



The Scottish Parliament  
Pàrlamaid na h-Alba

## Official Report

# INFRASTRUCTURE AND CAPITAL INVESTMENT COMMITTEE

Wednesday 31 October 2012

Session 4

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**Wednesday 31 October 2012**

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**INFRASTRUCTURE AND CAPITAL INVESTMENT COMMITTEE**

**18<sup>th</sup> Meeting 2012, Session 4**

**CONVENER**

\*Maureen Watt (Aberdeen South and North Kincardine) (SNP)

**DEPUTY CONVENER**

\*Adam Ingram (Carrick, Cumnock and Doon Valley) (SNP)

**COMMITTEE MEMBERS**

\*Malcolm Chisholm (Edinburgh Northern and Leith) (Lab)

\*Jim Eadie (Edinburgh Southern) (SNP)

\*Alex Johnstone (North East Scotland) (Con)

\*Gordon MacDonald (Edinburgh Pentlands) (SNP)

\*Margaret McCulloch (Central Scotland) (Lab)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

Belinda Oldfield (Scottish Water)

John Simpson (Water Industry Commission for Scotland)

Alan Sutherland (Water Industry Commission for Scotland)

Chris Wallace (Scottish Water)

**CLERK TO THE COMMITTEE**

Steve Farrell

**LOCATION**

Committee Room 6



# Scottish Parliament

## Infrastructure and Capital Investment Committee

*Wednesday 31 October 2012*

[The Convener *opened the meeting at 10:00*]

### Water Resources (Scotland) Bill: Stage 1

**The Convener (Maureen Watt):** Good morning, everyone, and welcome to the Infrastructure and Capital Investment Committee's 18th meeting in 2012. I remind everybody to turn off their mobile phones and BlackBerrys, because they affect the broadcasting system.

Agenda item 1 is further evidence on the Water Resources (Scotland) Bill at stage 1. We will hear first from Scottish Water. Before we begin, I would like to record the whole committee's condolences on the sudden death of the Scottish Water chief executive, Richard Ackroyd. Naturally, our thoughts are with his family, friends and colleagues at this very sad time. It is also fitting to highlight the committee's recognition of the hugely significant role that Mr Ackroyd played in the growth and development of Scottish Water in recent years.

I welcome our witnesses from Scottish Water, who are Chris Wallace, director of communications, and Belinda Oldfield, regulation general manager. Adam Ingram will begin the questioning.

**Adam Ingram (Carrick, Cumnock and Doon Valley) (SNP):** The committee has heard many calls for the definition of the value of Scotland's water resource to include not just economic value but environmental and social aspects. What is Scottish Water's view on that discussion that we have been having?

**Belinda Oldfield (Scottish Water):** Scottish Water welcomes the proposals that are laid out before the Scottish Parliament in the bill, which provide a strong statutory basis for developing Scotland's water resources in the interests of Scotland. Our belief is that there are economic, societal and environmental benefits, so we see the value as covering all the pillars of sustainability.

**Adam Ingram:** Would it be helpful to spell that out in the bill, rather than having what has been taken to be a narrow definition of the value?

**Belinda Oldfield:** That might provide useful clarification. We have certainly always interpreted the value in the wider sense.

**Adam Ingram:** Several witnesses have called for ministerial directions to designated bodies to be subject to consultation with other designated bodies and, possibly, the wider public prior to coming into force. What is Scottish Water's view on that suggestion? Would it bring any benefits?

**Belinda Oldfield:** As one of the designated bodies, we do not have strong views on that. We are fairly clear that we are designated in the bill. It might be appropriate to consult other bodies more widely should they become designated, and to have wider discussion, but we do not have strong views on that.

**Adam Ingram:** I ask Mr Wallace, as director of communications, whether it would be useful to consult the wider public on such issues.

**Chris Wallace (Scottish Water):** Our philosophy is to be as open and transparent as possible. We are answerable to the Parliament. Any channel that broadens the possibility of engagement with our public and stakeholders has to be welcomed.

**Adam Ingram:** We will take that as a yes.

The committee has heard suggestions that the requirement for Scottish ministers to report to the Scottish Parliament on the exercise of their functions under the bill after three years should be aligned with reporting requirements under other water-related legislation. What is your view on that suggestion? Witnesses have suggested that the bill requires not a rolling three-year report but simply one report after three years. What is your interpretation of that and what is your view on the reporting structure as laid out in the bill?

**Belinda Oldfield:** It is fair to say that the bill is a little ambiguous in that respect. We have interpreted it as providing for a duty to report every three years. That seems reasonable. Reporting over a longer period would not be effective, and a shorter period might be too short for there to be anything of substance on which to report. It might be useful if the bill clarified whether the requirement is to report every three years or just once.

**Adam Ingram:** What should be included in reports?

**Belinda Oldfield:** We have not thought that through, but I guess that it would be helpful for the public to understand what the Government has done, what activities have taken place during the three years and what benefits activity is bringing to the economy and the environment. We envisage an overarching report on what has been done and how much progress has been made.

