TRANSPORT AND THE ENVIRONMENT COMMITTEE

AGENDA

5th Meeting, 2001 (Session 1)

Wednesday 14 February 2001

The Committee will meet at 9.15 am in Committee Room 1, to consider the following agenda items:

1. **Water Inquiry (in private):** The Committee will consider possible lines of questioning for witnesses on its inquiry into water and the water industry.

   *Not before 9.30 am*

2. **Items in Private:** The Committee will consider whether to take item 5 in private.

3. **Water Inquiry:** The Committee will take evidence as part of its inquiry into water and the water industry from—

   Councillor Robert Cairns, Jon Hargreaves, Iain Gardner, Jonathan Cape, and Douglas Millican, East of Scotland Water Authority

   Jim Milne and David Reid, Dundee Anti-Poverty Forum

   Sandy Snell, Marybank, Scatwell and Strathconan Community Council

   Ron Hughes and Seumas Macinnes, Braeside and Mannofield Community Council

   Katharine Bryan, Doug Sutherland and Ron McAulay, North of Scotland Water Authority

4. **Increasing the effectiveness of Committees:** The Committee will consider the Conveners’ Liaison Group paper “Increasing the effectiveness of Committees”.

5. **Water Inquiry:** The Committee will review evidence taken at the meeting.
6. **Telecommunications Developments (in private):** The Committee will consider a draft response to the Scottish Executive’s consultation on proposed changes to permitted development arrangements for telecommunications developments.

   Shelagh McKinlay
   Clerk to the Transport and Environment Committee
   Room 2.02, Committee Chambers
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The following papers are relevant for this meeting:

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INCREASING THE EFFECTIVENESS OF COMMITTEES

1. The attached paper sets out the agreed views of the Conveners' Liaison Group on a number of working practices which, if adopted by committees, the conveners believe will increase effectiveness.

2. Whilst recognising that in some circumstances committees will require to meet at least weekly (for example when considering legislation) and that the system of scheduling meetings must be flexible, the Group believe that, where possible, committees should aim to meet on a fortnightly cycle thereby making more time available for work outside the formal setting of committee meetings. This would enable the committees to undertake work by other means including civic participation events and fact-finding visits. It would also enable committee members to act more effectively as reporters and to obtain support from clerking staff when exercising that function.

3. The paper deals with:

- The scheduling and frequency of meetings
- Business planning
- Pre-legislative scrutiny
- The development of best practice amongst conveners.

4. The Committee is invited to consider this paper and agree to adopt these working practices.

ELIZABETH WATSON
INCREASING THE EFFECTIVENESS OF COMMITTEES

Background

1. As can be seen from the first annual report of the Corporate Body, the Committees have played an important and effective role in the work of the Parliament. A total of 117 reports were produced and 352 meetings took place.

2. The Conveners’ Liaison Group has, however, been considering what steps might be taken to make the committees operate even more effectively. The Group has identified a number of working practices which, if implemented, should facilitate the work of the committees and improve further their effectiveness in holding the Executive to account. This paper sets down these working practices for implementation in the committees.

3. Separately, the Group has also identified a number of areas where it considers that Standing Orders should be reviewed and these have been referred to the Procedures Committee who are taking them forward as part of their review of committee operations.

4. In addition, the Group is continuing consideration of whether there would be benefit in a change to the Standing Orders to enable committees to meet at the same time as the Plenary. A further paper on this subject will be brought to the Group at the earliest possible date.

Working practices

Scheduling and frequency of meetings

5. It was agreed that:

- Routine committee meetings should continue to be scheduled for Tuesdays and Wednesday mornings.
- Exceptionally, meetings could be scheduled on Mondays, Fridays and Wednesday evenings, but this should be avoided if possible.
- Further consideration should be given to whether there would be benefit in amending Standings Orders to allow committees to meet at the same time as the Plenary.

6. During the first year of operation, many committees found it necessary to meet weekly to complete their planned work programmes. When handling Bills, it was often necessary to meet more than once a week in order to meet the timescales for completion of stages 1 and 2 agreed with the Bureau.
7. When conducting inquiries, committees have, in the main, obtained the bulk of their information through formal evidence taking sessions during their weekly meetings. Working to this pattern has left little flexibility in the system to allow members to undertake work relevant to the committee outside the formal setting of the committee meetings. This includes work as reporters. The effective use of reporters, supported by clerks could enable a committee to handle a wider range of work and has proved an effective use of members’ time in committees such as the Equal Opportunities Committee.

