FINANCE COMMITTEE

AGENDA

11th Meeting, 2003 (Session 2)

Tuesday 4 November 2003

The Committee will meet at 10.00 am in The Chamber, Assembly Hall, The Mound, Edinburgh to consider the following agenda items:

1. **Work Programme:** The Committee will consider its future work programme.

2. **Cross-Cutting Expenditure Review on Economic Development:** The Committee will consider its approach to the review.

3. **Criminal Procedure (Amendment) (Scotland) Bill:** The Committee will take evidence on the Bill's Financial Memorandum from—
   - John Ewing, Chief Executive and John Anderson, Principal Clerk of the Session and Justiciary, Scottish Court Service.
   - Douglas Haggarty, Head of Legal Services (Technical), Scottish Legal Aid Board.

4. **Scottish Water:** The Committee will consider a position paper collated by Scottish Water.

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

**Agenda item 1**

Paper by the Clerk

**Agenda item 2**

Paper by the Clerk and SPICe Briefing

**Agenda item 3**

Criminal Procedure (Amendment) (Scotland) Bill, Policy Memorandum and Explanatory Notes

Paper by the Clerk - written evidence

PRIVATE PAPER

**Agenda item 4**

Paper by the Clerk and SPICe Briefing

Paper collated by Scottish Water
Finance Committee
Work Programme

1. The Committee had an initial discussion on its future work programme on 24 June 2003. Since that time, various pieces of legislation have been introduced with which the Committee needs to deal and the Committee has also agreed to carry out a cross-cutting review on economic development.

2. The Committee’s potential work programme for November and December is attached. Following the Committee’s discussion at its meeting on 28 October, this programme incorporates forthcoming legislation as the Committee has signalled its intention to scrutinise all financial memoranda until any alternative mechanism is agreed. The programme also sets out the Committee's commitment in relation to the Budget Process and factors in work on issues such as Petition PE670.

3. Members should be aware that whilst all work which the Committee is either required to, or has agreed to undertake has been incorporated into the Programme, the timing of some of this work could be subject to change. This is the reason why some items are followed by a question mark.

4. The Committee is invited to consider this future work programme.

Susan Duffy
Clerk to the Committee
## FINANCE COMMITTEE WORK PROGRAMME
### November and December 2003

<table>
<thead>
<tr>
<th>Date</th>
<th>Committee Business</th>
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<tbody>
<tr>
<td><strong>Monday 10 November</strong></td>
<td><strong>EXTERNAL MEETING (ALL DAY)</strong></td>
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<tr>
<td>(Motherwell)</td>
<td><strong>Budget Process 2004-05</strong> –</td>
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<td>- Workshops am</td>
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<td>- Evidence from Deputy Minister</td>
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<td>- Budget revision SSI</td>
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<td><strong>Tuesday 11 November</strong></td>
<td><strong>Nature Conservation (Scotland) Bill</strong></td>
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<td>(CR1)</td>
<td>- SNH, Scottish Land Court, S Executive</td>
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<td><strong>Criminal Procedure (Amendment) (Scotland) Bill</strong></td>
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<td>- evidence – S Executive</td>
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<td><strong>Budget Process 2004-05</strong> – consider Stage 2 reports of subject Committees</td>
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<td><strong>Tuesday 18 November</strong></td>
<td><strong>Additional Support for Learning (Scotland) Bill</strong></td>
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<tr>
<td>(Chamber)</td>
<td>- evidence</td>
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<td><strong>Anti-Social Behaviour Orders (Scotland) Bill</strong></td>
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<td></td>
<td>- evidence</td>
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<td></td>
<td><strong>Criminal Procedure (Amendment) (Scotland) Bill</strong></td>
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<td></td>
<td>- consideration of draft report</td>
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<td></td>
<td><strong>Nature Conservation (Scotland) Bill</strong></td>
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<td></td>
<td>- consideration of draft report</td>
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<td><strong>Ombudsman Memorandum of Understanding</strong> – to be discussed and agreed?</td>
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<tr>
<td><strong>Tuesday 25 November</strong></td>
<td><strong>Budget Process 2004-05</strong> – consider Finance Committee’s draft budget report</td>
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<tr>
<td>(CR2)</td>
<td><strong>Holyrood</strong> – consideration of November monthly report and evidence-taking from SPCB, Holyrood Project Director and HPG.</td>
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<td><strong>Relocation policy</strong> – report from reporters?</td>
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| Tuesday 2 December (Chamber) | Additional Support for Learning (Scotland) Bill  
- evidence from S Executive  
Anti-Social Behaviour Orders (Scotland) Bill  
- evidence from S Executive  
Cross-cutting review into Economic Development – selection of adviser  
Budget Process 2004-05 – agree Finance Committee’s final budget report |
| Tuesday 9 December (CR4) | Additional Support for Learning (Scotland) Bill  
- consider draft Report?  
Anti-Social Behaviour Orders (Scotland) Bill  
- consider draft Report?  
Relocation policy – evidence from Minister? |
| Tuesday 16 December (Chamber) | Budget Process 2004-05 – discussion of process and of the approach to next year’s Annual Spending Review (ASR) and the UK Spending Review |

**Executive legislation still anticipated:**

Education (increased role for Heads in school running and tribunal service for pupils)  
Water Services  
Gaelic Language  
Local Government  
Sentencing Commission  
Strategic Environmental Assessment  
Fire Service

**Other issues to be dealt with in 2004:**

Cross-cutting review into Economic Development  
Consideration of Annual Spending Review for 2005-06  
Strategic review of the impact of the UK Spending Review on budget process  
Cross-cutting review into Sustainable Development
Finance Committee
Cross-cutting Expenditure Review of Economic Development

1. In the first session of Parliament, the previous Finance Committee produced a report on Financial Scrutiny\(^1\). Part of this report concentrated on cross-cutting reviews and outlined why the committee believed such reviews should be undertaken - “as most scrutiny of expenditure proposals by subject committees is carried out on a portfolio or departmental basis, we were concerned that expenditure in pursuit of policy objectives which cut across more than one department was not being scrutinised in any systematic or strategic way.”\(^2\)

2. The previous committee recommended that this Committee should undertake similar cross-cutting, budgetary reviews in the future. This Committee has decided that it wishes to undertake a cross-cutting review of Economic Development.

3. At its meeting on 7 October 2003, the Committee agreed in principle to appoint an adviser to help formulate the remit of the review and to assist the Committee’s consideration of the issues. The Committee also made some requests for additional information and suggestions for issues to be considered and these have been encapsulated into the briefing prepared by SPICe which is attached to this paper.

4. The Committee agreed that it wished to have a further discussion to clarify and determine what issues should be investigated as part of its review.

5. The previous committee stated that a cross-cutting review must, by definition, investigate issues across more than one department, should relate to budgetary matters and simultaneously, it should be borne in mind the need to avoid overlap with subject committees. All of these issues will have to be taken into account when deciding how to proceed.

6. The Committee is invited to agree what areas it wishes to consider for its review.

Susan Duffy
Clerk to the Committee

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\(^1\) SP Paper 784
\(^2\) ibid
Finance Committee: Economic Development Cross-cutting Review

Background
At its meeting on 7 October 2003, Finance Committee members outlined a number of initial thoughts on the potential scope of any cross-cutting inquiry into economic development in Scotland. This paper looks at some of the themes raised by members in that meeting.

Themes raised
A table from SPICe briefing 03/80 (reproduced as table 1 below), outlining expenditure having economic development as its primary objective, was mentioned as being “key to the whole discussion.”

Table 1: Executive expenditure (2003-04) where economic development might be considered the primary objective

<table>
<thead>
<tr>
<th>Budget head</th>
<th>£m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprise and Lifelong Learning</td>
<td>2351.29</td>
</tr>
<tr>
<td>Transport</td>
<td>845.59</td>
</tr>
<tr>
<td>VisitScotland</td>
<td>31.76</td>
</tr>
<tr>
<td>Regenerating our Communities</td>
<td>231.26</td>
</tr>
<tr>
<td>Rural Development</td>
<td>135.56</td>
</tr>
<tr>
<td>Agricultural services</td>
<td>117.86</td>
</tr>
<tr>
<td>Fisheries</td>
<td>63.94</td>
</tr>
<tr>
<td>CAP Market support</td>
<td>340.29</td>
</tr>
<tr>
<td>Forestry</td>
<td>73.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4190.65</strong></td>
</tr>
</tbody>
</table>

Source: Scottish Executive 2003

It was requested that the money spent on enterprise and lifelong learning “should be split up into money that is spent on the enterprise network, money that is spent on further education and higher education and money that is spent on industrial support at the hands of the Executive.” Figure 2 presents a pie chart depiction of expenditure under the enterprise and lifelong learning budget head.
Figure 1 provides a visual and percentage terms representation of table 1, namely, the breakdown of expenditure across departments that might be deemed to have a primary objective of economic development.

**Figure 1: Pie chart depicting figures in table 1**

![Pie chart depicting figures in table 1](source: Scottish Executive 2003)

**Figure 2: Expenditure on Enterprise and Lifelong Learning (2003-04) by category**

![Pie chart depicting figures in table 2](source: Scottish Executive 2003)
Figure 3 adds to the picture by outlining the expenditure presented in table 1 and presenting the enterprise and lifelong learning budget under thematic headings (e.g., higher and further education, enterprise networks).

**Figure 3: Economic Development expenditure by theme**

![Economic Development expenditure by theme](image)

Source: Scottish Executive 2003, adapted by SPICe

Analysis of economic development expenditure cutting across departments would allow the committee to scrutinise a stated policy objective of the Executive in a systematic and strategic manner. Indeed, such an approach was explicitly recommended by the previous Finance Committee in its *Financial Scrutiny Review*.

It was suggested that it would be useful to have work done on comparing economic development expenditure in other devolved regions. It was further mentioned that it would be useful to find out how the budget was divided within Scotland.

Members will also be aware that the Committee has at its disposal a budget for commissioning **external research** on primary research that SPICe do not have the resources to carry out “in-house.” This comparative analysis and the geographical expenditure across Scotland are areas the Committee may like to consider in this regard. If it was agreed to do this, then the Committee would need to have approval from the Conveners’ Group and the Bureau to commission such external research.

For members’ interest, the following is an interesting piece of research looking at the factors making for successful regional economic growth.
An alternative approach was suggested that the Committee could look at “regulation” and “taxation”. There was a recent publication from the Scottish Manufacturing Steering Group which compared business tax revenue in OECD and European countries.

Previously, there has not been a great deal of work done on the implications of business tax and regulation on Scottish business. In 1995, a study was commissioned by the Department of Transport, Local Government and the Regions, entitled *The Impact of Rates on Business*.

Interest was also expressed in looking at the key sectors of the Scottish economy, because they were identified in *A Smart, Successful Scotland*. It was thought that it could be of interest to find out more about the level of funding that has gone into the sectors and about the outcomes.

Scottish Enterprise operating plans for 2003-04 outline planned expenditure in different programmes for this financial year – a summary of the allocations can be found in table 2 below.

*Smart, Successful Scotland* identifies seven sectors as “key clusters” – namely, biotechnology, creative industries, food and drink, forest industries, microelectronics, optoelectronics and tourism. The committee may wish to further scrutinise Scottish Enterprise allocations outlined in their operational plan (see table 2 below) and whether they mirror the priorities of a Smart, Successful Scotland.

Alternatively, in looking at the budget overall, members may want to consider the degree to which expenditure is prioritised on these “key clusters” mentioned above.

The potential problem was raised of a Finance inquiry into economic development replicating what should legitimately be the work of a subject committee, particularly the Enterprise and Culture committee whose predecessor committee inquired into a number of areas such as the impact of the new economy, local economic development services and the levels of spend for Enterprise networks which was addressed as part of its budget scrutiny.
Table 2: Summary of Scottish Enterprise Finance

<table>
<thead>
<tr>
<th>Expenditure</th>
<th>£m</th>
</tr>
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<tbody>
<tr>
<td><strong>Growing Business</strong></td>
<td></td>
</tr>
<tr>
<td>Entrepreneurial Dynamism and Creativity</td>
<td>76</td>
</tr>
<tr>
<td>More E-Business</td>
<td>9</td>
</tr>
<tr>
<td>Increased commercialisation of R &amp; D</td>
<td>35</td>
</tr>
<tr>
<td>Global Success in Key Sectors</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total Growing Business</strong></td>
<td>125</td>
</tr>
<tr>
<td><strong>Global Connections</strong></td>
<td></td>
</tr>
<tr>
<td>Digital Connectivity</td>
<td>34</td>
</tr>
<tr>
<td>Involvement in Global Markets</td>
<td>22</td>
</tr>
<tr>
<td>Globally Attractive location</td>
<td>53</td>
</tr>
<tr>
<td>People choosing to live and work in Scotland</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total Global Connections</strong></td>
<td>110</td>
</tr>
<tr>
<td><strong>Skills and Learning</strong></td>
<td></td>
</tr>
<tr>
<td>Improving the operation of the Scottish Labour Market</td>
<td>49</td>
</tr>
<tr>
<td>Best start for all our young people</td>
<td>73</td>
</tr>
<tr>
<td>Narrowing the gap in unemployment</td>
<td>52</td>
</tr>
<tr>
<td>Improved demand for high quality in work training</td>
<td>19</td>
</tr>
<tr>
<td><strong>Total Skills and Learning</strong></td>
<td>193</td>
</tr>
<tr>
<td><strong>Research and Development</strong></td>
<td>16</td>
</tr>
<tr>
<td><strong>Delivery and administration (excluding Careers)</strong></td>
<td></td>
</tr>
<tr>
<td>Service Delivery staff</td>
<td>42</td>
</tr>
<tr>
<td>Support staff</td>
<td>12</td>
</tr>
<tr>
<td>Staff Development</td>
<td>4</td>
</tr>
<tr>
<td>Premises (rents and rates)</td>
<td>9</td>
</tr>
<tr>
<td>ICT</td>
<td>6</td>
</tr>
<tr>
<td>Utilities, Consumables etc</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total Delivery and administration (excluding careers)</strong></td>
<td>83</td>
</tr>
<tr>
<td><strong>Total Expenditure</strong></td>
<td>527</td>
</tr>
<tr>
<td><strong>Income</strong></td>
<td></td>
</tr>
<tr>
<td>Scottish Executive</td>
<td>454</td>
</tr>
<tr>
<td>Business Income</td>
<td>55</td>
</tr>
<tr>
<td>EU Income</td>
<td>18</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>527</td>
</tr>
</tbody>
</table>

Source: Scottish Enterprise 2003

REFERENCES


Ross Burnside
Senior Research Specialist
Public Finance
Finance Committee
Criminal Procedure (Amendment) (Scotland) Bill
Financial Memorandum

Written Submissions

1. In order to assist the Committee in its consideration of the Financial Memorandum of the Criminal Procedure (Amendment) (Scotland) Bill, written submissions have been received from the following organisations:

   Appendix A – Scottish Prison Service
   Appendix B – Crown Office and Procurator Fiscal Service
   Appendix C – Scottish Legal Aid Board

2. The Committee is invited to consider these submissions.

Jane Sutherland
September 2003
SUBMISSION FROM SCOTTISH PRISON SERVICE

Thank you for providing SPS with the opportunity to comment on the financial implications of this bill to the Scottish Prison Service. The SPS have examined the financial memorandum and we are satisfied that the potential impact on prisoner numbers is accurately reflected.

We do not consider that the proposed modernisation of the 110 day rule will have significant cost implications for us. So far as we can see we will be able to meet any costs from within our existing budget. We assess the worst case scenario as being an additional 20 remand places. This would cost an estimated £600,000 (based on an average annual cost of about £30,000 per prisoner place) which is a small proportion of our existing operational budget. And it is likely that an additional 20 remand places would be offset by a corresponding reduction of 14 sentenced places. This is because 70% of those proceeded against in the High Court received a custodial sentence, which is usually backdated to cover the period spent on remand. If this offsetting effect is taken into account, the worst case impact would be a net increase of 6 prison places.

Tony Cameron
Chief Executive
24 October 2004
SUBMISSION FROM CROWN OFFICE AND PROCURATOR FISCAL SERVICE

The Crown Office and Procurator Fiscal Service welcomes the proposed changes to High Court Procedures to be brought in by the Criminal Procedure (Amendment)(Scotland) Bill. We have been actively involved with our criminal justice partners in the development of the terms of the Bill, and are confident that, if implemented, it will deliver significant benefits to the prosecution of the most serious crime in Scotland.

COPFS is committed to working to ensure a more effective, more efficient, High Court in Scotland.

The improvements and changes envisaged by the Bill do not come without a price, and COPFS has assessed the anticipated impact on our organisation, on the basis of current information, in order to ensure that we will be able to implement effectively the new procedures. This is a period of significant change for this Department, and we are working hard, using the enhanced funding which we have already secured, to make real improvements to our service and to modernise the prosecution of serious crime. It is our view that these wider changes will provide the appropriate environment within which the new procedures envisaged by the Bill will work to deliver the desired objective of a more efficient High Court.

At the start of this year, we brought forward a package of reforms in relation to the appointment and role of Advocate Deputes, including an increase in number, increased preparation time and improved induction and training. Related changes have been introduced in relation to improving the quality of precognitions and improving post-indictment case management, enhancing our High Court support and bringing our units at Glasgow and Edinburgh High Courts under the command of the High Court Unit in Crown Office.

The main impact for COPFS of the Bill is the greater preparation time required for each case and the need to service the new, mandatory, hearing – the preliminary hearing, with an associated requirement for the Crown and defence to make contact to discuss the case and complete a report for the court in advance of this hearing. We have therefore produced figures that reflect the resources that will be required to make the new preliminary hearing system function properly.

As indicated in the Financial Memorandum, we are of the view that we will require additional Advocate Deputes and legal and administrative staff to support them. It is estimated that these additional requirements will amount to £508,000 per year. This is broken down into recurrent and non-recurrent costs of £258,000 and £250,000 respectively.

In relation to the non-recurrent costs, as it is not proposed that there will be phased implementation, we recognise that it is imperative that we ensure we are able to operate the new system as soon as it is brought in. The assumption, for these calculations, is that there will be a preliminary hearing in
every case. Additional staff will therefore be required to cope with the initial significant increase in preparation work and actually covering the new hearings for all High Court cases. However, clearly the aim of this legislation is to eliminate the ‘churn’ phenomenon, reducing unnecessary repeated adjournments and providing greater certainty in the arrangement of trials. It looks to deliver a change of culture in our legal system, and once this has happened we should see greater efficiency at the trial court stage, which will mean that resources wasted on adjourned hearings will off set the initial costs involved in the new procedures. We are therefore of the view that after the initial 2 year period, the system should be sufficiently efficient that the £250,000 will be offset by the consequential savings.

Preparation and communication are the keys to making this Bill work. Even after the initial 2 year period, there will be a need for commitment of additional Advocate Deputes and support, both administrative and legal, to ensure the continued success of the new system. We anticipate continuing recurrent costs of £258,000 per annum. We expect to be able to absorb these costs from efficiency gains elsewhere in consequence of our programme of modernisation and from the anticipated reduction of High Court business following the planned commencement section 13(1) of the Crime and Punishment (Scotland) Act 1997 which will enhance Sheriffs’ sentencing powers.

We have stated that we will incur capital expenditure of £830,000. This will allow for the development and roll out of software, which will support the management of witnesses and evidence and the greater level of assistance to the defence, which Lord Bonomy recommended.