**The Convener:** Part 2 of the bill is on control of water abstraction.

**Alex Johnstone (North East Scotland) (Con):** We heard from a number of witnesses that part 2 came as something of a surprise and that there was limited or no consultation on its provisions prior to the introduction of the bill. Was Scottish Water consulted on the proposed new abstraction rules?

**Belinda Oldfield:** I think that we were aware that there would be abstraction rules. We are a major abstractor, and I think that we were consulted.

**Alex Johnstone:** You are here now. What is your view of the proposals?

**Belinda Oldfield:** It is quite reasonable for abstractions at the level that is envisaged—which are perhaps exceptional; there are not a load of abstractions at that level in the country—to come to the attention of the Scottish ministers. We are quite comfortable with that.

**Alex Johnstone:** Do you have a view on the logic behind the 10 megalitre limit?

**Belinda Oldfield:** No. I cannot comment on that, I am afraid.

**Alex Johnstone:** What about the exemptions in the bill?

**Belinda Oldfield:** The exemptions are proper. There is a question as to whether they are sufficiently comprehensive. One or two sectors might well have been missed out and it would be worth clarifying whether that is the case. Scottish Water is an exempted organisation, because we abstract for the purposes of providing drinking water to protect public health.

**Alex Johnstone:** Abstraction will be exempt

“if it is carried out for the sole or principal purpose of the exercise by Scottish Water of its core functions”.

Do you anticipate that qualifying abstractions will be undertaken in relation to Scottish Water’s non-core functions?

**Belinda Oldfield:** It is clear to us that if we wanted to abstract on the non-core side of our business, we would have to come through the Scottish ministers. Indeed, we would have to come through the controlled activities regulations with the Scottish Environment Protection Agency. The exemption does not cover non-core activities.

**Alex Johnstone:** You would be treated in the same way as anyone else would be treated if you wanted to abstract on that basis.

**Belinda Oldfield:** Yes.

**The Convener:** Scottish Water said in written evidence that it supports the proposals in part 3. Some witnesses expressed concern that Scottish Water Horizons might have an advantage over its

commercial rivals in the fields of waste management and renewable energy. Did you have a role in the development of the proposals in part 3?

**Belinda Oldfield:** We were consulted on aspects of the bill relating to the separation of core and non-core activities. Our view is that the bill offers a helpful clarification that our core business is to provide water and waste water services for customers in Scotland. It is helpful to understand that the charges that those customers pay are only for water and waste water services. The bill helpfully clarifies that non-core activities will not be financed by customers and must be financed by other means. I am sure that the Water Industry Commission for Scotland will be happy to elaborate on that.

**The Convener:** I understand that, through Scottish Water Horizons, you are already investing in renewable energy generation and undertaking waste management activities. How will this part of the bill benefit Scottish Water in how it carries out its existing activities?

**Belinda Oldfield:** What is helpful is that the bill places a proactive duty on us to fully utilise, where we can, assets on the non-core side of the business for the benefit of Scotland. That might seem like a very slight and subtle movement, but the bill makes that a proactive duty instead of something that falls naturally out of our core business.

**The Convener:** Is that the only route to achieving that, or could other options, such as formal directions from Scottish ministers to Scottish Water in its role as a designated body, be considered?

**Chris Wallace:** The bill sets out a statement of ambition and expectation about how ministers want us to develop and grow our business. As you rightly point out, we are already involved in these commercial activities, but the bill provides, if you like, a formal green light and will make it much more publicly known and transparent that we are expected to move in this direction.

Relating that back to your previous question, I think that, if people are concerned about unfair advantages in a competitive market, making all this transparent and bringing it out into the open that we are expected to develop in this area will lead to more scrutiny, which can only be a good thing. There is nothing to hide here. We keep these two bits of the business absolutely separate and I am sure that, as Belinda Oldfield suggested, the Water Industry Commission for Scotland will be able to provide reassurance on the way we are regulated.

We probably would not welcome direct ministerial guidance on commercial matters,

because the market is more fluid, dynamic and competitive. Either you are a business or you are not, and part of our philosophy is that we should be given a free hand in that respect. It might be interesting to discuss the attitude to risk in the public sector, because that, too, plays into this issue. If we are acting and trying to make headway as a business—which is the expectation that is clearly indicated in the bill—it might be worth having a debate not just with the committee but more widely on the public's expectations of us, how we are to perform, how we manage risk and what is and is not acceptable. We have taken very small and careful steps into these markets; after all, given that Scottish Water Horizons has only a very small amount of share capital to invest, we have to be careful. However, now that we have been given a signal saying, "Can we have more of the same please? Can you accelerate all this?" we have to juggle that risk and, if we are going to take bigger steps, we must examine how we mitigate risk, what we need to offload and how we make our owners aware of the dangers as well as the opportunities.

**The Convener:** Do you share the concerns expressed by the centre for water law that the wording of the section defining core functions means that certain hydro nation-related activities such as the generating of electricity by Scottish Water Horizons for use by Scottish Water could fall within the definition of a core function?