8. Time is also required to allow members to undertake fact-finding visits. Where these have occurred (for example Justice and Home Affairs Committee members visiting prisons; Local Government Committee members visiting local authorities; Audit Committee members visiting ambulance stations) these have provided valuable sources of information relevant to the subject of inquiries.

9. The Group also saw great benefit in making time to enable committees to obtain relevant information by methods which encourage civic participation such as the “Business in the Chamber” event hosted by the Enterprise and Lifelong Learning Committee and the Open Space event currently being organised by the Social Justice Committee.

10. All these working practices have been difficult to accommodate in the current working pattern and it was recognised that some adjustment to the programme of weekly meetings is required to enable these activities to take place. The Group, however, also recognised that committees would require to continue to hold weekly (or even more frequent) meetings when considering legislation or dealing with matters that were time critical.

11. It was, accordingly, agreed:

   • Committees should, where possible, carry out more work outside the setting of formal committee meetings including fact finding visits and civic participation events.

   • Committee should make more use of reporters, supported by clerking staff.

   • In order to provide sufficient time and staffing resources for these activities, the forward programme of committee meetings should be based on fortnightly meetings.

   • Exceptions should be made for committees handling Bills or other work which requires completion in a fixed timescale and such committees should continue to meet at least weekly.

   • For committees meeting on a fortnightly programme, if necessary short, focussed meetings should be called to deal with subordinate legislation.

   • The forward programme of meetings should be sufficiently flexible to allow any committee to schedule additional meetings to accommodate fluctuating workloads.
Business planning

12. It was agreed that all committees should develop and agree a forward programme with meetings scheduled according to the principles set out above which should take into account all known calls on committee time (for example the allocation of time to consider budget proposals; Bills announced in the legislative programme; SSIs renewed annually). In their planning, committees should be sufficiently flexible to allow priorities to be altered if required.

Pre-legislative scrutiny

13. It was agreed that the pre-legislative phase presented a committee with an excellent opportunity to familiarise themselves with issues arising from a draft Bill or consultation paper. In some cases, it might prove useful to enter into a dialogue with the Executive and to take evidence at this stage. However, the Group also agreed that any work done at this stage should clearly be seen to be at arms length from the Executive and that nothing should be done that might be viewed as collusive. It was important that the committees should maintain their independence and that nothing should impinge on the key role of the committee at stage 1 in scrutinising the general principles of an Executive Bill. The importance of the pre-legislative phase was recognised in terms of gathering information to prepare a committee to deal effectively with stage 1 consideration. In the circumstances, it was not considered appropriate to formalise arrangements for pre-legislative scrutiny or to develop any form of protocol with the Executive.

Conveners awayday

14. It was agreed that there was much to be gained from conveners discussing their experiences with a view to promoting consistency and best practice. A facilitated awayday should be arranged as a first step in this process.

Conclusion

15. The Group is invited to note the areas of agreement outlined above and, where appropriate, to implement these practices in their committees.

Committee Office
10 January 2001
North of Scotland Water Authority

Submission to Transport and Environment Committee – 5 February 2001

Unique Challenge

• We have the largest area, longest coastline yet fewest customers of any water and sewerage provider in the UK. We have more treatment plants and pipework than the other two Scottish water authorities combined.

• Much of our infrastructure is disintegrating and needs to be upgraded urgently.

• Around 65% of the sewage in our area is discharged into the sea with no proper treatment at the moment.

• More than one in ten of our customers are served by small supplies and currently receive an inadequate supply of poor quality drinking water.

Investment

• We have embarked upon a massive programme of investment to improve our infrastructure and provide a better service to all our customers, irrespective of where they live.

• Over a six year period (2000 - 2006) we are investing more than £500 million to clean up beaches and rivers in the North of Scotland. In many places we are providing sewage treatment for the first time but are also upgrading many of our existing plants to meet modern day standards.

• To meet the immediate requirements of the Urban Wastewater Treatment Directive alone, work is complete or underway on 14 different sewage treatment plants round our coasts. In total these plants are worth £426 million. £387 million of this is financed through Public Private Partnership and £39 million through traditional financing methods.

• Again in the same six year period we are spending more than £400 million on providing a safe and reliable supply of drinking water to all our customers by replacing ageing mains and building new water treatment works.

• Last year we completed 15 schemes to improve sewage treatment and 30 schemes to improve water quality. We also laid or replaced 25 km of sewer and 140 km of water main.

• This year we will complete 20 sewage treatment projects and 40 water quality projects. We also plan to lay 30 km of sewer and 140 km of water main.
Charges

• Our charges inevitably have to rise to fund this massive programme of investment.

