



**Environment and Rural Development Committee**

**22nd Meeting, 2004**

**Wednesday 29 September 2004**

The Committee will meet at 9.30 am in Committee Room 6.

1. **Subordinate legislation:** John Farquhar Munro MSP to move motion S2M-1712—That the Environment and Rural Development Committee recommends that nothing further be done under the Environmental Protection (Restriction on Use of Lead Shot) (Scotland) (No.2) Regulations 2004 (SSI 2004/358).
2. **Water Services etc. (Scotland) Bill:** The Committee will take evidence at Stage 1 from—

Panel 1

Alan Sutherland, Water Industry Commissioner for Scotland;

Dr John Simpson, Director of Cost and Performance, Office of the Water Industry Commissioner for Scotland;

Panel 2

Tony Smith, Director of Competition and Consumer Affairs, Office of Water Services (Ofwat);

John Banfield, Senior Inquiry Director, Competition Commission; and

Panel 3

Stuart Rolley, Senior Development Manager, Environment Team, The Coal Authority;

Stephen Hill, Development Manager, Environment Team, The Coal Authority.

3. **Subordinate legislation:** The Committee will consider the following negative instruments—

the Oil and Fibre Plant Seed (Scotland) Regulations 2004, (SSI 2004/317);

the Fodder Plant Seeds Amendment (Scotland) Regulations 2004, (SSI 2004/380);

the Agricultural Wages (Permits to Infirm and Incapacitated Persons) (Repeals) (Scotland) Regulations 2004, (SSI 2004/384);

the Sea Fishing (Enforcement of Community Satellite Monitoring Measures) (Scotland) Revocation Regulations 2004, (SSI 2004/391);

the Sea Fishing (Enforcement of Community Satellite Monitoring Measures) (Scotland) Order 2004, (SSI 2004/392); and

the Common Agricultural Policy Support Schemes (Modulation) (Scotland) Amendment Regulations 2004, (SSI 2004/398).

**Tracey Hawe**  
Clerk to the Committee  
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The following papers are attached:

<p><u>Agenda Item 1</u></p> <p><a href="#">The Environmental Protection (Restriction on Use of Lead Shot) (Scotland) (No.2) Regulations 2004 (SSI 2004/358).</a></p> <p>Briefing paper from the Clerk is attached</p>	<p>ERD/S2/04/22/1a</p> <p>ERD/S2/04/22/1b</p>
<p><u>Agenda Item 2</u></p> <p>Submission from the Water Industry Commissioner for Scotland</p> <p>Submission from Ofwat</p> <p>Submission from the Competition Commission</p> <p>Submission from the Coal Authority</p> <p>Briefing paper from SPICe (<i>for members only</i>)</p>	<p>ERD/S2/04/22/2a</p> <p>ERD/S2/04/22/2b</p> <p>ERD/S2/04/22/2c</p> <p>ERD/S2/04/22/2d</p> <p>ERD/S2/04/22/2e</p>
<p><u>Agenda Item 3</u></p> <p><a href="#">The Oil and Fibre Plant Seed (Scotland) Regulations 2004, (SSI 2004/317)</a></p> <p>The Fodder Plant Seeds Amendment (Scotland) Regulations 2004, (SSI 2004/380)</p> <p>Extract from the Subordinate Legislation Committee's 33rd Report</p> <p><a href="#">The Agricultural Wages (Permits to Infirm and Incapacitated Persons) (Repeals) (Scotland) Regulations 2004, (SSI 2004/384)</a></p> <p><a href="#">The Sea Fishing (Enforcement of Community Satellite Monitoring Measures) (Scotland) Revocation Regulations 2004, (SSI 2004/391)</a></p> <p><a href="#">The Sea Fishing (Enforcement of Community Satellite Monitoring Measures) (Scotland) Order 2004, (SSI 2004/392)</a></p> <p>The Common Agricultural Policy Support Schemes (Modulation) (Scotland) Amendment Regulations 2004, (SSI 2004/398).</p>	<p>ERD/S2/04/22/3a</p> <p>ERD/S2/04/22/3b</p> <p>ERD/S2/04/22/3c</p> <p>ERD/S2/04/22/3d</p> <p>ERD/S2/04/22/3e</p> <p>ERD/S2/04/22/3f</p> <p>ERD/S2/04/22/3g</p>

**Agenda item 1**

**Environment and Rural  
Development Committee**

29<sup>th</sup> September 2004  
ERD/S2/04/22/1b

**ENVIRONMENT AND RURAL DEVELOPMENT COMMITTEE**

**The Environmental Protection (Restriction on the Use of Lead Shot)  
(Scotland) (No 2) Regulations 2004 (SSI 2004/358)**

1. This paper outlines the background to this instrument, and describes the procedure for consideration of the motion lodged by John Farquhar Munro MSP to annul the instrument.

**Background**

2. The Environmental Protection (Restriction on the Use of Lead Shot) (Scotland) Regulations 2004, (SSI 2004/289) were considered by the Environment and Rural Development Committee on 30 June 2004. In considering the regulations the Committee took into account the report of the Subordinate Legislation Committee, which raised substantial concerns regarding the drafting of the instrument. Having considered this report the Committee agreed to write to the Minister asking that he revoke and relay the instrument in order to take account of the concerns regarding its drafting.
3. The Minister agreed to revoke the instrument in order to respond to these concerns. This revocation was achieved by the laying of fresh regulations (The Environmental Protection (Restriction on the Use of Lead Shot (Scotland) (No 2) Regulations 2004 (SSI 2004/358)). These regulations revoke the earlier SSI 2004/289 and take account of the drafting issues raised by the Subordinate Legislation Committee. The Subordinate Legislation Committee raised no points in relation to the revised regulations. It is these regulations that are now the subject of consideration by the Committee.