**Chris Wallace:** No. As a regulated business, we are absolutely transparent. Scottish Water Horizons makes commercial decisions. I see no conflict in that respect; everything is audited and open to scrutiny.

**Jim Eadie (Edinburgh Southern) (SNP):** I want to return to the suggestion that the convener has mentioned and which you have partly addressed, which is that Scottish Water Horizons enjoys an unfair competitive advantage because it can access not only loans at favourable rates but Scottish Water's substantial facilities and land banks. You have said that you keep the different parts of your business separate and that you are happy for the issue to be subject to maximum scrutiny and transparency, but it is only fair to give you the opportunity to put on record at the committee your fullest possible response to the suggestion that you have an unfair advantage. I would certainly welcome your views on the matter.

10:15

**Chris Wallace:** I think that we would need more specific instances of what you are referring to.

**Jim Eadie:** As the convener has pointed out, the Scottish Environmental Services Association and SSE have suggested that you enjoy an unfair

competitive advantage with regard to your waste management and renewable energy activities. Could you address that point?

**Belinda Oldfield:** I can understand how that might be the perception of those organisations, but the reality is that the non-core business is financed at commercial rates and not at any Scottish Government-subsidised rate. We and indeed the Government have to be very careful of European Union state aid rules. For the record, Scottish Water Horizons does not enjoy any beneficial financing rate from the Scottish Government; everything is carried out on a proper commercial basis.

**Jim Eadie:** You are very clear that there is no breach or potential breach of EU state aid rules in this regard.

**Belinda Oldfield:** Indeed, and I also point out that we are routinely subject to scrutiny by WICS through the reviews that it undertakes as part of its auditing of transfer pricing. There is protection both for customers and for the Government in ensuring that we have no cross-subsidies between our core and non-core activities or with regard to financing from outside Scottish Water.

**Jim Eadie:** So you are not expecting a legal challenge any time soon.

**Belinda Oldfield:** No.

**The Convener:** Part 4 relates to raw water quality.

**Margaret McCulloch (Central Scotland) (Lab):** I have three questions. First, how will the bill's provisions allowing Scottish Water to enter into agreements with land managers assist in improving raw water quality? Is there anything to prevent Scottish Water from entering into such agreements at present?

**Belinda Oldfield:** The bill proposes powers for Scottish Water to enter land, if needed, to protect raw water. We do not have those powers at the moment.

We have a duty to provide customers with drinking water that is fit for consumption. However, a lot of the difficulty in treating water arises from things that happen in the catchment such as farmers' animals breaching fences and entering and putting faecal matter in a watercourse, the use of particular pesticides on crops and so on, and we are actively working with land managers, farmers and landowners on behavioural changes to ensure that, for example, there are properly fenced-off buffer zones. We would also talk to land managers and farmers to make them aware of the difficulties that their activities were causing the water environment.

There are, therefore, a number of strands to this issue, including educating and raising the awareness of the farming community. For example, we are having on-going discussions with farmers about switching the pesticides in use and encouraging them to use pesticides that have less impact on raw water. If we can manage the raw water problem at source and increase the quality of the raw water that comes into treatment works, we will be able to reduce the cost of treatment, which in turn will reduce charges to customers. Indeed, at the moment, we are working actively with a lot of land agents, land managers and farmers in the Ugie and Deveron catchments.

In any case, we think that the proposed powers will be used very judiciously and that they will give our catchment liaison officers legitimacy as they walk the catchments and build relationships with farmers.

**Margaret McCulloch:** Is that not part of SEPA's role?

**Belinda Oldfield:** As a monitoring and enforcement agency, SEPA walks a number of what it regards as priority catchments for the environment. The proposed powers are very complementary, but I note that our focus is different and relates to the protection of raw water for consumption and public health reasons.

**Margaret McCulloch:** Evidence has highlighted the importance of a catchment-wide approach to managing Scotland's water resources and suggested that Scottish Water must work in partnership with land managers, local river basin management teams, and other bodies such as the Royal Society for the Protection of Birds to ensure that the quality of raw water is managed properly. To what extent do you work in partnership at local level? Could the bill do more to emphasise that type of catchment-wide approach?

**Belinda Oldfield:** We are currently working in partnership with SEPA and NFU Scotland, we are involved with the voluntary initiative in the River Ugie and we are about to start conversations with the RSPB. Certainly, our approach is highly collaborative with stakeholders in the environment. We have also been working with SEPA on shared training initiatives in which Scottish Water staff are being trained by SEPA, so that we can dovetail our activities and work collaboratively. The bill proposals are quite extensive in that regard and they are sufficient; my personal view is that they could not be reinforced further.

**Margaret McCulloch:** The centre for water law is concerned that Scottish Water may end up entering into agreements that support land managers simply to meet their legal requirements. Can you give any assurances that that will not occur?