• Our position is the most difficult of the three Scottish water authorities. We have the smallest customer base and all our services are entirely funded by our charges which is why we have the highest charges in Scotland.

Competition

• We need a level playing field and appropriate regulation so that we as a public body can compete with private companies. The current public ownership model needs to be modified to allow us more flexibility to compete effectively.

• We are already facing competition as there is nothing at the moment to stop many of our customers switching to a competitor. Some of our business customers are already using alternative supplies such as boreholes.

• We need to be flexible in the way we operate to allow us to retain our existing customers.

• We have to be sensible in our approach to new business opportunities. We need flexibility so we can pursue new ventures but only where there is a market opportunity and we have a clear competitive advantage which is sustainable in the long term.

New Look Public Sector Model

• Our aim is to provide a sustainable and dynamic public sector water and sewerage industry.

• We have been involved in a detailed project with our sister authorities to identify opportunities for collaboration to make efficiencies.

• We are determined to meet the tough new efficiency targets set by the Water Industry Commissioner. Although our efficiency targets are less than those of the other two water authorities, it will still be a considerable challenge to meet them over the next 5 years.

• We have to become more efficient, not just to meet these targets but also to survive in a competitive environment. Since we were set up in 1996 we have reduced our base operating costs by 25%. At the same time we have significantly improved customer service.

• Our biggest challenge is to meet our investment and efficiency targets while delivering our investment programme and improving the service to our customers.
Specific Areas of Interest

Fluoridation

- The costs of fluoridation would be met by the Health Boards
- There has been no comprehensive analysis of the costs involved but an initial assessment put the cost of fluoridating the water in 28 of NoSWA’s larger treatment works at around £4m initial capital cost for the equipment, plus £300,000 annual running costs.
- More than 80% of our water supplies serve fewer than 5,000 people. It is unlikely that it would be cost effective to introduce fluoridation in these smaller treatment works.

Future Investment Plans/Priorities

- The Scottish Executive has just issued the Water Quality and Standards consultation paper. Our plans and priorities will to some extent depend on the outcome of this consultation.
- Meanwhile we continue to work towards meeting the various statutory deadlines.
- Work is underway to meet the 2001 deadlines of the Urban Wastewater Treatment Directive. Beyond this a substantial number of projects are planned to meet the 2006 deadlines for smaller settlements.
- We also need to meet the requirements of the Shellfish Directive and the Bathing Waters Directive which may involve tertiary treatment in some places.
- On the water quality side, most of our investment to meet the revised Drinking Water Quality Directive deadlines must be in place by 2003 with the remainder required by 2006.
- At the same time as meeting all our legislative requirements we must also continue to upgrade our water mains and sewers. Our investment programme must increase substantially over the next 5 years to improve our existing underground infrastructure.
- We also need to continue to make investments in new technology which will allow us to safely reduce manning levels at our plants and increase efficiencies.

Efficiencies

- Over the last few years we have significantly improved our capital efficiencies through benchmarking against our UK counterparts and adopting best practice.
- A range of initiatives has been introduced to reduce costs including greater standardisation of design, value engineering workshops and more innovative partnering arrangements with contractors.
• We have completed work on a collaborative project with the other two Scottish water authorities which has identified opportunities for savings on areas such as asset management, purchasing and some support services.

• Our third largest expense is our electricity bill and an energy efficiency programme is in place which will reduce costs.

• It is vital to change the culture of our organisation to encourage and reward efficiency and creative solutions to reduce costs.

Balance of costs/investment between rural and urban areas

• The nature of the legislation we must comply with is such that we have to make the same improvements to water supplies that serve three households as to those serving large towns and cities.

• By 2003 we will have invested £107 million on improving water quality and £124 million on sewage treatment in rural communities.

• Because of the number of small water treatment works we operate, legislation such as the Cryptosporidium Directive which involves a significant sampling regime, has a disproportionately greater impact on us.

• Our most recent analysis suggested that water charges in Shetland last year would have been 4 times greater than their actual level if they paid the full cost of delivering their own services.

• Recent analysis showed that it costs nearly twice as much to deliver water and sewerage services to the Highlands and Islands than to Grampian and Tayside.

Public Private Partnership

• We have already published business plans for 2 of our PPP schemes. These have been made available to the Committee. A third plan for Moray will be published when the contract is finally signed.

• A net present value analysis of the Highland scheme was undertaken which showed that the public sector cost would have been £66.2 million. The PPP cost was £65.6 million.

• All PPP schemes must be tested against the public sector comparator. At Montrose it became clear that PPP would not be a value for money solution so we chose the traditional funding route.

