TRANSPORT AND THE ENVIRONMENT COMMITTEE

AGENDA

18th Meeting, 2001 (Session 1)

Monday 18 June 2001

The Committee will meet at 1.30 pm in The Signet Library to consider the following agenda items:

1. **Items in private:** The Committee will consider whether to take items 2 and 5 in private.

2. **Highlands and Islands Ferry Services:** The Committee will consider areas of questioning for witnesses as part of its consideration of the Scottish Executive’s proposals for the future of the Highlands and Islands ferry service network.

3. **Public Petitions:** The Committee will consider the following Public Petitions—
   - **PE 96:** The Committee will consider how to take forward consideration of Petition PE 96, by Mr Allan Berry, which calls on the Parliament to hold an inquiry into the adverse environmental effects of sea cage fish farming.
   - **PE 327:** The Committee will consider Petition PE 327 by Mr Duncan Hope on behalf of the Blairingone and Saline Action Group calling for the Scottish Parliament to request that legislation be revised to ensure that public health and the environment are not at risk from the current practice of spreading sewage sludge and other non-agriculturally derived waste on land in Scotland.

*Not before 2.00 pm*

4. **Highlands and Islands Ferry Services:** The Committee will take evidence from—
   - Dr Harold Mills, Chairman, and Lawrie Sinclair, Managing Director, Caledonian MacBrayne Ferries
   - Bill Spiers, General Director, Scottish Trades Union Congress
   - Tom Kennedy, Transport Salaried Staff Association
   - Dan Sharpe, Transport and General Workers Union
   - National Union of Marine, Aviation and Shipping Transport Officers
   - Councillor Charles King, Chairman, Highlands and Islands Strategic Transport Forum
Murdo Murray, Director of Technical Services, Comhairle nan Eilean Siar

Dave Duthie, Head of Transportation Services, Argyll and Bute Council

Cameron Kemp, Principal Transport Officer, Highland Council

5. Procedures Committee Inquiry into the application of Consultative Steering Group principles in the Scottish Parliament: The Committee will consider a draft response to the Procedures Committee inquiry.

6. Water Inquiry (in private): The Committee will consider a further draft report on its inquiry into water and the water industry

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Introduction

The Transport and the Environment Committee considered Petition PE327 by Mr Duncan Hope, on behalf of the Blairingone and Saline Action Group, on 23 May 2001. The petition asked the Scottish Parliament to request that legislation be revised to ensure that public health and the environment are not at risk from the current practice of spreading sewage sludge and other non-agriculturally derived waste on land in Scotland.

The Committee agreed to appoint the Convener as a reporter on this issue.

This paper invites the Committee to approve a terms of reference for its examination of the petition, and to consider how it wishes to approach its on-going consideration of the petition.

Draft Terms of Reference

Members are invited to consider the following draft terms of reference for the Committee’s examination of the petition:

The Committee will examine—

- the issues raised in Petition PE327 from the Blairingone and Saline Action Group;
- the Scottish Executive’s response to SEPA’s Strategic Review of Organic Waste Spread on Land;
- whether, and to what extent, the Executive’s response addresses the issues raised in Petition PE327; and
- whether the Blairingone and Saline petition raises any broader questions about the adequacy of the current regulatory and legislative framework for waste disposal in Scotland.

The inquiry will seek to determine whether, either at a local or national level, further action is required to meet the petitioner’s goal of “establishing a safe, sustainable and enforceable strategy for waste disposal in Scotland”

Approach

As a first step, it is proposed that a call for written evidence is issued, seeking the views of specific bodies (such as SEPA and Snowie Ltd), plus other interested parties, via a general call for evidence. This would be issued over the Summer Recess. After the closing date for submissions, the Reporter, and any other interested Committee members would have the opportunity to undertake a site visit to Blairingone and Saline, and Doune.

Members may consider it useful for the Committee to hold an evidence-taking session from relevant groups with an interest in the petition. This evidence-taking could be held in September, as soon as possible following Summer Recess. The
Committee could then make a formal response to the petition on the basis of the written and oral evidence taken, plus any site visits undertaken by members.

