FINANCE COMMITTEE

AGENDA

24th Meeting, 2004 (Session 2)

Tuesday 28 September 2004

The Committee will meet at 10.00 am in Committee Room 4 to consider the following agenda items:

1. Declaration of interests: The new member of the Committee will be invited to declare any relevant interests.

2. Choice of Deputy Convener: The Committee will choose a new Deputy Convener.

3. Scottish Water: The Committee will take evidence on broad water issues from:

   Ross Finnie, MSP, Minister for Environment and Rural Development

   Andrew Scott, Head of Division; Janet Egdell, Operational and Institutional Governance Team Leader; Andrew Fleming, Capital, Regulatory Protocols, Off-Network Supplies Team Leader; and Clare Morley, Water Services (Scotland) Bill Team Leader, Water Services Division, Scottish Executive Rural Affairs Department

4. Scrutiny of Financial Memoranda: The Committee will consider a paper regarding the Committee’s approach to scrutinising future Financial Memoranda.

5. Budget Process 2005-06 (in private): The Committee will consider a paper by the Budget Adviser on performance issues and consider the options for its proposed Budget Seminar.

6. Fire (Scotland) Bill (in private): The Committee will consider its draft report on the Bill’s Financial Memorandum.

7. Water Services etc. (Scotland) Bill (in private): The Committee will consider its draft report on the Bill’s Financial Memorandum.

Susan Duffy
Clerk to the Committee
The papers for this meeting are:

**Agenda Item 3**

Written evidence

PRIVATE PAPER

**Agenda Item 4**

PRIVATE PAPER

**Agenda Item 5**

PRIVATE PAPER

**Agenda Item 6**

PRIVATE PAPER

**Agenda Item 7**

PRIVATE PAPER
Finance Committee

24th Meeting 2004 – Tuesday 28 September 2004

Scottish Water
Written Submissions

1. At an away day on 25 August, Members agreed to take evidence on the Scottish water industry from Ross Finnie MSP, Minister for Environment and Rural Development. In order to inform the Committee’s questioning, written submissions were sought from organisations involved in the water industry. Responses have been received from the following organisations:

Scottish Engineering
Civil Engineering Contractors Association Scotland (CECA)

2. The Committee is invited to consider these submissions.

Terry Shevlin
September 2004
SUBMISSION FROM SCOTTISH ENGINEERING

Scottish Engineering has been involved with Scottish Water in progressing necessary works to prevent further water incursions caused by heavy rainfall at Newhouse Industrial Estate.

The flooding has had a major impact at the premises of two of our member companies on the Estate.

On behalf of various member companies, we are also pursuing a number of matters regarding the overall level of service, availability of appropriate emergency personnel and a variety of financial matters.

Following meetings with senior Scottish Water officials in recent weeks, we have been assured that Scottish Water is in the process of addressing all of the above issues.

SUBMISSION FROM THE CIVIL ENGINEERING CONTRACTORS ASSOCIATION SCOTLAND (CECA SCOTLAND)

CECA supports the contention that there has been a backlog in physical construction on the ground and one that our industry identified several years ago and has consistently brought to the attention of Ministers, a number of MSPs, Scottish Water itself and, most recently, the Cross Party Group for Construction and Scottish Water Solutions.

Causes of the Backlog

CECA believes the backlog can be attributed largely to the management of change firstly during the establishment of Scottish Water and then, following a very demanding tender process, Scottish Water Solutions. In all fairness, we believe that it is only now that these organisations have been suitably equipped to focus fully on programme delivery. Furthermore, we believe that these organisations are now developing a workable delivery model.

During the early years of Q&S II several other factors added to the problem of getting work out on the ground, notably:

- **WIC Efficiencies.** The imposition of the Water Industry Commissioner (WIC)’s efficiencies for Q&S II necessitated an effective halt to physical construction so that strategic optioneering and design work could further examine the potential for savings. This undoubtedly held up the programme for a prolonged period. In retrospect it would probably have been more beneficial to have kept up a reduced rate of “work in progress” to maintain some momentum.
• **Consents.** Much of Scottish Water’s programme is dependent on consents from SEPA and Local Authorities. In many case these were slow in coming but we have been heartened by the closer engagement between Scottish Water Solutions, SEPA and the Local Authorities, which we hope will bring more cohesion to the programme and its delivery.