Norman McFadyen
Crown Agent
29 October 2003
SUBMISSION FROM SCOTTISH LEGAL AID BOARD

The Criminal Procedure (Amendment) (Scotland) Bill contains a number of provisions substantially implementing the recommendations of Lord Bonomy’s Report on the Review of the High Court of Justiciary. Not all of the provisions impact on the Legal Aid Fund. The provisions which are likely to have an impact on the Fund have been identified in the following tables and, to the extent possible, costed. The system envisaged by the Bill will be very different from the current system, requiring certain assumptions to be made. These are annexed to the tables relating to costs and potential savings. Calculations have been based on the experience of Board staff and available statistics.

Provisions impacting on Legal Aid costs

The key areas which, it is anticipated, will impact on legal aid costs are:

1. Introduction of a mandatory preliminary hearing. This does not presently exist and will involve additional costs in the form of fees of solicitors and counsel for attendance at court and preparation.

2. Provision for a managed meeting between the Crown and the defence. Although in some cases such a meeting does take place from time to time prior to the first hearing, the proposals envisage a meeting as a matter of course. This, again, will involve the time of solicitors and counsel and, therefore, additional costs.

3. It is proposed that preliminary hearings should generally be held in Edinburgh and Glasgow rather than elsewhere in Scotland. If preliminary hearings are held in Edinburgh/Glasgow rather than, say, Aberdeen, Inverness or Dumfries, this will involve travelling on the part of the solicitor who will normally be situated near the local court. On the other hand, counsel’s place of business is in Edinburgh and the additional costs of solicitors’ travel are likely to be offset by the savings in counsel’s fees travelling from Edinburgh to the local courts elsewhere in Scotland.

4. New procedures for accelerating diets. The further procedure will involve additional fees payable to solicitors and counsel but only involves written work.

5. Payments to counsel to remain available for fixed trial diet. One of the benefits of the proposals is that trials be set down for a particular day rather than the current system where the trial may proceed at any stage over the period of the “sitting”. To ensure the availability of counsel and to avoid a situation where counsel has commenced a trial in another case, say the day before, some provision may have to be made for payments to counsel to remain available to ensure the trial can proceed.

The areas in which there is potential for savings are:

1. It is proposed that the Sheriff’s sentencing powers be increased from three to five years and that there be a corresponding transfer of cases from the high court to the sheriff and jury court. High court cases are more expensive and
the transfer of cases to the sheriff court is likely to result in savings to the Fund.

A substantial element in the higher costs of high court proceedings compared to sheriff court solemn cases is the involvement of counsel. Junior counsel is automatically available in terms of the legal aid legislation in high court proceedings. This is not the case in sheriff court proceedings and the prior authority of the Board (referred to in the legal aid legislation as the “sanction” of the Board) would be required before junior counsel would be available in a sheriff and jury case. Counsel will not always be necessary, nor indeed appropriate, in the cases which are being transferred from the high court to the sheriff court. Some cases are raised in the high court not due to any inherent complexity of the case but due to the record of the accused and, therefore, the likely sentence. The additional costs of counsel in the cases to be transferred to the sheriff court where counsel has been sanctioned has been factored in and set against the savings.

2. Pre-trial pleas/early settlement. The proposals anticipate an increase in pre-trial pleas of guilty and early settlement as a result of the earlier availability of information and increased communication between Crown and defence. The avoidance of a trial will produce savings.

3. Reduced number of adjournments. The Report draws attention to the significant number of adjournments in the high court. Any savings on the number of adjournments will result in savings to the Legal Aid Fund given that the payments from the Fund are largely in respect of fees for solicitors and counsel for attendance at court.

The current system where a case is set down for a “sitting” of the high court and can proceed at any time during the period of the sitting will be replaced by a system where a date will be set when the trial will commence. It is likely that this will lead to savings on legal aid costs as there are occasions when solicitors and counsel require to attend the court at various stages throughout the sitting but where the case does not call and is not identified as an adjournment as such.

4. It is intended that cases be adjourned for sentence to the local court. It is considered that this will be cost neutral as the additional costs for counsel to travel to, say, Aberdeen or Dumfries, will be offset by a reduction in solicitor’s travelling time.

Basis of Costings

More detail on the assumptions used in the costings are annexed to the appendices.

Calculations have been made on current fees structures and tables. It should be borne in mind, and factored into these figures, that Graduated Fees proposals for counsel are under consideration by the Executive and discussions will require to take place at some stage regarding solicitor’s fees in solemn proceedings. Although Lord Bonomy does highlight the issues as to the availability of experienced counsel and the perception that fees do not reflect the work done, these initiatives do not arise
from the Bonomy Report or its implementation. Any new fees structures will be subject to separate costings.

Due to the lack of available relevant data a number of assumptions have required to be made to arrive at the “potential” savings. These potential savings assume there would be no other changes to solicitor’s or counsel’s practices of which account has not otherwise been taken.

Basis of payment of solicitors and counsel

The costs to the Fund are largely incurred by expenditure on fees for the time of solicitors and counsel. It might be helpful, therefore, to briefly outline the basis on which solicitors and counsel are paid.

For solemn cases in either the high court or the sheriff court solicitors are paid per hour for individual items of work carried out eg. conducting a trial, preparation, perusal of documentation, meeting with client, letters, telephone calls etc.

Counsel are paid per day. This payment subsumes not only the conduct of the trial or hearing but also the preparation for it and other ancillary work, which is not individually chargeable, in connection with correspondence, perusal of documentation etc. No matter where counsel live, their place of business is Edinburgh and there is a prescribed fee for a “trial per day” in Edinburgh. Higher prescribed fees, increasing the further the court is from Edinburgh and subsuming travel, subsistence and accommodation, are laid down for Glasgow, elsewhere within 60 miles from Edinburgh, “Aberdeen, Inverness or Dumfries” and outwith 60 miles from Edinburgh. The cost of counsel, therefore, increases the further the court is from Edinburgh. Counsel are also paid for consultations and for a limited number of individual pieces of work.

Although the legal aid regulations lay down prescribed fees for counsel, there is provision for the fees to be increased because of the particular complexity or difficulty of the work or other particular circumstances.

Conclusion

Much of the Bill deals with the introduction of mandatory preliminary hearings in the High Court. Together with the formal exchanges between prosecution and defence which precede them and with other new procedures designed to increase flexibility, and ensure earlier availability of information to the defence, these clearly have cost implications for the Legal Aid Fund. The underlying approach to the costings is that there will be additional costs to the Fund generated by the additional procedures but that there is the potential for savings from the greater efficiencies which the proposals consider can be delivered to the process. The greater the efficiencies and, in particular, reduction in the number of adjournments, more cases settled before trial and shorter trials, the greater will be the savings. However, the greatest source of potential savings will be the transfer of cases to the sheriff court.

The costs outlined in Appendix 1 to the submissions will be incurred from the outset due to the introduction of the various procedures which have been identified. Whilst additional costs will be incurred immediately, especially over the transitional period,
the compensating savings are likely to be more gradual. There is, however, the potential for savings from the outset which are likely to increase as the system develops beyond the transitional stage and the new procedures have the opportunity of bedding in. Earlier provision of information to the defence, more time to prepare, disposal of procedural matters at the preliminary hearing and fixed trial diets can all lead to savings in the time of solicitors and counsel.

It is difficult to be more precise about the level of costs and savings to the Legal Aid Fund. However, the estimate of net costs of £1 million per year for the first two years is prudent although, perhaps, at the higher end of the spectrum and should be able to accommodate unforeseen additional costs which cannot be anticipated at this stage. Thereafter, and assuming that the system operates as intended, the effect on the Legal Aid Fund is likely to be cost neutral.

We think there will be some minor additional staffing requirements in view of the increased number of sanction requests for the employment of counsel in the sheriff court.

J Douglas Haggarty / Carol Scott
30 October 2003

Annexe 1 Costs
Annexe 2 Savings
Annexe 1

<table>
<thead>
<tr>
<th>Costs</th>
<th>Assumptions</th>
<th>Total £’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. A mandatory preliminary hearing</td>
<td>1</td>
<td>575,000</td>
</tr>
<tr>
<td>2. Managed meeting</td>
<td>2</td>
<td>300,000</td>
</tr>
<tr>
<td>3. Travel costs for cases where preliminary hearing held in Edinburgh or Glasgow</td>
<td>3</td>
<td>Nil</td>
</tr>
<tr>
<td>4. New Procedures for accelerating diets</td>
<td>4</td>
<td>25,000</td>
</tr>
<tr>
<td>5. Payments to counsel to remain available for fixed trial diet – “retainer fee”</td>
<td>5</td>
<td>100,000</td>
</tr>
<tr>
<td>6. Estimated Total Costs</td>
<td></td>
<td>1,000,000</td>
</tr>
</tbody>
</table>

Note: All calculations based on 1,667 cases (Annual Report 2001/02)

Assumptions

1. About one-third of cases currently have either a hearing on a minute of postponement or a preliminary diet. It is understood that the mandatory Preliminary Hearing may be lengthier and could involve greater preparation. We have therefore assumed that this will be an additional cost in 66% of cases and an increased cost in the remaining one-third of cases. All the Board’s assumptions have been based on 1,667 high court cases during the year 2001/2002, taking into account the likely costs of solicitor’s and counsel’s time.

2. We have assumed, on the same number of cases, one managed meeting per case and taking into account the likely costs of solicitors and counsel. A meeting already takes place in some cases so the total additional cost may be lower than stated.

3. Based on the same number of cases we have calculated the likely difference between counsel attending court in Glasgow and Edinburgh as against courts further afield. We have set against this the likely savings in costs incurred by solicitors requiring to travel to Glasgow or Edinburgh. The calculations suggest this provision will have a cost neutral outcome.
4. The procedure it is understood will involve the defence contacting the Crown and being involved in the preparation of a joint written application to the court to accelerate the diet. We have assumed 10% of cases featuring this procedure which is probably an upper figure.

5. It is difficult to assess the likely costs involved. On the basis that the proposals allow for a “stand by” fee to ensure the availability of counsel, calculations have been carried out on the basis of the prescribed fee for a day being paid in 20% of cases. Again this is likely to be an upper figure.

Annexe 2

<table>
<thead>
<tr>
<th>Savings</th>
<th>Assumptions</th>
<th>Total (£’000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Cases remitted from High to Sheriff Court.</td>
<td>1</td>
<td>1,000,000</td>
</tr>
<tr>
<td>2. Pre-trial pleas – early settlement</td>
<td>2</td>
<td>150,000</td>
</tr>
<tr>
<td>3. Reduced No. Of adjournments</td>
<td>3</td>
<td>100,000</td>
</tr>
<tr>
<td>4. Adjournments held in same court</td>
<td>4</td>
<td>Nil</td>
</tr>
<tr>
<td>5. Total Savings</td>
<td></td>
<td>1,250,000</td>
</tr>
</tbody>
</table>

Note: All calculations based on 1,667 cases (Annual Report 2001/02)

Assumptions

1. High court cases are much more expensive than sheriff court cases. The average cost of a High Court case includes the tranche of cases which are of a very high value. We have assumed these will largely continue to be heard in the High Court. For the purposes of this costing exercise we have therefore taken the average cost of the High Court cases “pushed down” to be at the lower end of High Court cases, and deducted the average costs of a Sheriff Court solemn case.

On the other hand, more cases in the Sheriff Court will involve counsel, a prime element in the cost, and this has to be added back in again. Not all cases moved down to the Sheriff Court will require counsel. We have assumed 20% of High Court cases being pushed down to the Sheriff Court.

2. Our estimations (based on manual sample of cases) are that 75% of the case costs will have been incurred at the pre trial plea stage. Savings have
therefore been based on the assumption that 25% of High Court cases may plead x 25% of average case costs (savings to be made) in solemn cases.

3. The savings in the reduced number of adjournments has been arrived at using the tables produced on page 133 of Lord Bonomy’s Report. Cases in excess of 2 adjournments (which has been adopted as a break even point allowing for the new compulsory preliminary hearing and one adjournment, to err on the side of caution) have the ability to produce savings. We assumed that the new provisions will reduce the cases involving 3 or more adjournments by 75%.

4. Counsel’s fees (if sanctioned to appear) are likely to increase as a result of this proposal. The vast majority of cases are adjourned for sentence to Edinburgh/Glasgow at present which means counsel will charge significantly less than they would if adjourned to the “local court” in say Aberdeen/Dumfries. It is, however, likely to be cost neutral overall in any given case as increased costs of counsel will be offset by savings on local solicitor’s costs given the solicitor may not need to travel.
1. At its meeting of 24 June 2003, the Committee agreed to write to various organisations to establish the current position of the water industry in Scotland and to ask Scottish Water to co-ordinate the responses.

2. These responses were provided in September and copies were sent to members. The Parliament’s information centre (SPICe) was asked to produce an analysis of the responses and this is attached. Also attached to this paper are further copies of the responses received.

3. The briefing paper from SPICe identifies common themes emerging from the responses and also highlights areas where the Committee may want to ask further questions.

4. The Committee is invited to agree how it wishes to proceed. A number of options could be considered in line with the approach adopted by the Committee thus far:

- The Committee may wish to invite Scottish Water for a one-off evidence session, using the areas highlighted in the SPICe briefing as a basis for questions, or
- The Committee may wish to appoint reporters to take forward issues which have arisen with a view to reporting back to the Committee, or
- The Committee may wish to explore whether or not they would wish and whether it would be possible for an organisation such as the Water Customer Consultation Panel to take forward some further fact-finding work and report back to the Committee, or

5. The above options may not be mutually exclusive, but in arriving at its decision, the Committee should take into account its current work programme.

6. The Committee is invited to agree on how it wishes to proceed.

Susan Duffy
Clerk to the Committee
The Scottish Water Industry: A summary of stakeholder views

Background
At its meeting on 24 June 2003, the Finance Committee agreed to write to the following organisations in order to establish the current position of the water industry in Scotland:

- Scottish Water
- Water Industry Commissioner
- Scottish Council for Development and Industry
- Confederation of British Industry Scotland
- Federation of Small Businesses in Scotland
- Forum of Private Business
- Scottish Trades Union Congress
- COSLA
- Water Customer Consultation Panels
- Drinking Water Quality Regulator
- Communities Scotland/peak construction industry body

It was requested that Scottish Water coordinate the responses of these organisations and set out an agreed statement on the current position of the industry in terms of budgetary matters, infrastructure provision and future development strategies. Scottish Water provided their response to the Committee in September 2003.

This document outlines some of the major themes emerging from the responses provided to the Finance Committee. The statements from the various bodies invited by the committee to contribute views are diverse and represent the respective organisations’ specific interests – they are therefore, best read on an individual basis. Nevertheless, it is possible to tease out some common themes and debates from their submissions. This paper will look at some of these themes and debates from their submissions. This paper will look at some of these themes and outline (throughout and at the end of the paper) some areas the committee may wish to receive additional information on.

Common Themes

Structure
There were a number of comments to be made about the structure of the industry. Scottish Water cited “the regulatory framework” as a “constraint on the industry.” They state that “with regard to the most important aspect of regulation – the determination of Scottish Water’s allowed revenues and hence price levels – the Water Industry Commissioner (WIC) is purely an advisory body to the Scottish Executive; it is the Scottish Executive that takes final decisions.” They state that the lack of executive powers for the WIC is different to the system in England and Wales where regulators do have executive powers.
The section on the regulatory framework in the submission by Scottish Water concludes by stating that “in Scotland, a highly codified system of regulation has not been adopted compared with England and Wales.” Scottish Water seem to be suggesting that there is a lack of clarity in terms of roles and responsibilities of key industry players.

The Scottish Trades Union Congress (STUC) in their submission revisited some of the concerns they initially raised over the creation of Scottish Water, but nevertheless recognised that further change was “unthinkable” and that the new organisation needed to be given time to settle down.

The Federation of Small Businesses in Scotland (FSBS) claim that there is a need for “clarity in the roles of all those involved in the water industry; the Water Industry Commissioner, Scottish Water, the Water Customer Consultation Panels and the Scottish Executive.” They cite potential conflicts of interest in the existing structure. For example:

- The Water Industry Commissioner is responsible for representing the interests of the consumer, yet as the economic regulator his actions may run contrary to the interests of the consumer.
- FSBS claim that the “tension between Scottish Water and the Water Industry Commissioner was unhelpful when attempting to elicit the reasons for this year’s price rises and the likelihood of any change in the future. Indeed, it has become difficult to ascertain exactly who has responsibility (or ability) to make changes, with a degree of “buck-passing” taking place.”
- FSBS accept that it is not the role of the Scottish Executive to get involved in the day-to-day running of Scottish Water. However, it is important for the Executive to be responsible for an efficient and fair water industry. (p51)

The Forum of Private Business in Scotland (FPBS) argued that there was a “democratic deficit” in the structure of the water industry in that neither the Scottish Executive or Parliament had “any real control over….operation and pricing policies.”

The Committee may want to seek clarification of roles and responsibilities for the key industry players.

Privatisation
Some submissions offered a view on the issue of privatising the Scottish Water industry.

CBIS stated:

“We have said publicly that if a privatised (or mutually owned) Scottish Water was likely to provide a better service at lower cost then the existing arrangement, then Scottish Water must not be kept in the public sector for ideological reasons. This remains our view” (p45).
The STUC state that central to their policy on the water industry is that it should remain “publicly owned and accountable.” They argue that privatisation offers no solution to the challenges faced by the industry and that it is the “partial privatisation of the industry through PPP/PFI schemes that has led to higher costs and a fragmented service.”

The Committee may want to consider whether comparisons with other privatised UK water utilities raise any issues around the merit / applicability of privatising the Scottish water industry?

Debt
The increase in net borrowing in 2002-03 resulted in a total net debt for Scottish Water of £2,149m (the maturity of the total borrowing is detailed on p8 of the Scottish Water submission to the Committee). Under the WIC’s financial plans, Scottish Water will not take up all of the additional borrowing made available to it by the Scottish Executive.

The STUC are of the opinion that the treatment of debt should not entirely be met by higher charges to customers. They argue that Scottish Water should retain a “reasonable level of debt” in order that prices do not rise at a higher than necessary level, and in order to fill the backlog of investment in the industry’s infrastructure.

The submission from CBIS states that while increasing borrowing to keep charges down is an attractive proposition in theory, it needs to be balanced by the high costs of servicing debts. On the borrowing issue they conclude that they “are not best placed to make a judgement about the appropriate level of borrowing for Scottish Water, but we would like to see a view from Scottish Water about the advantages and disadvantages of increasing borrowing (including assumptions made on future interest rates and overall debt levels) (p45).”

Staffing Levels
Scottish Water reduced its number of employees from 5648 in 2001-02 to 5007 in 2002-03 – a reduction of 641 employees, or 11.4%. Taking into account further staff leavers on 31 March 2003, the numbers of staff reported by Scottish Water in their submission to the Finance Committee is 4,592 (p8).

STUC raise the implications for safety and customer service from the reductions in staff numbers.

“Most of the staffing cuts have happened before capital investment has been introduced and therefore it is inevitable that safety is compromised and customer service reduced. It is somewhat ironic that having implemented the WIC’s cuts he [the WIC] then criticised Scottish Water for having insufficient capacity to respond to last summer’s cryptosporidium scare in Glasgow.

As with similar cuts in other utilities the first staff to leave the industry has been those with long service and experience. In an industry that does not
have well established data capture this knowledge is irreplaceable. It is not unusual for staff to be contacted years after they retire. The fatal consequences of similar cuts in the gas industry are now well understood. We should learn from previous mistakes in the Scottish water industry.”

The tensions between improving service levels whilst simultaneously cutting staff is also raised by Scottish Water themselves in their submission:

Scottish Water is required to reduce its inherited real operating costs over 40% from the 2001/02 level to the WIC target of £265m in 2005/06.

The pace of cost reduction creates risks to the delivery of services as staff reductions will require to be implemented before the necessary upgrading and automation of assets (to allow de-manning) has been fully implemented (p24).

This may be an issue the committee wish to pursue further.

