fire brigades. In certain parts of the country, there are arrangements between the fire authority and Scottish Water and service level agreements set out minimum standards for the servicing that ought to be carried out. That is a matter that can properly

be dealt with jointly by the fire authorities and Scottish Water. I do not think that any new provisions are required; certainly, no such provision is needed in the bill.

The Convener: I want to get your views on three issues, the first of which is the charge determination process. The bill seeks to end Scottish Water's freedom to negotiate individual agreements with customers. Will you outline the reason for that change, which it is clear is an issue for some of the larger-volume customers who, if they do not see a deal on the table, will go automatically to an alternative supplier? There are obviously implications from that for Scottish Water's revenue, as well as for its existing customers.

Ross Finnie: We are not trying to interfere with business decisions. There are situations in which authorised departures from the charging regime will not be prevented and will be justified. Some large customers in the chemicals and distilling industries have internal arrangements whereby they take steps to reduce the cost of being served by Scottish Water. The bill does not prevent us from reaching different charging arrangements that take cognisance of the fact that those customers have their own water plants to deal with certain aspects of water provision. However, there are situations in which those special arrangements simply require cross-subsidy by other smaller customers. We are trying to be fair to all customers and to secure harmonised charges throughout Scotland.

The Convener: I was thinking of the implications for smaller customers of some of the bigger customers going off network or using alternative suppliers. That could have an impact on Scottish Water's ability to serve smaller customers for the same cost. I understand the logic of what you are suggesting, but I am asking about possible unintended consequences.

Ross Finnie: There are several other issues that must be taken into consideration. Some of the older arrangements were put in place when the relevant water authority could not have claimed to have been able to deliver the service at anything like an efficient cost. On comparability, the real issue is about driving forward with efficiency in capital procurement, capital delivery and revenue costs within Scottish Water. In my view, the big issue in being able to retain customers is efficiency—efficiency in a broad sense. We do not want to cut across quality and other indicators and factors, such as those that relate to sustainability. Unwinding individual arrangements could not and would not happen overnight; it would have to be done gradually. I cannot remember what period we have set. We could not interfere with existing arrangements—they would have to run their course. We could not break a contract.

The Convener: So no one who has negotiated a deal will lose out immediately; the provision in the bill is just about new deals.

Ross Finnie: Yes.

The Convener: The Federation of Small Businesses suggested that the removal of Scottish Water's duty to act as supplier of last resort for non-domestic customers could be a problem for people who have previously been declared bankrupt. Potentially, that could prevent new businesses from getting access to water supplies. Will there be safeguards in place to avoid that happening?

Clare Morley: The bill provides for Scottish Water wholesale, rather than Scottish Water retail, to act as supplier of last resort. That is to ensure that Scottish Water retail will be on a level playing field with any other new entrants. The bill includes detailed provisions to ensure that disconnection happens only as a last resort and after a reasonable period. However, the view taken in the bill is that there might be circumstances in which supply should be cut off.

12:30

The Convener: The question was more about supply for new businesses. Would a person who was previously declared bankrupt or had a company that went out of business be given access to the network?

Clare Morley: It will be for the licensing regime to ensure that no customer is put in that position and to ensure that new entrants are under an obligation not to pick and choose merely the attractive customers.

The Convener: So the licensing system will have safeguards to protect potential businesses.

Clare Morley: Yes.

The Convener: My final question is on the new ministerial powers of direction in section 19. What is it envisaged that those powers will be used for? It was suggested to us that section 19 provides ministers with very broad powers, which could perhaps be defined more narrowly. Can the minister give an example of how the power to direct Scottish Water might be used?

Ross Finnie: Following the extensive discussion that has been mentioned this morning, we will arrive at a view on the objectives for Scottish Water's investment programme and, under section 19, we will instruct and direct Scottish Water to meet those objectives. Following the consultation on the principles of charging, we will direct Scottish Water and the water industry commission to adopt the principles that are agreed in determining final charges. In setting the

principles for charging and the objectives for the investment programme, we will have regard to all the factors that have been set out. There will be a distinction between the Executive, which will set the objectives, and Scottish Water and the water industry commission, which will set the framework within which those policy objectives are to be discharged.

The Convener: I want to check whether we are reading the bill correctly, given that we had assumed that those directions would be issued under section 18. I think that the minister's answer is what we expected, but I am trying to work out which section provides for that set of directions. We had assumed that they were provided for in section 18.

Clare Morley: Section 18 sets out the new charge determination process and it provides that the water industry commission must fully fund all Scottish Water's functions, including any functions provided for by a direction made under section 19. Section 18 also provides for a statement on charges. The two sections are intricately connected. Section 18 cross-refers to the direction power in section 19.

The Convener: Is that the only reason for the inclusion of section 19? Does section 19 not provide wider powers?

Clare Morley: The powers of direction are mentioned separately because they are inserted into a different place in the Water Industry (Scotland) Act 2002. The bill ensures that all the objectives that are set for the industry through the quality and standards process are functions that have to be funded by the water industry commission.

The Convener: That is a helpful clarification.

Mr Ruskell: I have two questions on reporting back to the Parliament. First, the Water Act 2003 places a duty on the secretary of state in England and Wales to report to Parliament every three years on what steps are being taken to encourage water conservation. Why does the bill not include a similar provision? Secondly, is the minister minded to impose a duty on SEPA to report to the Parliament under part 3 on what progress is being made on coal mine water pollution?

Ross Finnie: I am much more persuaded that Scottish Water should be required to report to the Parliament on its functions and accounts annually. Indeed, the chairman and chief executive of Scottish Water are required to report to the Parliament, presumably through this committee. That is a better way for Scottish Water, which is a publicly owned company. I am intrigued by Mark Ruskell's passion for importing all the Westminster sections into the bill but, with respect, I am bound to say that the requirement that Scottish Water

present an annual report to the Parliament and that its officials appear before the Parliament to be subjected to questioning presents an opportunity for monitoring progress that is far more alive and alert than a requirement on a privatised business to report to Parliament every three years.

Under the Water Environment and Water Services (Scotland) Act 2003, SEPA already has powers to address water pollution from disused mines and to ensure the ecological status under the river basin management plans.

The Convener: Okay, that is excellent. Our questions on the high principles and minor details have been exhausted, so I thank the minister and his team for taking us through exactly what is meant by the bill. It is helpful to have the authors of the bill explain how its different sections interrelate.

Subordinate Legislation

Pesticides (Maximum Residue Levels in Crops, Food and Feeding Stuff) (Scotland) Amendment (No 3) Regulations 2004 (SSI 2004/399)

12:36

The Convener: Under item 6, we must consider one negative instrument. The regulations have been considered by the Subordinate Legislation Committee and copies of that committee's comments have been circulated to members.

If members have no comments, are they content to agree that we make no recommendation on the instrument?

Members *indicated agreement.*

Meeting closed at 12:36

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