• **Procurement Strategy.** Another cause of backlog leading on from the WIC efficiencies was the “work by right” quotas agreed in the Scottish Water Solutions’ shareholders’ agreement for work by Solutions’ In-House Partners and Scottish Water’s in-house labour organisation Scottish Water Contracting.

Not only did these quotas further complicate the equation thereby leading to delay, but the majority of our members feel that the resultant demands of gearing up caused localised inflation and stifled the very potential for savings that was trying to be achieved. Most contractors feel the In-House Partners should now develop into more of a design and programme management role overarching a wider supply chain. This has the advantage of engaging, where commercially competitive, Scotland’s indigenous civil engineering capacity thus maintaining the civil engineering resource in place during and after the programme.

CECA does not believe that industry capacity has been or will be a barrier to the programme. The Environment Minister, Ross Finnie MSP, raised doubts at a Finance Committee meeting on 4th February 2004 when he questioned whether Scotland’s civil engineering had sufficient capacity for Scottish Water’s programme. We subsequently met the Minister on 20th July and dispelled any such doubts. For the record, we estimate that Scotland’s civil engineering industry has an annual outturn of around £1.4Bn and employs around 20,000 people across Scotland with many more in its supply chain. CECA (Scotland) members carry out in excess of 80% of this total and include all key contractors in the Scottish water sector including Solutions’ In-House Partners. Member surveys in April and June indicated that physical construction (i.e. not including design and programming) in the Scottish water sector currently accounted for less than £200M per annum. The same survey also identified potential capacity in the water sector well in excess of £500M per annum and confirmed that the industry was operating significantly below full capacity and that even the most ambitious run rate was still within the Scottish civil engineering industry’s capacity to deliver.

Furthermore, although we are conscious that the wider Scottish construction industry’s resources will be put under considerable strain if the programme of new build schools, hospitals and housing stock transfers come through at the same time as Q&S III, we do not feel that this would cause a capacity problem in the water sector. These other programmes are predominantly building orientated and, although there are some crossover skills with civil engineering, building resources are normally drawn from a separate labour market.
The Efficiency of Scottish Water to deal with the Backlog

CECA believes that it is not just the efficiency of Scottish Water that should be examined but the efficiency of all stakeholders involved in the water programme including the Scottish Executive, WIC, Scottish Water Solutions, SEPA and the construction industry. All have their part to play. As we mentioned earlier, we believe that the model is beginning to show genuine results and wrote to Ross Finnie earlier this month to say so.

The Way Ahead

The industry is virtually unanimous in its desire to avoid major changes, which, in our experience, lead to a hiatus in workload and escalating costs. There is no doubt that over the last two months Scottish Water Solutions run rate has increased and there are very encouraging signs that it will ramp up even further over the next six months and beyond. There is therefore widespread agreement across the industry that Scottish Water Solutions should continue into Q&S III provided it further develops its procurement model. Scotland’s contractors are acutely conscious of previous “false dawns” in Scotland’s water sector but believe there is a genuine will amongst all concerned in the water industry to get work out on the ground this time.

Noting that Q&S III will include a larger number of small projects we feel that Solutions should now concentrate on the design and strategic management phases of the programme where, it is generally accepted, the big efficiencies are to be found. This would leave more of the physical construction in the wider market where, as previously stated, we believe there are more than adequate resources to deal with the maximum run rate envisaged. To that end we have held meetings with Scottish Water and Scottish Water Solutions this month to examine how the Scottish supply chain can be mobilised to meet this challenge.

It would further add to the momentum if selected projects were brought forward from the Q&S III programme into Q&S II, if they are ready to go. Not only would this keep the run rate up but it would also provide Scotland’s civil engineering industry with much needed continuity of workload from which efficiencies tend to flow.

We would welcome the opportunity to give evidence to the Committee if it was felt that this would be useful.
I am writing to you in response to your consultation letter of 31 August 2004 to the Institution of Civil Engineers in my capacity as Senior Vice-Chairman of the Glasgow and West of Scotland Region. This response relates only to the water and wastewater aspects of the industry and does not consider the issues surrounding flood management in Scotland.

The Scottish water industry has been in a state of flux over the last 8 years and would benefit from a period of stability. Local Government reorganisation in 1996 saw the creation of the three water authorities, and this was followed in 2002 by the Water (Scotland) Act which saw the creation of Scottish Water, a single unitary authority. The integration of the three regional authorities has not been without difficulty. The drive towards efficiencies, achieved primarily through a reduction in staff numbers, coupled with the historical under funding of water and sewerage infrastructure was a significant challenge to Scottish Water and we believe had the effect of reducing the short-term effectiveness of Scottish Water in delivering their capital programme outputs.