**The motion to annul the instrument**

4. A negative instrument subject to annulment will become, or remain, law unless the annulment procedure is successfully invoked to prevent it. In this case, regulation 7 (which revokes the earlier regulations 2004/289) came into force on 31 August 2004, and will remain in force unless a motion to annul is successfully invoked. The remainder of SSI 2003/358 will come into force on 31 March 2005 unless a motion to annul is successfully invoked. The Parliament has until 25 October to annul the instrument.
5. As lead committee, the Environment and Rural Development Committee must report to the Parliament with its recommendations on the instrument. John Farquhar Munro MSP has proposed that the lead committee

recommend that nothing further is to be done under the instrument (i.e. that it be annulled).

6. Standing Orders provide that a member of the Executive is entitled to attend the meeting and participate in proceedings for the purpose of debating the motion. The Deputy Minister, Allan Wilson MSP, will attend the meeting for this purpose, but may not vote. A member of the Parliament who is not a member of the lead committee may also attend the meeting of the committee and may speak in the debate if invited to do so by the Convener but may not vote (Rule 12.2.2).
7. The discussion will begin with an opportunity for the Deputy Minister to make opening remarks outlining the policy intention behind the instrument. Members will then be able to ask factual questions or ask for clarification, whilst officials are seated at the table with the Minister. The Committee will then move on to formally debate the motion.
8. John Farquhar Munro MSP will be asked to move the motion to open the debate. The debate is limited to 90 minutes (Rule 10.6.3). The Deputy Minister will be given an opportunity to respond. To conclude the debate John Farquhar Munro will be asked whether he wishes to press the motion.
9. After a motion is moved it may be withdrawn at any time before the question is put, unless any member objects to it being withdrawn. (If any member objects to a motion being withdrawn, then the Committee will move straight to the question on the motion).
10. If the motion is pressed, the Committee will decide its recommendation. If it recommends that nothing further should be done under the instrument, the Bureau will then propose a motion to the Parliament that nothing further should be done under the instrument. If that motion is agreed to, the Executive will be required to revoke the instrument.
11. The Executive may also elect on its own initiative to revoke an instrument at any time, whether for its own policy reasons or in response to representations from a member or committee.

**SUBMISSION BY THE WATER INDUSTRY  
COMMISSIONER FOR SCOTLAND**

We are pleased to have this opportunity to provide evidence on the Water Services etc. (Scotland) Bill to the Environment and Rural Development Committee.

I welcome the Bill. This Bill should help to protect the interests of all customers in Scotland.

Strengthened Regulatory Regime

This Bill will establish a strengthened regulatory regime. I have advocated the creation of a regulatory board for some time. A regulatory board would be an invaluable source of advice and support to the executive staff of WICS. I had sought to gain some of the long term benefits of a regulatory board by establishing an advisory panel in 2002.

This advisory panel comprised the former Director General of Ofwat, a former Finance Director of a major English water company, business people, a lawyer, a consultant in public health medicine and the former Chief Economic Advisor to Standard Life. The panel invited experts in engineering, regulation, finance and the development of competition to contribute views on regulatory issues where I sought advice.

The creation of a Water Industry Commission could also depersonalise regulation. Similarly, changing the remit of the regulator to make a decision on charges on the basis of a policy framework set by Ministers should ensure that roles and responsibilities are clearer. It is important that Scottish Water should be able to appeal a decision to the Competition Commission or could challenge process through a judicial review. We already endeavour to ensure that the targets that we set are challenging but achievable, but the proportionality of the regulatory regime can only be strengthened if Scottish Water is seen to have a right of appeal.

In March, I wrote to the Finance Committee:

“You asked whether it is realistic to expect Scottish Water to achieve the improvements in performance, from which customers south of the border already benefit. I have no doubt that most, if not all, of the gap in performance could and should be eliminated.

It may be instructive to examine the reasons behind the companies’ success in England and Wales. In recent years, companies have delivered significant and sustainable efficiencies for customers and (again as discussed in my recent paper) survived corporate shocks. A key common thread behind the companies’ success is the existence of a sound regulatory, financing and corporate governance structure for the industry. Its features include:

- Independent regulation with powers of determination, subject to appropriate appeal
- A clear and appropriate role for ministers to provide guidance to the regulators

- Ring fencing of core water and sewerage activities (this ensured Wessex Water's survival after the collapse of its parent Enron)
- Financial discipline and tight budget constraints
- Audit by Reporters, independent of both company and regulator
- Effective incentives on companies to deliver, through accountability to stakeholders and the publication of objective performance assessments by regulators."

Many of these key success factors are now in place in Scotland. As a result, by 2006, I expect Scottish Water to have been able to reduce its inherited level of operating costs by some £145 million annually in real terms. Customers' bills will consequently be around 15% lower (over £40 a year for an average household) than they would otherwise have been.

Rigorous, objective regulation is therefore beginning to deliver real value to customers. However, much remains to be done and the strengthening of regulation is likely to ensure that customers will see further benefits.

The proposals for the competition framework and the definition of the core activities included in the 2002 Act should ensure that customers are able to benefit from the tight budget constraints and financial disciplines that exist south of the border. In short, customers would only pay for efficient expenditure

### Background to the Competition Framework

The possibility of competition in public networks has increased since 2000, when the Competition Act (1998) came into force. Although the Competition Act (1998) was to some extent the starting point for introducing competition into the water sector, a degree of competition did already exist, through 'off-network' deals and some small-scale brokerage (retail)<sup>1</sup> deals.

The Competition Act (1998) prohibits agreements, business practices and conduct that damage competition in the UK. More specifically, the Act prohibits:

- anti-competitive agreements (known as the Chapter I prohibition); and
- abuse of a dominant market position (known as the Chapter II prohibition).