**Belinda Oldfield:** Absolutely. We are very clear that, first and foremost, farmers' activities must comply with the general binding rules that have been set out in Scotland, which SEPA enforces. That is the baseline, but we enter into activities and agreements with farmers beyond that. Such activities and agreements include the provision of biobeds, which are biological beds that take away pesticide run-off when farmers fill up sprayers, and working with farmers to encourage them to fill up pesticide sprayers far from watercourses. We provide advice and finance to help farmers to put in place biobeds and extend buffer strips. We also help farmers to switch pesticides, in circumstances where it is beneficial for them to cease using chemicals such as metaldehyde and switch to some other pesticide. Those activities are beyond the general binding rules, and we are very clear about that.

We have been in discussion with the Scottish Government state aid department. Our schemes have been through the European Commission to ensure that we do not infringe state aid rules.

**The Convener:** There are no questions about part 5, so Gordon MacDonald will ask about part 6.

**Gordon MacDonald (Edinburgh Pentlands) (SNP):** I want to ask about the sewer networks. I understand that Scottish Water supports most of the proposals in part 6. In its written evidence, Scottish Water indicated that those proposals will support the development of a catchment management approach to the urban drainage network. What does an urban catchment management approach involve and how do the proposals in the bill assist in its development?

**Belinda Oldfield:** That goes back to the earlier conversation on powers of entry. We currently have catchment liaison officers out in the environment who walk rivers that are of particular interest to us because we are aware of pollutants coming into the sewer system, which is essentially an open system. With the powers that are proposed in the bill, we could have liaison officers or catchment inspectors who would be able to enter premises if we found significant inputs of something in the sewer system that should not be there. We would then work in collaboration with SEPA and its enforcement powers to make sure that that activity ceased.

**Gordon MacDonald:** Would private owners be expected to bear the cost of any improvement work?

**Belinda Oldfield:** In all likelihood, yes. It is very difficult to say in the absence of specifics, but it is probable that they would be infringing a particular aspect of their licence. The proposals in the bill



would give us the power to undertake active monitoring to check that.

**Gordon MacDonald:** We have heard evidence that Scottish Water should investigate innovative ways of connecting properties that are served by septic tanks to the sewer network. Does Scottish Water have any long-term plans to connect such properties to the public network?

**Belinda Oldfield:** As a general comment, no. Septic tanks are a highly sustainable and efficient way of treating waste water in a rural environment. It would not be cost effective for the generality of customers for us to start on a programme of connecting every septic tank to the sewerage network. There may be circumstances in which environmental issues arise and it becomes important that some other solution is found. Connection to the public network is absolutely a last resort. We work with householders, when appropriate, to help them to empty and maintain septic tanks routinely, and we give them advice. If a septic tank were having a huge environmental impact in a community setting, we would look, along with SEPA, at some other solution on which we could work with the community.

**Gordon MacDonald:** You said that septic tanks work well, but we have had evidence that only around 60 per cent, or two thirds, of all septic tanks are registered. The bill includes proposals whereby a proprietor could take responsibility for maintaining and emptying a shared septic tank without the consent of other owners. Given that we do not know about the ownership of a third of septic tanks, and that some owners may not be willing to take responsibility for maintaining their tanks, should Scottish Water have a role to play in taking over ownership or maintenance of those tanks in the interests of public health?

**Belinda Oldfield:** In response to your first question, we have certainly had discussions with SEPA about shared communication campaigns on septic tanks and the on-going need for emptying and maintenance. We would be happy to engage in such campaigns.

As far as your suggestion about addressing specific issues in the interests of public health is concerned, we would have to look at that.

**The Convener:** Malcolm Chisholm has some questions on water shortage orders.

**Malcolm Chisholm (Edinburgh Northern and Leith) (Lab):** In your submission, you indicate that water shortage orders are likely to be used only infrequently, with voluntary arrangements between Scottish Water, SEPA and land managers being the usual method for dealing with shortages. How do such voluntary arrangements currently operate? Have there have been any recent water

shortage incidents during which the powers in the bill would have proved useful?

**Belinda Oldfield:** It is fair to say that in Scotland, unlike in the south-east of England, large-scale water shortages have not happened for some time. However, we experience short-term, smaller-scale water shortages. We had shortages in Dumfries and Galloway in 2010, following periods of oddly dry weather. The fact that our storage facilities in that area are not large led to shortages. We worked collaboratively with all the stakeholders to ensure that a supply was maintained to customers during that period.

The proposals in the bill will modernise all the legislation to do with water shortages. What happened in Dumfries and Galloway highlighted the fact that the timescales under the existing legislation are such that there was a lack of responsiveness. The proposals in the bill will enable us to tackle water shortages by undertaking the activities that are needed to guarantee supplies to customers, through agreements with local landowners and so on, much more readily.

**Malcolm Chisholm:** That was helpful.

In the event that water shortage orders are issued, does Scottish Water intend to treat certain non-domestic consumers differently, depending on what they require water resources for?