Knowledge of assets and investment
Scottish Water acknowledge in their submission that the knowledge of assets they inherited was poor. Consequently, in 2002-03 they began gathering information on the condition and serviceability of assets inherited from the three previous water authorities – with the aim of identifying areas of poor quality and missing asset data and to better understand Scottish Water’s operational condition, thus allowing for prioritisation of investment.

The tension between affordability versus investment is cited (p 24) by Scottish Water as being a constraint on the industry. This issue is also raised by the STUC who make the argument that it is difficult to make-up investment backlog whilst simultaneously attempting to make efficiency gains.

Knowledge of customers
According to their submission to the Committee, Scottish Water has not inherited a usable customer database or effective processes for communicating and consulting with customers. In its submission (pp26-28) to the Committee, Scottish Water outline plans to improve its customer knowledge from the “very poor state of inherited customer data.”

Among the plans is significant investment in the development of staff to equip them “with a breadth and depth of business knowledge, coupled with the softer skills required to work effectively with customers. It is also intended that the Customer Service will be moved to a single site by April 2004, and the establishment of a single billing system, introduced in Summer 2003, will be completed by March 2004.

Comparison with other UK water utilities
Comparison with other UK water utilities is covered in section 3.3 of the Scottish Water submission. Recent comparative analysis of the asset type
judged to be poor, very poor or failing in Scotland versus England and Wales, carried out on behalf of the Water Industry Commissioner, revealed that:

- Scottish Water’s water mains and sewers are in significantly poorer condition than the average condition of water mains and sewers in England & Wales;
- the condition of Scottish Water’s Wastewater treatment works is poorer than the average condition in England & Wales; but
- the condition of Scottish Water’s Water Treatment Works is no worse than the average condition in England & Wales, however this ignores the fact that many of these works do not produce water of the same quality and so are currently subject to major up-grading to meet standards required by DWQR.

However, some of the other submissions claimed that comparisons with England and Wales are problematic in that companies in England and Wales, due to privatisation in 1989, are at a different stage of development and have experienced different investment patterns. Indeed, the STUC argue in their submission to the Finance Committee that comparisons with the water utilities in England and Wales are virtually meaningless.

“We believe this [comparisons with England] is unhelpful and confusing to the public as the two countries have very different water and sewage industries.

There are structural differences in relation to the large number of small treatment plants in Scotland, our sewers are closer to properties and of course we have a massive coastline. To compound these differences the level of investment has been very different. The English industry has benefited from £50 billion of investment over the past 13 years compared with £1 billion in Scotland. Even without debt write off at privatisation and the essentially different objectives a privatised industry has, these differences make comparisons almost meaningless.”

Charges and Costs

Charges for water services are usually cited as the issue resonating most with the public, and most of the submissions addressed it.

Scottish Water stated that they have a major challenge in educating their customers about the water industry and the costs of providing basic water and wastewater services – which they argue are far more complex than is publicly perceived. They state that a “communication programme has been implemented to begin to address these issues.”

The current charging scheme is cited by the Confederation of British Industry Scotland (CBIS) as an area of concern. They claim that there was no formal advance consultation prior to the introduction of the 2003-04 charging scheme, and that many companies have complained of receiving significantly higher bills requiring payment in a relatively short period of time.
CBIS suggest that the combined effect of Scottish Water’s new charging scheme has been to create “a large mix of ‘winners’ and ‘losers’ among Scottish Water non-domestic customers as bills have fluctuated”

Their submission continues:

“Our greatest concern, though stems from the fact that firms which are significant users of water tend to be in sectors with intense international competition, competing on price as well as quality, and where costs cannot easily be either absorbed or passed on to customers. Examples of such high water-use sectors would be electronics, paper, chemicals and drinks…. Such firms may already have had water charges of tens or hundreds of thousands of pounds, and now have had increases in some cases of 50-100% imposed with almost no warning. We do not see how this can be justified, and are not aware that anyone has tried to justify it. Given the competitive pressures these firms are already under, and the costs increases they already face through the NICs rise, environmental legislation and so on, the impact of the rises must call into question the Executive’s headline policy of growing the economy and promoting a competitive industrial sector in Scotland (p44).”

As a solution to this issue, CBIS propose a “short-term rebate system…for next year to reduce the bills for firms who had a very significant increase in water charges…..This will address the immediate risks to competitiveness in key sectors” (p45).

The introduction of fixed charges is criticised by the submissions representing the business community (particularly the Federation of Small Businesses in Scotland (FSBS)). The FSBS claim that the introduction of fixed charges is flawed and “creates an undue burden on low-volume, non-domestic users.” They also point out that a fixed charge system is not used elsewhere in the UK “and so disadvantages Scottish small businesses who are likely to account for the overwhelming majority of low-volume, non-domestic users.” The also suggest that the principle of fixed charges does not encourage sustainable water use, and contradicts the company’s statutory obligations around sustainable development.

Business representatives also expressed concern about fixed water bill charges being linked to firms’ assessed ratable values, making the point that water charges are not supposed to be a general tax on business (like the Business rates) but a charge for a service provided. The FPBS in their submission argued that it was unfair that inherited debts for Scottish Water, written off for water regulators in England and Wales with privatisation in 1989, had to be paid off by the Scottish consumer via higher charges.

**Issues requiring further clarification or investigation**

**The workings of the PFIs/PPPs**
Scottish Water mention (on p10 of their submission) that as at March 2003, there were “9 PFI contracts with contract start dates ranging from December
1996 to October 2000 and contract end dates ranging from December 2021 to October 2040. The estimated capital value of these projects is £577m." The cost of operating the PFI schemes in 2002-03 was £105.4m (Scottish Water submission, p7).

PFIs are also mentioned at the bottom of p13 of the Scottish Water submission, where it is revealed that PFI contracts collectively cover 21 separate sites across Scotland and treat the wastewater from 45% of the population.

The committee may, where possible, want to receive further information on these contracts. For instance, who are they with, how much are each of the contracts worth and what are the accountability mechanisms involved in each of the contracts?

Ross Burnside
Senior Research Specialist
Public Finance
RESPONSE TO THE FINANCE COMMITTEE

Further to the Finance Committee’s request of 24 June and subsequent clarification on 12 August, Scottish Water responds to the Finance Committee by way of the accompanying report.

The report is structured as follows:

Section 1 - Background of the Finance Committee’s requests and expectations
Section 2 - Common Themes
Sections 3 to 11 - Individual Organisational Responses

As requested, within Scottish Water’s response policy areas where information is sought that are properly the reserve of the Scottish Executive have been clearly flagged as Scottish Executive issues.

If you require any further input or clarification on the Scottish Water response, please do not hesitate to contact us.
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Appendix A – Initial Finance Committee Request and subsequent correspondence

Appendix B – Scottish Water Transformation High Level Programme

Supplementary Document - Scottish Water’s Annual Report
1. **BACKGROUND**

As an output from its meeting on 24 June the Finance Committee wrote to the following organisations in order to establish the current position of the water industry in Scotland:

- Scottish Water
- Water Industry Commissioner
- Scottish Council for Development and Industry
- Confederation of British Industry Scotland
- Federation of Small Businesses in Scotland
- Forum of Private Business
- Scottish Trades Union Congress
- COSLA
- Water Customer Consultation Panels
- Drinking Water Quality Regulator
- Communities Scotland/peak construction industry body

Scottish Water was asked to co-ordinate the production of the requested position paper setting out an agreed statement on the current state of the industry in terms of budgetary matters, infrastructure provision and future development strategies. The Finance Committee request is detailed in Appendix A.

The overall objective of the request was to give the Finance Committee a clear view of the current reality and constraints facing the industry while also generating a higher level of understanding on the part of all the participants about the different issues facing each of the contributory organisations.

Scottish Water wrote to the Finance Committee on 21 July expressing reservations about its role in co-ordinating responses and about the inherent difficulty in producing an agreed response. The co-ordinating role, with a minimum requirement of collation, was confirmed in the Finance Committee letter of 12 August. These letters are detailed chronologically in Appendix A.

Responses have been received from the parties originally identified in the Finance Committee request with the exception of:

- Communities Scotland
- COSLA
2. COMMON THEMES

It is evident from the responses that a wide range of views is held on the matters raised by the Finance Committee. In light of this it has been more appropriate to collate the various responses than to provide a single agreed statement.

From the submissions received, some common themes have emerged, as highlighted below:

- Charging in the industry;
- Structure of the industry;
- Roles and Responsibilities within the industry; and
- Backlog of investment.
3. SCOTTISH WATER RESPONSE

3.1 Introduction

There are three documents already in the public domain, which detail the current structure of the industry, its funding and the investment requirements for the period 2002 to 2006:

- Report on the Inquiry into Water and the Water Industry (The Transport and Environment Committee 9th report, 21 June 2001);
- Water Quality and Standards: Investment Priorities for Scotland’s Water Authorities 2002-2006 (Scottish Executive, August 2001); and

Scottish Water’s annual report and accounts were published in August 2003 and are incorporated in Appendix B.

The Water Industry Commissioner will be reporting on Scottish Water’s first year by way of:

- Costs and Performance;
- Investment and asset management; and
- Customer service.

In addition the Drinking Water Quality Regulator and the Scottish Environment Protection Agency will also be producing reports on drinking water and environmental quality in the coming months.
3.2 Statement of the Current Operating Position of the Industry in Scotland

Scottish Water’s Annual Report and Accounts, laid before parliament last month, summarises the current position of the business.

3.2.1 Finance

Scottish Water has only two sources of funding, customer revenue and borrowing from the Scottish Executive, through the Scottish consolidated fund. Scottish Ministers agreed the maximum level of revenue that can be collected in line with the advice given by the Water Industry Commissioner in the Strategic Review of Charges. Scottish Water’s borrowing powers are specified in section 42 and 43 of the Water Industry (Scotland) Act 2002, with the maximum level of borrowing agreed in the Budget Act.

Scottish Water’s financial position in 2002/03 was set out in pages 23-27 of its annual report as replicated out below.

Financial and Business Performance

In Scottish Water’s first business year, we can report the following key achievements in financial performance:

- Cost savings of £30 million
- Surplus after tax of £34.9 million, fully re-invested in the business.
- All Scottish Executive financial targets met

Financial Framework

Scottish Water operates within a regulated environment where a cap is set on the amount of revenue that can be raised from customer charges. The revenue cap for the years 2002-06 was set by Scottish Ministers on the advice of the Water Industry Commissioner for Scotland.

The revenue cap was set so that when taken together with net new loans they will finance the totality of Scottish Water’s operations and capital investment programme.

Financial results

Turnover for the year was £895.3 million and comprised core business turnover of £874.5 million and £20.8 million for the provision of other services. Core business turnover was within the revenue cap of £887.8 million, with water services providing £421.6 million (48%), and wastewater services £452.9 million (52%). 60% of total turnover came from charges to household customers. Commercial and trade effluent income accounted for 38% of total turnover with the remaining 2% coming from the provision of other services, generally non-core.

The graph below highlights the key sources of funding and how these were applied to Scottish Water’s activities. All of the revenue raised from customers, together with the £51.1 million of net new loans, was used to finance Scottish Water’s operational activities and capital investment programme. The surplus after tax of £34.9 million was fully reinvested in the business to enable the delivery of the capital investment programme.
Total operating costs before depreciation and PFI charges were £330.8 million. This was approximately £30 million lower in real terms than the similar costs for the former three water authorities in 2001/2. By the end of the year, the last of Scottish Water's inherited PFI schemes became fully operational. The cost of operating these PFI schemes during the year was £105.4 million.

Depreciation, including infrastructure maintenance charges, was £245.1 million reflecting the increased investment in infrastructure and non-infrastructure assets. These costs will rise in the future as a consequence of Scottish Water's significant capital investment programme to improve the quality, reliability and efficiency of service provision.
**Exceptional costs**

Exceptional costs charged in the year totalled £24.6 million and related to restructuring and transformation costs undertaken as part of the £200 million ‘Spend to Save’ programme allowed for by the Water Industry Commissioner for Scotland in his Strategic Review of Charges. This programme is for a discrete category of expenditure up to 2005-06, allowed by the WIC, to cover one-off transformation costs that will reduce future annual operating costs.

Exceptional costs are detailed in note 4 to the financial statements. By effective use of the employee voluntary severance scheme, the average number of employees during the year reduced by 641, from the average level employed by the former water authorities in 2001/2. The number of people employed at the end of the year, after taking account of 335 leavers on 31 March reduced to 4,592.

**Finance costs**

Scottish Water inherited £2,097.8 million of net debt with a weighted average interest cost of 6.61%. During the year net debt increased by £51.3 million to £2,149.1 million. The increase was driven by £140 million of new long-term loans at a weighted average interest cost of 4.08%, partially offset by £74.4 million repayment of long-term loans and £14.5 million net repayment of short-term loans.

At 31 March 2003 the weighted average interest cost of the £2,149.1 million outstanding net debt was 6.45%. Net interest payable during the year was £137.6 million.

The maturity profile of the loans outstanding at 31 March 2003 is set out below:
Capital expenditure in the year was £369.7 million. £352.8 million was invested in the delivery of the regulatory capital programme and £16.9 million related to capitalised “spend-to-save” costs. 86% of the capital investment programme was funded by customer revenue through net cash flow from operating activities and 14% was funded from new loans. The cash flow statement is shown on pages 40 and 41 of the financial statements.

Pensions

Although the full implementation of Financial Reporting Standard No.17 “Retirement Benefits” has been deferred by the Accounting Standards Board, pending the introduction of International Accounting Standards, certain disclosures are required. The disclosure information required is included in note 20 to the financial statements. Under the standard, a snapshot is taken of pension fund assets and liabilities at a specific point in time. Movements in equity markets and discount rates create volatility in the calculation of scheme assets and liabilities. At 31 March 2003, after taking account of deferred taxation, there was a shortfall of assets over respective liabilities of £145.5 million, reflecting the downturn in equity markets, low discount rates and increased pension liabilities.

The employer contribution rates, set by the funds’ actuaries, will increase Scottish Water’s average contribution, as a percentage of salary, from 14.3% to 16.6% by March 2006. However, in light of the uncertainty of future financial conditions, the financial position of pension funds will be monitored, if required by means of interim funding reviews, in the period up to the next triennial valuation in 2005.

Compliance with Government Financial Targets - Return on capital

Scottish Water had a duty to discharge its functions with a view to achieving an operating surplus, giving a return on its averaged deemed capital value for the year of not less than 6%. For this purpose, the operating surplus comprises the total of the current cost surplus for the year and all other gains and losses in respect of net operating assets, after adjustment for inflation in respect of financial capital. The average deemed capital value for the year is determined as the deemed capital value at the beginning of the year together with the average level of investment in net operating assets made during the year. The rate of return achieved was 7.3%.

Sufficiency of revenue

Scottish Water is required to cover costs with revenue one year with another. Scottish Water reported a surplus before tax of £51.4 million for the year. The surplus before tax consisted of a surplus on trading of £76.0 million before charging exceptional costs of £24.6 million.

Resource accounting and budget target (RAB)

Scottish Water is also subject to financial targets set by the Government as part of the resource accounting and budgetary approach to managing public finances. The target for Scottish Water in 2002/03 was to operate within a RAB score of £202.3 million, being the excess of capitalised expenditure over surplus before interest and tax after adjustment for any gain on asset sales. Performance was £21.7 million better than target at £180.6 million.
Scottish Water’s off-balance sheet commitments were set out in note 19 to Scottish Water’s Annual Report as replicated below.

Obligations under leases

Scottish Water has no amounts due under finance leases. Annual commitments under non-cancellable operating leases are as follows:

<table>
<thead>
<tr>
<th>Operating leases which expire:</th>
<th>Land &amp; Buildings £m</th>
<th>Others £m</th>
<th>PFI schemes £m</th>
<th>Total £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Within one year</td>
<td>0.1</td>
<td>0.6</td>
<td>-</td>
<td>0.7</td>
</tr>
<tr>
<td>Between two and five years</td>
<td>0.2</td>
<td>2.7</td>
<td>-</td>
<td>2.9</td>
</tr>
<tr>
<td>After five years</td>
<td>1.8</td>
<td>-</td>
<td>117.7</td>
<td>119.5</td>
</tr>
<tr>
<td>As at 31 March 2003</td>
<td>2.1</td>
<td>3.3</td>
<td>117.7</td>
<td>123.1</td>
</tr>
</tbody>
</table>

PFI schemes

As at 31 March 2003, there were 9 PFI contracts with contract start dates ranging from December 1996 to October 2000 and contract end dates ranging from December 2021 to October 2040. The estimated capital value of these projects is £577m.

3.2.2 Employment Issues

Scottish Water’s employment issues in 2002/03 were set out in pages 13-15 of Scottish Water’s Annual report as replicated below.

Key achievements in the first 12 months of Scottish Water are:

- Establishing the Scottish Water Council involving managers, unions and employees
- Giving the highest priority to health and safety, including new procedures and training
- Introducing a common set of values and objectives for the organisation
- Managing a voluntary severance scheme to reduce staff numbers following the merger of the three former authorities

Engaging all of Scottish Water’s people in the values and objectives has been a cornerstone from the outset of Scottish Water. All employees attended workshops shortly after the merger to participate in a shared vision of the future challenges and objectives of a newly created organisation.

Open and fair selection processes were established to invite appropriately qualified employees to apply for all roles down to team leader, and candidates were objectively assessed against key competencies required for the roles.

The Scottish Water Council, comprising of the Chief Executive, Human Resources Director, and the General Manager Employee Relations, together with trade union representatives and employee representatives, was established. Its remit, through the principles of partnership, is to consider the business strategy and its effect upon Scottish
Water employees. To date, subjects handled by the Council have included pay, terms and conditions and the structure of voluntary severance schemes.

Individual Business Unit Councils have subsequently been established with the same partnership remit, but with a focus on resolving local employee issues within the appropriate division or functional business unit.

Scottish Water inherited a less than satisfactory Health and Safety record. Our objective is to have in place a fully effective safety management system and culture across the business. This will mitigate risk through a behaviour-driven health and safety culture. This is being built into policies and procedures and rigorously adopted in the operational field. We have made significant progress in improving awareness through training and putting in place common systems and processes.

The business has undergone substantial re-structuring since the formation of Scottish Water and whilst goals and objectives have continued to be met, there has been significant downsizing through the very successful Voluntary Severance Scheme, now harmonised across the whole of Scottish Water.

Effective communications has been at the heart of the Human Resources agenda and key to establishing effective two-way communication practices. Monthly team briefings for all employees were established, there is a bi-monthly magazine (Scottish Water Life) and the Intranet is now a key communication tool whereby employees can have access to the most up to date information. Face-to-face communications continue to be an important method of sharing information. This was used when disseminating Scottish Water’s strategic business plan to employees, allowing ample opportunity for employee involvement.

During the year we formulated a common set of values to be adopted by all throughout the business. A group of employees was brought together to create a set of behaviours which are increasingly being used in the performance assessment of all of our people. These Values are:- ‘Challenge for benefit’; ‘Involve people’; ‘Deliver promises’ and ‘Clear conversation’.

Much remains to be done and our people face very real challenges ahead to meet Scottish Water’s demanding business objectives. Excellent progress has been made in Scottish Water’s first year on the people agenda and the task now is to continue and accelerate this momentum.

### 3.2.3 Assets

Scottish Water’s asset position in 2002/03 was set out in pages 17-19 of Scottish Water’s Annual Report and is replicated below.