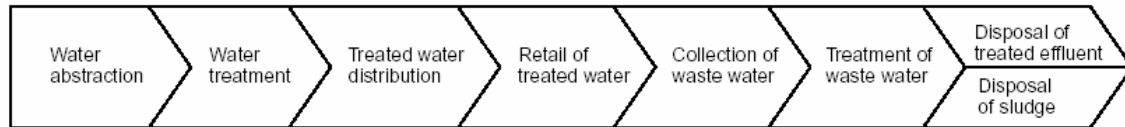
The impact of the Competition Act on the water industry would not become clear until there was a challenge. However, such a challenge may result in the framework for competition in the public water industry in Scotland being determined by the Courts. Any interpretation of the Act by the Courts may not be consistent with the broader policy objectives of the Scottish Executive for the water industry in Scotland. At the same time, the Scottish Executive has also recognised that, subject to safeguards, which ensure broader policy objectives can be delivered, it may be beneficial to allow

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<sup>1</sup> Brokerage : a deal by which water is sold to customers by a third party, who is not responsible for anything other than the final supply of water to a customer's premises . Off-network : a privately owned water supply or waste water treatment and disposal system that reduces or eliminates the need for a connection to the public water and waste watersystem.

the introduction of some competition into the water and sewerage industry in Scotland.

Scottish Water currently handles all aspects of the water and sewerage service. Its activities can be represented in a value chain.



We believe that Scottish Water's wholesale activities include all of the operational activities that do not involve interaction with the end customer. Our initial view is that retail activities (as you will note a relatively small part of the value chain) would include all matters relating to:

- retail pricing and tariffs;
- the billing process;
- collection of charges;
- debt follow up and debt management;
- meter reading, customer meter operations and ownership;
- call and correspondence handling;
- responses to customer enquiries, complaints or requests for information;
- key account management;
- liaison with the wholesaler to deal with customer issues; and
- marketing.

We currently plan an extensive consultation on both the detailed principles of the licensing regime and then the detail of a draft licence for Scottish Water Retail before the end of the 2005-06 Financial Year. This licensing regime will clarify the responsibilities of both the retailer to the wholesaler and the wholesaler to the retailer. The split of activities will, of course, have to be defensible if challenged under Competition law. We are proposing that there would be at least two further rounds of consultation before a licence was issued to a new entrant.

In our current Strategic Review of Charges methodology consultation, we are proposing to include the split of retail activities as a "notified item" within the price settlement. This would mean that if new information came to light on the appropriate split between wholesale and retail, the Water Industry Commission could review the wholesale price (during the 2006-10 regulatory control period) in an Interim Determination.

We believe that the framework proposed in the Water Services etc (Scotland) Bill will benefit all customers. It will also reduce the likelihood of legal challenge under the Competition Act. Such a challenge could, if successful, disproportionately affect vulnerable domestic customers. A successful challenge could place restrictions on:

- harmonised charges;
- cross-subsidy to assist vulnerable customers; and
- government lending to Scottish Water.



We would expect that new entrants, as focused, specialist retailers, could improve the level of service offered to customers. For example, they could offer customers multiple payment alternatives (in method of payment and frequency), could combine the bills of various locations into one single bill (for multi-site customers), or could offer advice about how to reduce consumption. Further opportunities could exist if the retailer were already providing the customer with another utility service, as they would benefit from economies of scope, and could offer their customers a single bill that covers a number of utility services.

### *Possible approaches to setting wholesale prices*

The Committee will no doubt hear a lot of evidence (much of which is likely to be conditioned by self-interest) about how prices should be set and all the dangers that could result. We would like to assure the Committee that we intend to take a balanced, considered and objective approach to setting a wholesale charge. Again, it may be worth re-emphasising that the Competition Commission represents an important procedural safeguard. The potential scrutiny of the Competition Commission will ensure that the decisions taken by the Water Industry Commission will be demonstrably even-handed- if not either a new entrant or the incumbent is likely to seek to appeal a decision. This should reassure all stakeholders.

There are four approaches to setting wholesale charges that we intend to consider:

- the efficient component pricing rule;
- the long run marginal cost approach;
- accounting approaches;
- comparator approaches.

### *The efficient component pricing rule*

Economists developed the 'efficient component pricing rule' (ECPR) during the 1980s as a method of setting charges for access to an essential facility. The ECPR applies the concept of 'avoidable costs'. An avoidable cost is the cost that a company no longer has to bear if it ceases to supply a customer.

ECPR was developed to set an access price when the incumbent would provide retail services itself – not to set a wholesale price for an arm's length subsidiary company. The separation of Scottish Water's retail arm is important because otherwise there would be a risk of challenge from new entrants that the retail business [with access to cheap Government borrowing] has an unfair advantage.

### *The long run marginal cost approach*

A second approach to access pricing would be to set the access charge at the 'long run marginal cost' (LRMC) of providing access to the network. The LRMC is a measure of those costs that could arise in the future if demand were to change. There are two potential problems with using LRMC. These are that there is insufficient information on the very long-term investment needs of the water industry in Scotland and the approach does not take account of central overheads. Modifying

LRMC to take account of central overheads is possible but is likely to result in the same answer as the accounting approach.

### *The accounting approach*

We would use our proposed regulatory accounts to define the accounting costs of the wholesale and retail businesses. These accounting costs would include all:

- direct and indirect operating costs (indirect costs include items such as shared legal, IT, and head office functions);
- direct and indirect capital expenditure; and
- financing costs.

### *The comparator approach*

We also propose to analyse other network utility industries that have wholesale and retail activities. In both the gas and electricity industries there has been structural separation between the vertical components of the businesses. The monopoly elements of the businesses have been separated from those elements that are subject to competition.

While we recognise that there are differences both in terms of cost structure and in the extent to which the industries have been opened up to competition, we believe that there could be important lessons to be learned. These would include:

- What does a gas retailer do that a water retailer does not?
- What are the costs of the gas retailer?
- Why should the water retailer's costs be different?

**SUBMISSION BY THE OFFICE OF WATER SERVICES  
(‘OFWAT’)**

This is Ofwat’s written evidence for the Scottish Parliament’s Environmental and Rural Development Committee. It focuses on the issues highlighted in parts 1 and 2 of the Water Services etc. (Scotland) Bill under the headings:

- Ofwat structure and governance.
- Development of competition in England and Wales.
- Setting and monitoring prices in England and Wales.
- Sustainable development.

In our evidence we have described briefly how these features of the regulatory competition frameworks operate in England and Wales, and how they are being changed as a result of the Water Act 2003. As regulator for England and Wales, it is not appropriate for us to comment about the situation in Scotland.

