



**Environment and Rural Development Committee**

**20th Meeting, 2004**

**Wednesday 15 September 2004**

The Committee will meet at 9.45 am in Committee Room 2.

1. **European issues:** The Committee will consider an update from the Convener on European issues.
2. **Water Services etc. (Scotland) Bill:** The Committee will take evidence at Stage 1 from—

Panel 1

Stephen Boyd, Assistant Secretary, STUC;

David Watson, Scottish Organiser - Unison, STUC;

Bobby Buirds, Regional Officer – Amicus, STUC;

Panel 2

Nigel Bromley, Chief Executive, Gemserv;

Ceri Jones, Regulation and Competition Director – Northumbrian Water, Water UK; and

Panel 3

Professor Alan Alexander, Chair, Scottish Water;

Dr Jon Hargreaves, Chief Executive, Scottish Water;

Douglas Millican, Finance Director, Scottish Water.

3. **Dutch Presidency of the European Union and the priorities of the Scottish Executive:** The Committee will take evidence on the priorities of the Scottish Executive as they relate to the Environment and Rural Development portfolio from—

Ross Finnie MSP, Minister for Environment and Rural Development.

**Tracey Hawe**  
Clerk to the Committee

ERD/S2/04/20/A

Direct Tel: 0131-348-5221

The following papers are attached:

<u>Agenda Item 1</u>  Paper from the Convener	<a href="#">ERD/S2/04/20/1a</a>
<u>Agenda Item 2</u>  Submission from the STUC  Submission from Gemserv  Submission from Water UK  Submission from Scottish Water  Briefing paper from SPICe ( <i>for members only</i> )	<a href="#">ERD/S2/04/20/2a</a>  <a href="#">ERD/S2/04/20/2b</a>  <a href="#">ERD/S2/04/20/2c</a>  <a href="#">ERD/S2/04/20/2d</a>  <a href="#">ERD/S2/04/20/2e</a>
<u>Agenda Item 3</u>  An extract from a briefing paper from the Scottish Executive ( <i>‘Scottish Ministers’ EU policy priorities for the Dutch Presidency</i> ) is attached.  Paper from the Clerk ( <i>for members only</i> )	<a href="#">ERD/S2/04/20/3a</a>  <a href="#">ERD/S2/04/20/3b</a>

**Environment and Rural Development Committee**

**European Union Issues – Update**

**Paper from the Convener**

**Background**

1. The volume of EU material relevant to the Committee's remit is very significant, and awareness of European legislation may be helpful in relation to a large portion of the Committee's referred work, such as petitions and both primary and secondary legislation.
2. Its workload means that the Committee has to be selective in undertaking detailed consideration of any EU issues on its own initiative (e.g. by undertaking inquiries). As part of its agreed approach to gathering information on relevant EU issues and legislative proposals (and integrating those into its work programme discussions) the Committee has therefore asked me to provide an update on relevant issues approximately quarterly as the basis for work programme decisions. This is the third such update.

**Developments in the European institutions**

***European Parliament***

3. Following the elections to the European Parliament in June, the Parliament has now allocated members to committees and appointed those who will chair committees. The European Parliament Details of the seven Scottish MEPS and the committees they sit on have previously been circulated to members (and is attached at **Annex A**).
4. The Chairman of the Environment, Public Health and Food Safety Committee is Karl-Heinz Florenz (EPP-ED, Germany). The Chairman of the Agriculture Committee is Joseph Daul (EPP-ED, France). The Chairman of the Fisheries Committee is Philippe Morillon (ALDE, France).

***European Commission***

5. The 20 current Commissioners leave office after their 5-year term on 31 October. Following enlargement there will now be 25 Commissioners, one for each Member State. The new Commissioners-designate have now been appointed. The Environment Commissioner is Stavros Dimas of Greece. The Agriculture and Rural Development Commissioner is Mariann Fischer Boel of Denmark. The Commissioner for Fisheries and Maritime Affairs is Joe Borg of Malta (This will now be a separate portfolio, having previously been held jointly with agriculture.).
6. Each Commissioner-designate will be engaged in presenting his/her policy priorities to the relevant European Parliament Committee from 27 September to 8 October. A vote on formal approval by the Parliament of the whole Commission is scheduled to take place during the session on 25-28 October, with the new Commissioners formally taking office on 1 November. The priorities and programmes of the Commissioners

are therefore emerging, with the Commission due to produce its overall work programme for 2005 before the end of the year. (Members may wish to note that the European and External Relations Committee promoted a committee debate in the Parliament on the 2004 Commission work programme on 15 January 2004, and it is hoped that this may become an annual debate.)

7. Members may also wish to note that the UK Government produced a white paper in April 2004 entitled 'Prospects for the EU in 2004'. It is anticipated that this will become an annual publication and that it will be produced earlier in the year in future.

### **Council**

8. During the current Dutch Presidency the Agriculture and Fisheries Council will continue to meet approximately monthly and the Environment Council will meet on 14 October and 20 December. The Committee will continue to receive annotated agendas in advance of, and formal reports after, each of these meetings.
9. Members may wish to note that the UK holds the presidency of the EU in the second half of 2005. The presidency is able to exert significant influence on the selection and progress of priority topics. This is likely to be the last UK presidency under the current rotating procedure. DEFRA has already sought input on recommendations for a set of priority issues to be pursued. **Members may therefore wish to explore in evidence with the Minister what the priorities of the Scottish Executive will be for that period, and how Ministers are working with the UK Government to maximise this opportunity.**

### **Recent Committee activity on EU issues**

10. Following consideration of the second quarterly update on 21 April 2004, the Committee wrote to the Minister seeking further information on the implementation of the Waste Electrical and Electronic Equipment Directive. The Committee also sought further information on the results of the Scottish Executive's consultation on the introduction of Regional Advisory Councils for fisheries management. Responses have been circulated to members (circular 12 on 12 May 2004).
11. In line with its agreed procedure, the Committee will take oral evidence at its meeting on 15 September 2004 from the Minister for Environment and Rural Development on Scottish priorities for the Dutch Presidency of the European Council, which began on 1 July 2004. In advance of this meeting the Executive has provided a written briefing outlining its priorities for the presidency period, which is included in the agenda papers for Item 3.
12. In addition, the Committee has recently completed an inquiry into the implementation of the CAP reform. A response to that report has now been submitted by the Executive. The Committee will be able to follow this work through in its Stage 2 scrutiny of the Scottish Executive budget for 2005-06, and in consideration of a number of significant statutory instruments which will implement elements of the CAP reform over coming months.
13. The Committee has also recently considered a number of other statutory instruments directly relating to implementation of EU agricultural and fisheries policy as well as environmental regulation. Further subordinate legislation related to other EU legislation is expected in the next few months.

14. Members may recall that the Scottish Executive was requested to provide an indicative case study of the implementation of a European regulation, in order to provide further insight into the process that the Department undertakes. This work has now been completed and the case study is attached at **Annex B**.
15. The Committee also wrote to the Minister in June, requesting that an Executive monitoring report on EU measures awaiting transposition in Scotland should be copied to the Committee for information. The Executive is to report on this to the European and External Relations Committee shortly and it is hoped that this information will soon be provided to the Committee.

### **Relevant current issues**

16. As noted above, there are a large number of EU legislative proposals which are relevant to the Committee's remit. The paragraphs below outline a number of current issues (along with a short note on their current status and their likely impact on Scotland or on the work of the Committee). This is not an exhaustive list, but a selection of some major items, and includes updates on some which were identified in previous quarterly reports. The list contains a mixture of items – some of which are at an early stage of development or not yet concluded at EU level, and others which are concluded at EU level and await domestic implementation. **Members are invited to note the recent and current work programme of the Environment and Rural Development Committee. Members are invited to consider whether they wish to undertake any further work, or seek further information from the Executive, on any of the EU issues noted below.**

#### **a) Environment**

##### ***Sustainable Development***

17. The EU adopted a sustainable development [strategy](#) in 2001. The Commission has now launched a [consultation](#) about the scope, contents and achievements of that strategy, inviting comments by 31 October. This consultation is expected to form part of the first review of the strategy, due for completion by January 2005.
18. The Commission indicates that there has been slow progress in integrating environmental considerations into other policy areas, and suggests that renewed political impetus is required. The review will consider possible co-ordination of the various sustainable development strategies emerging at regional, national and EU levels, and whether core themes common to all can be identified.
19. Members will note that this consultation coincides with the Committee's publication of its commissioned research into sustainable development in Scotland. **Members may wish to consider how this research relates to the European Commission review.** In particular, members may wish to invite the Minister to have regard to the research when considering any Scottish Executive response to the consultation or other input to the review process.

##### ***Waste electrical and electronic equipment (WEEE) directive***

20. In January 2003 [Directive](#) 2002/96/EC was agreed, aiming to promote re-use, recycling and other forms of recovery of electrical and electronic waste. This should be transposed into UK law by 13 August 2004. At its last update on EU matters on 21 April 2004, the Committee was particularly anxious to ensure that relevant businesses

and stakeholders are fully aware of all the implications of this legislation in good time. The Convener wrote to the Minister, who confirmed that he did not now expect to meet the formal transposition date for the WEEE Directive, but aimed to do so by December.

21. The Minister indicated that a combination of UK and Scottish subordinate legislation may be used to transpose this directive. He also indicated that a consultation would be issued on draft regulations and non-statutory guidance would also be issued.

### ***Chemicals policy (REACH)***

22. The Commission's major [proposal](#) for a new framework to regulate the manufacture, import and use of chemical substances (called REACH) would replace over 40 existing Directives and Regulations. The new regime will also create a European Chemicals Agency. The proposal aims to improve the protection of human health and the environment while maintaining the competitive and innovative capability of the EU chemicals industry. The proposal is for a Regulation, which will be directly applicable in UK law without the need for subordinate legislation to transpose it. It will be agreed by co-decision of the European Parliament and the Council.

23. The Committee received further briefing on this proposal from the Executive prior to oral evidence from the Minister on 14 January 2004. The UK Government held a [consultation](#) (which closed on 25 June) on the proposals and the UK line.

24. At present the proposal remains at an early stage in the EU legislative process. Further policy debates will be held in November and December at the Competitiveness Council and the Environment Council. With agreement still some way off, the Dutch presidency hopes to have achieved a clear picture of all Member State positions and to have found "as much common ground as possible" by the end of the year. Alongside this work, national experts will begin discussing the regulation's annexes in Council working groups. Key elements include: the regulation's scope and the duty of care, its cornerstone registration requirement, and data submission and exchange procedures. In the European Parliament a number of committees are working towards producing opinions. It is anticipated that negotiations will continue for some time on this proposal, and that work to develop a common position or to finalise negotiations will still be required during the UK presidency.

### ***Climate change review***

25. As part of its climate change programme the emissions trading scheme becomes operational throughout the EU from January 2005. The Commission has also proposed a [regulation](#) on certain fluorinated greenhouse gases. This aims to set a framework to reduce these gases by establishing a system for their reporting, containment, marketing and use. It is expected that the October Environment Council may reach initial agreement on this proposal. Other work being developed at European level includes proposals on carbon dioxide 'sinks' in forestry and soils, and the potential mitigating of greenhouse gases from the agricultural sector.

26. The Dutch Presidency priority is to formulate an EU position for the tenth meeting of parties to the Kyoto protocol, scheduled for 6-17 December 2004 in Buenos Aires. The UK and Scottish Climate Change Strategies are due to begin a review process in 2004 with a view to publishing updated strategies early in 2005.

27. The UK has already stated that it intends to press for air services within the EU to be included in the emissions trading scheme. This may therefore be an important part of the agenda for the UK presidency.