**Belinda Oldfield:** I think that that would depend on the area that the water shortage was in and the types of non-domestic user that were in that area.

**The Convener:** As we have no further questions for the witnesses, I thank them very much for their evidence.

10:30

*Meeting suspended.*

10:32

*On resuming—*

**The Convener:** We continue with our evidence-taking session on the Water Resources (Scotland) Bill by hearing evidence from the Water Industry Commission for Scotland, commonly known as WICS. I welcome the witnesses from WICS—Alan Sutherland, the chief executive, and John Simpson, the director of analysis—and thank them for their written evidence.

**Adam Ingram:** What impact, if any, will the implementation of the proposals in the bill have on the price review for the period after 2015?

**Alan Sutherland (Water Industry Commission for Scotland):** The impact will be marginal, I think. To be clear, we are the economic

regulator for the core functions of Scottish Water. We have no involvement in any of its non-core activities, with the exception of its retail activity, in relation to which we have general responsibility for the licensing framework that allows Scottish Water Business Stream to compete alongside other retailers for non-household customers.

**Adam Ingram:** Will the proposals in the bill have any impact on price or customer service for Scottish Water's customers?

**Alan Sutherland:** The prices paid by Scottish Water's core customers—households and the retailers that pay wholesale charges to Scottish Water—will be at the lowest level that is consistent with the delivery of the objectives that the Scottish Government sets out. In essence, our job is to take the Government's objectives for the industry and its principles for charging and calculate the lowest reasonable overall cost of delivering them. We will keep that number as low as we can reasonably keep it, consistent with a sustainable industry, which we all want.

**Adam Ingram:** There is nothing intrinsic to the bill that would create upward pressure on prices, for example.

**Alan Sutherland:** No. Some of the things that you have discussed around catchment management and the like would push the other way and help us to keep bills down. The better regulation of fats and greases in the sewer system would clearly help to keep costs down. Such measures ought to help but, in the great scheme of things, they are relatively marginal to the overall impact on the end customer.

**Adam Ingram:** In terms of customer relations and customer service, you have heard some arguments about the need for wider public consultation on certain issues. Are you satisfied with Scottish Water's claims to be open and transparent? Is it consulting the public to a good standard, or could that be improved?

**Alan Sutherland:** It is always possible to improve communication and interaction with customers and stakeholders generally. However, within the core activities that we observe, Scottish Water is very active in communicating both at a local level and more generally about where it is going as a business.

**Alex Johnstone:** In your opinion, is the way in which the bill separates Scottish Water's core and non-core functions robust enough to ensure that we do not end up with customers paying extra to finance non-core activities?

**Alan Sutherland:** It is our job to ensure that they do not.

**Alex Johnstone:** Is the bill strong enough in its definition to avoid that?

**Alan Sutherland:** Yes, I think that the bill is strong enough—absolutely.

On a fairly regular basis, every two or three years—although, given other witnesses' comments, we will start again—we look very hard at how Scottish Water allocates its costs in order to ensure that there is no question of households or business customers picking up the costs of commercial activities. Although they do not pick up any of those costs, it is for the Scottish Government to decide where any benefits that accrue get allocated. It may choose to leave some of them in the business for households, or it may choose to use them for alternative purposes. What cannot happen is that customers get any of the benefits but bear none of the costs—that would not work in a rational commercial world. If we want Scottish Water to compete in its non-core activities, we must allow it to behave like a business.

**John Simpson (Water Industry Commission for Scotland):** Each year, we collect detailed accounting information that contains Scottish Water's allocations of costs between the core business and the non-core business so that we know what is going on. In addition, each year, we get a list of the transactions that have taken place between the core and non-core parts of Scottish Water, so that we know what is going on there, too. From time to time, we also carry out a detailed review, looking behind that information at the detailed paper trail within Scottish Water. We are very aware of the importance of ring fencing the core business from the non-core business, and it is a matter of our being on the ball, year on year, in ensuring that things are as they should be. We think that we have the necessary powers and procedures to do that.

**Alex Johnstone:** The bill places a duty on Scottish Water to pursue a number of non-core functions. Are you satisfied that that change will not impact on Scottish Water's pursuit of its core functions? Might we be diluting—a dangerous word, which I was trying to avoid—Scottish Water's pursuit of its core functions?

**Alan Sutherland:** Certainly we will have no regard to that in the efficiency challenge that we set before Scottish Water. Scottish Water will have the same regulatory settlement that it would have had irrespective of what it does in non-core areas of activity. It is for Scottish Water to find a way of justifying that. If Scottish Water needs extra resources in the non-core area in order to pursue those activities, that will be a commercial decision for Scottish Water and, frankly, that is not something that we will take much interest in. We are focused on ensuring that the core business performs in absolutely the very best way that it can to the benefit of customers in Scotland. In

Scotland, we have the lowest average household charges and, going forward, we see no particular reason for increases beyond the rate of inflation.

**Alex Johnstone:** If Scottish Water fails to get on with its core business, such as making sure that its pipes do not leak, you will be the first to point it out.