**Ofwat structure and governance**

*Present situation*

The Director General of Water Services (‘Director’), supported by the Office of Water Services (‘Ofwat’), is responsible for economic regulation of the water and sewerage industry in England and Wales. The regulatory framework within which the Director operates is set out in the Water Industry Act 1991 (as amended) (“WIA91”). The Secretary of State for Environment, Food and Rural Affairs (the “Secretary of State”) appoints the Director.

Following regulatory best practice, the Director has established a board structure. The Ofwat Board, which comprises the Director, Ofwat’s four executive directors and four non-executive advisory directors, meets monthly and acts in an advisory capacity. The Director makes decisions with the advice of his Board. The Board ensures that Ofwat’s strategic decisions are:

- subject to prior high level internal critical review;
- well informed and innovative;
- politically sound and deliver effective outcomes.

The Board monitors performance against Ofwat’s forward programme and oversees corporate governance. Both Ofwat’s remuneration committee and its audit committee have members who are non-executive advisory directors.

The day-to-day operation of Ofwat’s activities is delegated to the Management Committee, which comprises the Director and his executive directors.

*Water Act 2003*

The Director’s powers will shortly be amended by the Water Act 2003 (‘WA03’). The Director will be replaced by the Water Services Regulation Authority (‘Authority’) in April 2006, which mirrors recent changes to other

regulators (eg Ofgem). The Authority will consist of a Chairman – appointed by the Secretary of State in consultation with the Welsh Assembly – and at least two other members appointed by the Secretary of State in consultation with the Assembly and the Chairman.

It will be for Ministers to decide whether they wish to appoint a separate Chairman and Chief Executive. The Authority can establish committees, and committees can establish sub-committees. Membership of these committees can include persons that are not members of the Authority.

The Authority must prepare a code of practice covering the discharge of its functions, and in exercising its functions have regard to the code. We have already produced a code of practice for Ofwat and have said that we expect the Authority (once established) to review it.

### **Development of competition in England and Wales**

Prior to the WA03, opportunities for competition were the same in England and Wales as they were in Scotland, except that the Water Industry Act 1991 provided for inset appointments in England and Wales. Inset appointments allow an existing statutory water and/or sewerage company to be replaced by another for a specific area.

The WA03 provides for prospective competitors to enter the water industry as licensed water suppliers (“licensees”). Licensees may obtain either:

- a “retail licence”, which enables them to purchase water on a wholesale basis from an incumbent water company and transport it through the public distribution network; or
- a “combined licence” which entitles the supplier to input water from its own water source into the network for onward retail to its clients.

The key distinction between this regime and the one envisaged for Scotland is the provision for combined licensees with access to common carriage.

#### *Ofwat's role*

Under the WA03 Ofwat will have a primary duty to protect the interests of consumers, wherever appropriate by promoting effective competition. This will include:

- Developing appropriate guidance – in consultation with stakeholders and updated when necessary – to implement the competition provisions of the WA03;
- Monitoring the new regime and advising Defra where necessary of possible changes to improve its effectiveness;
- Using its powers to determine disputes, thereby setting suitable precedents for parties to agree terms without recourse to Ofwat;

- Discussing potential licence applications with applicants, assessing formal applications and granting licences where appropriate. Before deciding whether to accept or reject an application, Ofwat will consult publicly on the licence application and take account of any representations made.

#### *Current progress with the new regime*

In order to assist in producing guidance for the new regime, Ofwat set up two industry advisory groups and a project sponsor group to oversee the project. One advisory group was to discuss price and non-price access terms, and the other was to discuss licensing and eligibility issues. With the groups' help, we have produced draft guidance. We will consult on this draft in October and November 2004. By summer 2005 we expect to have all the necessary guidance and regulations in place. The regime will then commence in autumn 2005.

#### *Provision for common carriage – protecting public health*

The Government has decided to make provision in England and Wales for both retail and common carriage competition. It concluded that public health could be safeguarded with appropriate legislation. There are three main provisions to protect public health:

1. Potential common carriage licensees will only be granted a water supply licence if they can satisfy the DWI and Ofwat that they have sufficient technical expertise and understanding of the regulatory regime.
2. As part of the access agreement, licensees will be required to supply to the incumbent water company regularly updated information on predicted quality of water and possible impacts such as chlorination, plumbosolvency control and fluoridation practices. A licensee must provide the incumbent water company with additional information including a risk assessment of its water source; the type of treatment proposed, with safeguards and processes should that treatment fail; and the impacts on supply and demand balance.
3. The Water Act 2003 (WA03) amends WIA91 to extend the offence to supply water unfit for human consumption to anyone concerned in the supply of water.

#### *Protecting ineligible customers*

Like the Scottish Parliament, the Government has been keen to ensure that competition in England and Wales will not lead to higher prices or lower service standards for those customers who cannot (or do not) switch supplier. It has sought to provide this protection by establishing a "Costs Principle", in accordance with which incumbent water companies must set their wholesale and common carriage access prices. Ofwat will produce guidance to these companies, explaining how they should implement the Costs Principle in practice. And Ofwat will have powers to determine access and wholesale prices in the event of a dispute between an incumbent water company and a licensee.

Under the Costs Principle, incumbent water companies can recover not only the direct costs that they incur in providing access to licensees, but also an

amount that they would otherwise have recovered from the switching customer, net of any expenses that they can avoid, reduce or recover in some other way (ARROW costs). This means that incumbent water companies will set common carriage and wholesale prices by charging the prevailing retail price, less any ARROW expenses, plus any additional expenses. This is usually referred to as a “retail minus” approach to pricing.

The Costs Principle protects the incumbent water company’s remaining customers from the consequences of it losing customers to a competitor. For example, it saves remaining customers from having to finance any assets that are wholly or partly stranded as a result of a customer switching to a licensee. Under the Costs Principle, the incumbent would be able to recover from the licensee an appropriate share of the costs of any unavoidably stranded assets. This is because these assets do not count as an avoidable or reducible cost, so the incumbent can recover from the licensee the share of the asset that it previously recovered from the switching customer.