The Reporter has identified a number of possible groups the Committee may wish to take evidence from:

- the Petitioners
- Institute of Waste Management
- Snowie Ltd
- SEPA
- Scottish Agricultural College
- Friends of the Earth Scotland
- National Farmers’ Union of Scotland
- Scottish Executive

This list is not exhaustive, and members may wish to suggest other additional names. One formal evidence-taking session is proposed, with a maximum of 4 groups giving evidence to the Committee. The Committee is invited to agree which groups the Committee should invite to give oral evidence at a formal Committee meeting. It would be open to the Reporter to meet more informally with the other groups and to report back to the Committee. If members wished to take formal evidence from more than 4 groups, an additional evidence-taking session would have to be scheduled.

The Health and Community Care Committee is likely to have an interest in those aspects of the petition which fall within its remit. It is therefore proposed that the Committee writes to the Health and Community Care Committee to advise it of the Transport and the Environment Committee’s proposed action on the petition, and to invite it to consider those aspects of the petition that fall within its remit. The Health and Community Care Committee could be requested to pass any response to the Transport and the Environment Committee reasonably promptly, to enable consideration of the petition to be taken forward promptly.

Recommendations

The Committee is invited to approve terms of reference for the Committee’s examination of the issues raised in Petition PE327.

The Committee is also invited to agree—

- to write to the Health and Community Care Committee to inform its members of the Transport and the Environment Committee proposed actions on the petition
- whether to issue a call for written evidence to specific bodies, and also to issue a general call for evidence;
- whether to hold a formal evidence-taking session, and which bodies should be invited to that meeting
- which groups the Reporter should meet with informally; and
• whether the Convener, plus other interested members, should conduct a site visit to Blairingone and Saline and other relevant locations, and whether to approve formally this proposed travel.

Andy Kerr MSP
Reporter
June 2001
Dear Mr McKinlay,

Thank you for your letter of 6th May with regards to evidence-taking on Highlands and Islands ferry services. I am qualified to speak on this subject since I spent 20 years as captain of west coast ferries, followed by nine years Marine Superintendent on Caledonian MacBrayne.

My main reservations regarding the Transport Minister’s proposals are:

- Safety
- Operator of last resort
- Independent regulator
- Potential loss of Caledonian MacBrayne’s past experience

I would expand on the above as follows:

**Safety**

At present the financial remit of CalMac as laid down by the Scottish Executive is to break even thereby allowing for a large safety budget. Under a private operator their remit will be entirely different with the possibility that safety will be compromised. Taking Railtrack and Hatfield as an example, it is unfortunately more than a possibility. Since the present CalMac was set up about 1972 they have operated 30 ferries 352 days a year in the worst weather conditions in Europe without one major incident involving loss of life. This is a remarkable record set against private operators when you think of “Herald of Free Enterprise”, “Estonia”, “Scandinavian Star” and the most recent Greek island tragedy to name but a few.

All these accidents were caused by human error some of which were due to financial pressure and consideration being brought to bear on captains. This is not speculation, I have worked for both kinds of ship owners. In 20 years in command of west coast ferries under the present set up I was never once pressurised to sail. It should be noted that CalMac has never failed to complete 98.3% of all sailings on time.

It cannot be emphasised strongly enough that no roro ferry company in the world let alone Europe has a better safety record than Caledonian MacBrayne.
**Operator of last resort**

When you consider the performance of the last two ferry operators given public money, i.e. Campbeltown-Ballycastle and Invergordon-Orkney, it is imperative that the Scottish office have an operator of last resort in position before the tender process is complete. If CalMac is unsuccessful it will have to be disbanded and since the Transport Minister’s original proposal that VesCo would fill the role is not feasible since that company would not hold a “Letter of Compliance” to operate roro ferries, the minister must be made to name an operator of last report. Since these are lifeline services, should an operator withdraw the services must continue uninterrupted. If this requirement cannot be resolved it would in my opinion be sufficient reason for the Scottish Executive to persuade Europe to grant an exemption from their rules to the lifeline ferry services of the west coast of Scotland.