• There is no doubt that small projects are less suitable for PPP. The cost of the bidding process itself discourages companies from bidding for smaller, less financially attractive contracts.

• The only project we are considering for PPP in the future relates to sludge treatment. Beyond that we have no plans for undertaking any further projects through PPP although we would never rule it out as an option.
ABERDEEN PPP PROJECT

BUSINESS CASE

1. **Concessionaire:**

Aberdeen Environmental Services
A Joint Venture of Balfour Beatty plc, Kelda Group and Tyco Tech Ltd.

2. **Date of Concession Award**

04 May 2000

3. **Period of Concession**

30 Years from the date of Concession Award.

4. **Purpose of Project**

The project is a key element of the Authority’s environmental improvement programme to provide cleaner beaches, bathing waters and rivers. Customer research has confirmed widespread support for this initiative. Equally importantly, the project is part of a wider programme of capital investment in environmental improvements to meet the Authority’s obligations under the Urban Waste Water Treatment (Scotland) Regulations 1994.
5. **Choice of Procurement Route**

From its inception the Authority was required to deliver a large Capital Investment Programme associated with its statutory and other obligations. In line with Government policy, it was expected that delivery of the Programme would be achieved by a combination of public procurement and the Private Finance Initiative (now re-titled Public Private Partnership) subject always to the chosen procurement method providing value for money. Within the overall Programme, those projects associated with the UWWTR compliance programme appeared to offer the best opportunity to maximise the financial benefit to the Authority of innovation by the PFI procurement route within the tight timescales set down for UWWTR compliance. Accordingly, it was decided to seek competitive bids for this project on that basis subject to benchmarking the outcome against the alternative public solution.

6. **Description of Works**

The works will serve the main communities along the North East coast of Scotland, namely Aberdeen, Peterhead, Fraserburgh and Stonehaven, together with some smaller settlements. It comprises six main elements:

(a) A wastewater treatment plant constructed around the existing preliminary treatment works at Nigg in Aberdeen. This will provide secondary treatment for the majority of the City of Aberdeen, together with its surrounding settlements. In addition, from 2005 onwards it will also treat the foul wastewater emanating from Stonehaven. The treated wastewater will be discharged to the North Sea by way of an existing long sea outfall.

(b) The refurbishment and upgrading of the existing Persley wastewater treatment plant, which provides treatment for the remainder of the City of Aberdeen and discharges to the River Don.

(c) A wastewater treatment plant at Peterhead on the site of the Authority’s existing preliminary treatment works at Burnhaven. This will provide secondary treatment for the communities of Peterhead and Boddam, with the treated effluent being discharged to the North Sea via the existing long sea outfall.

(d) A wastewater treatment plant located on a greenfield site at Phingask in Fraserburgh, providing secondary treatment and disinfection for all foul flows from Fraserburgh and the settlements of Rosehearty and Sandhaven. The treated wastewater will be discharged to the North Sea through a new long sea outfall, with stormwater being discharged (following storage) from an existing outfall.
(e) A sludge treatment centre also located at Nigg within the site of the wastewater treatment plant. This will process all the sludges produced by each of the above plants and certain other wastewater sludges imported by the Authority to provide a high quality pasteurised sludge cake for recycling, principally to agricultural land. The Concessionaire also has the option to import similar trade wastes for processing at this facility.

(f) A preliminary treatment plant and pumping station at Carron in Stonehaven, which will remove screenings and grit and pump foul flows (utilising two new and one existing pumping station) to Nigg in Aberdeen for full treatment. The existing long sea outfall at Carron will be utilised to discharge screened stormwater to the North Sea.

All discharges will meet the stringent environmental protection standards set by the Scottish Environment Protection Agency.

7. Key Aspects of Concession

(i) Risk allocation – in accordance with the rules governing public private partnership projects the concession incorporates a substantial transfer of risk to the Concessionaire most notably the demand risk, construction risk, operation risk and SEPA prosecution risk.

(ii) Variable payment mechanism – the Authority will make payment to the Concessionaire according to the measured volume of wastewater treated. A separate payment will be made according to the quality and quantity of sludge processed. There are no fixed payments or standing charges.

(iii) Revenue share mechanism – in the event of the quantity of wastewater treated being substantially in excess of that predicted and giving rise to much higher equity return to the Concessionaire than anticipated a revenue share mechanism will be triggered enabling the Authority to benefit from a share of the higher revenue income.