### ***European Environment & Health Plan 2004-2010***

28. The European Commission estimates that around 25-33% of disease in industrialised countries can be attributed to environmental factors, for example increasing instances of asthma relating to pollution levels from traffic. Understanding these types of relationship is a key element of sustainable development. In 2003 the European Commission adopted a new [Strategy on Environment & Health](#). This Strategy focuses on children, and in particular, environmental factors relating to respiratory disease, neurodevelopment disorders, cancer and endocrine disrupting effects.

29. In June 2004 the Commission published the [European Environment & Health Plan 2004-2010](#). This Plan implements the Strategy and is designed to give the scientifically grounded information needed to help Member States reduce the adverse health impacts of environmental factors and to encourage improved cooperation between actors in the environment, health and research fields. The three main areas of action are: Improve the information chain; fill the knowledge gap; review policies and improve communication. The Plan will be subject to mid term review in 2007.

### ***Thematic Strategy on the Prevention and Recycling of Waste***

30. Further to the consultation in 2003 on the Thematic Strategy on the Prevention and Recycling of Waste, the Commission is currently carrying out a further [extended impact assessment consultation](#). This type of consultation is in line with the European Commission Better Regulation package and European Sustainable Development Strategy.

31. In 2003 the Environment and Rural Development Committee wrote to the European Commission outlining the highlights from the Committee's waste inquiry with a view to feeding into the Commission's initial consultation. The further consultation seeks more detailed information from stakeholders on the potential environmental, economic, and social implications of different options outlined as potential components of the Thematic Strategy. The consultation outlines various potential waste scenarios based around: expanding current policy; focussing on recycling materials, common standards and eco-design; focussing on economic instruments; implementation of existing legislation only. The consultation closes on 24 September 2004.

### ***Batteries directive***

32. In November 2003 the Commission adopted a [Proposal](#) for a new Batteries Directive, which will require the collection and recycling of all batteries placed on the EU market. Following previous discussions the Committee wrote to the Minister, seeking information on the progress of this proposal, and its practical preparations for implementing it. The Executive indicated in January 2004 that it was too early to consider preparations for implementation, and that it was likely to approach transposition in conjunction with the other UK administrations. It is anticipated that the December Environment Council may reach political agreement on this proposal.

### ***Groundwater directive***

33. In addition to the existing measures for the protection of groundwater against pollution caused by certain dangerous substances, groundwater protection is also a feature of the Water Framework Directive. Article 17 of that Directive requires that, on the basis of a proposal from the Commission, the European Parliament and the Council shall



adopt specific measures to prevent and control groundwater pollution by defining common criteria on good chemical status and on quality trends. In September 2003 the Commission adopted a proposal for a Groundwater 'daughter' [Directive](#) to meet that requirement. This is subject to the co-decision procedure, and is likely to require Scottish legislation to implement it in due course. The proposal is expected to reach political agreement in the December Environment Council.

## **b) Fisheries**

### ***December Fisheries Council and management of fishing resources***

34. The Committee has previously taken evidence on the outcome of the annual December Fisheries Council, including decisions on the management of stocks via quotas and a days-at-sea scheme. The Committee has also considered subordinate legislation implementing some of these measures. This year the Council is scheduled for 21-22 December. ICES advice on the state of some of the stocks of most interest to the Scottish fleet (e.g. North Sea cod, haddock and whiting) is usually published in late October, and the Commission advisory committee gives its advice in November. Based on this advice the Commission will table a proposal for the following year's fishing quotas before the December Council meeting.
35. In 2003 and 2004 boats fishing for cod and associated species in the North Sea and to the West of Scotland have been subject to limits on the number of days they can fish per month. Scottish boats have been limited to 15 days fishing per month. In 2004, a permit scheme was introduced which was intended to allow an increased catch of haddock, while still protecting cod stocks. Experience of operating the scheme has shown that fishermen can catch haddock without impacting on cod. A Commission [proposal](#) of 16 August would give fishermen who hold permits to catch haddock an additional 2 days per month, so that they would be allowed to fish for 17 days per month, instead of 15.
36. A major feature of the reform of the CFP of 2002 was that multiannual recovery plans should be prepared for the most threatened fish stocks. Plans have already been agreed for some cod and Northern hake stocks, and have been proposed for Southern hake, sole in the Channel and Bay of Biscay and the Norway Lobster fishery around Spain. At the December 2003 Fisheries Council the Commission indicated that it intended to prepare a recovery plan for North sea plaice. This is the only recovery plan in the pipeline which would cover waters of significance for the Scottish fleet. This plan would be incorporated into the cod recovery plan so e.g. is unlikely to result in stricter controls on days at sea than are applied at present.
37. The CFP reform of 2002 confirmed that the restrictions on access to fishing within coastal waters (6 and 12 mile limits) would continue until 2012. The Member States agreed that the Commission would prepare a report (together with legislative proposals if appropriate) on access restrictions outside coastal waters. These access restrictions include the Shetland box which restricts trawling in the waters around the Shetland islands. This report is expected to be published soon, possibly accompanied with a legislative proposal and has been included on the provisional agenda for the November Agriculture and Fisheries Council.

### ***Proposal for a European Fisheries Fund***

38. EU support for fisheries from 2000-06 has been provided by a single structural fund, the Financial Instrument for Fisheries Guidance (FIFG). In common with the other

structural funds, decisions on the budget and the rules for spending it are set for multi-annual periods called 'financial perspectives'. The next one will run from 2007 to 2013 and the European Commission has recently tabled a proposal for support for fishing for this period. It proposes to rename the FIFG the European Fisheries Fund (EFF). As with the FIFG the proposal contains a menu of options for supporting fishing, aquaculture, and fishing communities. As decided under the 2002 CFP reform, subsidies for building new fishing boats will no longer be allowed. The revised measures are intended to target support at projects to encourage more sustainable fishing methods, at aquaculture, and at areas which have been particularly affected by declining fish stocks. Once the rules and budget have been decided upon, Member States will produce programmes indicating how they intend to spend this money. Members may wish to note that the Scottish Executive has recently launched a public [consultation](#) on the proposal, with responses sought by 19 November.

### ***European fisheries control agency***

39. As part of the CFP reform package the Commission has [proposed](#) to set up a European Fisheries Control Agency. It is expected that its headquarters will be located in Spain. The proposal deals with the practicalities of setting up such an agency, including how the enforcement agencies of Member States will co-operate under the Agency, how the Agency will relate to Regional Advisory Councils, etc.. In the European Parliament, Scottish MEP Elspeth Attwooll is the rapporteur on this proposal for the Fisheries Committee. She is required to draft a report for the Committee, with proposed amendments. It is anticipated that this report may be finalised towards the end of October, and that final agreement on the proposal is anticipated by mid-2005. This is a proposal for a regulation, which will be directly applicable in national law. Elspeth Attwooll has offered to provide the Environment and Rural Development Committee with further details on the procedure and key issues if required.

### ***Regional Advisory Councils***

40. Following its discussions in April, the Committee wrote to the Minister seeking further information on the proposed Regional Advisory Councils (RACs). The Scottish Executive had conducted a consultation (which closed on 6 February 2004), to help inform its position on this proposal. On 24 May 2004 the Council reached political agreement on the Regulation and decided to establish seven RACs, including those for the North Sea; the North Western Waters; and the widely dispersed Pelagic fisheries (mackerel, herring, blue whiting and horse mackerel). The Regulation provides RACs with the operating principles and guidelines that are necessary to perform their work, and also provides each RAC with Community financial assistance for start-up and operating costs. Discussion at Council concerned the appropriate level of funding and the requirement for RACs to work transparently, in public. A compromise agreement on these issues was reached – and supported by the United Kingdom.

## **c) Agriculture and Rural Development**

### ***Transport of live animals***

41. Following discussions over various Councils, in April 2004 the Council again failed to reach agreement on the Commission [proposal](#) on the protection of animals during transport. The proposal aimed to introduce improved enforcement measures and much stricter rules for journeys. It appears that there is little prospect of the proposal resurfacing in the immediate future, as it was impossible to find a clear majority in favour of various compromises proposed by the Irish Presidency earlier this year.

### ***Rural Development Regulation***

42. In July the Commission published its [proposal](#) for a new rural development regulation for the period 2007-13. The Committee has examined the background to this (as well as the opportunities available under the current regulation) in some detail during its recent inquiry into implementation of CAP reform. The Committee has expressed its desire to see the UK secure an increased share of the available EU funds, and to see a range of options available which will allow Scotland to maximise the opportunities for rural development.

43. The new regulation will be the major focus for agriculture negotiations over the coming months. The key aims of the proposal are: improving the competitiveness of farming through support for restructuring; enhancing the environment through support for land management; and improving the quality of rural life and promoting diversification. It is proposed that these objectives are delivered through a simplified single funding and programming instrument to increase the coherence. It also seems likely that the approach to support for Less Favoured Areas will be revised, which will be of significant Scottish interest. An initial discussion is expected at the Agriculture and Fisheries Council in September, and negotiations are expected to run until the end of 2005.

44. The Committee may wish to be informed of the development of rural development regulation at various stages. The proposal is subject to the consultation procedure and will be directly applicable in national law. However, it is expected that the regulation will provide a menu of options which Member States (and, in the UK, devolved administrations) will select from in preparing their own rural development support plans to be submitted for approval by the Commission.

45. In the meantime, the Scottish Executive can revise its implementation of the current regulation once a year for approval by the Commission. The recent Executive consultation on Land Management Contracts suggests that the measures in that will begin in Spring 2005. It therefore seems likely that an amendment to the plan will be needed. The Executive will be required to secure Commission approval in the next 2 or 3 months. Subordinate legislation to implement such changes will be considered by the Committee in due course.

**46. The Committee may wish to consider how it will monitor developments, both in negotiations at an EU level and in the development of Scottish policy and the representation of Scottish interests in the process.**

### ***Organic action plan***

47. The Commission produced an [action plan](#) on organic food and farming in June 2004. The plan contains 21 actions and policy measures to assist the organic sector. These include EU co-funding for promotional campaigns to better inform consumers about organic farming, recommending ways in which Member States can use rural development funds to support organic farming, supporting research and training, defining common principles of organic farming to make the public benefit from it more explicit, and improving common EU standards. The Commission proposal was presented at the June Agriculture and Fisheries Council. The Dutch Presidency is currently working on Council conclusions with a view to these being adopted at the November Agriculture/Fisheries Council meeting.

## **Summary**

48. Members are invited to note the recent and current work programme of the Environment and Rural Development Committee. Members are invited to consider whether they wish to undertake any further work, or seek further information from the Executive, on any of the EU issues noted at paragraphs 17-47 above (or on any other EU issue). If so, members are invited to consider whether they wish to:

- pursue these in evidence with the Minister later today;
- authorise the Convener to seek a detailed briefing from the Minister on any topic of particular interest;
- request further information and detailed options for further consideration of any particular issue from the Convener as part of future work programme discussions.

Sarah Boyack MSP  
Convener  
9 September 2004

**EUROPEAN PARLIAMENT  
OFFICE IN SCOTLAND**



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**EUROPEAN PARLIAMENT MEMBERS FOR SCOTLAND**

**Committee Memberships**

**DAVID MARTIN MEP**

Scottish Labour Party (PES)



**Committee on International Trade:**

[www.europarl.ep.ec/committees/inta\\_home.htm](http://www.europarl.ep.ec/committees/inta_home.htm)

Committee responsible for:

matters relating to the establishment and implementation of the Union's common commercial policy and its external economic relations, in particular:

1. financial, economic and trade relations with third countries and regional organisations;
2. measures of technical harmonisation or standardisation in fields covered by instruments of international law;
3. relations with the relevant international organisations and with organisations promoting regional economic and commercial integration outside the Union;
4. relations with the WTO, including its parliamentary dimension.
5. The committee liases with the relevant interparliamentary and ad-hoc delegations for the economic and trade aspects of relations with third countries.