Key achievements in the first 12 months of Scottish Water are:

- Improved the quality of drinking water
- Improved the environmental compliance record of Scottish Water’s Wastewater Treatment Works
- Reduced Scottish Water’s impact on bathing water quality.
- Dealt with over 8,000 water mains bursts
• Invested £353 million on 250 capital projects
• Rehabilitated 450 kilometres of new water mains
• Working with others committed £25 million to combat flooding in Glasgow
• Prepared the framework for the formation of the joint venture company, Scottish Water Solutions, to deliver the asset investment programme

Asset management is about balancing performance, cost and risk. To do this effectively we need reliable asset information. During the year we began to gather information on the condition and serviceability of assets inherited from the three previous water authorities. This will identify areas of poor quality and missing asset data.

Significant effort is being made to determine and confirm location, capacity, condition and performance of the assets. This exercise also includes water demand forecasting and resource planning, together with the modelling of the network assets. This will mean we will better understand their operational condition that will enable us to prioritise investment.

Good progress has been made in asset risk management. This has involved using the best practice and experience of the oil industry to determine risk exposure and the impact on customers of network failures. This approach has resulted in the production of a risk manual and risk based ‘tool kit’ covering Scottish Water’s critical assets. Training is also being rolled out to employees to create a new culture for the management of risk.

During 2002/3 we began the implementation of Scottish Water’s £1.8 billion capital investment programme. Assets are now in urgent need of upgrading to achieve regulatory compliance. This follows many years of under investment.

This area is absolutely critical in transforming the future performance of the water industry in Scotland. The aim is to improve the quality of our product and service whilst significantly reducing operating costs. The current capital investment programme ends in 2006.

Currently we are focused on both improving assets and preventing further deterioration. It is targeted at water quality and wastewater treatment in order to meet the ever tightening regulatory and EU standards.

In 2002-03 £353 million was invested to deliver improvements to water and wastewater services. We carried out around 250 individual projects. Schemes ranged from new treatment works serving large populations, to a sewer rehabilitation scheme that will solve flooding in just one property.

Scottish Water inherited some 150 Wastewater Treatment Works that were either failing to comply, or are at risk of failing to comply, with environmental compliance standards.

In 2002/3 we reduced the number of non-compliant wastewater treatment works from 78 to 60. Over 40% of the investment programme is dedicated to wastewater improvement schemes.

In 2002/03, the number of non-compliant bathing waters around Scotland’s coasts attributable to Scottish Water discharges was reduced to four, out-performing the target figure of seven.
In relation to Drinking Water we have to construct 161 projects to further improve standards including colour. The most significant project in the investment programme is the provision of a Water Treatment Works at Milngavie for Glasgow. In February, East Dunbartonshire Council approved planning for the £100 million Katrine Water Project, critical to protect Glasgow’s public health.

To complete the Capital Investment Programme, we propose to enter into a joint venture partnership to be known as Scottish Water Solutions. Scottish Water will be the major shareholder with the Stirling Water consortium (Thames Water, M J Gleeson, McAlpine and KBR) and the UUGM consortium (United Utilities, Galliford and Morgan=Est).

One of the challenges for this partnership is to reduce the estimated £2.3 billion capital cost of the investment programme by £500 million to achieve an efficiency target set by the WIC. This has to be done while achieving all the agreed outputs of the programme.

Our regional operational teams are focused on effective asset performance to ensure reliability and minimise disruption to customers. The operational teams dealt with over 8000 water mains bursts across Scotland in our first year. The work of the operations and maintenance crews links directly into the Guaranteed Standards of Service performance for customers.

Unfortunately, in the north of Scotland, on the Black Isle, water main bursts have continued to increase with customers suffering interruption every week. Consequently, we are planning 490km of mains renewal in the North. This extensive programme will be completed in 2005/6.

Scottish Water is completing an exercise to introduce operational practices that are comparable with industry best practice at water and wastewater treatment works. This exercise is part of the wider transformation programme designed to improve efficiency and compliance with standards.

We have developed an operating and maintenance plan for existing assets, understanding how important this strategy is for customers and the security of their water supply and wastewater services.

**Our PFIs**

By the year-end all of Scottish Water’s nine Private Finance Initiative (PFIs) contracts were operational. These PFI Wastewater Treatment Works were designed, built and financed by private sector consortia that will now operate the new plants for periods of up to 40 years. They will provide wastewater and sludge disposal to specifications set by Scottish Water.

These contracts ensure that we comply with both UK and European regulations in respect of the treatment and disposal of wastewater and associated sludge projects. These projects represent capital investment of £577 million. Collectively they cover 21 separate sites across Scotland and treat the wastewater from 45% of the population. These sites cover the Aberdeen, Dundee, Edinburgh, Glasgow and Inverness conurbations as well as the Ayrshire and Moray coasts and the Leven Valley.
3.3 Comparison of Scottish Water's Operating Position with Other UK Water Utilities

In assessing Scottish Water's current operating position with the privatised water companies in England & Wales it is necessary to consider the historical context in which the industry has developed.

Historical Context

In England & Wales the water industry has changed radically over the last 14 years:

- publicly owned water and sewerage authorities were created in the reorganisation of 1973;
- privatisation of the water industry occurred in 1989;
- in the second periodic review in 1994 (for 1995-2000) the companies had to finance investment programmes to meet new standards relating to water quality and the environment and improve infrastructure. In this second review Ofwat assumed considerable improvements in efficiency and so the focus on efficiency increased if companies were going to deliver profits to shareholders. Corporate stability was generally increasing notwithstanding merger and acquisition activity in the market; and
- the third periodic review in 1999 (for 2000-2005) assumed continued scope for efficiency improvements and again the companies increased their focus on efficiency.

In England and Wales, since 1989, there has been a focus on driving out in efficiency and maintaining profits for shareholders with a total of £50 billion having been invested in the industry’s ageing assets.

In contrast, in Scotland the public water and sewerage service was provided by 9 regional and 3 island councils during the period 1975 until 1996, under the Water (Scotland) Act 1980 and the Sewerage (Scotland) Act 1968. During this period the Central Scotland Water Development Board was responsible for the development of new water sources in providing bulk supplies to regional councils in the central belt.

The water industry in Scotland took the form of three public water authorities in April 1996 with the change in local government. Assets and staff previously employed by the local authorities in Water and Drainage Departments transferred to the new public bodies on 1 April 1996. From 1996 until 1999/2000 was a period of considerable upheaval for the industry as:

- concentration in the industry was emphasised;
- standards expected by the consumer and required by environmental legislation became more demanding;
- the various regional charges schemes were harmonised; and
- the authorities were expected to behave in a more commercial manner.
The 1997 Government water policy review recommended the appointment of the Water Industry Commissioner for Scotland in 1999 and the first Strategic Review of Charges was published in Autumn 1999 for the period 2000-02.

At this time the focus of the authorities was to ensure that the levels of service and environmental investment required could be funded from the capped revenue and borrowing facility. This resulted inevitably in the investment of solutions that were less capital intensive but resulted in higher operating costs.

In 2001, the WIC published the Strategic Review of Charges for 2002-2006, with demanding efficiency targets for the three authorities or for Scottish Water.

On 1 April 2002 Scottish Water was created under the Water Industry (Scotland) Act 2002.

**Current Efficiency Position relative to Targets**

Scottish Water reduced its operating costs by £30m in the financial year 2002/03 to £330m. This reduction would have been greater if some savings had not been offset by increases in rates (£2.8m), bad debt (£2.5m) and the absorption of operating costs on new works (estimate £2.3m). A breakdown of costs for the financial year 02/03 is shown in the graph below.
Scottish Water has planned to meet the WIC operating cost target of £265m in 2005/06. Overall Scottish Water will reduce its inherited operating costs by over 40% over 4 years to meet the WIC operating cost target of £265m in 2005/06.

**Efficiency Position Relative to England & Wales current Performance**

Scottish Water has made significant early progress by reducing its inherited operating costs by £30m in 2002/03 (including £6.8m of new costs being absorbed). In making comparisons the relative starting positions should be recognised. Companies in England & Wales began the process of investing to improve performance and efficiency in 1989. This resulted in a period of increased operating costs that were later followed by cost reductions.

This is illustrated in the graph below that is taken from Ofwat’s Water and sewerage service unit costs and relative efficiency 2001-02 report for England & Wales.

Ofwat Water & Sewerage service unit costs and relative efficiency 2001-02 report

**Figure 5 Comparison of total operating costs (2001-02 prices)**

<table>
<thead>
<tr>
<th>£ billion</th>
<th>2.2</th>
<th>2.4</th>
<th>2.6</th>
<th>2.8</th>
<th>3.0</th>
<th>3.2</th>
<th>3.4</th>
<th>3.6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual total operating expenditure</td>
<td>2.8</td>
<td>3.0</td>
<td>3.2</td>
<td>3.4</td>
<td>3.6</td>
<td>3.8</td>
<td>4.0</td>
<td>4.2</td>
</tr>
</tbody>
</table>
Comparative Asset Analysis

A comparative analysis of the % asset type in condition 4 and 5 (poor, or very poor and failing) in Scotland versus England & Wales, as per the WIC analysis\(^1\), has been carried out on the current asset inventory as reported in the Scottish Water Annual Return to the WIC, 2002/03. The results from this are tabled overleaf.

This analysis demonstrates that:

- Scottish Water’s water mains and sewers are in significantly poorer condition than the average condition of water mains and sewers in England & Wales;
- the condition of Scottish Water’s Wastewater treatment works is poorer than the average condition in England & Wales; but
- the condition of Scottish Water’s Water Treatment Works is no worse than the average condition in England & Wales, however this ignores the fact that many of these works do not produce water of the same quality and so are currently subject to major upgrading to meet standards required by DWQR.

\(^1\) Investment and Asset Management Report 2000-02, pages 20, 21
Wastewater Treatment Works

Water Treatment Works
Other operating issues

Scottish Water has procedures and protocols in place or in preparation that will be in line with best practice elsewhere in the UK. Examples of this are Integrated Network Management, Risk based approach to asset management, and partnering e.g. creation of Scottish Water Solutions joint venture to deliver the capital investment programme.

In some instances the rollout of best practice procedures are not yet complete across Scotland.

Their introduction requires many significant cultural as well as procedural and technical changes to the inherited position and therefore requires time to implement successfully.

Pace of Transformation

Scottish Water has developed a transformation programme designed to give the optimum pace of change given the need to:

- improve customer service, water quality and environmental performance levels throughout;
- rationalise business functions, invest in enabling activities and transform working practices to create a step change in efficiency to enable the necessary reduction in operating costs;
- work in co-operation with the Trade Unions and employees through the Scottish Water Council as being the most effective way to gain employee support for sustainable change; and
- to seek staff reductions currently through a voluntary severance scheme.
The diagram above shows a number of the principal milestones within the transformation programme. This demonstrates that in the first year many milestones have been achieved.

These include:

- instituting planned maintenance to displace breakdown maintenance;
- developing and starting to implement the IT strategy;
- announcing the closure of the Glasgow laboratories;
- gaining agreement from the Trade Unions to the creation of the Business Support Unit for displaced employees;
- commissioning and implementing a revenue maximisation and debt reduction programme;
- developing and gaining agreement to the property strategy; and
- implementing the data improvement programme.

A key early decision of Scottish Water was that the best foundation for delivering sustainable business transformation was to completely rebuild the Scottish Water management through a competency-based selection process. By summer 2002, Scottish Water had removed all the former Water Authority management structure and managers, and replaced it with a structure and appointees (many of whom had transferred from the
former Water Authorities) that would be capable of delivering sustainable business transformation. Without this solid foundation, there would have been a high risk of transformation failure because of the possible lack of full support from previous management.

Scottish Water continuously reviews the progress of the transformation programme so benefits and cost reductions can be accelerated where possible. The following milestones have already been brought forward by 6 months:

- WAMS now Sept ’04 rather than Dec ’04; and
- integration of call centres (part of the Promise to Resolution project).

However many of the changes (to reduce costs) requires other enablers to allow acceleration, for example IT systems, automation, and introduction of telemetry systems. Acceleration of these enablers is dependent on having carefully thought through strategies, implementation plans, revised processes and training. Experience elsewhere demonstrates that if these are not carefully planned, the benefits are not realized in full.

Appendix 2 sets out the high-level transformation programme.
3.4 Future Strategy on Long-Term Development Plans and Contribution to the Wider Economy

The future strategy on long-term development plans and contribution to the wider economy from 2006 onwards is a matter for the Scottish Executive.

Scottish Water is working closely with the Scottish Executive in the Quality and Standards III process that will determine the investment priorities for the period after 2006. This is a multi stakeholder process involving SEPA, DWQR, WIC, Scottish Water, Consumer bodies, Local Authorities and many others. It has been designed as an inclusive process and has set a demanding programme of activities to be completed before commencing the Scottish Executive consultation exercise in July 2004.
3.5 Constraints on the Industry and Strategies for Meeting the Concerns of Consumers

3.5.1 Constraints on the Industry

Scottish Water considers that the current constraints on the industry revolve around:

- affordability versus investment,
- pace of change; and
- the regulatory framework.

Affordability versus investment

Investment for the period 2002-2006 was limited to the 'central option' through the Quality and Standards II process in order to limit the revenue requirement with the consequent impact on charges for customers. The choice of the central option is discussed later in section 3.6.

Whilst Quality & Standards II was designed to prevent further deterioration in the asset base, this has resulted in the maintenance of a significant investment backlog and the continuing challenge of operating an aged asset base, with significant non-compliance of works, high numbers of network bursts and the attendant operating costs, (“prop-up” costs) to maintain service to customers.

Pace of Change

Scottish Water is required to reduce its inherited real operating costs over 40% from the 2001/02 level to the WIC target of £265m in 2005/06.

The pace of cost reduction creates risks to the delivery of services as staff reductions will require to be implemented before the necessary upgrading and automation of assets (to allow de-manning) has been fully implemented.

Regulatory framework

The Water Industry Commissioner for Scotland carries out the economic regulation of Scottish Water.

The creation of the WIC was designed to entrust regulation to an expert body, thereby aiming to improve the effectiveness of regulation. However, with regard to the most important aspect of regulation—the determination of Scottish Water’s allowed revenues and hence price levels—the WIC is purely an advisory body to the Scottish Executive; it is the Scottish Executive that takes final decisions.

The WIC’s advisory position is in contrast to the models of regulation in England and Wales, where regulators have executive powers, and in particular make key decisions regarding price setting.

Although largely having no executive powers, the WIC has a broad remit across all of the industry’s activities. In addition to his duty to advise Scottish Ministers on the amount of revenue that Scottish Water requires to fund its investment programme, the WIC’s duties include:
• consideration and approval of Scottish Water’s annual charges scheme;
• investigation of customer complaints not resolved by Scottish Water.
• advising Scottish Ministers on Scottish Water’s standards of service and customer relations;
• approval of Scottish Water’s Code of Practice;
• provision of advice, when requested by Scottish Ministers, on a range of matters relating to the impact of Scottish Water on its customers.

In some of the above areas, the regulator has more than an advisory role. In particular, the WIC is responsible for approving the Scottish Water’s scheme of charges and code of practice.

However, in all of these areas, the Scottish Executive—whilst the owner of Scottish Water—also plays the role of the arbitrator as there is no formal appeals mechanism, in cases where WIC either:

• does not give approval to Scottish Water’s proposals; or
• his modifications are not accepted by Scottish Water.

As a result, the Scottish Executive is inevitably a key player in decision-making on these issues, as with revenue requirements.

The process and methods of regulation, and the tools employed by the regulator are crucial to the ultimate effectiveness of the regime, in terms of its delivery of overall objectives.

In Scotland, a highly codified system of regulation has not yet been adopted compared with England and Wales. The WIC has wide discretion in developing the process and tools of regulation. In practice, he has borrowed from the English and Wales model the manner in which he assesses the efficiency targets for Scottish Water.

3.5.2 Strategies for meeting the concerns of customers

Scottish Water recognises that Customers are mainly concerned about:

• Level of Service;
• Communication and Information;
• Quality of Service; and
• Cost and Price.

The business and household markets would place these in different orders of importance but nevertheless the themes are common.

Over the next three years it is clear that customer expectations will continue to rise. Scottish Water therefore needs to improve its levels of service, at the same time as building relationships with its customers and reducing costs. The target standards of customer service are set by regular reference to research into customer opinion and channels of communication with all Scottish Water customers are being developed extensively.
**Level of Service**

Early attention is focused on achieving high levels of compliance with the WIC’s Guaranteed Standards of customer service.

The improvements in service result from targeted investment in Scottish Water’s networks, developing people and continuing to improve the organisational arrangements and working practices.

Scottish Water is reviewing all aspects of domestic and commercial billing and relationships with the Local Authorities are being strengthened with a focus on working more effectively together to improve billing and collection.

Creating the right environment for delivering service excellence is a key objective for everyone in a leadership role within Scottish Water. To become a genuinely customer centred organisation requires significant change in operating practices and behaviours, relying on excellent communication and strong leadership.

**Communication and Information**

Scottish Water has not inherited a usable customer database, nor were there strong processes for communicating and consulting with customers. Scottish Water is building the platform that will enable it to consult effectively with customers and their representative groups.

In order to best serve its customers and anticipate their future needs, Scottish Water must have access to high quality information on all its customers groups. Improving the integrity of the data held on its customers is a priority as poor data quality not only prevents the development of strong customer relationships but also prevents maximisation of existing revenue streams. A focus on data integrity and accurate recording of customer information is a clear feature of Scottish Water’s operational approach.

A variety of approaches to understanding customer needs and enhancing customer data are used to achieve Scottish Water’s strategic goal. With smaller businesses and household customers, Scottish Water seeks to understand customer needs through:

- segmenting the market and examining the value and behaviour of each segment;
- use of in-house data - individual customer feedback from personal contacts, enquiries, complaints etc
- commissioning specific, tailored, segmented primary research;
- gathering commercially available customer data e.g. lifestyle and business stage profiling data;
- constructing a comprehensive customer database capable of analysing all data and constructing customer and/or segment profiles and providing a single view of each customer;
- analysing customer panel data;
- developing relationships through trade associations and community groups.
With direct billing arrangements for all non-domestic customers, Scottish Water is developing detailed knowledge of individual customer profiles and usage patterns. However, due to the very poor state of inherited customer data, it will be at least 2 years before Scottish Water will be confident in its customer data for this sector.

For its largest 450 industrial and commercial customers, those who buy more than £100,000 per annum of water services, Scottish Water employs full time sector-specific Key Customer Managers (KCMs) whose role is to meet regularly with customers to understand, and respond to, their needs.

For smaller businesses and household customers, the Business and Community Relations Team has been created to focus on community and business representative groups. This team is creating strong links with active Community Councils across Scotland and helping Scottish Water to better understand the views of the business customers.

**Quality of Service**

Scottish Water’s Customer Relationship Management Strategy is to transform basic services and improve relationship management. In this context, a strong Scottish Water brand will complement the strategy. It can help build on existing goodwill, or where necessary regain lost goodwill in the face of competition and reputational pressure.

Scottish Water is committed to local service delivery and to a personal approach to dealing with its customers. Whilst technology has a major role to play, particularly in the management of information, Scottish Water believes that one of the keys to customer satisfaction is the development of lasting relationships with its customers.

Significant investment will be made in the development of Scottish Water staff to equip them with a breadth and depth of business knowledge, coupled with the softer skills required to work effectively with customers. Investment will also be required in the right tools to support effective customer relationship management, which may also offer customers new choices in how they do business with Scottish Water.

Relationships with household customers are being developed around a commitment to deliver on promises from both Scottish Water’s Customer Service Centre and field Customer Advisers, dedicated to spending time with customers to advise them on any aspect of Scottish Water’s service or resolving service delivery problems. A key transformation project is delivering the ability to offer customers a timed appointment, rather than the standard utility offering of half day, or even full day, slots.

Scottish Water has initiated a “Promise to Resolution” project that will deliver a single Customer Contact system and an appointment management process giving staff the ability to manage resolution of customer requests in an agreed timeframe. This process will also optimise the cost and availability of field resources, and facilitate more effective planning and scheduling.