**Independent regulator**

The Transport Minister when questioned on this subject continues to state that it is not needed since the Maritime and Coastguard Agency is responsible for safety. Whilst the MCA does a superb job it, like a lot of government agencies, is undermanned and its limited number of surveyors in Glasgow have to cover all shipping and fishing vessels for the Solway to Stornoway including the Clyde. Due to this they can only make infrequent visits to Calmac ships. Its should be noted that the Health and Safety Executive perform a similar role to Railtrack and the MCA does to shipping but a regulator is considered necessary for rail also. A Regulatory body’s role is much more far reaching than safety as it would cover amongst other things efficiency, fares, timetabling and accountability.

Under the Transport Minister’s proposal the private operator will lease the ships from “VesCo”. There must be a body in place to ensure that money is spent maintaining the ships and shore facilities to ensure safety is not compromised. Again, I have no apology for bringing Railtrack and Hatfield to your attention regarding what can happen even with a regulator in place when financial consideration is put above safety. No doubt without a regulator it would be worse.

**Loss of experience**

Should Caledonian MacBrayne be unsuccessful in the tendering process, they would have to go out of business resulting in the loss of vastly experienced people and a company with an unsurpassed safety record. Whilst CalMac’s safety record is second to none their business efficiency could be vastly improved. While the seagoing staff numbers are governed by MCA crewing regulations there are no such regulations with regards to shore staff. In my opinion these numbers have grown alarmingly over the last five years, and now are at an unacceptable level which could result in CalMac being unsuccessful in the tendering process leading to the loss of their vast experience. I could highlight numerous areas where manpower savings could be made but this is neither the time or place to do so.
Finally it is my considered opinion that the Scottish Executive should give careful consideration to the fact that they are proceeding down the exact route as was taken with British Rail, which is private operators with a “Vesco” in place of Railtrack. No-one could deny that has been an unmitigated disaster financially, and much more importantly safety-wise with a dreadful safety record resulting in numerous disasters and loss of life.

Captain A. B. Ferguson.
TENDERING OF HIGHLANDS AND ISLANDS FERRY SERVICES
(WRITTEN EVIDENCE)

Professor Neil Kay

I am Professor of Business Economics at Strathclyde University. My main areas of research cover the economics and strategies of firms. I have also researched and advised on industrial policy matters, and have been a member of UK government working parties on technological change (DTI), and the completion of the EU internal market (ACOST, Advisory Committee on Science and Technology).

I am grateful for this opportunity to comment on the proposals for Highlands and Islands ferry services. I have previously submitted comments to the Reporters on this matter. My earlier comments are not subject to significant modification, but I will try not to cover ground dealt with earlier, except where I need to reintroduce points for emphasis or continuity. I am also grateful to Captain Sandy Ferguson and Professor Tony Prosser for providing me with copies of their written evidence. I fully endorse the points they make, and again will try not to cover the same ground except for purposes of emphasis or coherence. Consequently, the points set out below are made on the assumption that the arguments in the Ferguson and Prosser evidence are taken as read.

Converting a nationalized industry (which CalMac is) into one in which the operation of services is organized through competitive tendering generally involves three essential ingredients:

(a) Creation of an independent regulator to set and police prices and standards of service.
(b) Provision for guaranteeing continued and uninterrupted supply of essential services in the event of operator default (e.g. operator withdraws, loses its license, or goes bankrupt). This may be achieved by designating an operator (or supplier, or provider) of last resort (SOLR). The power to designate SOLR is generally supported with statutory obligation of public bodies or compulsion of private firms to act as SOLR, should this need arise.
(c) A well developed supporting statutory framework.

These ingredients have become recognized as fairly standard where industry restructuring has led to the introduction of competitive tendering into formerly nationalized industries in the UK and elsewhere. In this context there are three major issues that should raise public concern in this context:

(1) The Executive has no plans for an independent regulator, no devices whereby a qualified SOLR can be obligated or compelled to take over running of the CalMac network in the event of operator default post-competitive tendering, and no plans for a statutory framework (the Executive have only said they will consider whether such a framework is needed in the course of operation of the first tender). It short, it is missing
all three of the basic ingredients that are conventionally regarded as
essential in restructuring a publicly owned industry to open it up for
competitive tendering.