**Committee on Agriculture, Substitute**

[www.europarl.eu.int/committees/agri\\_home.htm](http://www.europarl.eu.int/committees/agri_home.htm)

**Committee on Petitions, Substitute**

[www.europarl.eu.int/committees/peti\\_home.htm](http://www.europarl.eu.int/committees/peti_home.htm)

**IAN HUDGHTON MEP**

Scottish National Party (Green-EFA)



**Committee on Fisheries:**

[www.europarl.eu.int/committees/pech\\_home.htm](http://www.europarl.eu.int/committees/pech_home.htm)

Committee responsible for:

1. the operation and development of the common fisheries policy and its management;
2. the conservation of fishery resources;
3. the common organisation of the market in fishery products;
4. structural policy in the fisheries and aquaculture sectors, including the financial instruments for fisheries guidance;
5. international fisheries agreements.

**Committee on Economic and Monetary Affairs:**

[www.europarl.eu.int/committees/econ\\_home.htm](http://www.europarl.eu.int/committees/econ_home.htm)

Committee responsible for:

1. the economic and monetary policies of the Union, the functioning of Economic and Monetary Union and the European monetary and financial system (including relations with the relevant institutions or organisations);
2. the free movement of capital and payments (cross-border payments, single payment area, balance of payments, capital movements and borrowing and lending policy, control of movements of capital originating in third countries, measures to encourage the export of the Union's capital);
3. the international monetary and financial system (including relations with financial

- and monetary institutions and organisations);
- 4. rules on competition and State or public aid;
- 5. tax provisions;
- 6. the regulation and supervision of financial services, institutions and markets including financial reporting, auditing, accounting rules, corporate governance and other company law matters specifically concerning financial services.

**Committee on the Internal Market and Consumer Protection, Substitute:**

[www.europarl.eu.int/committees/imco\\_home.htm](http://www.europarl.eu.int/committees/imco_home.htm)

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**STRUAN STEVENSON MEP**

Conservative & Unionist (EPP-ED)



**Committee on Fisheries:**

[www.europarl.eu.int/committees/pech\\_home.htm](http://www.europarl.eu.int/committees/pech_home.htm)

Committee responsible for:

1. the operation and development of the common fisheries policy and its management;
2. the conservation of fishery resources;
3. the common organisation of the market in fishery products;
4. structural policy in the fisheries and aquaculture sectors, including the financial instruments for fisheries guidance;
5. international fisheries agreements.

**Committee on Employment and Social Affairs:**

[www.europarl.eu.int/committees/empl\\_home.htm](http://www.europarl.eu.int/committees/empl_home.htm)

Committee responsible for:

1. employment policy and all aspects of social policy such as working conditions, social security and social protection;
2. health and safety measures at the workplace;
3. the European Social Fund;
4. vocational training policy, including professional qualifications;
5. the free movement of workers and pensioners;
6. social dialogue;
7. all forms of discrimination at the workplace and in the labour market except those based on sex;
8. relations with:
  - the European Centre for the Development of Vocational Training (Cedefop),

- the European Foundation for the Improvement of Living and Working Conditions,
- the European Training Foundation,
- the European Agency for Health and Safety at Work; as well as relations with other relevant EU bodies and international organisations

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**CATHERINE STIHLER MEP**

Scottish Labour Party (PES)



**Committee on Regional Development:**

[www.europarl.eu.int/committees/regi\\_home.htm](http://www.europarl.eu.int/committees/regi_home.htm)

Committee responsible for:

regional and cohesion policy, in particular:

1. the European Regional Development Fund, the Cohesion Fund and the other instruments of the Union's regional policy,
2. assessing the impact of other Union policies on economic and social cohesion,
3. coordination of the Union's structural instruments,
4. outermost regions and islands as well as trans-frontier and interregional cooperation,
5. relations with the Committee of the Regions, interregional cooperation organisations and local and regional authorities.

**Committee on Fisheries:**

[www.europarl.eu.int/committees/pech\\_home.htm](http://www.europarl.eu.int/committees/pech_home.htm)

Committee responsible for:

1. the operation and development of the common fisheries policy and its management;
2. the conservation of fishery resources;
3. the common organisation of the market in fishery products;
4. structural policy in the fisheries and aquaculture sectors, including the financial instruments for fisheries guidance;
5. international fisheries agreements.

**Committee on Transport and Tourism, Substitute:**

[www.europarl.eu.int/committees/tran\\_home.htm](http://www.europarl.eu.int/committees/tran_home.htm)



## **ELSPETH ATTWOOLL MEP**

Scottish Liberal Democrat (ALDE)



### **Committee on Regional Development:**

[www.europarl.eu.int/committees/regi\\_home.htm](http://www.europarl.eu.int/committees/regi_home.htm)

Committee responsible for:

regional and cohesion policy, in particular:

1. the European Regional Development Fund, the Cohesion Fund and the other instruments of the Union's regional policy,
2. assessing the impact of other Union policies on economic and social cohesion,
3. coordination of the Union's structural instruments,
4. outermost regions and islands as well as trans-frontier and interregional cooperation,
5. relations with the Committee of the Regions, interregional cooperation organisations and local and regional authorities.

### **Committee on Fisheries:**

[www.europarl.eu.int/committees/pech\\_home.htm](http://www.europarl.eu.int/committees/pech_home.htm)

Committee responsible for:

1. the operation and development of the common fisheries policy and its management;
2. the conservation of fishery resources;
3. the common organisation of the market in fishery products;
4. structural policy in the fisheries and aquaculture sectors, including the financial instruments for fisheries guidance;
5. international fisheries agreements.

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## **ALYN SMITH MEP**

Scottish National Party (Green-EFA)



### **Committee on Regional Development:**

[www.europarl.eu.int/committees/regi\\_home.htm](http://www.europarl.eu.int/committees/regi_home.htm)

Committee responsible for:

regional and cohesion policy, in particular:

1. the European Regional Development Fund, the Cohesion Fund and the other instruments of the Union's regional policy,
2. assessing the impact of other Union policies on economic and social cohesion,
3. coordination of the Union's structural instruments,
4. outermost regions and islands as well as trans-frontier and interregional cooperation,
5. relations with the Committee of the Regions, interregional cooperation organisations and local and regional authorities.

### **Committee on Industry, Research and Energy, Substitute**

[www.europarl.eu.int/committees/itre\\_home.htm](http://www.europarl.eu.int/committees/itre_home.htm)

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## **JOHN PURVIS MEP**

Conservative & Unionist (EPP-ED)



### **Committee on Economic and Monetary Affairs:**

[www.europarl.eu.int/committees/econ\\_home.htm](http://www.europarl.eu.int/committees/econ_home.htm)

Committee responsible for:

1. the economic and monetary policies of the Union, the functioning of Economic and Monetary Union and the European monetary and financial system (including relations with the relevant institutions or organisations);
2. the free movement of capital and payments (cross-border payments, single payment area, balance of payments, capital movements and borrowing and lending policy, control of movements of capital originating in third countries, measures to encourage the export of the Union's capital);
3. the international monetary and financial system (including relations with financial and monetary institutions and organisations);
4. rules on competition and State or public aid;
5. tax provisions;
6. the regulation and supervision of financial services, institutions and markets including financial reporting, auditing, accounting rules, corporate governance and other company law matters specifically concerning financial services.



## SCOTTISH EXECUTIVE

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Minister for Environment & Rural Development  
**Ross Finnie MSP**

Pentland House  
47 Robb's Loan  
Edinburgh EH14 1TY

Sarah Boyack MSP  
Convener  
Environment and Rural Development Committee  
The Scottish Parliament  
Edinburgh  
EH99 1SP

Telephone: 0131-556 8400  
scottish.ministers@scotland.gsi.gov.uk  
<http://www.scotland.gov.uk>

Our ref: FXD 3/2

September 2004

I am pleased to enclose a paper detailing the process by which the regulations governing this year's management arrangements for North Sea Haddock were developed.

The paper has been prepared in accordance with a request made by the Committee to Allan Wilson at its meeting of 25 February. I understand that you wish to consider the paper at your meeting on 15 September.

I hope that the Committee will find the paper helpful. I am copying this letter to the Committee Clerk.

**ROSS FINNIE**



# DEVELOPMENT OF NORTH SEA HADDOCK MANAGEMENT ARRANGEMENTS

## Introduction

1. At the meeting of the Environment & Rural Development Committee on 25 February<sup>1</sup> the Executive was asked to produce a note outlining the process by which EU fisheries regulations are made. **This paper traces the development, as an example, of the regulations which provide for this year's management arrangements for North Sea Haddock.**

## Background

2. New management arrangements governing fishing for haddock in the North Sea were introduced for 2004. Haddock is caught in varying proportions along with cod and whiting in the mixed demersal whitefish fishery.
3. Ministers secured a 49 per cent increase in the UK's North Sea haddock quota at the December Fisheries Council, intended to take into account the increased catching possibilities offered by the growth of a strong 1999 haddock year class. However, to protect the comparably vulnerable cod stock, and in line with continuing cod recovery measures, Council stipulated that 80% (subsequently amended to 65%) of that increase should be subject to special permit arrangements restricting access to those haddock fishing grounds where cod remains relatively abundant.
4. The management arrangements are prescribed in **Annex IV of Council Regulation 2287/2003**, which fixes the fishing opportunities (TACs and quotas) for 2004 and associated conditions for regulated fish stocks in Community waters and for Community vessels. The particular arrangements for North Sea Haddock were **amended through Council Regulation 867/2004**, which provided for changes to the boundaries of the 'Cod Protection Area (CPA)' and the proportion of haddock quota that can be caught within and outside the CPA.
5. The North Sea Haddock stock is jointly managed with Norway. It was therefore necessary to find agreement to the increase in the haddock quota within the negotiation of the **EU-Norway agreement for 2004**.

## Development of the TAC and Quota regulation

6. The shape of the annual TAC and Quota Regulation is developed through a process that draws together the European Commission, Member States, third party countries, the International Council for the Exploration of the Sea (ICES) and the EU's Scientific, Technical and Economic Committee for Fisheries (STECF).

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<sup>1</sup> Extract attached at Annex A

7. The regulation is informed by the scientific advice on fish stocks provided annually by the ICES Advisory Committee on Fishery Management (ACFM). ACFM provides advice in May (largely on pelagic stocks) and in October (largely on demersal stocks). The European Commission considers the scientific advice when drafting initial proposals for the following year's TAC and Quota and associated management measures. These proposals generally emerge during November, after which the Commission begins a dialogue with Member States, involving bilateral meetings, round-table discussions in Council Working Groups, and discussion at November and December Fisheries Councils.
8. In parallel, the EU (represented by the European Commission, in co-ordination with Member States) negotiates bilateral fisheries agreements with Norway, Iceland, the Faroe Islands and Greenland. These negotiations agree the TACs for a specific category of jointly managed stocks (which includes North Sea haddock), similarly agree the TACs and quota shares for a category of stocks on which there is no permanently agreed management framework (which includes western mackerel and other stocks present in international waters or the waters of more than one coastal state), and agree mutual access arrangements for each party in the other party's waters. Although formally an internal EU matter, associated control arrangements do in practice feature in these international discussions. For the EU, the end-product is then incorporated in the annual TAC and Quota Regulation. In finalising the TAC and Quota Regulation, the Commission also seeks the opinion of STECF (an advisory committee to the Commission).

#### **Development of Annex IV of the TAC and Quota Regulation**

9. The development of the regulatory arrangements particular to North Sea Haddock should be seen as part of the general process described above. Within that process, a number of milestones can be identified.

<b>All 2003</b>	<b>Discussions with Scottish fishing industry</b>
	Discussions on spatial management in North Sea demersal mixed fishery and proposals for haddock.
<b>Jan-Aug 2003</b>	<b>Scientific stock surveys and assessments (including collation of 2002 commercial data)</b>
<b>April 2003</b>	<b>Meeting of EU scientific experts on cod assessment and technical measures</b>
<b>Oct 2003</b>	<b>ACFM advice on cod/haddock</b>
	Advice presented in context of mixed fisheries and adaptive management; no haddock catch forecast available for 2004 due to a combination of unreliable landings data, and lack of information on fishery activity during 2003 with which to condition the forecast. Range of haddock catch forecasts from 48 to 128 Kt.