The “Promise to Resolution” project will provide upskilling of staff in the contact centres and decision matrices for call handling to deliver:-

- Resolution of 85% of contacts in the call centre at the time of initial contact;
- 15% of contacts only being referred to operational staff for resolution.
An improved experience for the customer.
Timed appointments certain activities such as choke squads, network inspectors and field customer advisors where there is a need for face to face contact with the customer.

Until recently Scottish Water delivered its customer contact service through 3 main sites, and customers are segmented geographically. This has lead to inefficiency in all areas of customer service due to the lack of consistency in the application of processes and systems and lack of the critical mass of any of the 3 sites which is required to drive efficiencies.

Customer Service is being considerably enhanced through more effective processes delivered through moving the Customer Service department to a single site by April 2004 and establishing a single Scottish Water billing system in Summer 2003 for completion by March 2004.

Network Management also impacts on Scottish Water’s reputation with its customers. Strategic management and day to day operation of the network are both integral to high customer satisfaction.

Recent incidents have further raised the profile of Emergency Planning in the eyes of customers, media and the politicians. As a result of political concerns for incident management, Scottish Water is taking the lead in improving working relationships with key external Emergency Planning Groups including the Scottish Executive, Health Boards, Local Authorities, SEPA and the Police.

The Priority Register remains a concern and Scottish Water will continue to develop plans for this group of vulnerable customers, but this is particularly complex for household customers where we do not have a direct billing relationship with customers.

Scottish Water is proposing partnership with social services as the principal measure of activity. To date most progress has been made with Edinburgh Council, Glasgow City Council and Clackmannanshire Councils.

Discussions with Councils are ongoing but success in this initiative depends largely on the Councils taking up the offer of partnership.

The development and implementation of customer focussed incident plans will be completed by December 2003.

Scottish Water has completely revised its approach to incident management and a new strategy and associated processes have been introduced to provide appropriate counter measures for any incident affecting any customers, businesses or reputation. This includes a Situation Centre to provide constant monitoring and early warning of potential issues, which is relayed to Directors and key staff on a 24/7 basis.
Cost

Clearly customers are concerned over the rising costs of their water services, with business customers particularly concerned over the different approach to charging adopted in Scotland compared to England and Wales.

Scottish Water has a major task ahead in the education of customers about the water industry and in particular the cost of providing basic water and wastewater services. The perception still exists that water is a natural commodity and customers therefore do not attach value to the service provided by Scottish Water and in some cases resent paying for it. A communication programme has been implemented to begin to address these issues. Clearly this will take time and Scottish Water is consulting with its customers and stakeholders on how the charges debate might be taken forward.

Scottish Water is committed to achieving the 2005/06 efficiency targets. This will mean operating more efficiently and being able to pass the benefits on to customers in lower price increases in the years to come. It should be noted that the efficiencies for period 2002/06 have already been passed to customers within the WIC’s revenue cap. A key area will be the reduction in the inherited customer debt position and Scottish Water is working closely with the Local Authorities on alternative debt management strategies for the household sector.

In the business sector Scottish Water has a major transformation project to implement a single billing system and improve the in-house debt management capabilities.

Scottish Water is creating a single Customer Management Centre at Fairmilehead in Edinburgh to ensure that a consistent level of customer service can be provided at a reduced cost. Operational customer management will be run from this site from September 2003, with Account Management and other functions moving on a rolling programme through to January 2004.
3.6 Charges

In the Strategic Review of Charges 2002-2006, the WIC offered advice to the Minister for Environment and Rural Development on the issues of harmonisation of charges and cost reflective tariffing for the water industry in Scotland, as follows:

- **Harmonisation of Charges**
  “Charges should be harmonised across Scotland for both domestic and non-domestic customers, by no later than 2005-06.”

- **Cost reflective tariffs**
  “Scottish Water should seek to develop tariffs that more broadly reflect the economics of the service provided. This will require that the fixed element of the charge faced by customers increases significantly from the current level.”

These statements were also echoed in the Executive Summary.

iv) **Harmonised and broadly cost-reflective tariffs**

“There are significant anomalies in the charges that result from the current three authority model. It is, for example, cheaper to supply Dundee than North Fife, yet charges are much higher in Dundee. A harmonised charge across Scotland is equitable for all customers. At the current time the tariff structure does not reflect the economic costs of supply and, as a result, can send inappropriate signals to customers. It would be in the general customer interest to have more broadly cost-reflective tariffs. This would probably mean higher fixed and lower volumetric tariffs.”

The Scottish Water scheme of charges for 2003/04 was developed in line with the advice and recommendations contained in the Strategic Review of Charges.

As such, all business tariffs have been harmonised, two years ahead of the WIC identified deadline of “2005/06 at the latest”.

In line with WIC advice to the Minister, all business customers (and metered households) now pay fixed and volumetric charges for water and waste water services, including trade effluent.

For metered properties, the fixed charges relate to the size of the water meter that serves the property. This reflects the peak demand that can be delivered to a property and hence provides a basis for allocating fixed costs between customers. Unmetered customers are assumed to have the same demand characteristics as customers served by the smallest water meters.

This tariff structure has drawn criticism as not providing sufficient incentive to promote efficient water use. However, customers can still influence the volumetric element of their bills which amounts to £1.77 per cubic meter (combined water and wastewater). Additionally where peak demand is greater than that of the smallest users, customers have an additional incentive to reduce their peak demand. If the required volume of water can be delivered by a smaller water meter, the customer benefits from lower fixed charges,

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* Advice items iii) and iv) (Section 8 – chapter 40 – page 386) relate to charges.
Scottish Water benefits from the freed-up capacity, in both the treatment and networks, and there is a general wider sustainable benefit of not needing to upsize assets earlier than would otherwise be needed.

Unmetered charges are levied on the basis of property rateable value but also have flat rate fixed charges at £130 for water and £140 for wastewater. This tariff structure is new for unmetered properties in the former West and North areas, where unmetered charges were previously based only on rateable value. Historically this meant that many customers paid only a few tens of pounds for their services, considerably less than the cost of providing service and maintaining service availability.

The least well understood charge relates to surface water drainage.

Dealing with rainwater that drains from private property such as roofs and car parks, as well as from public roads is currently estimated to account for 40% of the costs of the wastewater business, a cost of around £200m p.a.

To collect and safely return rainwater to the environment, sewers, pumping stations and treatment works have capacity many times larger than that needed to deal with sewage from within properties. Increasing environmental standards are further increasing the costs of dealing with rainwater at overflows along the length of the sewer network.

It is estimated that more than 50% of the rainwater that drains into the sewers does so from public roads. In reality the councils and highway authorities are the customer in this case. Scottish Water is obliged to recover this cost from its customers, but can only do so from those that have a connection to public sewers. The highway drainage charge for business customers is currently 2p per £ Rateable Value. Scottish Water would welcome a review into the current arrangements for recovering the costs associated with dealing with rainwater from public roads.

Harmonisation of charges across Scotland has brought the highway drainage charge most sharply into focus for former East of Scotland Water customers where costs associated with highway drainage were recovered through higher wastewater charges. Historically, customers in the areas secured by the former North and West of Scotland Water Authority paid highway drainage through rateable values.

The remaining 1.5p of the surface water drainage charge relates to property drainage. Scottish Water recognises that levying property drainage charges through rateable value is not perfect. However there is an area based component within the calculation of an individual property rateable value.

Arguably the fairest way of levying property drainage charges would be to base the charge on area. To implement such an approach it would be necessary to assess the area drained by all properties, households and businesses to allow an area charge to be calculated. At this stage Scottish Water regards this to be too complex and costly to undertake and maintain.
3.7 Middle Investment Option

During the costing for Quality and Standards II, in moving from the enhanced option to the central option, investment linked to capital maintenance and growth was stripped out in all three predecessor authorities’ programmes, along with some investment linked to water quality undertakings in the NoSWA programme.

Scottish Water inherited some 168 wastewater treatment works that are either failing to comply, or are at risk of failing to comply, with environmental compliance standards. Similarly in water treatment the inherited investment deficiency (with corresponding cost and performance consequences) is reflected in the 308 undertakings and 682 relaxations in water supply. The investment linked to growth that was stripped out of the enhanced option has resulted in Scottish Water operating and maintaining assets, which are in some cases at or beyond capacity. At works where there is no headroom there is a greater need for manual intervention to maintain asset performance and maintain compliance. There is little scope to manage this differently until capital investment is implemented.

A recent major review exercise has resulted in constraints being identified in certain areas, particularly where there is a need to upgrade an existing treatment works and/or infrastructure improvements. A consequence of the Quality & Standards II investment programme is that investing in £213million of schemes targeted at other drivers, some development constraints will also be alleviated. Further investment is required to alleviate other development constraints, for which no funding exists in Quality & Standards II.

Scottish Water continues to work actively with Local Authorities, SEPA and Development Agencies to review the development needs in Scotland and the capability of Scottish Water assets to meet the increased demand.

This work will feed into the assessment of investment requirements for Q&S III.
Mr Simon Watkins
Temporary Clerk to the Finance Committee
Scottish Parliament
Room 2.1
Committee Chambers
George IV Bridge
Edinburgh
EH99 1SP

Dear Simon

Water Industry Commissioner for Scotland’s response to the Finance Committee.

I have pleasure in responding to the Scottish Parliament Finance Committee’s request for information relating to the current position of the Scottish water industry.

Please find enclosed my response to this request along with copies of reports recently published by my office containing information central to the issues raised in the Committee’s request.

Should you have any further questions or comments, please do not hesitate to contact me on 01786 430200.

Yours Sincerely

Alan D A Sutherland
Commissioner
The Water Industry Commissioner for Scotland (WICS) welcomes the opportunity to respond to the request for information from the Finance Committee of the Scottish Parliament. WICS would like to draw the Committee’s attention to its already published reports, as these detail the issues as completely as necessary. In the coming months WICS will publish additional reports as follows:

- Costs and Performance Report 2002/03 – October 2003
- Strategic Review of Charges Methodology Consultation – February 2004

WICS believes that these reports provide objective information to stakeholders on the relative performance of the water industry in Scotland. In particular WICS would highlight the following four issues to the attention of the Committee. These are all covered in our various publications.

**Issue One**

Some commentators have suggested that current charge levels are set in order to reduce Scottish Water’s debt.

**Response**

This is untrue. It is likely that Scottish Water’s debt will actually increase during the current 2002-06 regulatory period by about the same percentage as the growth in revenue. Capital investment is also likely to continue at about current levels for the foreseeable future. Consequently, given the already high level of debt accumulated by the three former authorities, further increases in debt are unlikely to be sustainable.

**Issue Two**

Some commentators have suggested that comparisons between the privatised companies in England and Wales and Scottish Water are not possible.

**Response**

The methods of benchmarking used have been subjected to intense scrutiny by private companies wanting to get an improved regulatory settlement; by the Competition Commission; by the Performance Improvement Unit of the Cabinet Office and by many firms of private consultants. The benchmarking allows small companies such as Folkestone and Dover Water to be compared to Thames Water and for the company supplying Manchester and Liverpool to be compared with that supplying Cornwall.
Issue Three

Many customers report to us at public meetings that they have been told that efficiencies mean cuts either in intended investment or levels of service. On occasions some customers have been told that WICS have directed Scottish Water to delay an investment project.

Response

This is not the case. WICS defined efficiency in its evidence to the Transport and Environment Committee inquiry into the Scottish water industry:

“Let me make clear what I mean by efficiency. I mean providing the same, or a better, level of service for less money; I do not mean any reductions in service, any short cuts or risks to health, safety, water quality or anything else. I am talking about delivering the same or better for less.”

This definition was re-iterated in the Strategic Review of Charges:

“I would like to emphasise that I will consider an efficiency to be achieved only when an equivalent or better level of service is delivered to customers at a lower cost.” (Strategic Review of Charges 2002-06, page 36).

Neither WICS nor regulators in general have any management role in delivering the service. Such a role would undermine our objectivity:

“It is for the owner, board and management of the proposed Scottish Water, or the existing three authorities, to determine how best to deliver value for money to customers. There are important minimum agreed improvements in the levels of service available to customers and to public health and environmental compliance. These are not negotiable. It is, however, for management to establish an appropriate balance between operational and capital expenditure. My intention is to monitor the delivery of service level improvements within the agreed revenue cap.” (Strategic Review of Charges 2002-06, page 32).

Issue Four

It has been widely reported that the condition of assets in Scotland is worse than in England and Wales.

Response

Regulatory returns from the three predecessor authorities and more recently from Scottish Water in June 2003 to WICS do not support this. In most asset categories, the average condition of assets in Scotland is no worse than those of comparable companies south of the border. Even in the case of water mains, there is a company with a much worse average condition. There is, however, no reason for any complacency. Reasonable maintenance and refurbishment schedules based on asset life and serviceability to customers will need significant ongoing investment. There are also outstanding legislative (both water and sewerage) compliance needs that must be delivered. Ongoing maintenance is essential if the level of service to customers in areas such as water pressure, sewer flooding etc is to be maintained and improved.
Statement of the current position of Scottish Water

The information relating to the current operating position of Scottish Water can be found in its recently published Annual Report. What follows is a brief summary of the issues raised in the Committee’s request for information.

Scottish Water’s turnover for the year 2002/03 was £895.3m. This is about 1% higher than the annual revenue cap of £887.8m specified in the Strategic Review of Charges 2002-2006. Total spending was £969.3m, partly funded by a £51m increase in net borrowing from the Scottish Executive. This is lower than forecast in the Strategic Review of Charges, largely due to a £100m lower capital spend.

The increase in net borrowing resulted in a total net debt of £2,149m. This net increase comprised new borrowing of £140m at an interest cost of 4.08%; £74.4m of long-term loans matured and had to be repaid. The average cost of total borrowing fell to 6.45% as at 31 March 2003. The maturity of the total borrowing is detailed in Scottish Water’s Annual Report (page 26).

Scottish Water outlines in its Annual Report that it has embarked on a programme of reducing its total number of employees. This is said to be a result of the merger of the three former water authorities into one entity and the drive to achieve the efficiencies determined in my Strategic Review of Charges 2002-2006. Total numbers of employees were reduced from 5648 in 2001/02 to 5007 in 2002/03 (as reported in Scottish Water’s Annual Report, page 15).

WICS’ Costs and Performance Report will offer more detailed analysis on Scottish Water’s operating and capital costs. This will include comparisons between the costs of Scottish Water and those of the water and sewerage companies south of the border. The Asset Management and Investment Report will comment on progress in the delivery of the capital programme.

A statement of comparison with the operating position of other water utilities in the United Kingdom including any agreements on best practice.

The need to improve efficiency was highlighted in the Strategic Review of Charges, published in November 2001. This document set challenging but achievable targets for the industry in Scotland for the period 2002-06.

The first annual Costs and Performance Report, published in February 2003, analysed the operating position of the Scottish water industry during the period 2001/02. It should be stressed that the analysis was carried out on data relating to the three former water authorities, rather than the single entity Scottish Water. This analysis included detailed comparisons with water companies in England and Wales. It also focused on the slow progress being made in Scotland towards improving the levels of operating and capital efficiencies much needed in the industry. The conclusions reached in the Costs and Performance Report, showed that the performance of the three former water authorities was getting worse relative to the water and sewerage companies in England and Wales. It also highlighted the fact that a significant proportion of customers’ bills was financing inefficiency in the industry.

Given that the next Costs and Performance Report is due to be published in October, it would not be appropriate for me to offer comment in advance of the completion of this analysis.
The first annual Investment and Asset Management Report was published in March 2003. This report discussed the condition and performance of the industry’s assets in the year leading up to the formation of Scottish Water. It also made comparisons of the processes employed by the industry in procuring its capital projects.

The conclusions drawn by this report were that in general, the state of the industry’s assets lay within the range of comparable companies in England and Wales. As with the Costs and Performance Report however it was noted that the investment being made in Scotland was not as effective as that made south of the border, as a result of inefficiency in both the strategic planning and procurement of capital projects. As stated previously, this inefficiency is having a significant impact on the level of charges being passed to customers.

**Future strategy of the industry covering long term development plans and contribution to the wider economy.**

Scottish Water’s strategy ought to be consistent with three key documents:

- Water Quality and Standards: Investment Priorities for Scotland’s Water Authorities 2002-2006 (Scottish Executive, August 2001)

At present, industry stakeholders are working together to identify the investment priorities for the Scottish water industry for the period 2006-2014. WICS understands that these priorities will go to public consultation in 2004, giving stakeholders and the Scottish public chance to determine their preference for how investment should be made in the future. The wide stakeholder involvement in the process to date will ensure both long term sustainable development and the needs of customers are addressed.

The investment priorities identified in the process described above will be a major contributing factor to the advice offered to Ministers in my next Strategic Review of Charges. WICS is currently commencing work on this document and will consult on the methodology that will underpin the process.

**Constraints on the industry and strategies for meeting the concerns of consumers.**

Constraints on Scottish Water impact from three main directions. Firstly there are those constraints coming from within the organisation itself, secondly there are regulatory constraints on Scottish Water’s monopoly power and finally those placed on it by other parties, such as organisations supplying goods and services to Scottish Water.

Scottish Water is at a relatively early stage in its corporate development, having been established just 18 months ago. WICS took account of this in phasing its efficiency targets. Such a phasing increased bills to customers in the short term but WICS thinks that they have made the targets more likely to be achieved.
The advice to Ministers, in the Strategic Review of Charges 2002-2006, was for an annual cap on the revenue that Scottish Water can collect over the period, as set out below.

<table>
<thead>
<tr>
<th>Water Authority</th>
<th>Projected Revenue 2001-02</th>
<th>2002-03</th>
<th>2003-04</th>
<th>2004-05</th>
<th>2005-06</th>
<th>Total Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scottish Water</td>
<td>£825.9m</td>
<td>7.5%</td>
<td>7.8%</td>
<td>4.6%</td>
<td>(1.3%)</td>
<td>19.6%</td>
</tr>
</tbody>
</table>

Scottish Water’s activities (particularly its capital investment) are also constrained by the size of the market supplying goods and services to it. It is generally acknowledged that the annual investment programme could not currently be larger than approximately £550m due to the capacity of the supply market.

It has been publicised that customers of Scottish Water have concerns over various aspects of the water industry in Scotland and its future development. WICS holds regular public meetings in which all customers, both domestic and non-domestic can raise any issues they feel are affecting them in their area or Scotland as a whole. WICS also holds regular meetings with stakeholder groups such as the Federation of Small Businesses, Confederation of British Industry (CBI) and large user groups. The recent establishment of the Customer Consultation Panels also gives customers another route by which they are able to raise concerns.

The current Quality and Standards III discussions include several consumer and customer groups (including the Convener of the Customer Consultation Panels).

**Charges and the charging regime.**

The Strategic Review of Charges 2002-2006 advised Ministers on the revenue cap for the period 2002-06. The annual charges passed on to customers as part of the revenue caps is however for Scottish Water to determine and propose. I have the role of approving the annual Scheme of Charges as proposed by Scottish Water. As part of this approval I ensure that the split between the various categories of customer is equitable and that the interests of all customers are promoted.