**Alan Sutherland:** We will indeed. You can rest assured of that.

**Malcolm Chisholm:** Given that Scottish Water is already investing in renewable energy generation and waste management activity, is part 3 of the bill necessary? Will it benefit Scottish Water in carrying out such activities?

**Alan Sutherland:** I suppose that it is worth making a clear distinction here. Scottish ministers place on Scottish Water certain obligations within the core business, such as using certain proportions of green energy. Those are strategic decisions that have been made by Government and, as such, we ensure that those activities are funded at the lowest reasonable overall cost along with everything else. Where Scottish Water goes beyond that, it becomes a non-core activity. Some renewables activities are core because they are part of the defined objectives that have been set out by the Scottish Government; other renewables activities are not part of what has been defined by the Scottish Government but are at Scottish Water's discretion. I guess that the bill is trying to provide much greater clarity around those activities by drawing a very clear distinction between them and what is required by ministerial objective.

**Malcolm Chisholm:** In practice, is there not a clear distinction at present?

**Alan Sutherland:** On the margin, it can always be questionable how much comes from one source versus another. Things such as wind energy are very variable in the amounts that they put into the grid, so you will get slightly different answers depending on the time period that you look at. I think that it is just worth having the clarity there.

**Malcolm Chisholm:** Will it help your work to have that clarity?

**Alan Sutherland:** I suspect that it is one of those additional things that John Simpson mentioned. We get lists of transactions and this is another thing that we can add to that list to ensure that we get greater clarity.

**John Simpson:** On the margins, it can only help. As and when the activity increases in size, it becomes more material and more important that we have clarity at the boundaries.

**The Convener:** I want to look a bit more closely at Scottish Water's subsidiaries. We have heard concerns from others that Scottish Water Horizons may be operating at an advantage in comparison with commercial rivals in the fields of waste management and renewable energy due to its access to loans at favourable rates and access to substantial existing facilities such as land banks. How do you respond to such concerns?

10:45

**Alan Sutherland:** All businesses have modestly different costs of capital, depending on ownership structure, levels of debt and the quality of management. Simply comparing the cost of capital of one business with that of another does not necessarily show that a business has an advantage, or if that does show an advantage, it does not necessarily show why there is an advantage. The arrangements for the expected returns of Scottish Water Horizons or for the costs of debt that it is charged are purely matters for the Scottish Government. You have heard this morning about state aid rules that must be abided by.

In the retail space, we clearly set a return that Scottish Water Business Stream must be capable of earning, to ensure that it has absolutely no advantage over other potential retailers in Scotland. So although Business Stream is publicly owned and, similar to any element of a public entity, is accountable through Scottish Water to the Parliament, it has absolutely no financial advantage. Given that, legally on paper, the structures of Horizons look similar to those that we created for Business Stream, I would assume that similar arrangements exist. However, the right people to ask about that are Scottish Water and the Scottish Government. I assume that they will be careful, as we have been. The Scottish Government was keen for us to be careful on the issue to ensure that the cost allocations that are made are reasonable and fair and do not compromise people's ability to compete. No two businesses will be absolutely identical. If one has a bit more land than another and if the land happens to be at the top of a hill, it might or might not be better land for a wind farm, depending on the circumstances.

**The Convener:** We have heard evidence from others that the Scottish Government's support of Scottish Water Horizons might breach EU state aid rules. Do you have a view on those claims?

**Alan Sutherland:** We have taken counsel's opinion on state aid for other purposes. Based on that opinion, I think it unlikely that the Government is breaching the rules. In essence, under those rules, there must be a material advantage that impacts on interstate trade in a material way. It is

unclear that any of the specific projects in which Scottish Water would be involved are big or substantial enough to be caught by that. That does not mean that the Government does not want to be careful on the issue. It certainly does not want to be cavalier and it wants to ensure that the financing is not overtly generous.

**The Convener:** The bill allows the Scottish ministers to make loans and grants directly to subsidiaries of Scottish Water as part of the total annual Scottish Government finance that is provided to Scottish Water. What is your view on that proposal? Could such additional funding deplete the available resources for Scottish Water's core water and sewerage functions?

**Alan Sutherland:** It certainly would not be desirable if it impacted in any way on the levels of borrowing that were made available to Scottish Water for its core functions. We consider the borrowing carefully in relation to Scottish Water's on-going financial sustainability. We want to ensure that we do not delay expenditure that will ultimately put up bills just to keep bills a bit lower than they otherwise would be today. We want to create a financial regime for Scottish Water in which we can look ahead confidently, as we can now, and we see no particular reason why bills need to go up in the foreseeable future, which includes beyond 2015, when the next regulatory period kicks in.

If someone decided that no borrowing at all was going to be available to Scottish Water because the money was all going into its non-core activities, there would clearly be an impact on household bills. We would no doubt want to say something about that, but I suspect that quite a lot of MSPs might want to say something about that as well.