- Oct 2003      ACFM advice considered by STECF**
- Oct 2003      Fisheries Research Service brief Scottish fishing industry on ACFM advice**
- Oct 2003      Round 1 of EU-Norway negotiations for 2004 Agreement**
- UK presents arguments for an increase of NS Haddock TAC to 90 Kt. Commission indicate intention to propose rollover TAC (55 Kt).
- Oct 2003      Commission meetings with industry stakeholders**
- Nov 2003      UK Fisheries Departments discuss UK lines and priorities, including haddock**
- Nov 2003      Round 2 of EU-Norway negotiations**
- UK presents and circulates detailed arguments for an increase to the NS Haddock TAC, despite absence of ICES scientific forecasts. FRS involved in producing scenario forecasts for discussion
- 4 Dec 2003      Commission circulate proposal for TAC and Quota Regulation**
- Proposal is for rollover haddock TAC of 55Kt
- 4,5,8 Dec 03      Council working group (internal fisheries policy) discussion of Commission proposals**
- Dec 2003      UK/Executive consultation with fishing industry on Commission proposals**
- Fisheries Departments and fishing industry agree 'Haddock Box' approach, intended to restrict fishing against increase haddock quota to certain areas of low cod abundance.
- Dec 2003      UK presents 'Haddock Box' proposal in bilaterals with Commission**
- 10 Dec 2003      Fisheries Debate in the Scottish Parliament**
- 12 Dec 2003      Discussion of Commission proposal in COREPER**
- 16-19 Dec 2003 Discussion in December Fisheries Council**
- Commission presents its own proposals for spatial management in the North Sea cod/haddock fishery
- 19 Dec 2003      Decision reached on TAC and Quota Regulation**

- 19 Dec 2003      Round 3 of EU-Norway negotiations**
- EU negotiating position includes increased haddock TAC (80K tonnes) and associated management measures. Agreement not reached with the Norwegians on the terms of the EU-Norway agreement as a whole.
- Jan 2004            UK writes formally to Fisheries Commissioner requesting changes to 'Cod Protection Area' arrangements; further UK bilaterals with the Commission**
- Jan 2004            Round 4 of EU-Norway negotiations**
- Agreement reached, including haddock TAC of 77K tonnes.
- Jan-Mar 2004      UK bilaterals / correspondence with Commission on requested changes; detailed exchange of views**
- 28 January        UK Minister writes to Commissioner Fischler, seeking adjustments to haddock arrangements**
- 12 Feb 2004      Commissioner Fischler writes to UK authorities, accepting in principle case for limited adjustment of ratios and boundaries and offering mid-year review of arrangements**
- March 2004        Agreement reached between UK Ministers and Commissioner Fischler**
- April 2004        Commission publishes proposals for amendment to regulation**
- Proposals are for changing the boundaries of the CPA and the ratios of haddock that can be caught with and without a permit.
- April 2004        Adoption of amending regulation 867/2004 at April Council**
- June 2004        Mid-year review of management arrangements**
- Analysis by FRS of observer trip data reveals low by-catch of cod by vessels fishing in unrestricted area. Presents data to Commission
- June 2004        UK writes to Commission seeking extra allowance of days at sea for vessels using special permits in the haddock fishery**
- 16 Aug 2004      Commission publishes proposal for additional days at sea for vessels using special haddock permits**
- Proposed further amendment to the TAC and Quota Regulation.

- Jan-Aug 2004**    **Scientific stock surveys and assessments (including collation of 2003 commercial data)**
- 2 Sept 2004**    **Council Working Group discussion of proposed amendment**
- [Oct 2004**        ***Adoption of amending regulation***]
- Oct 2004**        **ACFM to publish scientific advice for 2004**

ERAD: Sea Fisheries Division  
2 September 2004

## **ENVIRONMENT & RURAL DEVELOPMENT COMMITTEE MEETING, 25 FEBRUARY 2004: EXTRACT FROM OFFICIAL REPORT**

**Rob Gibson** (Highlands and Islands) (SNP): I am interested in the processes that are followed between the making of regulations and their application by producers in the fishing and agriculture sectors. I am receiving an increasing number of representations about the fact that instructions are sent to organisations and then quickly withdrawn and replaced.

Indeed, in relation to the common fisheries policy, applications under the 1 February instructions were being delivered days and weeks after the start of the fishery. In relation to the common agricultural policy, year-to-year changes to the rules on aspects of the policy—which may be simplified by the single farm payment in due course—often leave people in the dark. People are left in the dark about when they can go out fishing, the force of the regulations or how to fill in applications before the details of the schemes are known.

I am concerned about the process between Pentland House and the local offices and the producer organisations. People are put in difficult situations and do not know whether they are carrying out operations correctly or whether they are applying for the correct subsidies. I would like the minister to respond to that, although I am prepared to write to him on specific issues. The civil service process—because of the way in which we have annual rounds in the fishing business—throws up these issues practically every year. It is of great concern that people are often left in the dark about parts of the process.

**Allan Wilson:** I share Rob Gibson's general concern that people should not be left in the dark. I assure him that officials in the department work tirelessly to ensure that information is disseminated to the individual producers timeously and in such a manner that it can be easily understood and effectively implemented.

I will separate the fisheries council process from the CAP reform process, because the two are not the same. Specific external pressures properly arise annually in

relation to the protection of stocks and the sustainability of fishing management practices, which require complex negotiations and subsequently require to be clarified annually or tidied up—call it what you will—in intergovernmental discussions, in discussions with the Commission and in bilateral negotiations. A classic example is that EU Council decisions on fisheries management, to which Rob Gibson referred, are subsequent to agreement with Norway, which normally is reached before the end of the year. That did not happen this time until later in the new year, which inevitably delayed the fisheries management decisions and complicated the subsequent process.

As a general rule, I agree entirely that we want to ensure that all the relevant information is disseminated speedily, timeously and in a simple manner to every producer and to everybody who is affected by a decision. It is not always possible to do that, but we would be happy to examine individual instances that members wish to bring to our attention to see where the systems could be improved to benefit the recipient of the information.

**Rob Gibson:** I have a short follow-up question. Once the process has settled down, can we take as an example one of the regulations that was supposed to be applied on 1 February and trace the route from the decision-taking process, through the various stages of refinement, until it is applied, so that we can understand the complexities? It would be of great help to the committee if the minister could give us that information in due course.

**Allan Wilson:** I would be happy to do that. It might be a useful exercise for members to appreciate the difficult conditions under which our officials sometimes have to operate given the way in which the decision-making process works, or does not work in some instances.

**The Convener:** That would be a good development and would build on what we tried to do with the budget last year, when we wanted to track through what was happening with future budget lines—one of your answers then was that you were not in a position to tell us exactly what scheme would be approved for funding to deliver objectives. Thank you for that useful suggestion.

## **SUBMISSION BY THE STUC**

### *INTRODUCTION*

1 The STUC welcomes the opportunity to give evidence to the Scottish Parliament Environment and Rural Development Committee on the Water Services (Scotland) Bill. This response needs to be seen in the context of the STUC's and our affiliates' submissions to recent Scottish Executive consultations on the water industry and in particular the consultation on the Draft Water Services Bill.

2 This is the latest of a number of legislative developments affecting the water and sewage industry in Scotland including the establishment of a public water corporation, *Scottish Water* and a revised regulatory framework. This bill focuses on changes to the regulatory framework and the development of competition in networked water and sewage. Competition already exists in off-network services.

3 In this context it is important to recognise the scale and speed of change that has already taken place in the industry and the importance of a period of stability to bed in the current structure.

### Part 1: Water Industry Commission for Scotland

4 The STUC welcomes the establishment of the Water Industry Commission for Scotland as a corporate body replacing the Water Industry Commissioner. Experience elsewhere has demonstrated that regulatory frameworks that rely on one person have not operated satisfactorily and we endorsed many of criticisms of the current arrangements in the recent Finance Committee report.

5 The model proposed in the bill has many similarities to the regulatory framework that exists in private utilities. These have been subject to some criticism not only from the utility industry and trade unions but also as reflected in the recent House of Lords report on regulation. Other ideas from the think tank Demos include the concept of adding 'public value'.

6 In essence the problem has been that regulators promote competition to the detriment of other factors. There has been an over emphasis on price and efficiency with little consideration of the impact their decisions may have on employment and other social and environmental concerns. These economic models can also be in conflict with government policy as we have seen recently over the transmission loss proposals from Ofgem that would have ended the nascent renewables industry in Scotland. Schedule 1 does not set out the type of person that should be appointed to the WIC. Membership should reflect the wider public policy considerations and not simple economic factors.

7 Getting the right framework and objectives is all the more important in a public service. The objectives of the water industry are of wider concern than simply those connected to the current system as defined in section 1 of the Bill.

8 The STUC welcomes the provisions in section 3 allowing regulations to define how the balance of costs between Scottish Water and developers will be calculated. We believe there is a strong case for developers meeting a much greater share of the cost of new water and sewerage services so that new development can proceed without detracting from the urgent need to renew the existing infrastructure.

## Part 2: Provision of Water and Sewerage Services

9 The driver for this legislation is the UK Parliament's Competition Act 1998 that seeks to prevent the restriction or distortion of competition and the abuse of a dominant market position. The STUC and our affiliates have previously highlighted the danger of this ill thought out legislation for essential public services. In essence the Water Services (S) Bill seeks to implement the provisions of the Competition Act whilst minimising the adverse impact on Scotland. It should however, remind the Scottish Parliament to be vigilant about other international competition initiatives that impact on public services. In particular, reforms of the EU internal market and GATS.

10 The policy basis for this section of the bill takes a more realistic view, than the original Water Services Bill consultation in 2001, on the alleged benefits of competition. Experience in other utilities has shown that the alleged benefits are more apparent than real and comes at a significant cost to the consumer. The STUC rejects the view that competition in essential utilities brings benefits to consumers. There is no evidence to support this often-quoted position.

11 The Competition Act 1998 introduced a new framework for competition bringing into domestic law (this is a reserved power to the UK parliament) provisions which enact European law on this issue. In particular it introduces new sanctions for anti-competitive behaviour. The Act applies to Scottish Water and is enforced by the Director General of Fair Trading (DGFT) as the WIC in Scotland does not have the same powers as the water industry regulator in England and Wales, OFWAT.

12 The Act includes provisions for exemptions and exclusions on a number of grounds. The STUC believes that the provisions of Schedule 3 (7) remain a sound basis for an exclusion under the Competition Act. Water and sewerage is an essential service in a civilised society and competition puts that service at risk, particularly for disadvantaged customers. The public policy grounds could relate to rural, economic and social exclusion strategies under this heading. In addition the Executives environmental objectives will be difficult to achieve in a competitive framework and this provides a further public policy basis for an exclusion.

### Prohibiting common carriage on the public networks

13 The STUC agrees that the risks to public health and the environment outweigh any foreseeable benefits from allowing access to public water and wastewater systems. Our affiliates have previously highlighted some of the many technical difficulties in achieving common carriage including:

- Many existing mains have no spare capacity for additional water
- The Fraser Report (Burncrooks) recommended the zoning of water from different sources as a precaution against contamination.
- Arrangements for proving and compensating for mains pipes fractures caused by third party supply e.g. pressure surges.
- Responsibility for boosting disinfectant residuals.
- Backflow protection to stop accidental or fraudulent back-syphonage
- Allocation of the cost of leakage or lost water e.g. misuse of fire hydrants.
- Pipe size incompatibility when new sources are attached to the mains.