(2) The model that the Executive has been proposing (opening up operation of
services to competitive tendering while leasing out physical assets held in
public ownership) differs from typical restructurings of nationalized
industries in the UK and elsewhere (also in having no regulator, no SOLR
and no strong legislative back up). Indeed, is difficult to find
corresponding models of the arrangement proposed by the Executive to
see how and whether it will actually work. This adds to the riskiness,
complexity and learning problems of the restructuring, given that there is
little, if any, prior experience to draw on.

(3) The original time frame envisaged for restructuring this nationalized
industry up to the stage in which the first tender(s) would be awarded was
originally one year (Spring 2000 to Spring 2001). This contrasts with
corresponding programmes for restructuring other nationalized industries
which typically took place over a much longer time frame. While the
original deadline has been breached and has been subsequently extended,
the fact is that the Executive was planning to effectively complete
restructuring and introduce a novel and untried system over a period of
just a few months. Such a time frame was never realistic, but a process
framed with such a deadline in mind will almost inevitably turn out to be
rushed and not well thought out.

It is generally understood that the Executive felt such a tight deadline was necessary in
view of the need to comply with EU directives in this area. However, it should be borne
in mind that the fundamental driving force behind EU directives is the protection and
enhancement of the public interest, just as it is the driving force behind the formulation of
government policy at UK and Scottish level. Yet here there appears to be a potential
conflict between the responsibility of the Scottish Executive to protect and promote the
public interest, and EU policy. Why should this be?

The answer is that the EU tends to focus on certain aspects relating to the public interest,
and leaves other aspects for respective national authorities to deal with. The EU prefers to
take a hands-off approach and tends to only become involved if it feels that there is a
danger of distortion of competition at EU level that may disrupt the public interest - this
is where the competitive tendering aspect comes in here. It tends to leave other matters
such as form and practice of regulation to national authorities as far as possible,
following the principle of subsidiarity, which essentially means that things best dealt with
at national level should be left for national authorities, including details of regulatory
structures, so long as competition within the EU is not limited. In particular, the issue of
SOLR is little discussed at EU level, the general implication being, not that this is not
important, but that issues relating to security and continuity of supply are the
responsibility of the national authorities to sort out before they start any restructuring
process.
For example, in the case of the energy market, a recent European Commission Staff Working Paper *Completing the Internal Energy Market* 12th March 2001 (downloadable at http://europa.eu.int/comm/energy/library/438.pdf) recognizes that “security of supply” (of energy services) is an essential public service obligation (helped by designation of SOLR in the case of the UK) but also states explicitly in the case of electricity that: “The security of network infrastructure ….. is unaffected by the creation or completion of the internal market. It is for each Member State to take the appropriate regulatory measures, both in terms of setting and monitoring security standards, which will differ from country to country in the light of factual circumstances, in order to ensure that high standards are defined and met.” And in the case of gas “it (is) important for each Member State to take the appropriate and necessary regulatory measures to clearly define security (of supply) objectives and allocate the responsibilities of each of the market players with a view to ensure the achievement of the defined security objectives.” The important issue from the point of view of the EU is that the measures and mechanisms Member States put in place should not restrict trade and competition more than is necessary. Similar points hold for regulation of prices and quality of services in these markets by national authorities.

For that reason, there may be only limited scope for arguing that the EU is endangering the public interest. The Commission in Brussels is likely to respond that they recognize that appropriate mechanisms for regulatory control - as well as to ensure security and continuity of supply of essential services - are indeed desirable and may even be necessary. But these issues are the responsibility of (in this case) the Scottish Executive, and if the solutions are not satisfactory, that is the responsibility and fault of the appropriate national authority.