**The Convener:** I am sure that they would.

**Margaret McCulloch:** The committee has also heard calls for Scottish Water to promote water efficiency among its customers with a view to reducing costs. What are your views on that?

**Alan Sutherland:** Scottish Water is already required to give advice to customers on water efficiency. On the non-household side, Business Stream has set up a whole new business activity—it is irritating because I want to call it a business stream—that provides advice to non-household customers to save them money. However, the truth of the matter is that saving water does not reduce costs very much, at least not in the short run. Until the next asset replacement cycle, when the size of the assets can be reduced, customers are just reducing the amount of water that they consume. That literally saves them the cost of the energy to pump the water and the cost of the chemicals that go into it,

which would be about 2 or 3 per cent of costs. Is that right, John?

**John Simpson:** It is about 3 or 4 per cent.

**Alan Sutherland:** It is just not that big a deal. Yes, it is desirable—anything that allows us to reduce abstraction and leave the environment in a better state is a good thing—but it is not a big deal from the standpoint of reducing costs to customers.

**Gordon MacDonald:** Consumer Focus Scotland expressed concerns about the operation of the deemed contract system in the energy supply industry. It said in its evidence:

“our experience in the energy sector tells us that lack of clarity and agreement between suppliers and customers on whether, and what, services are being provided can cause significant, sometimes intractable, problems.”

Can you explain what WICS is doing to learn the lessons of how the deemed contract system has operated in other industries in order to prevent such issues from arising in the water industry?

**Alan Sutherland:** It is not entirely clear what Consumer Focus Scotland is saying in that regard. Deemed contracts are about introducing clarity as to the responsibility of each particular customer behind a particular meter. The likelihood is that we will keep it as simple as we possibly can, so if there are six customers behind a meter, they are each going to be liable for one sixth of the total bill—it is not going to be any more complicated than that.

The difficulties arise when we start trying to put in exemptions for this or that or adjust for the number of rooms here or say that that customer is on the top floor so their water pressure is not quite so good. Once we get into that territory, we introduce complexity. The art is to get something that is simple and clear—the responsibilities need to be clear. That is certainly our starting point. Clearly we will consult on the proposal and we will see what the responses are, but I suspect that we will get some people who desire a bit more complexity and who will argue for that because they think that they might be best served by it. However, if we are going to solve the problem, keeping the responsibilities as simple as humanly possible is the key.

**Jim Eadie:** Good morning, gentlemen. Your written evidence raises the issue of non-domestic customers who are connected to shared supplies but do not contribute to the operation and maintenance of the public water and sewerage network. I am keen to understand the scale of that problem. Will you please enlighten us on how big the problem is? Can you quantify the number of non-domestic customers who benefit from the network but do not contribute to it? Do we know

what the loss of income is and what it means for suppliers?

**Alan Sutherland:** At one level, the figure is very small. Business Stream's entire bad debt charge—this relates to non-payers and people whom we know are liable but who are not paying—was about 0.7 per cent the last time that I looked. That has come down considerably since Business Stream was set up.

**Jim Eadie:** Will you put a figure on that?

**Alan Sutherland:** The figure is 0.7 per cent.

**Jim Eadie:** What does that mean in terms of income?

**Alan Sutherland:** Sorry—that is 0.7 per cent of about £300 million, which is £2.1 million.

**Jim Eadie:** Not insignificant sums are involved, although the percentage of the overall business is small.

**Alan Sutherland:** That is the entire bad debt charge, which does not relate just to the issue that you raise.

**Jim Eadie:** I am trying to quantify the extent of the problem. We will discuss your suggested solution, so I want to understand the problem.

**Alan Sutherland:** The issue forms a small part of the £2.1 million of debt.

**Jim Eadie:** After the meeting, could you provide the committee with the information that I am asking for, so that we can better understand the issue?

**Alan Sutherland:** We can certainly provide the information that we have—that is not a problem. However, a problem is that we do not necessarily know the position. I will try to explain that.

When an occupier leaves premises, they call up to have the electricity or gas disconnected. When someone else moves into those premises, someone has to flick a switch. Suppliers of gas, electricity, telecoms and other things can easily disconnect services temporarily and then reconnect them.

The only way of definitively disconnecting someone from water services is to cut a pipe, which is a radical solution. We do not do that. We can turn a stopcock or whatever, but someone can turn that on without telling anyone.

The water industry has more of a problem when the tenancy of household or non-household premises changes, because someone has to tell us and admit that they have moved in and are now liable for the bill. Some businesses—and, for that matter, some householders—are less scrupulous than others are in admitting exactly when they moved in and became liable. Part of the issue is

that such use is going on when we do not know that it is going on. We are trying to get as much clarity about that as we can.

**Jim Eadie:** We are looking for clarity and I am grateful for your explanation. It is clear that the situation is not straightforward; otherwise, you would have more information to provide to the committee.

You ask us to consider a solution—the incorporation of a new provision in the bill—but we do not know the extent of the problem. Is that an accurate summation of what you are saying?