Similarly, the Costs Principle will ensure that licensees are unable to exploit geographic cross-subsidies by supplying only those customers who are least costly to supply. In low cost areas, access prices – set on the basis of the prevailing retail price less ARROW costs – will be relatively high, reflecting the fact that ARROW costs are low. This approach to access pricing will mean that incumbents do not have to deaverage their tariffs geographically in order to compete with licensees.

#### *Protecting licensees’ customers*

When agreeing terms for access to the water supply system both incumbent water companies and licensees will have to specify arrangements for customer service. This is to ensure that customers have a clear point of contact at all times for emergencies, general enquiries and complaints. In the event of a supply problem such as failure of a licensee or its water source, the WA03 and access codes provide mechanisms to ensure supplies are maintained to licensees’ customers.

Incumbent water companies must not discriminate between customers connected to the supply system, whether they are their own customers or those of licensees.

#### *Protecting licensees*

The WA03 requires each incumbent water company to publish an Access Code setting out the terms for access to its water supply system (including price). The WA03 requires incumbents in producing this Access Code to comply with Ofwat’s guidance. If they do not, they could be in breach of their appointment. Incumbents must offer reasonable terms to licensees and must not discriminate unduly between licensees when making access and wholesale agreements. Where licensees believe that they are being unfairly treated, Ofwat can determine disputes.

The Government chose not to pursue the forced separation of incumbent water companies’ retail activities from the rest of their businesses. But we will

continue to review options to ensure that incumbents' common carriage and wholesale prices are set using transparent and audited cost information.

#### *Competition in sewerage services*

The Government decided to apply its framework for competition only to the sale of water, and not to the provision of sewerage services. Its view was that there was already a significant level of competition in sewage and effluent treatment, provided through, for example, on-site facilities and tankered removal and treatment of sewage and effluent.

#### *Phasing in competition for non-household customers*

The Government chose to take a cautious approach to competition by restricting it initially to customers using at least 50Ml of water per year. This will allow the Government to assess how the competitive framework operates in practice before extending it to more customers. The Government has committed itself to making such an assessment 3 years from the start of the new regime.

### **Setting and monitoring price limits in England and Wales**

#### *Setting price limits*

Ofwat sets price limits for each company every five years by forecasting the revenue that it is likely to need to run its business efficiently. We then compare this with the revenue the company is expected to receive and calculate the percentage change needed after allowing for inflation. Ofwat's objective is to set price limits no higher than they need to be to allow efficient companies to finance their functions.

In setting price limits, Ofwat takes into account guidance from the Secretary of State and the Welsh Assembly Government on the improvements to drinking water quality and the environment that the companies are required to deliver between 2005 and 2010.

Companies can ask for their price limits to be re-examined by the Competition Commission. At the last price review in 1999, two small water only companies used this referral mechanism. The Competition Commission decided that the price limits for these companies should be revised upwards, but by a smaller amount than the companies had requested.

#### *Approving charges schemes*

Price limits apply to a basket of charges. Once price limits are set, companies are responsible for deciding individual charges within that basket. These charges then form part of a company's charges scheme. The Water Industry Act 1999 (WIA99) requires all companies to have a charges scheme approved by the Director. It prohibits companies from charging household customers other than in accordance with an approved charges scheme<sup>1</sup>.

In approving companies' charges schemes, we make sure that their charges:

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<sup>1</sup> This does not affect agreements made between companies and households before WIA99 took effect.

- comply with price limits;
- are neither unduly preferential nor unduly discriminatory;
- are consistent with guidance on charging matters from the Secretary of State and the Welsh Assembly Government; and
- are consistent with the Director's duty to protect customers.

Companies are also entitled to charge their non-household customers by agreement, rather than in accordance with charges published in their charges scheme. They do this to reflect the unusual conditions of supply in some cases. Agreements that commenced after privatisation are subject to the requirement that the charges they contain must be neither unduly preferential nor unduly discriminatory.

### **Sustainable development**

When implemented, the Water Act 2003 will oblige the new Water Services Regulation Authority (WSRA) to carry out its duties in the manner which it considers is best calculated, amongst other things, to contribute to the achievement of sustainable development. This obligation is not yet in force. However, we believe that the concepts underlying sustainable development are consistent with our current statutory duties. We aim to act in a way that contributes to social progress, effective environmental protection, prudent use of natural resources and maintenance of high and stable levels of economic growth.

Although at a price review we inevitably concentrate on the next five years we set this within an evolving longer-term perspective. For the present price review, we asked companies to set out proposals that extend to 2014-15, with longer-term projections for asset maintenance requirements, and water resource plans that cover a 25-year period.



## **SUBMISSION BY THE COMPETITION COMMISSION**

### **Role of the Competition Commission**

1. One of the functions of the Competition Commission (CC) is to conduct in-depth inquiries into the regulation, including the price regulation, of the major regulated industries. Such inquiries, like all its other inquiries, are undertaken in response to a reference made by another authority, such as, in England and Wales, Ofwat, the economic water regulator.

### **Role in relation to the Water Industry Commission for Scotland**

2. The Bill confers on the Water Industry Commission for Scotland (the economic regulator for the water industry in Scotland) two new functions.
  - The first is the function of licensing those bodies who wish to provide retail water and sewerage services to non-household customers in Scotland in competition with Scottish Water (the publicly owned service provider in Scotland).
  - The second is the function of determining Scottish Water's charge caps in much the same way as Ofwat determines price caps for the water companies in England and Wales. (This is a change from the present position, where the Water Industry Commissioner advises Scottish Ministers about the amount of revenue that Scottish Water should raise from charges and in the light of that advice, Ministers determine Scottish Water's revenue cap.)
3. The CC understands that these changes are to secure that essentially technical decisions in relation to matters of economic regulation are taken by a duly constituted authority, possessing the expertise necessary for the task; and that it is further the intention to subject the Water Industry Commission's licensing determinations and charge determinations to independent and expert scrutiny.
4. Accordingly, the CC has been asked, and the Secretary of State has agreed, subject of course to statutory authority:
  - to consider appeals from retail water/sewerage providers (as defined in the Bill) against:
    - the inclusion by the Water Industry Commission of a condition in a licence on the grounds that it is unreasonable in the circumstances of the case; and

- the modification by the Water Industry Commission of a condition in a licence on the grounds that the condition as modified is unreasonable in the circumstances of the case; and
  - to consider appeals from Scottish Water against price controls determined by the Water Industry Commission.
5. That is, in relation to licence conditions, a reference to the CC will provide an opportunity for a licensed retailer to appeal a decision by the Water Industry Commission on public interest grounds where matters of competition policy are concerned, in the same way that licence conditions in water and energy industries in England and Wales may be appealed to the CC now. In relation to charge caps the approach will be similar to that in England and Wales for challenging Ofwat's determination of price controls as part of the conditions of a water undertaker's appointment.
  6. These two new tasks for the CC would make good use of its experience in determining water and other utility references and the CC will be pleased to have such determinations referred to it.