In putting such emphasis on satisfying the area of the public interest (competitive tendering) which the EU tends to regard as its responsibility, the Executive is running the risk of inadvertently endangering the public interest in areas which are generally seen by the EU as being the Executive’s responsibility (specifically, regulatory control and SOLR). *If there is one thing that above all else must be recognized in this debate, it is that the Executive must refocus its attention away from just satisfying those aspects of the public interest that are the responsibility and concern of the EU, and give appropriate and careful attention to protecting and pursuing the public interest in the areas that the Executive has direct responsibility for.* If the public interest is subsequently damaged because issues such as regulatory control and SOLR have been neglected, this will be the Executive’s responsibility, not the EU’s. If the Executive needs more time to work these matters through, this must be communicated to the EU, not rushed through

**Specific points**

I will concentrate on the issue of security/continuity of supply of essential services (SOLR) and add some brief notes on other points at the end

The designation of a SOLR is a device which is intended to protect security/continuity of supply of essential services. The guarantee of continuity of supply may be pursued
through making a public body obligated to act as SOLR should the need arise (e.g. water, rail) or having the power to direct a qualified private firm to act as SOLR even if they are unwilling to act in this capacity (e.g. electricity, gas)

The issue of SOLR is one that has been the subject of a considerable amount of analysis in other essential services where competitive tendering has been introduced. See for example, OFGEM’s Supplier of Last Resort: Guidance on Current Arrangements, March 2001 (downloadable at http://www.ofgem.gov.uk/docs2001/27_supplier.pdf). This handbook has 118 pages, demonstrating at the very least that this is a subject which may require complex and detailed analysis.

As Captain Ferguson and I have noted earlier, it is simply not adequate for the Executive to designate VesCo (the proposed vessel leasing company) as “procurer” of last resort with responsibility for finding an alternative operator in the event of the default of the incumbent operator, and leave things at that. Indeed, “procurer of last resort” is not a recognized or accepted role in the context of provision of essential or lifeline services. If the only potential inducement or incentive open to the Executive is the carrot of potential subsidy, there is no guarantee that an alternative operator can be found, immediately or indeed ever (viz. Campbeltown-Ballycastle, Invergordon-Orkney services). This raises the possibility of whole communities being stranded and cut off indefinitely in the event of operator default. This means that provision must be made for a SOLR (which seems to have been recognized by the Executive to begin with when they mistakenly described VesCo as “operator of last resort” in press release).

If the Executive is to go down the route of having a public body or bodies obligated to act as SOLR, at first sight there would be seem to be four candidates for this role (1) VesCo (2) CalMac (3) NorthLink (CalMacs joint venture with Royal Bank for the Northern Isles) (4) Councils, (e.g. Argyll and Bute, Western Isles)

VesCo cannot be SOLR as the Executive have belatedly confirmed because it would not get the required certification from the MCA.

It is difficult to see how CalMac could be SOLR, because if it loses its tender bid it would have no further function to perform and would presumably have to be wound up. Even if a shell CalMac company was kept it is doubtful if would have sufficient managerial systems and competences to act as a potential operator should the need arise. Whether such a shell company could even get recognition and documentation to be recognised as qualified to potentially run the network as SOLR is a question that the MCA is best qualified to deal with. If VesCo cannot get such recognition and certification, it is difficult to see how a shell company could.

NorthLink cannot be relied on to be the designated SOLR because, as with CalMac, there is no guarantee that it will outlive its current five-year contract, a private firm could win the next Northern Isles contract. In any case, the Royal Bank’s shareholders may have objections to such obligations being put on the joint venture.
It is difficult to see how the *councils* could be SOLR. Firstly, there is poor geographical fit between CalMacs integrated operations and the areas covered by individual councils. Secondly, councils such as Argyll and Bute were asked in earlier consultation if they were interested in bidding for any of CalMacs routes. They did not express an interest and if they were not interested in bidding for any of the routes, they are likely to be even less excited about the prospect of being obligated as SOLR. Thirdly, councils may subcontract their ferry operations to private firms (Serco-Denholm in the case of Argyll and Bute), so what appears as a council service is actually privately-operated with the expertise and competences in private rather than public hands.

In short, there appears to be no obvious way in which designating a public body to be obligated to act as SOLR for the CalMac network would provide a satisfactory and stable solution to the problem of maintaining secure and continuing supply of lifeline ferry services in the event of operator default.