**Alan Sutherland:** We know that the issue causes frictions, which are identified by retailers that are competing for customers. Before there was a contestable market on the non-household side, Scottish Water worried about whether the right amount of revenue was coming in from its non-household customers to cover the costs that it allocated to those customers. It did not worry about whether properties A, B and C were paying exactly the right amounts. In a contestable world, that changes. If someone wants to switch a customer but finds that that customer has not been paying, it is clear that that customer is exempt from the market.

When you start to discover that someone is getting a service and not paying for it, everyone else's bill is marginally increased as a consequence. There is a need to ensure that that sort of friction is addressed as proactively as possible.

11:00

**Jim Eadie:** Just to be clear, the amount involved would be a very small percentage of the £2.1 million that you mentioned.

**Alan Sutherland:** Yes.

**Jim Eadie:** Really, the principle is that all non-domestic customers should contribute towards the network rather than possibly help to bankrupt the company.

**Alan Sutherland:** Yes, absolutely.

**The Convener:** Environmental groups have suggested that WICS be added as a designated body. What is your view on that?

**Alan Sutherland:** My personal view of the way in which we do our job is that we take strictly the objectives and principles of charging that we are given by Government and then calculate the lowest reasonable overall cost from those. We have no remit to say, "This does not seem to be value for money, so why are we doing it?" In many cases, these are essentially political or national state obligations, and it is not really for us, as the bean counters of how much money Scottish Water

should be given, to have a view on such things. That is what the Government does and that is what the Government is accountable to the Parliament for. I do not think that, as a matter of practice, involving us in conversations about environmental value for money would be a particularly useful step forward.

One of the real strengths of the governance framework that was created for the industry in Scotland is the fact that everyone's role is very clear: the Government has a very clear role in setting objectives and the principles of charging; we have a clear role in counting up how much that should cost households and non-household customers; Scottish Water has a very clear delivery role; and then there are the two quality regulators in the form of SEPA and the drinking water quality regulator. Everyone's role is very clear. Anything that confuses that, changes responsibilities or blurs accountabilities would not, I think, be a very good idea.

**The Convener:** There are no more questions, so thank you very much, gentlemen, for your evidence today. I briefly suspend the meeting to allow the witnesses to leave the room.

11:03

*Meeting suspended.*

11:04

*On resuming—*

## Subordinate Legislation

### Housing (Scotland) Act 2001 (Assistance to Registered Social Landlords and Other Persons) (Grants) Amendment Regulations 2012 (SSI 2012/258)

**The Convener:** Item 2 is consideration of an instrument that is subject to the negative procedure. I refer members to paper IC1/S4/12/18/3 and the regulations. No motion to annul has been lodged in relation to the regulations.

The Subordinate Legislation Committee has brought two issues to our attention, one of which relates to what that committee thinks is defective drafting. As our paper says, the problem

“relates to the part of the Regulations that is meant to provide for the procedure ... which local authorities must follow in considering applications for IIF”—

innovation and investment fund—

“grants.”

The Subordinate Legislation Committee said:

“It does not appear that”

the instrument

“contains any provision which regulates the procedure to be followed by local authorities in considering applications for IIF grants. The document rather concerns itself with how the Scottish Ministers and COSLA will deal with applications for IIF grants from local authorities themselves.”

The committee said that there is, therefore,

“doubt as to whether the instrument effectively makes any provision as to the procedure to be followed by local authorities, despite that being its apparent intention.”

I invite comments from members.

**Malcolm Chisholm:** It would be good to get the Government officials along to next week's meeting. Based on what the Subordinate Legislation Committee said, I have concerns about the regulations, but it would be reasonable to hear what the officials have to say in response.

**Margaret McCulloch:** I agree.

**The Convener:** Okay. I take it that the committee agrees to defer consideration of the regulations and to invite Government officials to next week's meeting, so that they can explain the position.

## European Union (Reporter)

11:07

**The Convener:** On 9 December 2010, the Parliament agreed to introduce a Parliament-wide scheme for European Union engagement and scrutiny, including an early warning system for EU legislative proposals, which requires subject committees to appoint EU reporters and to scrutinise EU proposals in their areas. Now that Aileen McLeod has moved on to another committee, we must appoint a new reporter. I refer members to paper ICI/S4/12/18/4 and invite nominations.

**Adam Ingram:** I nominate Jim Eadie.

**Alex Johnstone:** I hear that Margaret McCulloch is interested.

**The Convener:** You should have let us know, Margaret. Do members agree to appoint Jim Eadie, or do we want to have a vote?

**Malcolm Chisholm:** I think that we need to have a vote.

**Alex Johnstone:** We could shut the two of them in a room.

**The Convener:** Rather than go to a vote, we can defer the decision until next week, so that we can discuss the matter and see whether we can reach agreement. Let us do that.

Our next meeting will take place on Wednesday 7 November, when we will hear from the cabinet secretary on the budget and the Water Resources (Scotland) Bill.

*Meeting closed at 11:08.*





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