14 Scottish Water would have to be responsible for managing a comprehensive access code to ensure that there was adequate supply. This code would be enormously complex covering all possible situations including seasonal demands, bursts, drought provision etc. There would also



have to be costly physical systems in place to isolate new entrants supply and provision for 'last resort' supply.

15 We understand that the provisions of s4(5) are intended to cover contractors working for Scottish Water. The wording could however be interpreted to allow a somewhat wider private sector access.

16 The consequences of common carriage even with costly systems intervention could include at worst contamination of water supplies or at best interruption and damage to the water and sewage infrastructure. The public health consequences are obvious and therefore the provisions in the bill prohibiting common carriage are sensible.

#### Prohibiting retail competition for households

17 The STUC agrees that retail competition poses risks for households.

18 For household customers water charges, linked to Council tax bands, reflect broadly the ability to pay. The current arrangements include a discount for single adult households. The STUC notes that revisions to the current banding system will be considered as part of a wider review of local government finance. Competition would bring separate water charges and the loss of the essential progressive charge basis, which is in our view a requirement for an essential public service. There is no practical alternative to piped water and sewage disposal.

19 The arrangements in place in other competitive utilities for disadvantaged consumers are generally very limited. For example fuel poverty still impacts on one in six Scottish households despite the excellent measures taken by the Scottish Executive to address this issue.

20 The original consultation paper rightly identified the serious risk that new entrants to the market would 'cherry-pick' high-banded properties. This has also been the experience in other utilities where existing suppliers have been forced, because of competition, to chase 'high value' customers at the expense of other consumers. Not only would charges increase for most consumers but Scottish Water would be left with stranded assets brought about by off network provision.

21 The STUC therefore agrees that competition would develop in a way that would not benefit all customers and welcomes the provisions in the bill prohibiting this form of competition.

#### Licensing non-household retail competition

22 The STUC does not support the introduction of retail competition in non-households. The 160,000 premises covered by this competition are a significant part of Scottish Water's operation. Business separation (s12) will be a further and unwelcome disruption to the corporation, which is attempting to address the long-standing problems facing the industry.

23 Some of the main problems include:

- Experience in the energy industry shows that business separation is an expensive business. The loss of integrated operations, economies of scale, rebranding etc all add to the costs charged to customers.
- The financial arrangements for business separation are crucial to the viability of the proposed retail arm and the wholesale organisation. The assumptions built into the Regulatory Impact Assessment give us considerable cause for concern. The efficiency gap calculations (para 14)

are based on the 2002 estimates and the position has changed significantly (from a claimed 42% to less than 10%) since then. The size of the retail business is also crucial. Para 23 assumes the full retail segment is £109m (15%) compared with Ofwat's estimate of 8% for England and Wales. This could lead to unnecessary burdens on the retail arm and a weakening of the core Scottish Water organisation. In essence both organisations would be set up to fail if this financial structure is put in place.

- A whole new industry is created with new customer service, billing, marketing and sales operations, all of which divert resources which could be more effectively deployed improving our water and sewage networks.
- Further systems will have to be established to allow switching between suppliers. This has caused chaos in the energy market and will inevitably do the same in water and sewage. The provisions in s10 are particularly vague and the costings in the financial memorandum are optimistic in the extreme.
- As Scottish Water will have a statutory obligation to supply everyone they will be left with disjointed operations. Many of the cherry-picking arguments set out above also apply to non-household competition. Most of the 160,000 properties are small businesses in high street locations. New entrants will inevitably focus on larger consumers or those in geographically concentrated areas such as out of town estates in urban areas. S15 will also place additional costs on Scottish Water that should be spread across all suppliers.
- The WIC will gain further powers to directly set wholesale charges. Current experience indicates that this may not be wholly beneficial to either customers or the industry. Unlike other utilities the water and wastewater systems are not organised into a cohesive network. The industry has not diverted essential investment resources into management information systems that are an integral part of a regulated market. This is reflected in the WIC's reports on Scottish Water's alleged performance. Despite the apparent detail the judgements are based on limited data. In the privatised utilities the companies establish extensive regulatory functions to engage with the regulator. Again all of this would be recharged to the customer.
- Whilst not set out in this bill (because it is a reserved function) it is intended that any differences over charges between the WIC and Scottish Water will be referred to the Competition Commission. This body has no experience in dealing with a public service and in particular interpreting the broader objectives that Scottish Ministers can set under s18. Their expertise is in the economic and competition sphere. The STUC takes the view that these are properly public policy interpretations that should be decided in Scotland and not handed over to an inappropriate London based organisation.

## **Conclusion**

24 The STUC broadly welcomes the provisions of the bill as being a more realistic recognition of the realities of the industry that those set out in the original Water Service Bill consultation in 2001.

25 The major problem relates to the proposals for non-household retail competition. We suspect that this more modest proposal reflects a concern to be seen to provide an element of competition in accordance with the philosophy inherent in the Competition Act. However, the proposals still constitute a major upheaval for little value to the consumer. It is also a further stage along the road to the full privatisation of Scotland's water.

## **SUBMISSION BY GEMSERSV**

### *Introduction*

This paper is a response to the request by the Environment and Rural Development Committee for interested parties to provide evidence on the general principles of the Water Services etc (Scotland) Bill ("the Bill") and in particular the effects of the approach to competition, regulation and pricing on those involved in the industry.

For clarity, we have divided our response into 3 sections:

- A short introduction to Gemserv;
- Our overall view of the proposals; and
- Specific observations in respect of 5 key issues:
  - Avoidance of undue influence;
  - Harmonisation with England & Wales;
  - Business Separation;
  - Customer Transfers; and
  - Governance Framework.

### *Gemserv Limited*

Gemserv is an independent company originally established by utility companies to manage, control and develop utility retail processes. We support de-regulated markets and provide assurance that market participants can operate in accordance with the relevant industry baseline.

We have extensive experience in the operation and development of the UK energy retail markets. Gemserv also advised the Dutch Parliamentary Committee on energy liberalisation and we are playing a key role in opening the competitive electricity market in the Republic of Ireland. In water, we have provided major input to one of Ofwat's Advisory Groups in the production of a customer transfer protocol for the England and Wales water industry.

### *Overall View of Proposals*

Gemserv believe that the overall approach, as described in the Bill, is appropriate for the market in Scotland.

By focusing on the delivery of retail services to customers, the complications of common carriage and the need for balancing and settlement processes have been avoided. Within the UK Electricity Market for instance, over 80% of the information exchanged (data flows) is a consequence of the settlement requirements. As a result of these simpler proposals, effective and cost efficient customer transfers should be possible, thereby attracting new entrants and minimising regulatory oversight.

We believe that the size of the proposed market is sufficiently small and well defined to minimise the risks of market opening.

### *Specific Observations*

In implementing the Bill, the industry will need to develop an appropriate governance framework. To ensure that this framework is appropriate, we believe that there are a number of issues that need addressing more fully.

### *Avoidance of Undue Influence*

Based on Gemserv's experience in utility retail markets, we feel that the Water Commissioner should take an active role in the organisation of advisory, expert and representative groups in the design and ongoing development of the market. New entrant companies need to be encouraged to participate in developing the market infrastructure.

When decisions are left exclusively to commercial companies, there is a risk that some parties may exert undue influence, distorting the market design in their favour.

### *Harmonisation with England and Wales*

It would be beneficial for those involved in the Scottish market to be cognisant of what is being developed for the competitive water market in England and Wales.

It would be appropriate that any customer transfer process be compatible across both markets. This would be particularly beneficial in enabling transfers for group (multi-site) companies who operate across the UK.

Whilst Gemserv do not advocate that the two markets should adopt the same framework, our experience has shown that there is usually a move towards harmonisation as markets mature.

### *Business Separation*

European legislation has required energy companies to focus on business separation between their regulated monopoly businesses (pipes and wires) and competitive (retail/supply) businesses. This has taken time to achieve, but the physical separation of these two functions by the creation of separate companies has been successful in eliminating potential advantages for suppliers with associated distribution businesses.

The ideal position in water would be to establish regulated monopoly businesses and competitive retail businesses. A clearly defined process to determine what assets and liabilities should fall into which of the incumbents businesses should be prepared. However, given that the distribution element in water comprises such a high percentage of the overall cost, Gemserv recognise that it may not be practical or cost effective to create separate companies at this juncture.

Instead, appropriate "ring fencing" between Scottish Water Wholesale and Scottish Water Retail should be required to force the incumbent supply business to operate on the same terms as new entrants. This would avoid Scottish Water Retail from deliberately or inadvertently benefiting from cross subsidies (premises costs, the cost of getting customer data, etc.) from the regulated monopoly business.

Customers can be afforded protection by the use of an independent central registration authority operated by an organisation that is not connected with any retail or distribution business in the market.

Furthermore, there may be a requirement for an independent "policeman" to ensure adherence to business separation rules.

### *Customer Transfers*

A clear, simple and standardised transfer process ("Transfer Protocol") is essential to ensure that customers can change supplier easily. An ill-defined transfer process will cause

participants to devise their own systems, potentially resulting in inefficient transfers or customers being transferred in error.

There should be an agreed set of principles to provide a measure against which processes and rules are tested. These principles should recognise that:

- for any competitive market to function effectively, there must be a defined process to enable customers to switch supplier;
- existing market players and new entrants must be able to interoperate and communicate efficiently in a cost effective way;
- processes must be consistent with current legislation, existing practices, licence obligations and commercial arrangements;
- data items that are exchanged between participants should be clearly defined in a catalogue that is maintained and the communication medium clear; and
- the process needs to be appropriate to the level of competition (limited to 160,000 non-household premises) but be adaptable for any future lowering of the eligibility threshold, e.g. to domestic premises.

Gemserv recommend a customer transfer process comprising of an independently managed registration function coupled with the minimum number of processes and dataflows necessary to facilitate competition.

In order to minimise costs, the registration system need not be complex. As a minimum, it should support the electronic transfer of information. The system could comprise a simple database with internet based technology for communication between market participants.

As well as being able to send / receive data, the registration system should:

- allow for appropriate monitoring and interrogation on the status of competition;
- demonstrate compliance with the Protocol including appropriate audit controls; and
- ensure consistency of functionality, application and maintenance of accurate information.

As part of our work for the England and Wales water industry, a basic customer transfer process was devised consisting of only 5 dataflows. We believe that this process could also be used as a basis within the Scottish Market, potentially providing a common process across the whole of the UK.

The Ofwat Advisory Group also defined other elements of the transfer protocol that will be essential to operating an effective process. These include the definition of transfer objection & rejection rules, data validation, treatment of debt, transfer timescales, erroneous transfers, disputed meter reads and compliance to the transfer protocol.

### *Governance Framework*

A structure allowing all parties to have representative input to the operation and development of the market is essential. Processes and data structures will inevitably change over time and it is critical that the management of change is controlled in such a way that all participants in the market are able to have input and rights of appeal.

Gemserv recommend that a Governance Framework be developed to provide:

- an issue resolution process for resolving operational issues where the solution necessitates changes to the industry design;
- a representative change management process that defines the process for initiating change, the timing and implementation of such changes and the role (if any) for the Water Commissioner; and
- any rights of appeal and the supporting funding & voting arrangements.

The Governance Framework and rules for change control should operate for the benefit of all legitimate constituencies without undue influence from any individual party.

In line with the proposals of the UK Government's Better Regulation Task Force, we recommend the establishment of a Governance Framework enabling self-regulation to develop within the industry. Self-regulation within robust governance regimes allows all stakeholders, including customers, to play an appropriate part in shaping the pace and direction of change.

The Governance Framework should be defined within a multi-party agreement to which all parties are bound. Suppliers operating within the competitive market should be obliged to enter into the multi-party agreement as a condition of licence.