### **The legal position**

7. These functions are not described on the face of the Bill because the statute needs to be supplemented by secondary legislation at Westminster to confer new functions on the CC. This can be done means of an order under section 104 of the Scotland Act which provides the means by which UK legislation can be amended in consequence of an Act of the Scottish Parliament.
8. The CC understands that Scottish Ministers have agreed in principle with the Secretary of State to make such an order. This would be made after the Water Services (Scotland) Bill had been enacted and commenced. That is likely to be in April 2005, which would enable the Water Industry Commission's decisions on determining charges for the period 2006-10, as well as its decisions on licensing, to be subject to the new arrangements.
9. The CC is ready to work with DTI officials and Scottish Executive officials to prepare such an order.

### **Costs**

10. It has been agreed in principle that the Scottish Executive will reimburse the CC's costs.

## **SUBMISSION BY THE COAL AUTHORITY**

### **Minewater pollution – the problem**

During coal mining operations it is necessary to dewater the mine workings in order to keep the mine dry for both operational and safety reasons. In some cases extensive drainage systems were installed and even today these remain impressive engineering feats.

Once a mine, or complex of mines, is closed the pumping is discontinued and the mine allowed to flood. The influent water comes into contact with iron pyrite in the exposed surfaces of the coal and the surrounding strata which has become oxidised with exposure to air during the operating life of the mine. Should this water then discharge from the mine (as is often the case as water levels return to a pre-mining position) the ensuing chemical reactions produce acids and ferrous sulphates which result in the trademark orange coloured (ochreous) water. The deposited ochre smothers the riverbed and any invertebrate life on which fish depend for their food chain. Stretches of river are therefore devoid of fish and the effects, both visually and biologically, can impact for up to 10 kilometres downstream of the discharge point.

### **The Coal Authority's Role**

Prior to The Mines (Notification of Abandonment) (Scotland) Regulations 1998 a person was not guilty of the offence of causing or knowingly permitting the pollution of controlled waters if he is merely 'permitting' a discharge from an abandoned mine. As a consequence minewater pollution from the many mines closed prior to this legislation was generally uncontrolled and without a legal owner.

The above factors led to representations to Government in 1993/4 by a number of bodies including the National Rivers Authority, Coalfield Communities Campaign and various local authority's. The concerns arose due to the fear of the consequences of pollution arising from the abandoned mines and the fact that no-one could be held legally responsible.

Representations were made during the consultation process for the Coal Industry Bill in 1994 and subsequently, Lord Strathclyde, outlined the Government's expectations of the soon to be formed Coal Authority in this area ;

*" The Government will expect it (the Authority) to go beyond the minimum standards of environmental responsibility which are set by it's legal duties in these areas and to seek the best environmental result which can be secured from the use of the resources available to it for these purposes  
....."*

Since that time the Authority has developed this area of work to be one of its core activities.

In the early stages of the Authority's work, most of the activity related to providing treatment schemes to clean up pollution caused by existing minewater discharges. More recently, efforts have been targeted on developing a better understanding of the minewater 'recovery' position in all of the UK coalfields and developing preventive schemes where future outbreaks are predicted to arise.

The work principally covers three main areas:

- i) Minewater monitoring
- ii) Pumping operations to prevent future polluting discharges
- iii) Remediation of existing discharges

### *Minewater Monitoring*

Since many of the feared consequences of the most recent closure programmes have not yet manifested themselves, it is important to have an understanding of what is happening below ground in terms of minewater 'recovery', to enable informed decisions to be made on the need for future preventive action.

The Authority inherited a number of monitoring facilities at disused shafts and boreholes from British Coal. It has supplemented these with additional monitoring points by drilling boreholes into workings or through shaft caps. Regular monitoring and evaluation of the position allows consideration of future actions which may be necessary to control pollution due to rising minewaters.

In 1999 the Coal Authority commenced a series of reviews of the minewater recovery position and the adequacy of existing monitoring in each of the UK coalfield areas. The extent of monitoring facilities left by British Coal on closure of the coalfields varied widely with the north east of England being best served with over 40 monitoring points.

Monitoring points in many other coalfields were very sparse and as a result of these studies over 50 new monitoring boreholes were sunk from 2001 to 2004 into blocks of mineworkings where outbreaks of minewater were considered likely but predicting when they might occur was difficult due to lack of monitoring facilities. Further boreholes will be required over the coming years to continue to investigate the potential risk of new polluting outbreaks posed by rising minewater.

### *Pumping operations to Prevent Future Discharges*

Many mines were closed and the shafts filled without leaving facilities to monitor minewater recovery and without predictions as to the likely impact on the environment. That is not to say that other implications of underground water movement were not recognised or considered. If operational mines remained, the safety implications of water build up was given due regard and often pumping operations were established at closing mines to protect connected mines which were to remain in production.

This was largely the case in County Durham in the north east of England until late 1993 when the last mine in the coalfield was closed. The proposal by British Coal to cease all pumping operations was met with stern opposition from local authority's who made representations at the highest political level. As a consequence, the pumps remained and were inherited by the Coal Authority in October 1994.