This means that the Executives plans lead it into the territory covered by OFGEM, at least in so far as it may have to resort to searching for a private operator in the event of incumbent default. The candidate firms here may be expected to be the kind of firms that have been shortlisted for tender bids for Scottish ferry services in the past - e.g. P&O, Serco-Denholm, Superfast Ferries of Greece. The blunt fact is, there is actually no guarantee that the Executive could persuade operators to act as SOLR in this case – even if they expressed a willingness in principle, such a promise would be impossible to enforce given the powers the Executive have and propose in this context. Indeed, firms such as Superfast, P&O and Serco-Denholm cannot be expected to accept "direction" from the Executive, without or without legislation, if it does not suit their interest at the particular time. The weakness of the Executive in this context has been demonstrated in the case of the recent withdrawal of operators on the Campbeltown-Ballycastle and Invergordon-Orkney cases, where the Executive could do little more than express regret. Handwringing does not guarantee continuity of supply of service.

I cannot see any obvious solution to the SOLR problem in the case of the Executive’s proposals, and this alone raises questions concerning their workability.

Some other brief points:

- Even if the SOLR problem can be solved, the Executive’s proposals still raise severe problems. As I have noted, there will be strong incentives on the part of a private firm to put in a loss-leading bid to get rid of CalMac permanently from the scene. Once it is incumbent, it will be in a strong bargaining position to renegotiate or breach contract, especially if there is no CalMac and there is no SOLR. The EU can be expected to assume (and may ensure) that the firms bidding for the lowest subsidy will win the contract, so it will be difficult or impossible for the Executive to turn down a loss-leading bid, even if it believes it to be a loss-leading bid.
- The case for an independent regulator in such cases is so well established that it is for the Executive to justify why it is not needed here. This they have not done.
have separately argued that CalMac’s fares appear extremely high when compared to other domestic ferry operators in other countries. There are strong economic and social arguments for putting this in the hands of a regulatory agency and buffering these issues from short term political interests (see Professor Prosser’s evidence). A case can be made for including councils and enterprise agencies in this process.

- The resourcing of independent regulatory control need not be expensive. The Executive already allocates significant resources to inhouse analysis and commissioning of consultancy reports from external sources in this context, and some of these resources could be diverted to support and advise the new regulator or agency. The Regulator or Regulatory Board or Tribunal could be appointed largely or entirely on a part-time basis, possibly with an advisory panel of outside experts as happens in other contexts.

Professor Neil Kay

13th June 2001
Highland and Islands Ferry Services

If possible, I would like to add a codicil to my evidence submitted yesterday. I have since received comment from informed industry sources that although the Executive still plans to tender CalMac's routes this year, in their view this is not realistic and tendering is not likely to take place until 2003 or even 2004.

If this is accepted, it has are two implications. Such potential delay reinforces the point I have made earlier that the tendering process is likely to overlap or overshoot the EU's own review of its guidelines in this context planned for 2002. There is every reason why the proposed CalMac tendering process should be included in this review process and not go ahead without reference to it.

The second implication relates to the point made by Professor Prosser that experience at UK level suggests that proper regulatory control and mechanisms should be put in place before tendering takes place. In addition to the points made by Professor Prosser, it should be noted that many of the present aspects of the CalMac network and operations (including the present level of fares - which in my view is unjustifiably high, and which will not be reduced by the current review process) are likely to be locked into the period of the tender (5 years). If tendering does not take place until 2003-04, this means that the window of opportunity which exists to seriously review fare levels will be missed, and there may then be little, if any, scope for major changes in specifications, including fares, until 2008-09.

Professor Neil Kay
TRANSPORT AND ENVIRONMENT COMMITTEE: EVIDENCE TAKING ON HIGHLANDS AND ISLANDS FERRY SERVICES

THE NEED FOR INDEPENDENT REGULATION

Tony Prosser, John Millar Professor of Law, The University of Glasgow

I would like to thank the Committee for asking me to give evidence on this matter. I am a lawyer specialising in law and economic regulation, and have written extensively on this area (eg Nationalised Industries and Public Control in 1986; Law and the Regulators in 1997). I am convenor of the Centre for Regulatory Studies at the University of Glasgow, and I also serve as utilities consultant to the Scottish Consumer Council and am on the Academic Advisory Panel to the Water Industry Commissioner for Scotland and the Advisory Panel to the National Audit Office study of the regulation of postal services, though of course this evidence is written in a personal capacity.