The operation of the multi-party agreement and decisions taken should be transparent to all relevant parties. The issue of participation is not merely access to the relevant documentation, but the ability to actively and effectively participate in its development. There should be no exclusion of relevant information or viewpoints and consequently, appropriate contributions should be allowed from all interested parties on key decisions.

Once implemented, parties should be accountable within the multi-party agreement for their performance against their obligations. Failure to comply with any mandatory elements could amount to a breach of licence, which would allow for enforcement action to be taken.

### *Summary*

In conclusion, Gemserv believes that:

- the overall approach, as described in the Bill, is generally appropriate for the market in Scotland;
- the Water Commissioner needs to take an active role in ensuring that all relevant parties have the option to input into the design and development of the market;
- there should be full cognisance of the competitive market being developed in England and Wales;
- appropriate "ring fencing" between Scottish Water Wholesale and Retail will be required to ensure a level playing field for all market participants;
- a clear, simple and standardised customer transfer process should be developed, comprising of an independently managed registration function coupled with the minimum number of processes and dataflows necessary to facilitate competition; and
- a Governance Framework should be developed to allow all parties to have representative input to the operation of the market and its ongoing development.

**Agenda Item 4**

**Environment and Rural  
Development Committee**

15 September 2004  
ERD/S2/04/20/2c

**SUBMISSION BY WATER UK**

*Introduction*

Water UK is very pleased to have the opportunity to comment on the Water Services etc. (Scotland) Bill. Water UK represents the water and sewerage service operators in England, Wales, Scotland and Northern Ireland, in both the private and public sectors. It is as a UK organisation that we comment here, as we commented in response to the 2000 “Managing Change in the Water Industry” and the 2001 “The Water Services Bill – the Executive’s Proposals” consultations.

We support the prime objective of the Bill, as stated in the Policy Memorandum, ‘to ensure that there is a robust transparent regime that operates in the interests of all customers.’ In particular, we agree that the competition regime proposed for Scotland should benefit all customers, not just those who are able to change service supplier. Our comments focus on the way in which the Bill proposes to achieve this objective and we have grouped them under three broad headings:

- Links with the Competition Act 1998 (CA98)
- Pricing regime
- Wholesale price charged by Scottish Water

*Link with the Competition Act 1998*

In many respects, the Scottish Parliament has to face the same competition issues in formulating the Bill as the UK Parliament did in passing Water Act 2003 (WA03). We note with interest that the Bill will create a different competition regime in Scotland from that now being introduced in England and Wales. The crucial difference appears to be that the Drinking Water Inspectorate (DWI) in England and Wales concluded in 2000 that the public health and water quality risks attached to common carriage were not significant provided its guidelines were followed. In contrast, the public health risks of common carriage are considered unacceptable in Scotland.

We wonder whether this judgement could be legally challenged. We also wonder how the argument that the public health risks are unacceptable could be sustained if the applicant for common carriage were a company using common carriage in England or Wales. There is also the question of whether the Bill goes further than is necessary to protect public health when it rules out sewerage common carriage. Generally, we wonder whether two quite different solutions, north and south of the border, to, essentially, the same problem can co-exist for long.

The relationship between CA98, European law and the Bill is, of course, for the Scottish Parliament to determine. We are raising questions here because we share the Scottish Executive and Parliament’s wish that the competition regime in Scotland should be primarily determined by Acts of Parliament and not through the courts.

The proposal in the Bill for a licensing regime is a solution which is common to both competition regimes north and south of the border and we very much support its principle. From the start, we lobbied hard for a licensing regime to supplement CA98 and there is now a general consensus that only licensed competitors should be allowed.<sup>1</sup>

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<sup>1</sup> Licensing has been brought into law in England and Wales with WA03.

### *Pricing Regime*

We are concerned about the provisions, as we understand them, that the Bill makes for the pricing regime which will apply in the competitive area. One concern is that, if too much of the pricing regime is left to regulator's discretion, it may be open to legal challenge. Our other concern is that the pricing regime should be fully supportive of the social and environmental objectives assigned to Scottish Water. Essentially, the issue is that competition without a proper pricing methodology prescribed by legislation could lead to cherry-picking by new entrants seeking to supply only the highest return/lowest cost customers. The likely effect of this would be twofold:

- Regional tariffs might become 'de-averaged', either because the undertaker chooses to de-average in order to protect its customer base, or because the regulator or courts find that this is necessary for tariffs to be cost-reflective, and therefore non-discriminatory under CA98. Since there are several cross-subsidies – which the Scottish Parliament is likely to consider socially desirable – implicit in regionally averaged water tariffs<sup>2</sup>, some mechanism is needed to preserve them in the face of competition.
- Competition risks reducing Scottish Water's ability to finance its national functions, particularly those regarding the protection of the environment. Scottish Water customers pay for these activities through water charges. An unbridled competition regime could encourage business customers to become free-riders by opting to be supplied by a competitor who does not have the same obligations as Scottish Water and can undercut it.

The Bill proposes to avoid these problems by setting up a retail subsidiary of Scottish Water which Scottish Water will charge on the basis of an averaged wholesale tariff. We understand that this wholesale tariff will be the same for all customers, whether they are customers of the Scottish Water retail subsidiary or of its competitors. This approach, to set an averaged price on Scottish Water activities – none of which will be open to competition – has similarities to the solution chosen in WA03, where the problem of protecting social and environmental objectives is addressed through strict pricing rules. That Act states in formal legal terms the access pricing principle that economists will recognise as the efficient component pricing rule (ECPR), also referred to as "retail minus".<sup>3</sup> The success of the approach proposed in the Bill depends crucially on the correct setting of the wholesale price between Scottish Water and its subsidiary (discussed in the next section) and on the pricing regime applied to the retail subsidiary.

Subject to the wholesale price being set correctly, the proposed wholesale pricing regime, as we understand it, could protect Scottish Water's objectives and its remaining customers. However, its retail subsidiary will be open to cherry-picking and free-riding if its charges are based on average accounting principles. Customers for whom retail services are relatively cheap to provide will be attractive to competitors, leaving the relatively expensive ones to the Scottish Water retail subsidiary. Moreover, if the retail subsidiary had obligations that its competitors do not, it would be unable to compete and its prices would increase for its remaining customers. It is important that the retail subsidiary be set up carefully with a remit consistent with its competition objectives. Otherwise, competition

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<sup>2</sup> For example, cross-subsidies are likely to exist between urban and rural customers, and between high and low rateable value domestic customers. In England and Wales the cross-subsidy from large industrial users to domestic customers has now been unwound, primarily due to the threat of "inset" competition.

<sup>3</sup> ECPR is the only access pricing approach that both promotes efficient market entry and prevents cherry-picking.



will be distorted, will not provide appropriate incentives to the retail subsidiary, and will provide benefits to some customers only at the expense of others.

#### *Wholesale price charged by Scottish Water*

The separation of Scottish Water from its retail subsidiary can, in principle, produce some real benefits – clarity, accountability, control - that make it worth supporting. Indeed, some of our members in England have chosen this organisational structure. However, it is not clear that the Bill recognizes the conditions that need to be put in place for the benefits of separation to arise in Scotland. More important, there is a risk that the wholesale price will be set too low, which will not protect Scottish Water's objectives nor protect domestic customers from increases in charges as a direct consequence of competition for business customers.

Our experience of helping develop a framework for competition in England and Wales is that customer-facing activities reach deep inside operational functions. Customers are instrumental in helping to identify network or supply failures; they also need to be informed of operational events. In addition, particularly in emergencies, some domestic customers, including those located on a business customer site, need special services that can only be provided by a water operator, not by a customer care function. We do not know the extent to which customer-facing activities will be retained within Scottish Water or transferred to its retail subsidiary, especially as it is not always feasible or desirable to separate facilities for domestic customers from those for business customers. It will be crucial to separate these functions between Scottish Water and its subsidiary most carefully, to determine how those transferred to the retail subsidiary will be financed and how the two entities will inter-act and exchange information. These questions have implications for the retail subsidiary's ability to compete, as we said earlier, and also for the cost estimates in the Financial Memorandum. However, we are unable to quantify them and would refer to Scottish Water's evidence to Parliament.

Crucial to the regime is the averaged wholesale price which Scottish Water will charge its retail subsidiary and, thus, the retail margin assumed to be included in end-user tariffs. We have evidence that leads us to doubt the estimates for the turnover of the Scottish Water retail subsidiary in paragraph 14 of the RIA. It gives the Water Industry Commissioner's estimate of the retail gross margin as being in the order of 15% to 20% of business customers' bills. Experience in the gas and electricity industries is cited in support of this estimate, which was first published in the document "Strategic Review of Charges 2002/6". However:

- This estimate is based partly on assumed data for three English water companies; we understand from them that some of the estimates are grossly inaccurate.<sup>4</sup> If this was corrected, the estimate above would be reduced by about half, to less than 10% of customers' bills.
- The comparison with energy industries is likely to be misleading; there have been several publications highlighting the fact that network costs represent a much greater proportion of total costs in the water industry than is the case in gas and electricity. It is not reasonable to assume that retail costs in water are in similar proportions to those in gas and electricity.
- A recent survey by the Office of Water Services (Ofwat, the economic regulator in England and Wales) of the retail margin in England and Wales showed that water retail operating costs, expressed as a percentage of water turnover, average only

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<sup>4</sup> A significant element of the cost assumptions appear wrong by a factor of 7

9.6%.<sup>5</sup> We have no reason to believe the position in Scotland is significantly different

It is also worth noting that the retail costs considered above (quoted for English water companies by the Water Industry Commissioner, in gas and electricity and in Ofwat survey) are for the costs of serving the entire customer base, both domestic and non-domestic. The retail cost of serving domestic customers in England and Wales, expressed as a percentage of the average household bill, is much greater than that for non-domestic customers, reflecting the much lower average domestic bill. Therefore the relevant retail percentage for non-domestic customers is lower. Using Ofwat survey quoted above it can be shown that retail costs for large business customers may be as low as 4% of their total charge.

The true scale of water retail costs is obviously of interest to prospective licensees, but there is a danger from a public policy perspective of over-stating them. If the wholesale price is set too low in order to encourage the retail market to develop, domestic customers will suffer increased charges in order to maintain Scottish Water overall revenue; licensees, initially, will benefit at their expense. Later, as retail margins are competed away, the benefits will transfer to business customers, still at the expense of domestic customers. The size of the retail gross margin is therefore a very important issue and we urge Parliament to research it most carefully.

There is some recognition of the potential cost to domestic customers of not setting the wholesale price correctly in the RIA and Policy Statement, but the assumption that Scottish Water is 42% less efficient than English water companies is used to justify the financial pressure on Scottish Water's wholesale operation. By the time the market opens in 2008 it appears likely that Scottish Water will have largely eliminated the efficiency gap. In this case, an overstatement of the retail gross margin – namely a wholesale price that is too low – will have a negative impact on domestic customers.

### *Conclusions*

The issues of how the separation is achieved between Scottish Water and its retail subsidiary and of the wholesale pricing regime are crucial to the success of the competition regime proposed in the Bill. The Bill's proposal to create a separate retail arm for Scottish Water does not in itself ensure that the effects of competition are confined to retail activities serving business customers. The allocation of costs to both wholesale and retail will affect the financing of the wholesale business and may ultimately affect charges to domestic customers. If these issues are not addressed, through legislation and regulation, competition in Scotland could encourage cherry-picking and leave domestic customers alone to pay for the environmental and social objectives given to Scottish Water.

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<sup>5</sup> This covers all water customers (household and non-household). The figure for non-household customers only is much smaller, as indicated in the next paragraph.

## **SUBMISSION BY SCOTTISH WATER**

### *Summary*

Scottish Water welcomes the opportunity to present evidence on the Water Services etc. (Scotland) Bill. This Bill proposes a range of reforms to the structure and regulation of the Scottish water industry, and Scottish Water supports the Minister's policy aims in this Bill. Scottish Water has also presented evidence to the Finance Committee in respect of the financial impacts of the Bill. This document discusses the wider policy implications of the Bill<sup>1</sup>.