The Coal Authority has continued to operate the Durham pumping regime, which is a substantial and expensive operation with the 9 remaining stations pumping around 8 billion gallons of water per year at a cost approaching £1.5 M p.a. At some stations the water pumped is of reasonable quality and assists with dilution of other pollutants in the River Wear and its' tributaries.

Similar pumping and treatment schemes have been established at Frances in Fife, Monktonhall in East Lothian and Polkemmet in Midlothian. These installations control the underground minewater at a level that precludes surface discharges.

It is considered that further preventive pumping regimes will need to be established in other coalfield areas in future prior to the water reaching the surface to prevent significant environmental damage from occurring. Although it may be possible to occupy parts of former colliery sites for this purpose, often this is not possible and new sites may need to be acquired for the operation with boreholes sunk into the workings to allow pumping to take place. The suitability of potential sites are therefore often constrained by the configuration of the underground workings limiting the options available.

#### *Remediation of Existing Discharges*

The Coal Authority minewater remediation programme is focussed on a 'priority list', currently numbering over 100 discharges which cause significant pollution of controlled waters. The list is drawn up by SEPA (and the Environment Agency in England and Wales) and is reviewed annually. In addition, there are believed to be a further 300 to 400 less significant discharges whose impact is such that remediation is not at present considered necessary. However, standards may change. In particular any proposed initiatives from Europe need to be monitored closely.

The work is carried out through a rolling programme starting with feasibility studies for each discharge. These studies consider many issues including the mining situation, appropriate treatment technology, planning and land availability. These issues are then progressed for the preferred option to seek to arrive at a viable project for detailed design and construction. Generally passive treatment technologies are preferred since they are more sustainable and can be made to integrate much better into their surroundings.

The programme has developed substantially over the last 7 years with 33 major schemes (10 in Scotland) being completed.

## **Land issues**

The schemes so far completed lead to significant improvements to previously polluted Scottish rivers, together with the watercourses protected by preventive schemes. Feasibility studies have been carried out at numerous other sites and work continues to resolve outstanding issues to enable the desired progress to be made

The Authority has in the past commenced construction of an average of four new schemes in each year and although the programme has been widely welcomed, the fact remains that approaching 90 discharges still have to be dealt with. If this is continued it will take well over 20 years to reduce pollution from minewater to acceptable levels. This is not consistent with the requirements of the recent EC Water Framework Directive, which is a principal driver in the Authority seeking to accelerate the programme.

The Authority's programme was therefore accelerated to 6 schemes in 2002 and to 8 schemes from 2003 and thereafter.

Unfortunately some of the most significant and highly polluting discharges have not yet been dealt with due to difficulties encountered in acquiring the necessary land upon which to construct a treatment system. This can be either due to a flat refusal to sell or grossly inflated values being sought by landowners. It must be stressed that in all cases a number of options are considered and explored in order to seek a solution to the problem and this has in the majority of cases led to a satisfactory resolution through negotiation.

Compulsory purchase powers are being sought through the Water Services etc (Scotland) Bill and are seen as very much a last resort where solutions cannot be found through negotiation or exploring other technical solutions.

Clearly the compulsory purchase process will be tightly defined and the consideration for land will reflect open market value.

Further monitoring boreholes will be required over the coming years to continue to investigate the risk of new polluting outbreaks posed by rising minewater. It is critical to be able to hit the appropriate underground roadways in order to obtain accurate information and so access to surface land is necessary to enable this. The proposed Bill contains provisions to gain access to land to allow this monitoring to take place but, as with the treatment schemes, other options are carefully considered and are seen as a last resort when all other reasonable options fail.



*Report 2*

7. **As the Executive has acknowledged, the provisions is defectively drafted the Committee reports it on that ground.**

*Question 3*

8. The Committee asked for clarification of the reference in regulation 21(12), to “opening the package for the purposes of regulation 17(2)(b)” when regulation 17(2)(b) appears to authorise re-labelling rather than opening of seed packets.

9. The Executive’s helpful response explains the practical reason underlying the drafting of this provision.

*Report 3*

10. **The Committee draws the response to the attention of the lead committee and the Parliament for information.**

*Questions 4 and 5*

11. The wording of regulation 17(13)(a) did not seem to the Committee to read correctly and the Executive was asked to provide clarification.

12. The Committee also asked for clarification of the wording of regulation 17(13) as read with regulation 18. Regulation 18 is expressed as “subject to regulation 17(3)” which causes difficulties for the interpretation of the references to regulation 18 in subparagraphs (a) and (b) of regulation 17.

13. The Executive accepts that regulation 17(13) and regulation 18 are circular but believes that the intention is clear.

*Reports 4& 5*

14. **Again, as the Executive has acknowledged the defect, the Committee reports the instrument to the lead committee and the Parliament accordingly.**

*Question 6*

15. The Committee asked for an explanation of the reference to “this section” in regulation 24(2) as this does not seem to be correct.

16. The Executive again confirms that this is an error.

*Report 6*

17. **The Committee again reports the instrument on the grounds of defective drafting in the above respect, acknowledged by the Executive.**

*Question 7*

18. The Committee asked for clarification of the purposes of paragraph 17(b) of Schedule 6. In terms of subparagraph (a), which imposes an objective test, the requirements are either satisfied or they are not. The purpose and effect of subparagraph (b) is therefore obscure.



19. The Executive states that the requirements in paragraph 17(b) were inserted in order to make clear that the Scottish Ministers might want in certain cases to enforce the requirements in paragraph 17(a) for example by checking the unique reference numbers with the relevant authorities in other EEA States. The Executive accepts that the provision is not strictly necessary and the Executive will consider removing paragraph 17(b) at a future date.

*Report 7*

20. **Again, as the Executive has acknowledged the error, the Committee reports the instrument on that ground.**

21. The Committee noted that, while the Executive has acknowledged the drafting defects identified by the Committee and has undertaken to correct them in due course, it does not give any indication as to when those corrections can be expected. The Committee found itself in sympathy with the reader who is expected to identify that the text is incorrect and then to divine what the drafter intended. The Committee therefore agreed to write to the Executive to ask when the errors will be corrected.

the Fodder Plant Seeds Amendment (Scotland) Regulations 2004  
**(SSI 2004/380)**

*Background*

22. The Committee noted that the Fodder Plant Seeds Regulations 1993 amended by this instrument have been amended a significant number of times. They were consolidated for England in 2002 and the Executive Note explains that the Welsh are currently working on a consolidation for Wales. The Committee asked the Executive what if any progress has been made towards consolidation for Scotland.