(iv) Partial indexation of tariff – to incentivise the Concessionaire to operate efficiently and to reflect the fixed cost nature of his external debt obligations the annual tariff adjustment will be only partially index-linked.

(v) Poor performance – the concession includes the right of the Authority to withhold payment in clearly defined circumstances of poor performance and, ultimately, the Authority has the right to step in and remedy defects or ultimately terminate the concession.

(vi) Surplus land – the concession does not permit the Concessionaire to sell surplus land.
(vii) End of Concession – at the end of the 30-year concession period the assets revert to the North of Scotland Water Authority or its successor without payment to the Concessionaire.

8. Summary of Procurement Process

The procurement process was conducted in compliance with the Public Works Contracts Regulations 1991.


(ii) June 1998 – Following consideration of initial submissions and interviews four consortia were invited to tender for the project.

(iii) March 1999 – Following evaluation of the returned tenders according to the selection criteria established at the outset, two tenderers were invited to submit best and final offers (BAFO).

(iv) June 1999 – The BAFO submissions submitted in April 1999 were evaluated against the same criteria as before and a preferred tenderer was selected.

9. Criteria for the Assessment of Bids

(a) Technical and environmental acceptability.

(b) Deliverability and sustainability of proposals.

(c) Value for money.

(d) Commercial and legal acceptability including risk transfer.

10. Public Sector Cost Comparator

The main elements of the PPP solution match with that which had been envisaged by way of public procurement. However, the way in which the Concessionaire has dealt with demand risk, construction and design risk and operational management has led to a significant saving in whole life costs.
11. **Comparison of Costs**

To assess which of the PPP or public sector solutions offered best value for money a net present value analysis of each was undertaken. The analysis demonstrated that of the two project costs, in NPV terms, the PPP solution was significantly more favourable as follows:-

(i) PPP solution - £125 million NPV  
(ii) Public sector solution - £154 million NPV

12. **Corporate Plan**

The Authority’s corporate plan takes full account of the ongoing future costs arising from this and other PPP projects. The extent of these costs, annually, will be recorded in the Authority’s Annual Report and Accounts.

13. **Project Contact Person**

Any queries relating to this business case statement should be addressed to Mr Jim Cockburn, Managing Director – Water Services, North of Scotland Water Authority, Cairngorm House, Beechwood Park North, Inverness IV2 3ED.

14. **General Enquiries on PPP**

Any general enquiries on PPP should be addressed to Fiona McLellan, Private Finance Unit 3-C23 Victoria Quay, Edinburgh EH6 6QQ (Telephone 0131 244 7500; Fax 0131 244 4799).
TAY PPP PROJECT

BUSINESS CASE

2. **Concessionaire:**
   
   Catchment Tay Limited

3. **Date of Concession Award**
   
   16 December 1999

4. **Period of Concession**
   
   30 Years from the date of Concession Award.

6. **Purpose of Project**
   
   The project is a key element of the Authority’s environmental improvement programme to provide cleaner beaches, bathing waters and rivers. Customer research has confirmed widespread support for this initiative. Equally importantly, the project is part of a wider programme of capital investment in environmental improvements to meet the Authority’s obligations under the Urban Waste Water Treatment (Scotland) Regulations 1994.
7. **Choice of Procurement Route**

From its inception the Authority was required to deliver a large Capital Investment Programme associated with its statutory and other obligations. In line with Government policy, it was expected that delivery of the Programme would be achieved by a combination of public procurement and the Private Finance Initiative (now re-titled Public Private Partnership) subject always to the chosen procurement method providing value for money. Within the overall Programme, those projects associated with the UWWTR compliance programme appeared to offer the best opportunity to maximise the financial benefit to the Authority of innovation by the PFI procurement route within the tight timescales set down for UWWTR compliance. Accordingly, it was decided to seek competitive bids for this project on that basis subject to benchmarking the outcome against the alternative public solution.

6. **Description of Works**

The works will serve the main communities along the north shore of the Tay Estuary and lower Angus coast, namely Dundee including Invergowrie and Broughty Ferry, Monifieth, Carnoustie and Arbroath, together with some smaller settlements. It comprises three main elements.

(a) A wastewater treatment plant located at Hatton between Carnoustie and Arbroath providing secondary treatment for all of the foul sewage emanating from the aforementioned communities. The treated wastewater will be discharged into the North Sea by way of a long sea outfall and will meet the stringent environmental protection standards set by the Scottish Environment Protection Agency.