One concern raised in the Strategic Review of Charges was that charges were often not cost reflective. A significant move has been the introduction of standing charges to reflect the large fixed cost element of supplying water and wastewater services. Additionally, harmonised charges for the removal and treatment of surface and highway water have been introduced. As a consequence of this, large numbers of customers (particularly small/medium business users) have seen relatively large increases in bills this year. However these increases were in conjunction with substantial reductions in some aspects of customers’ bills, this is shown in the following table.
Summary of tariff changes for each area

<table>
<thead>
<tr>
<th></th>
<th>East</th>
<th>North</th>
<th>West</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standing Charges</td>
<td>-</td>
<td>++</td>
<td>+</td>
<td>reduction</td>
</tr>
<tr>
<td>Volumetric Charges</td>
<td>+</td>
<td>--</td>
<td>+</td>
<td>increase</td>
</tr>
<tr>
<td>Surface Water Drainage</td>
<td>++</td>
<td>--</td>
<td>-</td>
<td>large increase</td>
</tr>
</tbody>
</table>

Our intention would be to consult on tariffs and their incidence in the lead up to the next Strategic Review of Charges.
5. SCOTTISH COUNCIL FOR DEVELOPMENT AND INDUSTRY

22 August 2003

Professor Alan Alexander
Chair
Scottish Water
Castle House
6 Castle Drive
Carnegie Campus
Dunfermline
FIFE
KY11 8GG

SCOTTISH WATER
RESPONSE TO THE FINANCE COMMITTEE
OF THE SCOTTISH PARLIAMENT

Thank you for your letter of 15 August reminding us that our reply to the Finance Committee’s Inquiry is due by 22 August.

We have considered the six headings under which the Committee seeks information, contained in Des McNulty’s letter to you of 26 June. We feel that the evidence from Scottish Water, The Water Industry Commissioner and The Water Customer Consultation Panels will satisfy the Finance Committee in its two-fold objective and we look forward to reading these submissions in due course.

I note that Mr McNulty suggested a plenary session with as many organisations as possible, with the intention of consolidating inputs into a single document. To my knowledge, time has been against us and this has not happened. However, you will be aware that SCDI helped to convene a meeting on 25 June between Jon Hargreaves and his senior colleagues at Scottish Water with representatives from the CBI, the Scottish Chambers of Commerce, the Institute of Directors, Scottish Financial Enterprise, the Federation of Small Business and the Forum of Private Business.

SCDI and Scottish Water have worked together in recent months to increase awareness and understanding and to focus upon the plans and challenges which Scottish Water faces, and the concerns of our members. We believe that the series of five city seminars involving several hundred members has been very well received and a successful exercise and we are hopeful that we will be able to work with Scottish Water Solutions with a similar series of events throughout Scotland to focus upon the programme of investment in infrastructure.

SCDI responded to the Scottish Executive’s consultation paper entitled “The Future for Scotland’s Water Proposals for Legislation” in April 2002 and the Finance Committee can access this on our website. More recently, we have given verbal evidence to consultants commissioned by Scottish Water who are consulting stakeholders on water charges for 2004/2005. We have also met the Convener and Chief Executive of the Water Customer Consultation Panels to discuss the principles of charging for water and waste water. I attach a
short statement which we provided to the WCCP for inclusion in its imminent report. At Scottish Water’s annual public meeting in Dunfermline last week, I was comforted by the statement that customer prices on the five main elements of charging would increase next year “no more than inflation”.

I trust that this will suffice for the time being.

Yours sincerely

Alan Wilson  
Chief Executive
SCDI welcomes this report and agrees that there needs to be a more detailed debate into the economics of Scotland’s water industry and its charging regime. SCDI has, in recent months, taken steps to heighten the debate on water charges and investment by holding seminars with Scottish Water for SCDI members. Such communication is essential to improve the information available to domestic and non-domestic customers, to improve customer relations and mutual understanding.

Any further research and investigation must include a comprehensive analysis of the economics of water charging. Some of the main issues would include: sources of capital funding for Scottish Water; cross-subsidisation between households and between domestic and business sectors; the proportion of fixed and variable charges within bills; affordability of charges and bad debts accruing to Scottish Water. Addressing such issues will allow a more transparent view of Scotland’s water industry.

However, a key point to note concerning this report and any subsequent research is that Scotland is at a different stage of the investment cycle compared to England and Wales and this hinders a direct comparison between Scotland and the rest of the country. It should also be emphasised that increased investment to upgrade Scotland’s water infrastructure is a necessity to ensure compliance with domestic and EU legislation. We have no choice but to invest. This message needs to be more widely understood. Once this investment is completed the long-term competitiveness of the country will be improved as water standards and efficiency will improve considerably.
CBI Scotland welcomes the opportunity to contribute to the Committee’s inquiry. As Scotland’s leading business organisation, representing the interests of some 26,000 firms of all sizes and sectors, our principle interest in water policy is in protecting the interests of business customers of Scottish Water, and ensuring the Scottish Water supports economic development in general across Scotland.

CBI Scotland objectives for water policy

Business recognises that Scottish Water has inherited an unenviable legacy, including different practices and procedures across the predecessor authorities, a severe lack of knowledge about the state of its assets, and decades of underinvestment. Bearing in mind this starting point, business would see the following priorities for Scottish Water and water policy:

- Ensure that the rising costs of water for business customers are stabilised and as far as possible reduced
- Ensuring that the Scottish Water’s charging scheme allocates costs fairly both between businesses and between domestic and non-domestic customers in general
- Address capacity constraints which are hampering development in various parts of Scotland
- Ensure that Scottish Water is put in a sound financial and management position
- Compliance with EU law on water quality and water management

CBI Scotland has made these points consistently in recent years to Ministers and the Parliament.

Current charging scheme

While the high cost of water in Scotland has been a concern to CBI Scotland for several years, the current groundswell of concern relates mostly to the 2003/04 charging scheme. There are several key issues:

- Lack of advance warning of charges: There was no formal advance consultation on the 2003/04 charging scheme, prior to it being announced early this year, and many companies have complained to us that they only received bills containing very significant price rises a matter of days or weeks before payment was due.

- Revenue cap: The current year’s charging scheme was the latest of several years of above inflation increases in the revenue cap. This is an obvious cause for concern, although businesses do accept the need to comply with EU Water Directives and for the legacy of under-investment to be tackled. Given that this year is due to be the last above inflation increase in the cap, our criticism is more of the impact of the new charging scheme and the way it was implemented, rather than the overall cap.

- Harmonisation: The 2003/04 charging scheme completed a very rapid harmonisation of charging schemes for non-domestic customers across the three previous water authority areas. This harmonisation is right in principle, but has been carried out too quickly, with the
complexity of the charging schemes meaning that such rapid harmonisation has created many significant winners and losers. While we acknowledge that the number of different components in the historical charging schemes would have made the process of phasing a complex one, we still believe that it could have been done.

• **Fixed charges:** The fluctuation in firms’ charges caused by harmonisation was compounded by a parallel and equally rapid shift towards a more fixed-cost based charging structure. We understand the thinking behind this, and the desire to make charges more cost reflective. But the speed and scale of this change, plus the significant use made of rateable values in calculating drainage charges, has left many substantial firms with quite unacceptable rises in charges this year. In addition, many businesses are uncomfortable with the concept of most of their charges being fixed, on the basis that their water requirements may change either due to factors outside their control or due to their own efforts to reduce their water use, and they believe that the bills they pay should be sensitive to this.

• **Rateable value:** The increased use of fixed charges has made firms’ water bills very sensitive to their assessed rateable value (RV). Given that water charges are supposed to be not a general business taxation (like the Business Rates) but a charge for a service provided, we are concerned about the use of RVs in such a significant way in the charging scheme.

**Impact of the current charging scheme on businesses**

The combined effect of the various factors above has been to create a large mix of ‘winners’ and ‘losers’ among Scottish Water non-domestic customers as bills have fluctuated. We recognise that some businesses have seen water bills fall, while others have seen only modest increases. We are also aware that many of the highest percentage increases relate to the very smallest firms, where the absolute amount paid may only be a few hundred pounds. Our greatest concern, though stems from the fact that firms which are significant users of water tend to be in sectors with intense international competition, competing on price as well as quality, and where costs cannot easily be either absorbed or passed on to customers. Examples of such high water-use sectors would be electronics, paper, chemicals and drinks. Many firms in these sectors are among the ‘losers’ and have been hit by very large increases in water costs because of their particular characteristics (eg they had a large RV and were in the old East of Scotland area and so have been hit hard by the huge increase in surface drainage costs, or they cannot adopt the LUVA tariff because the conditions attached to it are unsuitable for their business, etc). Such firms may have already had water charges of tens or hundreds of thousands of pounds, and now have had increases in some cases of 50-100% imposed with almost no warning. We do not see how this can be justified, and are not aware that anyone has tried to justify it. Given the competitive pressures these firms are already under, and the costs increases they already face through the NICs rise, environmental legislation and so on, the impact of the rises must call into question the Executive’s headline policy of growing the economy and promoting a competitive industrial sector in Scotland.

**Financial performance of Scottish Water**

While recognising Scottish Water’s starting position, it is vital that the organisation matches the level of efficiency and customer service provided by the English water companies as soon as possible. This will be essential to keep future water charges under control. We therefore fully support the WIC’s targets and approach in this regard.
Borrowing levels of Scottish Water

We are aware both of Scottish Water’s current debt levels, and that under the WIC’s financial plans Scottish Water will not take up all of the additional borrowing made available to it by the Scottish Executive.

We note that some stakeholders are arguing Scottish Water should borrow more to help fund its current investment proposals and hence keep charges lower to present customers. We do want to see charges lowered, but we are also mindful of the existing high costs of servicing current debts, the possibility that high investment leaves may need to be maintained for many years, and the need to pay off the debt, rather than simply service an increasing debt indefinitely. We are not best placed to make a judgement about the appropriate level of borrowing for Scottish Water, but we would like to see a view from the Scottish Water about the advantages and disadvantages of increasing borrowing (including assumptions made on future interest rates and overall debt levels).

Domestic – non domestic customers

Domestic customers have a different charging structure than non-domestic customers, and also have their annual charging increases capped by the Minister. Historically Scottish Water has generated a higher proportion of revenue from its non-domestic customers than comparable English water companies, and we have consistently complained to Ministers about the apparent cross-subsidy taking place. SR02-05 concludes that some cross-subsidy probably is taking place, but that the data does not exist to clarify this. We note that in recent years, some progress has been made in reducing the share of income from non-domestic customers. This must continue until levels are at least comparable, if not better. We have requested data on this for the current year from Scottish Water.

Status of Scottish Water

We have said publicly that if a privatised (or mutually owned) Scottish Water was likely provide a better service at lower cost than the existing arrangement, then Scottish Water must not be kept in the public sector for ideological reasons. This remains our view.

Role of the Scottish Executive

We agree with the Executive that Ministers should neither be trying to run Scottish Water nor intervening in every detail of the charging scheme. But we believe that the implications for Scottish competitiveness of the impacts of the restructuring of the charging scheme are a policy matter and Ministers should legitimately be involved in ensuring that business concerns are addressed by Scottish Water and the WIC. We also note that the Act which set up Scottish Water does give Ministers wide powers of direction to Scottish Water should they need it.

CBI Scotland proposals:

- A short-term rebate scheme must be introduced for next year to reduce the bills for firms who had a very significant increase in water charges (both in percentage and cash terms). This will address the immediate risks to competitiveness in key sectors described above
- Scottish Water must meet its efficiency targets, so that the overall revenue can be held stable
• There must be more consultation on the charging scheme and firms must receive accurate bills well in advance.
• The National Planning Framework to be published by the Executive later this year must help clarify where the priority should be in terms of tackling development constraints and a strategy for delivering this must be drawn up.
• A wide review/consultation should be held to decide whether the new charging structures and the move towards higher fixed charges should be continued. Such a review/consultation must be supported by more detailed information about the way the recent changes have changed the pattern of revenue contributed by different customers and business sectors, and should cover:
  ➢ Whether surface drainage charges should be linked to drained area, rather than Rateable Value, and whether there is a case for passing the highways element of the charge on to local authorities
  ➢ The balance between fixed and volumetric charges
  ➢ The impact that the planned introduction of retail competition in the water industry will have on charging structures

The balance of revenue from the domestic and non-domestic sector, and the implications of businesses helping to pay for subsidies to low-income households through the operation of the charging structure.
As Scotland’s largest direct-member business organisation, the Federation of Small Businesses welcomes this opportunity to submit comments on behalf of our 17,500 members in Scotland. Whilst recent increases in water charges have prompted public interest and concern in the water industry, in truth, we believe that an open discussion of the principles of charging for water and wastewater in Scotland is long overdue.

The Federation welcomes the Finance Committee’s interest in this matter and we appreciate that information on a number of specific points was requested, some of which can probably best be provided by Scottish Water. We have not given detailed comment on some of the fundamental financial issues, such as the cost to the consumer of Scottish Water’s debt, borrowing constraints and use of public capital loans, against customer revenue, though these are, of course, worthy of further discussion by the Committee. Instead, we offer the committee our assessment of the difficulties facing the small business sector in relation to water charges and to offer some suggestions to ameliorate the situation.

Background

The FSB supported the creation of Scottish Water in 2002, following the merger of the previous three water companies in Scotland. Concern about increases in water charges was first raised a couple of years ago, yet it is with the unmistakably high increases in bills this year that there has been a wider acknowledgement of a problem with water charges. The magnitude of this issue for small businesses should not be underestimated. While it may be seen as little more than businesses complaining about the cost of their bills, the current outcry has revealed that, in our view, the system of water charges in Scotland has treated businesses unfairly and that, were prices to come down tomorrow, parts of the system would still be wrong.

Accordingly, we have tried to present a balanced case, presenting what we believe are achievable options which would help small businesses in Scotland. While the argument has been made for overhauling the entire industry, we do not believe that is the correct approach at this time. We accept that Scottish Water has a difficult task ahead, but it is clear that the current system is not perfect and there seems little reason why changes could not be made, without a great deal of disruption in order to ensure fairer bills for small businesses.

From the business perspective, it is important not to view water bills in isolation. Increases of several hundred per cent in water bills should be considered alongside similar increases (often worse) in Employer’s Liability Insurance, for example. Whilst accepting that comparisons with England and Wales may not be entirely fair, it is important for any government strategy which is
designed to encourage enterprise to also consider the effect that this issue has on the perception that “Scotland is an expensive place to do business.”

Our concerns on water can best be divided into three categories: Principles of Charging, Levels of Charges and Roles and Responsibilities. We have not made particularly detailed comments and would be happy to provide further comment on any aspect of this submission.
Principles of Charging

Recommendations:

1. An open consultation is required on the principles of charging for water and wastewater in Scotland.
2. As part of this consultation, we would suggest that the balance between volumetric and fixed charges should be revisited.
3. In addition, the formula used to calculate the surface water drainage charge should be reviewed.

- The Federation supports the findings of the paper commissioned from Heriot Watt University by the Water Customer Consultation Panels – “The Principles of Charging for Water and Wastewater”. The paper highlights the approach taken in England and Wales where the objectives of charging for water and wastewater, including the methods of charging and the structure of tariffs, were discussed by way of a public consultation exercise. We note that no such consultation has taken place in Scotland. Such a debate would allow a focused discussion about individual charges (where, in our opinion, many of the problems lie) without calling into question the entire industry in Scotland. The existing strategic review of charges covers the period until 2006 and it would therefore seem appropriate to ensure that any discussion on the principles of charging takes place before the commencement of the next period of charges.

- In particular, the Federation believes that the following charging issues require examination:

Fixed Charges
The Federation believes that the current move towards fixed (or standing) charges, and away from volumetric charges, is flawed and creates an undue burden on low-volume, non-domestic users. Most of the recent high increases were as a result of increases in fixed charges, as opposed to increases in the cost of water used.

The explanation for this move, as given by the Water Industry Commissioner, is that Scottish Water should recover more of the cost of providing the supply (rather than the water actually used), as this accounts for a greater proportion of Scottish Water’s costs. We understand this argument, but we assert that this system is not used elsewhere in the UK and so disadvantages Scottish small businesses who are likely to account for the overwhelming majority of low-volume, non-domestic users.

We are further concerned that this move towards fixed charges does nothing to encourage sustainable water use, which, while making little difference to Scottish Waters’ costs in the short term, would surely pay dividends in the longer term. This is also difficult to reconcile with Scottish Water’s statutory duties in terms of sustainable development. As detailed in the Heriot Watt paper, this view was supported by Ofwat which ensured that the general trend in England and Wales has been to reduce fixed charges overall. Consequently, we believe that a rebalancing between volumetric and fixed charges is required.

Surface Water Drainage
This charge is levied for the clearing and treatment of rainwater and run-off from roads, pavements, roofs and other public areas. This charge is only explicitly charged to metered, non-domestic users. Even where joint use exists i.e. business premises on the ground floor, with flats above, the charge for surface water drainage is only applied to the business premises. The
charge is based on rateable value, as this has traditionally been seen as the easiest way of calculating revenue. Rises in this standing charge have led to some of the most devastating increases in bills for small businesses. The charge has risen from 0.7p x £rateable value in 2001/02 to 3.5p x £rateable value in 2003/04.

The link between property rateable value and the cost of treating water from the highways is unfair and unrelated to the volume of rainwater treated or the surface area of the roof etc. It is understandably difficult to arrive at a formula which will satisfy everyone, but this charge appears needlessly unfair to non-domestic users.

**Water Meters**

The Federation sees no place for water charges based on the rateable value of a property. Instead, businesses should be charged for the water they use, by way of a meter. A number of small businesses are still without meters and many operate with a meter which is larger than required (meaning they pay higher fixed charges as a result of a larger meter). As an immediate step towards reducing bills, we believe that, where possible, those businesses without a meter should have one fitted, (at no cost to the business) and that Scottish Water’s project to ensure each business has the appropriate size of meter should be completed with a degree of urgency.

**Levels of Charges**

**Recommendations:**

1. Year on year increases in individual charges should not exceed inflation.
2. Appropriate sized water meters should be fitted for all business customers.

- There can be little doubt that the recent increases in many non-domestic water bills are completely unacceptable and cannot be repeated. We understand that at least some of the rises were not anticipated, as a result of poor customer records and the different charges of the previous water companies. This could have been prevented, at least in part, by a more gradual period of harmonisation (as is happening for domestic users) – over four years, rather than two.

- The comparisons between Scottish and English water bills (however valid) have shocked Scottish non-domestic bill payers and there is an urgent need for assurances of when Scottish water charges will start to come down in price. In the meantime, we would suggest that charges should go up by no more than inflation year on year.

- Large increases were perhaps exacerbated by the confusion over the relation of the revenue cap to actual charges. The figure usually given in public comment is the revenue cap, which rose by 7.8% this year. Unfortunately, this rise of 7.8% bears no relation to the 100, 200 or 300% rises in many bills. This is because most of the rises were due to the huge increases in individual charges (such as surface water drainage). This situation is regrettable and has led to the impression that businesses in some areas have been misled about the real rises they could expect in water charges.
Roles and Responsibilities

Recommendations:

1. A redefinition is required of the Roles and Responsibilities of the Water Industry Commissioner, Scottish Water, the Water Customer Consultation Panels and the Scottish Executive.

2. The Scottish Executive, in its role as arbiter, must have ultimate responsibility for ensuring a fair, efficient and value for money water service.
   - There is a need for clarity on the roles of all those involved in water industry; the Water Industry Commissioner, Scottish Water, the Water Customer Consultation Panels and the Scottish Executive.
   - This is most acute in relation to representing the interests of the consumer. This is primarily the job of the Water Industry Commissioner, yet as the economic regulator his actions may run contrary to the interests of the consumer, the move towards fixed charges, for example. Increasingly, the interests of the consumers are represented by the Water Customer Consultation Panels, though they do not deal with individual complaints.
   - In addition, we have found the tension between Scottish Water and the Water Industry Commissioner unhelpful when attempting to elicit the reasons for this year’s price rises and the likelihood of any change in the future. Indeed, it has become difficult to ascertain exactly who has the responsibility (or ability) to make changes, with a degree of “buck-passing” taking place.
   - We accept that it is not the role of the Scottish Executive to intervene in the day-to-day running of Scottish Water. It is, however, important that the Scottish Executive takes the lead in being accountable for an efficient and efficient and fair water industry.
   - We are concerned that this confusion has hindered attempts to resolve current issues and that it may be difficult to move on without a clarification of roles and responsibilities.
Dear Alan

Response to the Finance Committee

Further to your letter of 15 August, I am pleased to provide the following response to the points raised by The Scottish Executive’s Finance Committee in their letter of 26 June 2003. I understand that you will co-ordinate all the responses to the Finance Committee’s request and attach my response as an annex to that prepared by Scottish Water.