The Need for Independent Regulation
In this evidence I shall concentrate on the need for an independent regulator as an integral part of the process of tendering the lifeline ferry services. The need for such regulation in general has become well-accepted in the UK and as part of the European Union process of opening up essential services to competition. For example, in the case of telecommunications, the Commission has described the creation of independent regulatory authorities as ‘the cornerstone’ of the entire package for introducing competition.

One major reason for the acceptance of the central role of such regulation is that the need for regulation continues beyond the initial process of tendering or privatisation. Firstly, of course, the terms of any contract reached as a result of the tendering process need to be policed. Secondly, it is a universal lesson that future contingencies cannot be fully anticipated at the time of tendering or privatisation. Thus, in the case of the privatised utilities such as telecoms and energy, provision is made for the modification of the initial licences granted to deal with unanticipated problems such as new types of anti-competitive conduct, and for the revision of price controls. A further example is in the case of Railtrack, where the licence has had to be amended to impose more effective obligations to invest in the maintenance and improvement of the rail network. An extreme example would of course be failure to provide a service, for example through withdrawal or bankruptcy, and allocation to an operator of last resort. Thirdly, it will be necessary to have proper scrutiny of the meeting of public service requirements, such as the provision of a universal service and the maintenance of quality of service. Once more experience has shown that, although some standards can be imposed at the time of privatisation or tendering, in practice these will need modification with experience of their operation in practice.

The alternatives to independent regulation are to leave these matters to the dominant operator or for a government department to undertake these tasks directly. The former is unacceptable in a competitive environment as it permits one of the market players to dictate the central conditions in which competitors (current or future) will have to operate, thereby conferring a major competitive advantage. The role of player in the market and of referee are incompatible, and were only acceptable under public
ownership on the assumption of a continuing monopoly role for the public enterprise. Regulation by government department is also increasing seen as inappropriate. The obvious danger is that of intervention on political grounds by government, the possibility of which is a major deterrent for any private investor. A further difficulty arises where government retains a stake in one of the enterprises tendering or otherwise participating in the market, as will be the case, of course, for CalMac. To give a government department a regulatory role in this situation is once more to confuse the role of player and referee as government will be permitted to set conditions which financially benefit its own holding in the enterprise. Once more, operational and regulatory functions must be separated.

Independent Regulation and Public Enterprises

Because of this latter concern, there has been an increasing tendency to establish independent regulation of enterprises which remain in public ownership. The most important UK example is that of the Post Office, which was converted into a government-owned plc in March this year; provision was also made for increased competition with it and for it to be given greater commercial freedom. As part of the change, the Postal Services Act 2000 established a two-tier system of regulation. At the top is Postcomm (the Postal Services Commission) which is responsible for licensing the Post Office and its competitors and as part of that process protecting universal service and ensuring fair competition, including through price control. The second tier consists of Postwatch to protect consumer interests. A further example closer to home is that of the Water Industry Commissioner for Scotland. Although privatisation of the Scottish water industry is firmly off the political agenda, the Commissioner has been given the task of promoting the interests of consumers through advising on charges and in a number of other ways; with the possible development of competition in the industry he will also acquire a role in the licensing of competitors. Indeed, his role is to be increased by the forthcoming Water Services Bill to be introduced by the Executive in the near future.

The one example where it was not intended to introduce independent regulation at the time of contracting out a key service was in the arrangements for the London Underground Public/Private partnership, where an arbiter able to act only as permitted under the PPP contracts has been proposed. This has been heavily criticised, for example by the Environment, Transport and Regional Affairs Committee of the House of Commons and by the Financial Times, both of which have advocated independent regulation. After serious legal and political difficulties, agreement has now been reached that the Transport Commissioner for London will assume a quasi-regulatory role through protecting the public interest in the agreement of the contracts. It is imperative that the process of tendering ferry services avoids the difficulties which have been associated with the PPP.

When Should a Regulator be Established?