Scottish Water welcomes the changes to the structure of economic regulation and charge setting. These changes will increase the clarity and certainty of economic regulation, and will move the Scottish industry more closely into line with normal utility regulation in the UK.

In respect of the proposals for the introduction of retail competition for business customers, we support the Scottish Executive's proposal to establish a regulated response to the requirements of the Competition Act. The necessary changes should, however, be introduced with the minimum possible disruption and additional costs to the business and its customers.

Scottish Water notes that it may be required to establish a retail subsidiary, which will be subject to price regulation through its licence until there is sufficient competition in the retail market. Clearly, such a price control would need to provide the retail business with sufficient revenue to enable it to carry out its functions at the lowest reasonable overall cost.

The remainder of this document follows the chronological sequence of sections in the Bill. The relevant sections are noted in the heading for each part of this document.

### *Changes to the Office of the Water Industry Commissioner Sections 1 & 2 and Schedule 1*

1. The changes to the office of the Water Industry Commissioner will be helpful in establishing clear and transparent economic regulation in line with the recommendations in the recent Finance Committee report. These proposals also move the Scottish system into closer alignment with the normal structure of utility regulation in the UK.
2. Scottish Water welcomes the proposal to establish a Water Industry Commission with a board structure. While we agree that the Commission members should not be representatives of stakeholder or customer groups, the Commission should contain an appropriate breadth of economic, regulatory and customer service experience.
3. It would be appropriate at this time to consider whether any changes or clarification are required in the role and responsibilities of the Water Customer Consultation Panels.

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<sup>1</sup> This evidence does not deal with those parts of the Bill dealing with control of water from coal mines

*Proposals in respect of “reasonable cost” for new connections*  
*Section 3*

4. Scottish Water welcomes the provision for Scottish Ministers to make regulations dealing with the allocation of costs for new connections between Scottish Water and developers. As there is a range of potential models for the allocation of such costs, these regulations should be produced as soon as practicable to provide clarity for customers, developers and Scottish Water on their respective financial obligations. We recommend that these arrangements take into account the impact on the wider customer base.

*Changes to the Strategic Review of Charges process*  
*Section 18*

5. Scottish Water welcomes these changes to the structure of the Strategic Review of Charges process. Again, we note that these changes move the Scottish industry into closer alignment with the normal utility regulation system in the UK. We note that the Water Industry Commissioner is in the process of consulting on his methodology on this subject, and we will provide detailed comments on his proposals.
6. This section gives the Scottish Executive the duty of setting public policy priorities and objectives for the water industry. It gives Scottish Water responsibility for delivering the Executive's priorities and objectives, and the Water Industry Commission responsibility for the economic regulation of Scottish Water in full accordance with these priorities and objectives. This clear definition of roles and responsibilities is welcome. The ability of Scottish Water and the Water Industry Commission to discharge their respective roles successfully will be dependent on the Executive setting priorities and objectives that are comprehensive, clear and unambiguous.

*Changes to the process for setting Schemes of Charges*  
*Section 18 and Schedule 3*

7. The changes to this process for setting Schemes of Charges moves the Scottish industry into closer alignment with the normal structure for regulated utilities in the UK, with any final determination being made by the Commission rather than Ministers. The proposal to remove from Scottish Water the power to enter into agreements with customers is more restrictive than in other UK utility markets.

*Proposal to establish a retail market*  
*Sections 4 to 17, 20 to 22 and Schedule 2*

8. It is desirable to establish a regulated response to the requirements of the Competition Act, and Scottish Water supports the Minister's aims in this regard.
9. The proposed retail regime may require the establishment of a retail subsidiary by Scottish Water. This should be undertaken so as to minimise the disruption to Scottish Water's operations and to minimise the additional costs to the business and its customers.

10. It is proposed that the retail business will be subject to price regulation through its licence until there is sufficient competition in the retail market. Clearly, such a price control would need to provide the retail business with sufficient revenue to enable it to carry out its functions at the lowest reasonable overall cost. To this end, the Bill should include provision to enable the retail business to be funded to cover its reasonable costs, for at least the period when it is subject to a price control.

### Costs set out in the Financial Memorandum

11. Independent research<sup>2</sup> commissioned by Scottish Water suggests that the costs of establishing and operating the market mechanisms are likely to be higher than those set out in the FM.

12. There is a range of on-going costs to Scottish Water not included in the FM. These include new functions to manage the relationships and contracts with new retailers, the duty to act as retailer of last resort, and new increased costs of managing certain wholesale customer service functions due to additional frictional costs from the proposed business separation. In addition, Scottish Water Retail will incur additional costs due to its new functional responsibilities. The table below sets out Scottish Water's current assessment of the likely costs of implementing the new retail competition regime.

**Table 1: Implementation costs**

<b>Topic</b>	<b>Cost assessment in FM</b>	<b>Scottish Water's current assessment</b>
Costs of establishing competitive regime and market mechanisms	£2.5 million plus £0.5 million per year	£10.8-18.4 million plus £3.1-5.1 million per year <sup>2</sup>
Establishment costs to Scottish Water Wholesale	£5 million	£5.8 million
Establishing Scottish Water Retail as a legal entity	£100K	As per FM
On-going costs of Scottish Water Retail in respect of new functions and costs of separation	Not included	£1 million plus £1.5 million per year
New wholesale functions incl. support of market and on-going costs of separation	Not included	£0.75 million per year
Commissioner's costs	£5 million plus £1 million per year	As per FM
Switching costs	£30-50 per switch i.e. £300-500K per year	As per FM
Total – "One-off" costs of establishment plus "On-going" operational costs	£12.6 million plus £1.9 million per year	£22.7-30.3 million plus £6.6-8.8 million per year

<sup>2</sup> Research has been commissioned from IBM Consulting, who have developed market mechanisms for the deregulation of a range of European energy markets

## **Benefit assessment in Regulatory Impact Assessment (RIA)**

13. The RIA assumes that Scottish Water is 42% less efficient than competitors, a position that may refer to a historic assessment of the former water authorities' position in 2000/01<sup>3</sup>. Scottish Water has already reduced its inherited operating costs by 20% since 2002, and expects to reduce them by around 40% over the period to 2006. We expect that Scottish Water's level of efficiency relative to the water companies in England and Wales will have improved significantly by 2006, and even further by 2008.
14. The RIA assumes that the level of retail gross margin in Scottish Water is between 15-20%. Scottish Water has undertaken a comprehensive cost assessment project to examine the allocation of its own costs between retail and wholesale activities. This indicates that the retail element of costs for non-domestic customers is between 6-9%.
15. The data given in the RIA implies that the possible efficiency savings (42% inefficiency and 15-20% retail margin) that might be available to customers could amount to £22-29 million. Scottish Water estimates that such benefits will be substantially lower than those suggested in the RIA because of our lower assessment of retail margin and residual inefficiency when the market opens in 2008.

## **Impact on the Wholesale Business**

16. The correct setting of the retail margin and wholesale price will be critical because of the risk of creating an unintended cross-subsidy either to or from business customers in the new competitive market – at the expense, or to the benefit, of Scottish Water's household customers.

## **Transitional effects**

17. The proposals to establish a retail market are helpful in avoiding the potential disruption if water competition was allowed to develop without a formal regulatory structure. Even with this regulated response, there will be inevitable disruption to Scottish Water with the creation of new market arrangements and the likely creation of a separate retail subsidiary. Establishing a fully separated retail subsidiary could involve the transfer of around 200 staff from Scottish Water.

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<sup>3</sup> The data may be drawn from the Water Industry Commissioner's publication "Strategic Review of Charges 2002-2006", page 186, Table 18.4, which refer to 2000/01 analysis in respect of the predecessor water authorities

## **STATEMENT BY THE MINISTER FOR ENVIRONMENT AND RURAL DEVELOPMENT**

### **MINISTERIAL PRIORITIES FOR THE DUTCH PRESIDENCY OF THE EUROPEAN UNION**

#### **Prospects for the Environment Policy Area**

##### **The top priorities as stated by the Presidency**

During the course of its Presidency, the Netherlands will focus on 4 priority topics:

- (i) re-invigorating the **environmental dimension of the Lisbon Agenda**;
- (ii) discussions on the **REACH** Regulation on Chemicals;
- (iii) international negotiations on **Climate Change**; and
- (iv) **Sustainable Mobility**.

In addition, the Presidency hopes to make progress on a number of other proposed Directives of key interest to the Scottish Executive, including Directives on **Groundwater**, **the Aarhus Convention** (both Community ratification and the Access to Justice proposal) and **Batteries**. Further detail on these, and other relevant proposals, is provided below.

##### **Important Issues for the Scottish Executive to be dealt with by the Presidency**

My officials have been working on these issues for some time, in collaboration with counterparts in UK departments and in EU discussions. Of particular interest is the Scottish work on catchment management deployed within the EU Council Working Group on revision of the Bathing Waters Directive and officials' participation in international fora on climate change.

##### **Hazardous Substances**

The Regulation on **REACH** (**R**egistration, **E**valuation and **A**uthorisation of **C**hemicals) will be a priority for the Dutch Presidency. The Scottish Executive has three priorities regarding the proposal:

- to develop a fast, efficient and workable process to test and screen chemicals and tackle those of most concern;
- to minimise animal testing; and
- to maintain the competitiveness of the chemicals industry and downstream users.

Ministers discussed three key areas of the proposal at the June Environment Council: (i) authorisation and restriction of the most dangerous chemicals; (ii) substitution of chemicals of chemicals of concern; and (iii) quality of data. During the Dutch Presidency, the ad hoc working group set up in the Council will continue to discuss these key issues. A major seminar on impact assessment will also be held at the end of October. Political agreement will not be reached during the Dutch Presidency given the complexity and range of outstanding issues, but there will be a policy debate at the December Environment Council. In the European Parliament, the Environment Committee is not expected to adopt a first reading position until the first quarter of 2005. A first reading in plenary will likely follow in the second quarter.

##### **Water Issues**

The Presidency will look to take forward the proposed new **Groundwater** Directive. The proposal:

- calls on Member States to set standards for specific substances at a national, regional or local level;
- proposes a mechanism for the monitoring of trends in groundwater pollution; and
- provides for the control of indirect discharges of certain substances into groundwater.

The Presidency hopes to reach political agreement at December Council, but progress will depend on the European Parliament delivering a first reading in time. It will be important to ensure that the agreed text fully reflects the diverse nature of different groundwaters across the EU and allows for risk-based, locally determined, standards. In Scotland, only around 5% of drinking water comes from groundwater sources.

Political agreement was reached on the proposed revision to the **Bathing Waters** Directive at June Environment Council. There will be a second reading on the proposal in the European Parliament during the course of the Dutch Presidency, but final agreement will not be reached before the Luxembourg Presidency (January to June 2005).

On 15 July, the Commission adopted a Communication on **Flood Risk Management**, looking at the possibilities for enhanced cooperation and exchange of information between countries that share European river basins. The Commission proposes that Member States co-operate to develop and implement flood risk management plans at river basin level and within coastal areas in order to prevent problems being transferred from one area to another. The development of flood risk maps is also envisaged. The Presidency held an exchange of views on the proposal at the Informal Environment Council in July and intends to do so again at the October Environment Council. Council Conclusions may be adopted.

## **Waste Issues**

The Presidency hopes to reach political agreement at December Council on the proposed revision to the **Batteries** Directive. As drafted, the proposal - covering all batteries and accumulators - would require Member States to encourage producers to increase overall environmental performance of batteries/accumulators throughout their life-cycle and ban the disposal of automotive and industrial batteries in landfill and by incineration. Member States would be required to ensure that all batteries/accumulators are collected, while producers would have to finance (individually or collectively) collection, treatment, and recycling of all portable batteries. The proposal also sets collection and recycling targets. The European Parliament gave the proposal a first reading in April, proposing a ban on the use of cadmium and lead batteries (with some exemptions) and a fundamental change in recycling and collection targets.