(b) A collection and transmission pipeline system with associated pumping stations and stormwater storage tanks which will intercept all existing discharges of foul wastewater into the Tay Estuary and North Sea between Dundee and Arbroath and convey the flows to the wastewater treatment plant at Hatton. Stormwater will be discharged at limited locations along the Tay Estuary, also to SEPA environmental protection standards.

(c) A sludge treatment centre also located at Hatton within the site of the wastewater treatment plant to process the sludges produced from the wastewater treatment plant and certain other similar sludges imported by the Authority to provide a high quality thermally dried product for recycling to agricultural land.

7. **Key Aspects of Concession**

(viii) Risk allocation – in accordance with the rules governing public private partnership projects the concession incorporates a substantial transfer of risk to the Concessionaire most notably the demand risk, construction risk, operation risk and SEPA prosecution risk.
(ix) Variable payment mechanism – the Authority will make payment to the Concessionaire only according to the measured volume of wastewater treated. The level of payment may be adjusted marginally to recognise significant variation in the quality of the wastewater and separate payment will be made according to the quantity of sludge processed. There are no fixed payments or standing charges.

(x) Revenue share mechanism – in the event of the quantity of wastewater treated being substantially in excess of that predicted and giving rise to much higher revenue return to the Concessionaire than anticipated a revenue share mechanism will be triggered enabling the Authority to benefit from a share of the higher revenue income.

(xi) Partial indexation of tariff – to incentivise the Concessionaire to operate efficiently the annual tariff adjustment will be only partially index-linked.

(xii) Poor performance – the concession includes the right of the Authority to withhold payment in clearly defined circumstances of poor performance and, ultimately, the Authority has the right to step in and remedy defects or ultimately terminate the concession.

(xiii) Surplus land – the concession does not permit the Concessionaire to sell surplus land.

(xiv) End of Concession – at the end of the 30-year concession period the assets revert to the North of Scotland Water Authority or its successor without payment to the Concessionaire.

9. **Summary of Procurement Process**

The procurement process was conducted in compliance with the Public Works Contracts Regulations 1991.


(vi) July 1997 – Following consideration of initial submissions and interviews four consortia were invited to tender for the project.

(vii) April 1998 – Following evaluation of the returned tenders according to the selection criteria established at the outset, two tenderers were invited to submit best and final offers (BAFO).

(viii) July 1998 – The BAFO submissions submitted in May 1998 were evaluated against the same criteria as before and a preferred tenderer was selected.
9. Criteria for the Assessment of Bids

(e) Technical and environmental acceptability.
(f) Deliverability and sustainability of proposals.
(g) Value for money.
(h) Commercial and legal acceptability including risk transfer.

11. Public Sector Cost Comparator

It had been envisaged that to meet the UWWTR obligations by way of public procurement a series of five wastewater treatment plants would have had to be provided at strategic locations – three in Dundee and one each at Carnoustie and Arbroath. The proposed environmental solution was perceived as being less environmentally advantageous on account of there being five significant discharges into the Tay Estuary and North Sea compared with the one discharge from the chosen solution.

11. Comparison of Costs

To assess which of the PPP or public sector solutions offered best value for money a net present value analysis of each was undertaken. The analysis demonstrated that of the two project costs, in NPV terms, the PPP solution was slightly more favourable as follows:-

(iii) PPP solution - £144 million NPV
(iv) Public sector solution - £153 million NPV

13. Corporate Plan

The Authority’s corporate plan takes full account of the ongoing future costs arising from this and other PPP projects. The extent of these costs, annually, will be recorded in the Authority’s Annual Report and Accounts.

13. Project Contact Person

Any queries relating to this business case statement should be addressed to Mr Jim Cockburn, Managing Director – Water Services, North of Scotland Water Authority, Cairngorm House, Beechwood Park North, Inverness IV2 3ED.
15. General Enquiries on PPP

Any general enquiries on PPP should be addressed to Fiona McLellan, Private Finance Unit 3-C23, Victoria Quay, Edinburgh EH6 6QQ (Telephone 0131 244 7500; Fax 0131 244 4799).
ADVERT

NORTH OF SCOTLAND WATER AUTHORITY

The North of Scotland Water Authority has awarded concessions, under the Public Private Partnership initiative, to Aberdeen Environmental Services for the Aberdeen Wastewater Project; and to Catchment Tay Ltd for the Tay Wastewater Project. Full Business Cases (FBCs) for these awards have been submitted for public reference from Monday 3rd July as follows:

- FBC for the Aberdeen Wastewater Project – Aberdeen Central Library; Peterhead Library; Fraserburgh Library.
- FBC for the Tay Wastewater Project – Dundee City Library; Forfar Library.
TRANSPORT AND ENVIRONMENT COMMITTEE

INQUIRY INTO THE SCOTTISH WATER INDUSTRY

DEVELOPING THE PUBLIC SECTOR MODEL

JOINT PAPER BY THE SCOTTISH WATER AUTHORITIES

29 January 2001
Developing the Public Sector Model

Executive Summary

- The water services business environment is changing rapidly, leading to the provision of new business models in England and Wales and new offerings to customers e.g. onsite services, bundled services – gas, electricity, water, telecoms, insurance.