A final question is that of the timing of the establishment of independent regulation. In the major UK utility privatisations the regulator started operations only after privatisation; the key terms on which the privatised enterprise would operate were set by government in the initial operating licence which it granted. It is now recognised that this was a serious error. Price controls were set too generously, partly to aid privatisation and partly because of serious underestimates of the efficiency savings which could be made. In addition, the provisions dealing with anti-competitive
conduct were inadequate because no proper assessment had been made of the role of
the privatised enterprise in the market. As a result, the regulators were faced with the
difficult task of correcting these errors through licence modification after the licences
had come into effect, and indeed the ‘windfall tax’ was necessary to recover excess
profits made under the initial price controls. More recently the trend has been to have
the initial conditions on which competition operates, including the initial price
controls, set by the independent regulator. This was the case with Railtrack and more
recently with the Post Office, where the initial licence, including protection of
universal service, price control and prohibitions of anti-competitive conduct, was
issued by Postcomm before the new plc’s vesting date. This could be seen as likely to
cause serious delays due to the need to create a new statutory framework in
legislation. Such a framework is indeed desirable for reasons of clarity and
transparency, but, should time prevent it, a new regulatory body could be set up in
shadow form before the legislation is passed; the Strategic Rail Authority is a recent
example of such a shadow body, only very recently having been given full legislative
backing under the Transport Act 2000.

In this evidence I have concentrated on general issues relating to independent
regulation rather than the specifics of ferry tendering as no doubt detailed evidence
will be provided by others on these matters. I hope that this evidence is of assistance
to the Committee.

Tony Prosser

Scottish Parliament Transport & Environment Committee
Investigation into Tendering of Highlands & Islands Ferry Services

There are many matters of concern to Local Authorities in the Highlands & Islands in relation to the proposed tendering of ferry services currently provided by Caledonian Macbrayne Ltd, in accordance with European State Aids legislation:

- There is strong desire to see the present Calmac network tendered as one operating unit. This would give the successful operator maximum flexibility of vessel deployment, subject to the various route characteristics, in the event of breakdown or annual maintenance scheduling. The fleet has traditionally operated with a standby vessel for sound operating reasons. Tendering as one block is seen as the foremost priority.

- It is understood that there are no Calmac services that make a profit. Careful consideration will have to be given to the tender specification of operating timetables so that these vital services can continue to be provided as they are currently, as an absolute minimum, in relation to fare levels, frequency of operation, hours of operation, vessel capacity. There is a wider issue here that the tendering exercise should not result in diminution of current levels of service. If there are efficiency savings then these should be ploughed back into the provision of better ferry services/fares reductions.

- It is important that routes currently operated but not within the undertaking are included in the tendering process.

- There is concern over how the issue of competition on individual routes will be handled i.e. the potential for predatory competitors creaming off lucrative freight only traffic or competing operators coming on to routes at peak periods i.e. during the summer. There should be legislation which contains powers to grant exclusive rights for ferry routes in order to combat cherry picking and thereby minimising the levels of support required from the public purse. (Parallel with bus Quality Contracts).

- There is concern that the levels of investment in new vessels is ensured so that it is in line with the current regime of vessel replacement at 20 years and with sufficient capacity for breakdown and maintenance relief.

- It is understood that the current Calmac operation is to be split into two – vessel and infrastructure owning company and an operating company which can bid for the operation of the routes in competition with others. There is concern that a contract period of 5 years may not be appropriate.

- It will be vital that arrangements are in place to cover for the event of operator default, bearing in mind the lifeline nature of these services.

- It will be necessary to have future consultation arrangements, which are meaningful and effective. There needs to be clear accountability of operation for any new incumbents in the provision of ferry services on the current Calmac routes. The existing set up of Shipping Services Advisory Committees or some
other form of community consultation which is at least as effective needs to continue in order that the views of communities served can be recognised.

- Someone needs to take a clear lead in the coordination of the marketing of services under the new arrangements. This person or body should be responsible for ensuring the effectiveness of this and for managing through ticketing arrangements should the network be split up in any way. Particular regard is required to reaching overseas markets.

- The issue of Road Equivalent Tariff (RET) needs to be considered in relation to the tendering procedure.

- The Highlands & Islands Strategic Transport Partnership and the Local Authorities are keen to have an input into the specification of the new services in relation to fares, routes and levels of service. The body which oversees the contract(s) should include representatives from the communities served. The Scottish Executive itself should arrange extensive public meetings when seeking views on tender service specifications, to ensure it obtains at first hand a true reflection of the public’s wishes on the matter.