Ministers held a first policy debate at June Council on a proposed directive on **Mining Waste** which will regulate waste from prospecting and extraction, treatment and storage of mineral resources. Following that, the Dutch Presidency hopes to be able to reach political agreement at the October Council. The European Parliament delivered a first reading on the proposal on 31 March 2004.

## **Climate Change**

The Presidency will need to co-ordinate and prepare the EU position for the COP (Conference of the Parties) 10 meeting on **Climate Change** in Buenos Aires on 6-17 December. Themes to be discussed at COP10 are likely to include:

- accomplishments to date and future challenges;
- impacts and risks of, and adaptation to, climate change;
- energy and climate change; and



- investing in climate change.

A decision by Russia on whether or not to ratify the Kyoto Protocol will clearly have a significant impact on the meeting and the Dutch Presidency has invited President Putin to attend a conference in the autumn on Kyoto. The outcome of the US elections in November will also be of relevance to the direction of international discussions.

The Presidency will also look to reach political agreement at the October Council on the proposed Regulation on **Fluorinated Gases**. The draft regulation is intended to help Member States deliver on their Kyoto commitments by controlling emissions of fluorinated gases with the potential to cause global warming (HFCs (hydrofluorocarbons), PFCs (perfluorocarbons) and SF6 (sulphur hexafluoride)) during the design, manufacture, installation, operation and disposal of equipment including fridges, heat pumps, and fire protection systems.

### **Miscellaneous Issues**

The Presidency intends to deal with the outstanding **Aarhus Convention** related proposals as a single package, bringing together: (i) the Regulation and Decision required for the EU and its institutions to ratify the Convention; and (ii) the proposal for a Directive on Access to Justice. The Presidency aims to reach political agreement on the package at December Council.

The **Access to Justice** proposal, which would implement the third pillar of the Convention, would give members of the public with a sufficient interest access to judicial or other impartial procedures to challenge actions which contravene environmental law. Under the proposal, members of the public may also be entitled to make a request for a decision to be reviewed internally by the authority that made it before going to Court. As recognised in the Aarhus Convention, the provisions of the proposal will need to be developed in accordance with the provisions of national law. The Scottish Executive will therefore need to ensure that it reflects the position of Scots Law.

The Commission adopted its long-awaited Communication on **Financing Natura 2000** on July 15. The Communication looks at the future financing of the Natura 2000 network of natural sites designated for protection by Member State authorities, with an estimate that the maintenance of this will cost around €6.1bn per year. Rather than propose a new, stand-alone fund, the Commission proposes to deliver financing through existing instruments. Given the number of Natura 2000 sites in Scotland, the Communication is of particular interest to the Executive. There will be an exchange of views on the Communication at October Council.

### **Implementation Issues**

None directly. Environment dossiers tend to be longer term. In due course there will be targets for some eg climate change, batteries recycling.

## **Prospects for the Food and Agriculture Policy Area**

### **The top priorities as stated by the Presidency**

The main focus of the Dutch Presidency will be on **sustainable agriculture** in relation to economic, social and environmental impacts. Subordinate objectives relate to reducing the administrative burden, further reform of the CAP and integration of the new Member States.

## **Important issues for the Scottish Executive to be dealt with by the Presidency**

SEERAD officials have been fully involved in discussions and negotiations to date at both EU and UK level on the key topics listed below particularly animal health and beef marketing. This engagement will continue until issues are resolved and in some cases, such as the Rural Development Regulation which is of great importance to Scotland, the involvement will increase over the next few months.

### **Rural Development**

The current rural development programming period comes to a close at the end of 2006 and a new **Rural Development Regulation (RDR)** will be needed from 1 January 2007. The Commission has published its initial proposals for a new regulation and these will be progressed under the Dutch Presidency (although the final package is unlikely to be agreed until late 2005). The main objectives of the new RDR are to promote (i) competitiveness and restructuring, (ii) environmental improvements and (iii) diversification.

Key issues for Scotland will be:

- the future distribution of EU funds between Member States. Currently the UK, and therefore Scotland, receives a very small allocation and is pressing for a more equitable distribution of the available funding.
- adequate flexibility to use funds to meet national priorities. The new RDR will be the outlet for the modulated funding diverted from direct (Pillar 1) payments to farmers and will provide the platform for the development of Land Management Contracts in Scotland as envisaged in *A Forward Strategy for Scottish Agriculture*. It is important that we are not unduly constrained in the way we use this funding if Scotland is to derive maximum benefit.
- future support for less favoured areas. Currently 85% of Scotland's agricultural land is classified as less favoured area (LFA) and farmers receive additional financial support as a result. The Commission proposes a review of the eligibility criteria for LFA designation which will have implications for Scotland. We will be closely involved in the ongoing negotiations to look after Scotland's interests.

### **CAP reform**

Though the main commodity regimes were covered by the 2003 CAP reform package, there are a few remaining areas up for reform under the Dutch Presidency. There is a Commission proposal for changes to the **sugar** regime which will be controversial but of limited interest in Scotland. More significant may be consideration of the Common Market Organisation in **fruit and vegetables** which will be pertinent to Scottish growers. This is at an early stage but any emerging proposals will need to be carefully scrutinised.

### **Animal health and welfare**

Proposals are expected on broiler hens, welfare at slaughter and a review of pig welfare legislation. The controversial issue of **welfare of livestock during transport**, which stalled earlier in the year, is unlikely to re-appear but may do only if the Presidency sees any real prospect of making progress against a background of widely differing positions held by Member States. Discussions may also take place on a proposed new Avian Influenza Directive amending the current base for High Pathogenic Influenza and introducing a requirement for responding to outbreaks of Low Pathogenic Avian Influenza.

## **Beef marketing issues**

The first half of the year produced some encouraging signs in the drive to have the restrictions on beef sales and exports eased. This remains a priority for Scotland and the Executive will continue to press for relaxations of controls where scientific evidence clearly indicates that this would pose no risk to consumers. Decisions on the future of the Over Thirty Month (OTM) rule, which prevents older cattle from entering the food chain, will be relevant here.

Satisfactory progress was made during the Irish Presidency on beef labelling but there remain a few loose ends to be tidied up including consideration of combining batches of mince from different abattoirs and Member States in one batch and harmonisation of cattle categories for labelling purposes. We need to monitor developments and ensure that Scottish interests are covered.

## **Plant Health**

Discussion and possible vote on the ongoing EC review of the Potato Cyst Nematode, Potato Brown Rot and Potato Ring Rot Control Directives expected during the Dutch Presidency.

## **Implementation issues**

The main implementation issue for the Executive will continue to be completion of preparations for the introduction of the main 2003 CAP reform package by 1 January 2005.

## **Prospects for the Fisheries Policy Area**

### **The top priorities as stated by the Presidency**

The Dutch Presidency team has identified three specific fisheries themes as its own priorities for facilitating progress under their Presidency. These will inform the approach to handling Council business. They are:

- Establishing recovery plans for fish stocks outside safe biological limits;
- Improving control methods to ensure that CFP rules are being obeyed; and
- Simplification of the CFP regulations

Making progress in all three of these areas is a priority that is shared by the United Kingdom Government, and by the Scottish Executive. This reflects the overarching themes that were identified in the 2004-2006 multi-annual Presidency programme. Implementation of the multi-annual Presidency programme began under the recent Irish Presidency; the programme also embraces the forthcoming United Kingdom Presidency. The six Presidencies concerned worked collaboratively in advance, in order to progress a shared agenda over the three years. A relevant and useful Dutch Presidency can therefore be anticipated: guided by principles and priorities that have been agreed, and are shared by the Scottish Executive. This is expected to continue under Luxembourg Presidency, as the Dutch team will assume operational responsibility for most fisheries matters on behalf of the Luxembourg Presidency.

The Dutch Presidency will also continue to progress unfinished business inherited from the Irish Presidency, including final ratification of the EU-Greenland bilateral agreement and the debate on future development of

environmentally friendly fishing methods. The Dutch Presidency will also handle routinely scheduled Council business, including the annual round of TAC and Quota negotiations, which will need to be concluded at the December Council.

The detailed agenda of fisheries items to be considered under the Dutch Presidency will, as published, include all of the following:

- To amend TACs and Quotas for 2004
- To establish the TACs and Quotas for 2005
- To establish TACs for Deep Sea Species in 2005
- To establish guide prices for fish species for 2005
- To establish short term regulations for conserving the European eel stock
- To debate the establishment of the Community Fisheries Control Agency
- To debate reforms to structural measures in the fisheries sector (FIFG)
- To debate a proposal on Vessel Monitoring System (VMS)
- To debate a report on access restrictions (including Shetland Box)
- To debate measures for recovery of North Sea plaice
- To debate measures for recovery of Celtic sea cod
- To present proposals for the simplification of CFP regulations

Only the first five of these agenda items require Council decisions before the end of 2004: the opinions of a recently-elected European Parliament will be required before much progress is made on the various other of the Commission's proposals.

### **Important Issues for the Scottish Executive to be dealt with by the Presidency**

There are a number of agenda items that are scheduled for discussion under the Dutch Presidency that are of particular importance in Scotland. The Scottish Executive aims to ensure that progress on these items takes full account of the Scottish particular interest. These items include:

- An allowance of additional days at sea for 'haddock-permit' vessels, under the proposal to amend 2004 TAC and Quota regulations.
- Equitable and reasonable TACs and Quotas decisions for 2005, consistent with sustainable management of Scottish fisheries and the previously agreed stock recovery plans.
- Discussion of the socio-economic dimension of access arrangements; in particular the importance of maintaining or improving the Shetland Box.
- Establishment of Regional Advisory Councils (RACs), especially in those fisheries regions where we have a leading interest: we aim to facilitate a successful launch the North Sea RAC later this year, and we will continue our work with stakeholders to develop proposals for the North West Waters RAC and the Pelagic RAC.
- Effective contribution to the debate on the establishment of an EU Fisheries Control Agency, including a detailed examination of the Commission's proposals on this item and the related proposals for Electronic Logbooks and Vessel Monitoring Systems.

- We will welcome in principle the proposal for simplification of the CFP regulations in principle, and we will examine it in detail before next year's discussions.
- We will also contribute fully to the next stages in the development of the recently proposed European Fisheries Fund (EFF) which will replace the current Financial Instrument for Fisheries Guidance (FIFG) when it ends in 2006. The Commission presented its proposal at July Council; a policy debate is planned for the October Council. Commission proposes that EFF will have available an average of €700 million per year for 2007-13, with key objectives that will include reducing fishing pressure to allow stock recovery, encouraging the use of more environmentally friendly equipment and the development of sustainable aquaculture. The new fund would also provide aid for fishing regions most affected by job losses, to help them diversify into other economic activity. In line with CFP reform, aid for fleet renewal, vessel export or creating joint enterprises will no longer be possible.

The Dutch Presidency agenda does not envisage Council deliberations on aquaculture, but we will maintain a strong interest in its sustainable development - in line with the recently agreed strategic framework. We will also continue to press for the introduction of safeguard measures (tariff related import quotas) to provide stability in the European salmon market while other, longer term, market stabilisation measures are explored.

### **Implementation Issues**

The Dutch Presidency will be the first full Presidency to be conducted in an enlarged European Union. This will have serious implications for fisheries management processes. These include an increased requirement for translation, which is likely to delay decision-making. In addition, tactical constraints will be introduced by the new voting arrangements, which are likely to make the achievement of all our objectives more difficult. The over-riding implementation issue in fisheries remains that the Scottish Executive will be required to continue participation in the United Kingdom's delegation, as a routine matter, and remain closely engaged in the meetings of Council and all of its working groups.

**ROSS FINNIE**