- A statement of the current position of the industry in Scotland: my report “Drinking Water Quality in Scotland 2002” will be published in October 2003. This will show the level of compliance in 2002 with the drinking water quality standards. The calendar year 2002 was characterised by very poor weather in the summer and autumn. The number of occasions when disruption of water treatment processes was caused by weather illustrated the current vulnerability of Scottish Water assets to such conditions. One aim of the investment programme is to create assets which are robust to the normal challenge of this sort.

- A statement of comparison with the operating position of other water utilities in the United Kingdom: Scottish Water has procedures and protocols in place, or in preparation, that will be in-line with best practice elsewhere in the United Kingdom. However, these procedures and protocols have not yet been uniformly rolled out across Scotland. There is still a significant amount of work, including staff training, to do in this respect.

- A statement on future strategy covering long term development plans: this is a matter for Ministers and the Scottish Parliament, not for the Drinking Water Quality Regulator. I am of course involved in the Quality and Standards III process that will determine Scottish Water’s investment priorities over the period 2006-2013.

- A statement on constraints on the industry and strategies for meeting the concerns of consumers: EC Directive 98/83/EC on the quality of water intended for human consumption is very prescriptive and sets down standards for drinking water quality in Member States. Compliance with aesthetic standards may address concerns of consumers but very often improvements in drinking water quality do not relate to parameters which consumers can detect, and are therefore not immediately obvious. Many of the quality standards relate to reducing risk from long term exposure.
• **Charges and the charging regime**: this is not a matter for the Drinking Water Quality Regulator.

• **The impact of the “middle” investment option for Quality and Standards**: the middle investment option did not allow for any further deterioration in Scottish Water’s assets. However, there is still a significant backlog of under-investment that needs to be addressed. The condition of Scottish Water’s assets still varies hugely between sites. The poor performance of some assets arising from age or design continues to represent a high risk of failure to meet regulatory standards compared with the best performing assets. Many projects aimed at levelling out such inequality were not included in the Quality and Standards II middle option.

Yours sincerely

TIM HOOTON
9. FORUM OF PRIVATE BUSINESSES
10. SCOTTISH TRADES UNION CONGRESS
11. WATER CUSTOMER CONSULTATION PANELS
Professor Alan Alexander  
Chair  
Scottish Water  
Castle House  
6 Castle Drive  
Carnegie Campus  
Dunfermline  
KY11 8GG  

21st August 2003.

Dear Professor Alexander

Response from FPB Scotland for Scottish Parliament Finance Committee

The Finance Committee asked for the views of nominated organisations (including ourselves) to be added to an agreed statement on the current state of the water industry in Scotland. We fully support the Committee’s decision to do this.

Our response to that is as follows:

A. The constitutional position of Scottish Water
The main problem as we see it is as the way that Scottish Water is constituted, as neither the Scottish Executive nor the Parliament has any real control over your operation and pricing policies.

Business organisations that opposed the possibility of privatisation of Scotland’s water in the early nineties, did so for two reasons, namely:

a) Water was believed to be cheaper in Scotland and privatisation was reported to have resulted in further price increases in England and Wales.

b) We should maintain public accountability

The recently published research project prepared by Heriot-Watt University for the Water Customer Consultation Panels shows that, for SMEs, water costs between 2 and 3 times that in England and Wales. So the first reason is now clearly invalid.

The second point clearly no longer applies, as Scottish Water is, in effect, no longer accountable to the public through normal democratic means. Most MSPs tell us that they have been inundated with complaints from their small business constituents and they are trying to do something about it through normal parliamentary procedures and they are powerless to do anything about it. We see that as a democratic deficit.
C. Finance
The first concern arises from the report for the Water Customer Consultation Panels prepared by Heriot-Watt University. Small businesses pay 2½ times their counterparts in Wales and medium-sized businesses pay 3 times as much. As an organisation representing privately owned small and medium-sized enterprises (SMEs) this causes us major concern.

A major part of that are the inherited debts from the old water boards. These were written off in England and Wales on privatisation. It is unfair that, in Scotland, the consumer should pay these off at all and especially over such a short period.

Many of the increases to the smallest water users are unjustifiable and we believe that is because of the imposition of a high fixed charge, much higher than the rest of the UK.

We therefore recommend that present increases should be ‘capped’ to 100%. This will cost £4.1million.

D. Public perception
The public perception of Scottish Water is poor and recent media focus on price increases has done little to enhance that. On the whole, the media has only reported the truth – much of it fact given by business organisation like ours. Spin doctoring will do little to counter that, but tackling the unfairness of some water bills could help.

Some of the media ‘flack’ has been directed at the Scottish Executive and we believe that also is justified in view of what we have said in section A, above.

However, to announce bonuses for staff and then Directors was the height of folly from a PR point of view. We believe that editorial comments were perfectly justified as much of that money could have appeased some of the biggest increases to the smallest businesses (see C, above).

In conclusion, step in now to apply the same generosity to your customers as you have to your selves and your staff. We suggest that present increases should be ‘capped’ to 100%. This will cost £4.1million and the good publicity resulting from that will be well worth it.

We realise that some of what we have said may well contradict what you are saying but we can only represent the views of Scottish SMEs in this matter.

Yours sincerely

Bill Anderson
Campaigns Manager
FPB Scotland

Copy: Finance Committee
GS/PW

4 August 2003

Professor Alan Alexander
Chair
Scottish Water
Castle House
6 Castle Drive
Carnegie Campus
DUNFERMLINE KY11 8GG

Dear Professor Alexander

SCOTTISH WATER

Please find attached a copy of the STUC’s Evidence to the Scottish Parliament’s Finance Committee on the Water Industry in Scotland.

I trust that our comments will be of assistance.

Yours sincerely

Grahame Smith
DEPUTY GENERAL SECRETARY

Enc
Water Industry in Scotland
STUC Evidence to Scottish Parliament
Finance Committee

Introduction

The STUC is Scotland's Trade Union Centre. It exists to provide services for 46 affiliated trade unions and 32 trades union councils, representing 630,000 trade union members. Its purpose is to coordinate, develop and articulate the views and policies of the trade union movement in Scotland, reflecting the aspirations of trade unionists as workers and citizens.

The STUC welcomes the Finance Committee Inquiry into the Water Industry in Scotland. In recent months there has been considerable comment on the state of the industry in Scotland. Much of this comment is based on a limited understanding of the industry and the scale of the challenges facing it, often resulting in absurd solutions being proposed. This has done little for the morale of staff in the industry who are attempting to patch together a service with fewer staff than ever before, and ill serves the public who have the right to access high quality, efficient water and sewage services.

In preparing this paper, the STUC has sought the views of the trade unions representing staff employed in Scottish Water (UNISON, GMB, TGWU and Amicus), and has drawn on STUC policy on the water industry developed over a number of years. Central to our policy on the water industry is that it should remain publicly owned and accountable.

Structure of the Industry

The decision to merge the three Water Authorities into a new public corporation called Scottish Water was not universally welcomed by the trade unions. The decision was made with only limited consultation and appeared to be driven more by the need to harmonise water charges in light of significant increases in the NOSWA area, than the interests of the Industry as a whole. Although recognising the rational behind the creation of Scottish
Water as a means of combating the consequences of the Competition Act, our main reservation, which was confirmed in the Executive’s initial consultation, was that the disruption caused by a large scale reorganisation would distract management focus from the key issues facing the industry.

As with any large scale re-organisation the disruption has been every bit as great as we warned. New structures have taken time to settle down and have had to be implemented at the same time as substantial staffing cuts. We warned at the time that such a reorganisation would take at least two years to bed down and experience has proved that estimate correct.

During the limited consultation other organisational solutions were considered including privatisation and mutualisation. Recently these options have been proposed again exploiting concern over higher water charges. The STUC remains of the view that privatisation offers no solution to the challenges facing the industry. That view is supported by the experience of water workers and water users South of the Border. Ironically it is the partial privatisation of Scotland’s water through PPP/PFI schemes that has led to higher costs and a fragmented service. Mutualisation was also rejected by the trade unions on the grounds that a mutual solution in a capital intensive industry like water is simply privatisation with the façade of public involvement.

Whatever the reservations at the time Scottish Water was established, there is absolute unanimity amongst the water trade unions and within the STUC generally that the current structure is the only practical way forward. Whilst we recognise the problems, the corporation has to be given an opportunity to work and a further reorganisation is unthinkable.

Whilst we see no case for a change to the structure of the Water Industry in Scotland that does not mean that Scottish Water cannot be improved. In our evidence during the Parliamentary stages of the Water Industry (Scotland) Act we argued that the corporate governance provisions of the Act were very limited. We remain of the view that these could be strengthened.
Finance

The financing of the Scottish water industry is highly complex and not helped by the availability and presentation of published data. This is reflected in public understanding, particularly when charges increase. This understanding is not helped by exaggerated claims by special interest groups many of whom have benefited from years of very low charges.

The core of the issue is the need to finance a major upgrading of water and sewage systems. This was addressed in 2001 through the *Water Quality and Standards 2002-2006* consultation and later that year in the Water Industry Commissioner's epic (600 page) 'blue book' *Strategic Review of Charges 2002-2006*.

As was indicated in the water unions 2001 submission to the Water Quality Standards consultation, it is important to start by considering the state of Scotland's water and sewage services. Significant progress has been made in recent years in reducing pollution of Scotland's rivers, lochs, estuaries and coastal waters. However, there is still significant pollution of Scotland's water environment and in particular substantial investment is needed in the underground infrastructure to reduce the pollution incidents that appear after heavy rainfall. In addition, much of the infrastructure is now very old and there is insufficient data on the actual state of much of these facilities. It is inevitable that after years of patch and mend, a substantial backlog of investment exists, particularly in the underground infrastructure.

There is a widely held subjective view that Scotland benefits from high water quality. Unfortunately, the objective evidence does not support this view. Whilst there have been fewer breaches of the Water Quality Standards in recent years the quality of water compares unfavourably with many regions in England. Cryptosporidium and the by-products of disinfection are particular threats along with prolonged exposure to lead from lead communication pipes serving individual properties.
In addition to safety, underground water and sewerage systems are increasingly in need of replacement causing water bursts and low water pressure. Leaking or even collapsing sewers are a major problem particularly for those directly affected. Water leakage has been a major focus of attention south of the border and significant progress has been made in many areas there. Probably due to the abundance of rainfall, this has not been perceived as an issue in Scotland. However, all water has to be treated and therefore there is a real cost to water leakage. There is some anecdotal evidence that this problem is not limited to older pipes and poor installation of new systems may also be a contributory problem.

In essence Scotland has a patchwork of different water and sewage systems much of which is in need of replacement. There is no comprehensive data and real knowledge remains mostly at local level, dependent on the expertise and knowledge of staff, including those who have retired! Expensive data collection systems of the type which exist in other utilities have, probably correctly, never been viewed as a priority.

In 2001 we indicated that it is difficult, given the limited information in the consultation paper, to reach an informed view on the best option for investment. There was very little detail on how the investment would be deployed and the cost benefit analysis was to say the least somewhat speculative. Since then the cost of delivering schemes has risen well above the rate of inflation driven at least partially by a tightening construction labour market. Expertise has also haemorrhaged from the industry due to staffing cuts.

The investment options are based on an assumed constant public expenditure impact. This means that no additional public money was going to be put into the water industry and therefore the costs would largely have to be met by water charges. It is important to recognise that the Scottish Executive has reduced the real level of expenditure on the Scottish water industry in recent years. Given the decades of under-investment in the Scottish water industry, there is a case for significant public investment to at least bring Scotland up to levels achieved South of the Border. 25 years of additional investment and most importantly the cancellation of debt at the time of privatisation have benefited water consumers in England and Wales.
In 2001 we argued strongly against the minimum option set out in the paper. Simply patching and mending the existing infrastructure is a poor use of resources and would pass on the problem to future generations. We also doubted this level of investment would achieve the minimum legal standards. The enhanced option was attractive to staff within the industry and would have benefited customers as this would have enabled serious inroads into the backlog of investment and begin to provide Scotland with a modern water and sewage system. However, unless there was additional public expenditure such a programme would have had an even bigger impact on the level of water charges. This would inevitably lead to consumer resistance and the loss of public support for the industry. In addition, due to staffing cuts, we doubted if this level of investment could be delivered. This would lead to further expensive and inefficient use of contractors and/or further use of PPP/PFI schemes, the additional cost of which would have to be borne by the water consumer. Increased charges for non-domestic customers would inevitably make off-network schemes more attractive which, coupled with the impact of the Competition Act, could result in a loss of revenue. Due to the fixed costs of the water and sewerage system the loss of non-domestic customers will have to be met by the poorer domestic and small business consumer. Many of these predictions have turned out to be alarmingly accurate.

We therefore supported the central option, or a version of it, as probably the best intermediate solution for the Scottish water industry. It would provide significant investment to repair the existing infrastructure and begin to make an impact on the major problems identified above.

The investment options in the consultation paper did not specify how this investment was to be delivered or financed either by conventional public borrowing or through private finance. The Scottish water industry had been a major bonanza for companies involved in the Private Finance Initiative. £654 million of capital value had been made available through ten PFI schemes across Scotland. The companies concerned were making significant returns on capital invested well above the cost of public borrowing. This additional contribution to their profits was being financed by water consumers through higher charges. Since 2001 it has become apparent that water PFI schemes have been a dismal
failure with a string of problems. As a consequence no new schemes have been started. However, there has been a use of looser Public Private Partnerships (PPP) with their attendant costs. Not only is all this poor value for money, it also contributes to the gradual privatisation of the industry.

The latest private sector involvement has been the creation of Scottish Water Solutions. This is a joint venture between Scottish Water, Stirling Water and United Utilities to deliver the investment programme. Given the loss of in-house capacity the trade unions have supported this initiative and all staff will remain employees of their respective organisations. As with PFI many of these solutions are largely driven by public expenditure rules in relation to off-balance sheet financing, minimising the impact on the Executive's block grant. These Treasury rules are in need of reform to avoid solutions driven by accountancy conventions rather than the needs of the industry.

**Water Charges**

Much of the current public interest in Scottish Water has stemmed from recent increases in water charges. Headlines trumpeting 500% increases may make good copy or promote a political point, but they do not reflect the experience of most water charge payers.

It is certainly the case that water charges have increased significantly over recent years and will continue to increase over the period of the current review to 2006 and in our view well beyond. In simple terms the long overdue investment programme has to be paid for. There are two main options. The cost is either met by the water charge payer or by the general taxpayer. If it is to be the latter then other public expenditure programmes on the Executive's priorities (education, health etc.) have to be cut back or Government revenue increased. Whilst we have consistently opposed cuts in Executive support to the water industry we do recognise that it is unlikely that additional elements of the block grant will be allocated to water.

Whilst we accept that charges have to rise we would argue that they are rising faster than necessary due to the structure of charging proposed by the Water Industry Commissioner (WIC). Many of the headline increases are caused by harmonisation of bills across the former water authority areas. The WIC insisted that
harmonisation be introduced in one year rather than phasing the increases over several years. Similarly, he recommended increasing the standing charge element, again without sufficient phasing. The impact of these changes has been significant, particularly for non-domestic customers, creating considerable resentment. Whilst many of the original charges were ridiculously low (hence the headline increases) it would have been sensible to phase the changes. It is also worth investigating the impact of the surface water drainage charge on bills.

The key issue driving future water charge increases is the treatment of debt. The WIC has recommended that the cost of investment should be funded from customer charges. This means that by 2006 Scottish Water will have funded current debt and future investment will have to be met again by current customers resulting in further year on year increases. The investment programme should not be entirely funded by current customers, as there are long-term benefits. It therefore seems sensible (as other organisations do) to retain a reasonable level of debt in the corporation. Of course conspiracy theorists would argue that this policy is a deliberate attempt to make Scottish Water an attractive proposition for privatisation in 2006.

**Regulation**

In our view the WIC has become part of the problem facing Scottish Water rather than contributing to the necessary solutions. His approach to water charges as set out above reflects an attachment to economic theory rather than a grasp of the realities on (or in this case under) the ground.

Much of his considerable output is focussed on comparisons with the water industry in England. We believe this is unhelpful and confusing to the public as the two countries have very different water and sewage industries.

There are structural differences in relation to the large numbers of small treatment plants in Scotland, our sewers are closer to properties and of course we have a massive coastline. To compound these differences the level of investment has been very different. The English industry has benefited from £50 billion of investment over the past 13 years compared with £1 billion in Scotland. Even without debt write off at privatisation and the
essentially different objectives a privatised industry has, these differences make comparisons almost meaningless.

In terms of investment, if there are comparisons to be made they are with England in the 1990's (not today) when water charges increased rapidly to pay for investment. The efficiencies that this level of investment brings have resulted in a very different industry South of the Border and the consequential impact on water charges. However, it would appear that charges in England are likely to rise over the next few years therefore this may well be a one off relief for water charge payers South of the Border.

The WIC suffers from many of the problems facing regulatory regimes in other utilities. This is not the place to expand on the need for regulatory reform although many of the criticisms of these regimes are reflected in the work of the WIC in Scotland.

**Employment**

The trade unions have always recognised that the introduction of more efficient plant and equipment together with new methods of working and the economies of scale Scottish Water brings, would result in job losses. The debate has been around the scale of the losses and the speed of change.

In 2001 there was around 6,000 staff employed in the industry. At that time we estimated that the scale of financial cuts recommended by the WIC would result in the workforce being reduced by about a third to 4,000. At the time we were accused of scaremongering. On the basis of Scottish Water’s current plans the workforce will be cut to around 3,200 by 2,006. That is almost half the 2001 workforce. If the WIC’s proposals are implemented that figure could be even greater. Far from exaggerating the cuts we could now be accused of complacency!

Apart from the economic and social impact of job losses on this scale, often in small rural communities, there are very real implications for safety and customer service. Most of the staffing cuts have happened before capital investment has been introduced and therefore it is inevitable that safety is compromised and customer service reduced. It was somewhat ironic that having implemented the WIC’s cuts he then criticised Scottish Water for
having insufficient capacity to respond to last summer's cryptosporidium scare in Glasgow.

As with similar cuts in other utilities the first staff to leave the industry has been those with long service and experience. In an industry that does not have well established data capture this knowledge is irreplaceable. It is not unusual for staff to be contacted years after they retire. The fatal consequences of similar cuts in the gas industry are now well understood. We should learn from previous mistakes in the Scottish water industry.

Employees within the industry should be recognised as it's strongest asset. Good employment practice is at the heart of the delivery of high quality public services. High quality, efficient and effective water and sewage services, will best be achieved by a well resourced, motivated, trained and rewarded workforce, with extensive opportunities to influence decisions about the development of the industry.