- Our challenge is to meet our investment and efficiency targets whilst improving the service to customers. This requires the development of new packages of services which enable us to retain our customers.

- The current public ownership model provides many advantages but does need modification to enable us to compete.

- In recent months working with the Scottish Executive we have made good progress in developing the model. For example we are now able to make good use of our power to form joint ventures, including attracting the injection of small amounts of equity.

- There needs to be a recognition that in a competitive environment, part of our task should be to develop our products and services and to optimise and manage the balance of risk and reward rather than just minimising risk. This does not imply a diversion of focus from our core task of safeguarding water supply and waste water services.

- We believe that the forthcoming Water Services Bill in the Scottish Parliament provides an opportunity to put in place, but always subject to Ministerial direction or guidance, additional scope in particular a widening of enabling powers and the ability to raise appropriate financial resources for new business development.

- In addition, we believe the style of stewardship needs to reflect greater emphasis on controlling outputs and less control of inputs by our owner, having first established clear targets and goals appropriate to the objective of meeting the needs of all customers.
1. **Introduction**

On 12th December 2000, the three Scottish Water Authorities presented their collective submission to the Transport and Environment Committee. Having set a context of rapid change affecting our sector, the presentation highlighted the need to establish a redefined public sector model which has a better chance of stability and viability. The Committee invited the Authorities to amplify on how our business model should develop, within the public sector. This brief joint paper responds specifically to that invitation. We do not, here, reiterate, the overall messages set out in our December submission.

2. **Context**

2.1 Why does our model need to develop? In a stable business environment, we could meet efficiency, quality and service expectations by consistent strong management entirely within the model as it stands. But the shape of our marketplace is changing. Corporate customer loyalty will increasingly be earned by offering individually tailored solutions sometimes on a company-wide basis. Competition will bring with it the likelihood of domestic and small business water services forming part of wider packages of bundled services offered by strongly-branded retailers that already offer a range of home services e.g. gas, electricity, telecoms, insurance.

Most observers believe that investment, efficiency plus development of new and competitive packages of services will all be key to future business viability and success in the water sector. To rise to the unique challenge facing us will require a scale and pace of change probably unprecedented in the public sector. The Post Office faces a similar challenge in some of its markets and aspires to compete by changes to its model. A small number of the larger municipal airports have also proved they can compete given sensible freedoms.

2.2 We have been working with the Scottish Executive to develop the implications of these shifts. Important new flexibilities have been developed by the Scottish Executive for example broadening the Ministerial Guidance under which our commercial activity takes place, streamlining the approval process for new commercial activity. The Scottish Executive has positively encouraged the promotion of joint ventures with commercial partners where this strengthens the chance of success. It has also worked with us to develop new policies for our employees, consistent with the ‘Modernising Government’ report.

2.3 This paper reflects the water authorities’ views arising from the ongoing dialogue between themselves and with the Scottish Executive.
3. **Character**

3.1 Our character has developed in response to the short history of the WAs, partly determined by the political environment, partly by the style of stewardship both of the owner and the Boards and management. Government plays a number of roles notably, in our case, as public policy-maker, regulator (directly and via SEPA and WIC) and as owner. The first two of these need to apply to the whole of the Scottish water industry – both to incumbents and to any entrants. The last, the role of owner, is specific to the Scottish Water Authorities.

3.2 Last year HM Treasury set out some discussion points and ways in which Government can ‘become a better shareholder’ for publicly-owned businesses. This formed part of a wider document on partnership strategy.

The key message is about the Government taking a more strategic approach. “The Government is looking to step back from day to day management of public enterprises and instead focus on the drivers of long-term value”. They recommend this in the belief that regulation and the democratic process ensures accountability. Our new Quality and Standards process, as it matures, is designed, by being output-based, to illustrate this approach.