23. The Executive indicates that work on consolidation is currently ongoing. It hopes to be in a position to lay a consolidating instrument by the end of this year to come into force in or around July 2005. The Executive's reply is reproduced at Appendix 7.

*Report*

24. **The Committee is pleased to learn that work on consolidation is in hand and reports this information to the Parliament and lead committee.**

## **Appendix 3**

### **THE OIL AND FIBRE PLANT SEED (SCOTLAND) REGULATIONS 2004, (SSI 2004/317)**

1. On 14 September the Committee asked the Executive for an explanation of the following matters-

“2. Given the length and complexity of the Regulations, what steps has the Executive taken (or does it intend to take) to provide guidance to those persons affected by the requirements imposed by the Regulations?”

3. The Committee asks for clarification as to whether the reference in paragraph (a)(i)(bb) of the definition of “official post-control” in regulation 2 to “[paragraph] 15(1) of Part II to Schedule 4”, should in fact be a reference to paragraph 15(a) of Part II of Schedule.

4. The Committee asks for clarification of the reference in regulation 21(12), to “opening the package for the purposes of regulation 17(2)(b)” when regulation 17(2)(b) appears to authorise re-labelling rather than opening of seed packets.

5. The wording of regulation 17(13)(a) does not seem to read correctly. The Executive is asked to explain this wording.

6. The Committee asks for clarification of the wording of regulation 17(13) as read with regulation 18. Regulation 18 is expressed as “subject to regulation 17(3)” which causes difficulties for the interpretation of the references to regulation 18 in subparagraphs (a) and (b) of regulation 17.

7. The Committee asks for an explanation of the reference to “this section” in regulation 24(2) as this does not seem to be correct.

8. The Committee asks for clarification of the purposes of paragraph 17(b) of Schedule 6. In terms of subparagraph (a), which imposes an objective test, the requirements are either satisfied or they are not. The purpose and effect of subparagraph (b) is therefore obscure.”.

#### **The Scottish Executive responds as follows-**

The Regulations consolidate the Oil and Fibre Plant Seeds Regulations 1993 with only a few changes on which the Executive has consulted the trade. The Executive has considered issuing guidance to the legislation. However, the Department of Environment, Food and Rural Affairs in England, where the bulk of the UK seed production takes place, found that there was little demand for the guidance they produced and printed for the Oil and Fibre Plant Seed (Scotland) Regulations 2002. Based on DEFRA’s experience, the Executive considers a user’s guide to be a more useful document. The Executive is therefore drafting a

document entitled the Certification of Oil and Fibre Species in Scotland and intends to circulate this document to those persons affected by the Regulations.

The reference to paragraph 15(1) should be a reference to paragraph 15(a) as the Committee notes. However, there is no paragraph 15(1) in any Schedule and in the context of regulation 2 it is reasonable to expect the reader to realise that the reference is to paragraph 15(a) of Part II of Schedule 4 to the Regulations. The Executive is of the opinion that this mistake should be corrected but does not think that the correction requires to be undertaken now. The Executive will correct the error on the first amendment of these Regulations.

One method of sealing packages of seed is by stitching the top of the bag closed. One method of labelling packages of seed is to stitch the label to the bag at the same time using the same stitching as has been used to stitch the top of the bag closed. If this method of labelling has been used, then to relabel the package the stitched seal would have to be broken. This is why regulation 21(12) provides that it will not be an offence to open the package for the purposes of relabelling the package in terms of regulation 17(2)(b).

5.&6. Regulation 17(13) provides that if “regulation 18 applies” then information about any chemical treatment of the seed must be given with the unpacked seed particulars. The Executive accepts that the cross-referencing of regulations 17(13)(a) and 18 is circular. However it is clear that the intention is that if seed is to be sold as unpacked seed the information about chemical treatment must be displayed near the container from which the unpacked seed is taken for sale. The Executive is of the opinion that this mistake should be corrected but does not think that the correction requires to be undertaken now. The Executive will correct the error on the first amendment of these Regulations.

“This section” should be a reference to “this regulation”. However since there are no sections in the Regulations and since there is no other section that section 7 of the Interpretation Act 1978 could apply to in this context, it is clear that the reference is to regulation 24. The Executive is of the opinion that this mistake should be corrected but does not think that the correction requires to be undertaken now. The Executive will correct the error on the first amendment of these Regulations.

The requirements in paragraph 17(b) were inserted in order to make clear that the Scottish Ministers might want in certain cases to enforce the requirements in paragraph 17(a) for example by checking the unique reference numbers with the relevant authorities in other EEA States. The Executive accepts that the provision is not strictly necessary and the Executive will consider removing paragraph 17(b) at a future date.

**Scottish Executive Environment and Rural Affairs Department**

6 September 2004

## **Appendix 7**

### **THE FODDER PLANT SEEDS AMENDMENT (SCOTLAND) REGULATIONS 2004 (SSI 2004/380)**

1. On 14<sup>th</sup> September the Committee asked the Executive for an explanation of the following matters:-

“The Committee notes that regulations amended by this instrument have been amended a significant number of times. They were consolidated for England in 2002 and the Executive Note explains that the Welsh are currently working on a consolidation for Wales. The Committee asks the Executive what if any progress has been made towards consolidation for Scotland.”

#### **The Scottish Executive responds as follows:**

1. The Scottish Executive intends to consolidate the Fodder Plant Seeds (Scotland) Regulations shortly and that work is currently ongoing. We hope to be in a position to lay a consolidating instrument by the end of this year to come into force in or around July 2005. S.S.I. 2004/380 was made in advance of consolidation to comply with the provisions of the European Directive which require implementation into domestic law by 30 September 2004.

#### **Scottish Executive**

16 September 2004