Conclusion

The key points in our evidence are as follows:

- The Scottish water industry must remain publicly owned and accountable.
- As anticipated the creation of Scottish Water has resulted in disruption to the industry. However, whatever the reservations at the time the structure now needs to be supported and given time to work.
- Scotland's water and sewage infrastructure is in need of major investment to a level probably in excess of the current plans. However, the 'central option' is a reasonable compromise between infrastructure requirements, industry capacity and cost.
- The cost of upgrading the infrastructure is significant and can only be met by water charges or from the block grant. Given the Executive's priorities it is unlikely that they would be prepared to divert funding from education, healthcare etc to the water industry or to increase the revenue available for distribution. That is not however, justification for reducing grant support.
- Charges have risen faster than necessary due to the WIC's charging structure. In particular, harmonisation, standing charges and the treatment of debt.
• The WIC's comparisons with the industry in England are meaningless.
• The scale and pace of job losses has exceeded trade union estimates and is unsustainable if we are to maintain acceptable levels of safety and customer service.
• High quality, efficient and effective water and sewage services, will best be achieved by a well resourced, motivated, trained and rewarded workforce, with extensive opportunities to influence decisions about the development of the industry.

The problems facing the industry are considerable but not impossible to resolve given time. The key requirement is a more realistic financial framework rooted in the realities of the water and sewage infrastructure in Scotland, not economic theory or false comparisons with England.
Professor Alan Alexander
Chair
Scottish Water
Dunfermline

21 August 2003

Dear Professor Alexander

Scottish Parliament Finance Committee

I refer to the Finance Committee’s request to us, and other organisations, on 27 June for information and views on the position of the water industry in Scotland. The Convener and Members of the Customer Panels have finalised their six page submission to the Finance Committee and I now enclose it for the attention of Scottish Water and inclusion as an annexe to the papers for the Finance Committee, as sought by the letter of 12 August from the Convener Des McNulty MSP.

I have copied this to David McGill, Clerk to the Committee, and also to the Water Services Unit of the Scottish Executive. Our papers are public documents and we shall arrange to place this on our website and share it with Members of the Parliament, and with representative organisations who share our consultation work on behalf of customers.

Yours sincerely

Graeme Smith
Manager

Enclosure
Water Customer Consultation Panels

Information for the Scottish Parliament Finance Committee

The Scottish Parliament enacted the Water Industry (Scotland) Act 2002 bringing to existence the five Water Customer Consultation Panels across Scotland. The Minister for Environment appointed the Convener of Panels Ian Smith, most recently Local Government Ombudsman. The full memberships of the Panels started on 1 February 2003. The Panel areas and members are listed in Annex 1.

The Panels, representing household and business customers generating £1bn revenue to Scottish Water, are the first utility consumer organisation created by MSPs and are independent of Scottish Water and other agencies.

The Panels functions are to

1. represent the views and interests of the customers of Scottish Water, and each Panel must make
2. reports and recommendations on any matter they consider relevant to the interests of customers.

In addition to meetings with Scottish Water to date there have been 22 evening meetings with household customers, business customers, and community bodies; and a similar number of afternoon meetings with local authorities, business organisations and community organisations. Full minutes of the meetings, customer topics and issues, and research in progress are openly available on the Panels website www.watercustomer.org.

- United Kingdom comparison

1. Much has been stated recently of comparison with water and sewerage providers in England & Wales, where companies have had twice the timescale available to modernise and comply with new standards. The Panels affirm customers requirements, and those of the UK Better Regulation Taskforce, that open assessment of probable impacts on customers of likely policies, strategies, and timescales should be quantified, and be the subject of early and frequent consultation with those likely to be affected prior to decisions being made. The application of best practice should also be carried out and compared on a level playing field. In this respect it is significant to note that English & Welsh providers have the benefit of their loan debt being extinguished at commencement, and the additional benefit of a “green dowry” from government of £5bn cash. Customers also expect a level playing field and best practice in the UK to be applied to the principles of charging for water and wastewater services.
• **Strategy, development and the wider economy**
• **Constraints and strategies for meeting consumers concerns**

2 Openness, information, and consultation are also pivotal to the series of bullet-points from the Parliament Finance Committee. The Customer Panels have commissioned research from experts based at Heriot Watt University and Stirling University which will form the bases of public reports by the Panels in the coming weeks and be shared with MSPs, Scottish Water and interested organisations. This includes a report on “Openness in Scottish Water” by Dr David Miller and associates at Stirling University that will emphasise the need, and benefits, of being more open and pro-active and less secretive and reactive. Scottish Water has expressed interest in receiving the report at an early date.

3 The Panels look forward to systematic consultation with customers and Scottish Water, and are encouraged by the inclusion in the Act of a Consultation Code, which it may be anticipated will be approved by the Scottish Ministers later this year. The Panels consider that by being open and consultative the new body Scottish Water will be more fully informed and be able to merit the support of customers.

4 Such is the fundamental and strategic importance of water and sewerage to the country’s wellbeing, economy, health and social inclusion that the public (who are customers and owners of Scottish Water) properly expect a range of government ministries, a number of parliamentary committees, Scottish Water and all local government authorities to contribute to and benefit from co-ordinated policy making. Panels expect that all agencies will be committed to aligning strategic, local, and community plans with water and wastewater investment.

5 The merger resulting in Scottish Water has resulted in greater distance between the organisation and its customers, and degrees of dislocation in service and investment. To become closer to its customers, councils and organisations in each of Scottish Water’s four geographical areas Scottish Water must take steps to convince customers of sufficient flexibility at a local level in its investment and operational activities.

6 Fuller and more timely information is required for customers ranging from customer service responses and customer choices; to informing customers as to the source of their water supply, its content and purity levels, and destinations; to the location, purpose and scheduling of new investment which customers are paying for and expect to see in their area.

7 Customers and organisations have expressed concerns over delays and difficulties in obtaining increased service capacity and infrastructure to meet demands. The Panels are aware that Scottish Water wish to address these as fully as they can. However it would appear that the priority of the Water Industry Commissioner when giving Ministers his Strategic Review of Charges for a forward period has been to focus on current infrastructure renewal and new standards and less on ensuring capacity meets new demands and developments. Capacity gaps appear and economic developments are consequently hindered in
rural and fragile remote areas and in complex urban areas. Examples of major areas represented to Panels are to be found in (a) brownfield sites in Lanarkshire, including Ravenscraig which is the largest development site in Europe, and (b) new sites, and difficult sites, in Livingston and district where 18,000 houses are required, including social, affordable housing, schools and community facilities as a consequence of the overheating economy of Edinburgh. The Panels website contains minutes of meetings in Motherwell (4 March 2003) and Livingston (12 March 2003).

- Charges and the charges regime

8 Revenue from customers and capital loans provide the funding for Scottish Water to meet operational and investment expenditure on behalf of customers. Clearly the efficiency of operations and scale and pace of investment influence the amount of funding required. To assist the Panels work on behalf of customers interests the Customer Panels have commissioned a report on the “Principles of Charging for Water and Wastewater” from Heriot Watt University led by Dr John Sawkins of the Department of Economics to discuss the objectives of charging household and business customers, highlighting those principles which should underpin charging policy, reviewing charges in Britain in the light of these principles, and making recommendations in the light of the research.

9 Scottish Water have expressed especial interest in this body of work, stating on 17 July 2003 they are “willing to take part in any consultation with key stakeholder groups on the principles of charging for water and wastewater services.” The report will be fully published and addressed to MSPs and Scottish Water, who have statutory responsibility for charging policy, most notably under s29 of the Water Industry (Scotland) Act 2002 which states:

Scottish Water may fix charges...... and may adopt such methods and principles for the calculation and imposition of charges as appear to it to be appropriate.”

10 In 1990 the Director-General of OFWAT conducted a full and early public consultation in England & Wales into the methods of charging and structure of tariffs, and thereafter encouraged universal principles which command public support and understanding. In 2003 the OFWAT approach to the principles of charging was further endorsed by WaterVoice (the water customers representative body in England & Wales) in its response to a national Discussion Paper on sustainable water charging policy. No similar public consultation nor national discussion has yet taken place in Scotland. The Panels look forward to fully participating in the public consultation which is required.

11 Regarding the levels of charges, which are best discussed once there has been full consultation on the principles, it is clear that recent large increases and introductions of major standing charges are not acceptable to customers, small, medium and large. The practice of capping charges for groups of customers is not new and is a recognition of reality required. The Minister has capped increases for households in the West and East of Scotland at +9%, and 0% for
the North. There is a +15% cap in place for trade effluent customers. However there is no charges cap for business customers.

12 The Panels are encouraged by the statement by Scottish Water on 17 July 2003, which further states that “Scottish Water is aware of customers concerns about charges and we are already planning to consult customers on charging issues in August.” The Panels look forward to participating fully in consultation in the required months.

13 The Finance Committee will wish to be aware of the timetable in England & Wales for considering annual schemes of charges, which like Scotland come into effect for billing from 1 April each year. The full timetable for 2003/04 illustrates the months of consideration. A summary from Ofwat’s website www.ofwat.org.uk publicly issued document RD24/02 dated 28 August 2002 is as follows:

2002
Mid September Ofwat issues letter to providers on policy review work
4 October Providers submit draft charges schemes
Mid Oct to mid Nov Meetings/correspondence with providers
4 November WaterVoice Committees provide comments on drafts
6 December Ofwat issues letters with written comments on drafts
2003
7 January Clarification of any outstanding issues
14 January Providers submit final schemes
14 February (or earlier) Ofwat issues letters of approval

14 “Water-poverty”, which is akin to fuel-poverty, is of continuing and growing concern, shared by Scottish Water and the Parliament. The Panels have commissioned a report on “Affordability of Water Charges in Low Income Households” from Heriot Watt University. This is presently being shared with Scottish Water and community bodies to receive further information and understanding of the numbers and types of households who are unable to pay water charges, because of no or low incomes. The final report will be fully published and addressed to MSPs. The Scottish Executive introduced a transitional reduction scheme to assist in this area in 2001, but unless renewed or replaced by other means of assistance even this modest scheme will cease on 31 March 2004.

15 Related to the same concept of affordability to households is the need for charge reliefs for small charities and community groups. The current exemption scheme developed in conjunction with the Scottish Executive would benefit from review of experiences to date, not least that if a charity moves to different premises from the premises known to Scottish Water in 1999 the exemption does not move with them.
• Impact of investment selection

16 The Quality & Standards investment planning chaired by the Scottish Executive would benefit in scope and national application from open and early consultation with customers, government ministries, local authorities, business organisations and social organisations. No mechanism exists at present to do this, but the Customer Panels can assist in providing suitable mechanisms in each area.

17 In any plan period it is possible to have greater project detail in the earlier years but insensible to attempt similar project detail in years further out. It is also important to recognise the need for flexibility to meet changing needs and area priorities.

18 Customers would expect and understand a split of around 60%/40% in investment planning where 60% was for renewal and new standards compliance 40% for new capacity and new developments to support national economic and social development.

19 The consideration of investment options nationally and over years depends crucially on the reasonableness and availability of customer revenue and of long term capital loans. It is noteworthy that in England & Wales capital loan funding supports about 35% of capital investment by water and wastewater providers, the remainder being from customer revenue. The percentage of loan funding is likely to increase in future years.

20 The Panels are encouraged by the Minister for Environment’s letter of 21 August 2001, commissioning the Strategic Review of Charges 2002-2006 (to set revenue caps), in which he stated the availability of public capital loans of around £1.2bn for the four year period, approximately £300m each year. Customers will want to know what public loans will be utilised or not utilised.

21 Customers need to know the practical consequences of the Scottish Executive Coalition agreement published in May 2003, titled “A Partnership for a Better Scotland”, which states in section 4 “We will support Scottish Water with the resources necessary to invest in our public water and sewerage services so that they meet health standards.”

22 However within the resultant Review of October 2001 the Water Industry Commissioner projects use of less than half of that loan debt funding (Financial Models page 404, totalling £516m for the four years to 2005/06), and asserts a projection of no loan funding thereafter. This scenario would put Scotland and its customers at a major disadvantage compared to England & Wales.

The Convener and members of the Customer Panels will be pleased to provide further information, and meet the Finance Committee as required.

The Water Customer Consultation Panels
www.watercustomer.org

Water Customer Consultation Panels
Annex 1

5 Water Customer Consultation Panels

Orkney, Shetland & Western Isles
Population: 68,000
Orkney, Shetland, Comhairle nan Eilean Siar

North West Scotland
Population: 387,000
Highland, Moray, Argyll & Bute

North East Scotland
Population: 1.2 million
Aberdeen, Aberdeenshire, Angus, Dundee, Perth & Kinross, Fife

South East Scotland
Population: 1.2 million
Edinburgh, East Lothian, Midlothian, West Lothian, Falkirk, Scottish Borders, Dumfries & Galloway

South West Scotland
Population: 2.3 million
Glasgow, East Dunbartonshire, West Dunbartonshire, Inverclyde, Renfrewshire, East Renfrewshire, North Ayrshire, East Ayrshire, South Ayrshire, North Lanarkshire, South Lanarkshire, Stirling, Clackmannanshire

The Convener, Ian Smith, is a member of each Customer Panel.

South West Scotland
Margaret Seymour, Councillor Eric Gotts, Tom McClements, Helen Millar

South East Scotland
Dr John Sawkins, Heather Brash, Councillor Willie Anderson, Clare Wells

North East Scotland
Councillor Yvonne Allan, Mary Longhorn, Councillor Rob Murray, Jack Lord

North West Scotland
Jim Cockburn, Councillor Len Scouller, Jhanna Dundas, Councillor David Chisholm

Orkney, Shetland & Western Isles
George Eunson, Councillor Donald Nicholson, Bobby Hunter
26 June 2003

Dear Professor Alexander,

SCOTTISH WATER

At its meeting on 24 June, the Finance Committee agreed to write to various organisations in order to establish the current position of the water industry in Scotland. The intention is to receive a position paper setting out an agreed statement on the current state of the industry in terms of budgetary matters, infrastructure provision and future development strategies. More detail is provided below.

I would be grateful, therefore if you would co-ordinate the production of such a paper among the bodies listed in the annexe. I am writing to those organisations to secure their involvement in the paper and enclose a copy of the letter for your information. I suggest that a draft of the paper be circulated as early as possible to allow for the submission of an agreed statement to the Finance Committee on or before 15 August.

The particular information that the paper should cover is:

- a statement of the current position of the industry in Scotland. This should be a factual statement detailing the current operating position of Scottish Water in terms of finances, employment issues, infrastructure, Executive funding, borrowing powers, current borrowing position and the cost of capital. It would be helpful if the cost of borrowing information includes any commitments that are off balance sheet;

- a statement of comparison with the operating position of other water utilities in the United Kingdom including any agreements on best practice;
• a statement on future strategy covering long term development plans and contribution to the wider economy; and

• a statement of constraints on the industry and strategies for meeting the concerns of consumers

• charges and the charging regime, looking at the treatment of domestic, commercial and industrial customers

• the impact of the selection of the “middle” investment option for Quality and Standards on new economic and social development projects; and preliminary views of the key issues that will arise in Scottish Water’s consultation on Quality and Standards 3.

Ideally this exercise should involve a plenary session with as many of the other nominated organisations as possible (or bi-lateral meetings where that is not possible) and the consolidation of the individual inputs into a single document that addresses the above points.

However, in the event of their being no consensus on any particular aspect of the remit, a statement from any of the organisations expressing their viewpoint should be submitted.

The overall objective is twofold:

1. To give the Finance Committee a clear view of the current reality and the constraints facing Scottish Water, and

2. To generate a much higher level of understanding on the part of all the participants about the different issues facing each of the organisations involved in this exercise.

In the meantime, if there is anything you wish to discuss before setting the above in motion, please contact the Clerk to the Committee (David McGill, 0131 348 5215 or david.mcgill@scottish.parliament.uk) to whom this letter is copied.

Yours sincerely

[Signature]

Des McNulty
Convener, Finance Committee
Organisations to contribute to joint statement

Water Industry Commissioner
Scottish Council for Development and Industry
Confederation of British Industry Scotland
Federation of Small Businesses in Scotland
Forum of Private Business
Scottish Trades Union Congress
COSLA
Water customer consultation panels
Drinking water quality regulator
Communities Scotland/peak construction industry body
21 July 2003

Mr Des McNulty, MSP
Convener
Finance Committee
The Scottish Parliament
Edinburgh
EH99 1SP

Thank you for your letter of 26 June about your committee’s decision to seek information on ‘the current position of the water industry in Scotland’. Scottish Water is happy to assist the Committee in all appropriate ways. It may, however, be helpful to the Committee if I were to set out some basic points.

First, much of the information that is described in the bullet points in your letter is already available in the public domain. My colleagues here will be happy to work with the clerk of the committee to identify and provide the necessary documentation. I am thinking here of such documents as, annual reports, water quality reports, schemes of charges, the WIC’s Strategic Review of Charges, Scottish Executive directions to Scottish Water.

Second, it is likely that some of the areas on which you seek information will impinge upon policy areas that are properly the preserve of the Scottish Executive as ‘owner’ of Scottish Water. It would clearly be inappropriate for Scottish Water to comment on such matters and it will be important for us to work with the Clerk to identify those matters upon which questions should be directed to the Scottish Executive.

I think that it would not be appropriate for Scottish Water to ‘co-ordinate’ the production of an agreed paper. Given the public positions that have been taken by many of the organisations listed in the annexe to your letter and the statutory responsibilities of others, this does not strike me as either an appropriate or as a potentially productive way for the Committee to proceed. Agreement to a single document would be very difficult to achieve. If it were achieved, the document would be likely to be so bland as to be unhelpful. I believe that it would be much better for the Committee to seek individual submissions from the various stakeholders.

We will be happy to discuss the points raised here with you or, if it would be more appropriate to do so, with the Clerk.

Yours sincerely

Professor Alan Alexander
Chair

SCOTTISH WATER
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KY11 8GG

Customer Helpline
T: 0845 601 8855
F: 01383 848323
W: www.scottishwater.co.uk
E: customer.service@scottishwater.co.uk
Dear Alan,

Thank you very much for your letter dated 21 July in which you express reservations regarding the Finance Committee's request that Scottish Water collate responses from a variety of stakeholders on the current position of the water industry in Scotland and sought further clarity on our requirements.

As one of the mandatory Committees of the Scottish Parliament, the Finance Committee has a well-recognised role in considering and reporting on any matter relating to or affecting the expenditure of the Scottish Administration. It is therefore entirely competent for the Finance Committee to ask questions of both Scottish Water and the Scottish Executive in relation to the way in which public funding is spent.

It was with this in mind that I wrote to you on 26 June seeking your co-operation in collating a position paper which would further aid the Committee's understanding of the issues surrounding the water industry in Scotland. Because of pressure of the Committee's time we had decided in June not to undertake a full Parliamentary enquiry at that stage but sought instead to enlist the co-operation of Scottish Water and a number of key bodies in identifying the major issues currently affecting the industry and its key stakeholders.

It is in the public interest that both Scottish Water and the Scottish Executive are held accountable and I believe the Finance Committee has been reasonable in its request to Scottish Water on 26 June. Indeed the initial response from Scottish Water focused on the timescale for completing the exercise and the Committee Clerk, in consultation with myself, agreed to more time to permit the exercise to be completed by yourselves and the other bodies concerned.
I note in your letter that you have concerns that some of the areas which we seek information on would impinge upon policy areas that are properly the preserve of the Scottish Executive as 'owner' of Scottish Water. I recognise that it is not for Scottish Water to answer for the Scottish Executive on these issues. In the interest of transparency though, I would suggest that in your response you identify which issues are for the Scottish Executive and we will pursue those issues with them.

I appreciate that the areas where there is consensus between Scottish Water and the other organisations we have approached may be limited. However even this outcome would be informative to the Committee and we would certainly want to be able to more clearly identify those areas where there are differences of view. You may wish to include the other organisations' submissions as annexes to your position paper should their views be widely divergent from those of Scottish Water.

I believe that the Committee's request that Scottish Water collate responses on the position of the water industry in Scotland is reasonable and I look forward to your cooperation in this matter.

Yours sincerely

E. Beeley

[Signature]

P. Convener