For the delivery of the capital programme the three regional authorities adopted a number of procurement models with varying degrees of success. In part this can be attributed to uncertainty within the management structure due to an awareness that further reorganisation was imminent and a lack of decision making and accountability at the middle management level. Scottish Water was, therefore, faced with a significant project backlog when they were formed in April 2002.

The response to this by Scottish Water has been to create a new vehicle to deliver the remainder of the Approved Capital Investment Programme in the form of Scottish Water Solutions (SWS). The formation of this Public Private partnership (comprising Scottish Water, Water plc’s and a number of Construction Companies) has taken some time and resulted in reduced outputs being achieved for much of the period between April 2003 and June 2004. SWS would now appear to be fully established and are starting to deliver significant construction spend.

Considering now the individual outputs being achieved, it is clear that over the years significant advances have been made in the rehabilitation of water mains and the reduction of leakage. The focus has now turned to sewerage rehabilitation and major efforts are being made to deliver a programme of rehabilitation. Targets set by SWS are challenging and, if delivered, will represent a major achievement. Early signs are that SWS are meeting this challenge.

The early focus of SWS has been in the resolution of unsatisfactory intermittent discharges to coastal and inland waters. An accelerated programme of delivery of design and construction is currently underway. The execution of this element of the programme has demonstrated what can be achieved through a combination of collaboration with the consenting
authorities and a critical review of the approval procedures in place at Scottish Water.

In parallel with this a significant effort is being expended on water and wastewater treatment. The focus here is on only undertaking work that is required to meet the obligations set out in EC directives and acknowledged as such by the Scottish Executive and the Water Industry Commissioner for Scotland. This often gives rise to conflict at a local level where customer and local politician expectations are often higher than the proposed treatment solution.

It is clear that the efficient delivery of the capital programme and the clearing of any backlog is not wholly in the control of Scottish Water. The consenting authorities, in the form of the Scottish Environment Protection Agency and the Local Planning Authorities must play their part in enabling efficient execution. By communicating clearly their requirements to Scottish Water and engaging fully in exploring and setting approaches both at strategic and local level a significant improvement can be achieved in the delivery period for projects.

We believe that a more integrated approach by Scottish Water and the Statutory Authorities is required to the delivery of water and sewerage improvements. Strategic policy must be fully translated to a local level where many of the day to day decisions are made. It is evident that in some cases Scottish Water are regarded with suspicion and are treated more as a commercial organisation rather than a public service authority.

Scottish Water has an important part to play in enabling development by relieving infrastructure constraints through first time provision of water and sewerage infrastructure. This is perhaps one of the single most important aspects to be addressed in the future. It is clear that the capital investment programme for the next Quality and Standards period must include sufficient allowances for this.

There is no doubt that the existing budget for the delivery of the Approved Capital Investment Plan is challenging. To deliver the remainder of the programme within this budget will require efficiencies to be delivered both in terms of the actual construction costs and the management of the process. Operational efficiency in new and existing works will also need a thorough review to ensure that industry best practice is being adopted. There is a risk that capital efficiency will be the major focus as a short-term driver, and operational costs will not be adequately addressed. Scottish Water are aware of this as an issue and their capital approval procedures address this. On existing works, more efficient operating practices may be required, and this could involve expenditure on automation of works and the appropriate specification of equipment.

In summary, the ability of Scottish Water to clear the existing backlog of work within the available budget is yet to be proven. There are signs that the delivery of the programme is starting to happen though Scottish Water Solutions, particularly in the areas of water and sewerage rehabilitation.
The construction industry in Scotland is keen to participate fully in this challenge and believes that the framework now in place is an appropriate delivery vehicle. However, a long-term view needs to be taken by the Scottish Executive, as experience elsewhere in the UK indicates that procurement approaches take time to become fully effective. We would, therefore, be concerned if there was a radical change to the approach adopted for the Q&S III programme, as we feel that this would introduce a further period of uncertainty which would put at risk the outputs required to be met by Scottish Water. We would, therefore, encourage the Executive to work closely with Scottish Water at an early stage to discuss and approve the principles to be adopted for Q&S III delivery to remove concerns that exist in the industry regarding long-term workload. This would provide all the industry suppliers with the confidence to invest in development of staff to ensure increasing efficiency going forward.