3.3 We believe that our style of stewardship needs to develop broadly in the spirit suggested above. In particular, within the necessary framework of our public sector status, the Water Authorities would like to see:-

- Strong goals and objectives from our owner with regard to our core and commercial activities and outcomes.
- More room to manoeuvre to achieve these outcomes.
- A shared understanding that our task is to optimise and manage the balancing of business risk and reward, rather than to the conventional public sector presumption of minimising risk (even where risk can be managed).
- More broadly, a shared understanding that – in a competitive business environment – some ventures may fail to meet their objectives. Success cannot be built on a no risk platform.
- A shared understanding that employee rewards need to reflect performance – reflecting the principles set out in “Modernising Government”.
- A shared understanding that there is a need to invest now, in new products/services, in order to generate future reward.

4. **Scope**

4.1 When the WAs were set up their role was relatively straightforward, to improve the quality of the services we provide, cost effectively. This has not changed and remains a major challenge. However, our competitors are responding to
deregulated markets by mergers, separation of vertically integrated services, development of new products and offerings. Whilst the WAs cannot follow the same routes, they can and should have the ability to respond to market pressures for example, by developing new products, by collaboration with one another and forming joint ventures. This requires the powers of the WAs to be extended. But also a recognition by all that they need to respond in this way.

4.2 We believe that the opportunity should be taken, in the framing of the Water Bill, to provide WAs with wider enabling powers. The exercise of these powers should be made subject to Ministerial guidance (which may itself be developed in response to changing conditions), consistent with our public sector status. In the spirit of the comments in section 3 above, the opportunity should also be taken to shift the emphasis of owner (i.e. Government) disciplines from inputs (detailed approvals of financial, staffing and other management matters) to commercial outcomes (performance and results).

4.3 In summary:-

- We need flexibility and wide enabling powers – exercised within Ministerial guidance; shareholder disciplines should shift from inputs to commercial outcomes
- Our scope – in terms of market and product mix – may need to develop substantially if we are to be sustainable businesses over the long-term.

5. Resources

5.1 A distinction needs to be drawn between the resources needed to serve our water service business and the resources required for effective business (product and market) development so that we can take advantage of the opportunities presented and defend against the threats.

5.2 Investment in Water Services

Our regulated, incumbent business requires record levels of investment to continue in the coming years to meet both regulatory needs and efficiency targets (‘Spend to Save’). Whilst some uplift in borrowing consent (as implied by the mix of capital and expenditure and profit targets under RAB) would be beneficial, taking the three authorities as a whole we would not argue for a major expansion in borrowing to support investment in the incumbent business. Equally, however, we would caution heavily against a lowering of current borrowing levels.
5.3 Business Development

5.3.1 Investment funding for Business Development: The broad options

In principle, the main options can be summarised as follows:-

(i) Additional Investment for business development

Within our current framework, all our costs are met – immediately or over time – by our customers. All capital-raising is by borrowing. This naturally places a severe constraint on investment for business development. An increment of around 5-10% in our overall investment may be possible to ‘squeeze in’ within our current model (with additional borrowing consents).

The Additional Investment option (around 5-10% increment on incumbent business investment) provides significant opportunity to develop new products and services. This is particularly so in the corporate sector where external project finance can be leveraged i.e. a small amount of equity can attract larger sums from banks against the earnings of the project. The risks attached to this option are that we place ourselves as junior stakeholders in new partnerships with little muscle, and that – overall – we do too little too late to survive long-term against our competitors.

(ii) Larger scale investment

To create long-term value for our owner on a scale comparable to our competitors would require larger scale investment. Many of our plc competitors are investing to achieve – over the long-term – a position where the contribution from new business exceeds that of the incumbent business (which, they accept, will decline).

In practical terms, larger scale investment would be difficult for the Executive to contemplate at present. At this stage, our first business development priority is to earn a successful track record before reaching for more ambitious targets. But in the event that we could demonstrate success in the short-term that clearly demonstrates our ability to provide added value services to customers and in doing so retain or even grow our customer base then it would make commercial sense for the Executive to extend the investment in terms of scale and scope.

We recommend a phased approach to investment in business development, commensurate with our ability to demonstrate commercial success in retaining customers and producing relevant returns to our owners and local customers.
6. **Conclusions**

We recommend that, in dialogue with the Scottish Executive, the Committee considers the development of our public sector model in a manner appropriate to our long-term viability in a changing, competitive marketplace. In particular that

- The style of stewardship of the SWAs develops along the lines set out in para 3.3.
- We are capable of developing our scope – in terms of market and product mix – so that we remain sustainable businesses over the long-term.
- We are provided with flexibility and wide enabling powers – exercised within Ministerial guidance; owner disciplines should shift from inputs to commercial outcomes
- The ‘incremental investment’ option, for new business development, is provided for within the developing model.