



Commission for Energy Regulation

An Coimisiún um Rialáil Fuinnimh

**Economic Regulatory Framework for the
public water services sector in Ireland
Consultation Response Paper**

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Abstract:

On October 30 2013 the CER published a consultation paper describing its proposals for a regulatory economic framework for the public Irish water services sector. The purpose of the consultation paper was to support the CER in the provision of advice to the Minister for Environment, Community and Local Government on the form of the economic regulatory framework for the public water services sector under section 27 of the *Water Services Act (No. 1) 2013*. The CER received 16 responses to the consultation paper.

The purpose of this consultation response paper is to (i) summarise the responses received to the above consultation, (ii) set out the CER's response to the issues raised by respondents and (iii) support the provision of advice to the Minister for Environment, Community and Local Government on the form of the economic regulatory framework for the public water services sector in Ireland.

Target Audience:

This paper will be of interest to parties involved or concerned with the reform of the Irish public water services sector, including the provision of public water to both non-domestic and domestic consumers as well as the introduction of water charges.

Purpose of this paper:

The purpose of this paper is to (i) summarise the responses received to the above consultation, (ii) set out the CER's response to the issues raised by respondents and (iii) support the provision of advice to the Minister for Environment, Community and Local Government on the form of the economic regulatory framework for the public Irish water sector.

Related Documents:

- [Economic regulatory framework for the public Irish water services sector – Consultation Paper \(CER/13/246\)](#);
- [The CER and Water Regulation in Ireland \(CER/13/245\)](#);
- [Water Consultation Plan: 2014 Timelines \(CER/14/005\)](#);
- [Water Connection Charging Policy Consultation Information \(CER/14/109\)](#)

- [The Water Services \(No 2\) Act 2013](#)
- [Domestic Tariff Principles and Proposals \(CER/14/082\)](#)
- [Interim and Enduring Non-domestic Tariff Proposals \(CER/14/084\)](#)

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Executive Summary

Under Section 27 of the *Water Services Act (No 1) 2013*, the remit of the Commission for Energy Regulation (CER) was expanded to include a function to prepare to become the independent economic regulator for the public water services sector. The Act also allows for the CER to advise the Minister for Environment, Community and Local Government (the Minister) on matters related to the economic regulation of the public water services sector in Ireland.

On 30 October 2013 the CER published a consultation paper – “*Economic Regulatory Framework for the public Irish water services sector*¹” – which details the CER’s proposals for becoming the independent economic regulator for the public water services sector in Ireland. The CER received sixteen responses to the consultation – which are published alongside this document.

Since the publication of the Consultation Paper in October 2013, the legislation underpinning the CER’s new economic regulatory role has been published and enacted. The *Water Services (No. 2) Act 2013* sets out the functions and powers of the CER in the economic regulation of the water sector including:

- Direct Uisce Éireann to submit a water charges plan, review that document and approve, approve with modifications or reject it. The water charges plan will specify how charges are calculated and the costs incurred by Uisce Éireann in the performance of its functions.
- Approve or refuse to approve an agreement between a customer and Uisce Éireann for the charging of that customer for the provision of water services.
- Approve or refuse to approve codes of practice designed to secure the interests of Irish Water’s customers.
- Advise the Minister for the Environment, Community and Local Government in relation to the development and delivery of water services.
- Request information from Uisce Éireann to facilitate the CER performing its functions under the Act. Uisce Éireann must comply with such a request as soon as practicable.

¹ See [Economic regulatory framework for the public Irish water services sector \(CER/13/246\)](#)

In performing its functions under the Act, the CER shall do so in a manner that best serves the interests of customers of Uisce Éireann.

The purpose of this paper is to (i) summarise the responses received to the above consultation, (ii) set out the CER's response to the issues raised by respondents and (iii) support the provision of advice to the Minister for Environment, Community and Local Government on the form of the economic regulatory framework for the public Irish water sector. The *Water Services (No. 2) Act* provides the context to the CER response on matters raised by respondents to the October consultation paper.

The advice to the Minister of the Department of Environment, Communities and Local Authorities on the proposed form of the economic regulatory framework for the public water services sector in Ireland is as follows.

The CER recommends that an economic regulatory framework for the public water services sector in Ireland is put in place, similar to that in the electricity and gas sectors which is based on four key principles – stability, predictability, sustainability and cost efficiency. In regulating the water sector, the CER would apply the same values as it has done to the electricity and gas sectors, namely: fair and transparent regulation, acting with integrity and respect, consulting with stakeholders and customers, be accountable to customers and stakeholders, and making informed decisions. In order to ensure the regulatory framework continues to be appropriate to the future needs/priorities of the sector, the CER proposes to adjust/refine the economic regulatory framework over time, in line with the above principles and values, as the economic regulation of the sector evolves from its current formative state to a more mature system. Such modifications to the regulatory framework must be strategic in nature, carefully planned, flagged to participants in advance (with adequate consultation allowed), avoid retrospective action (where possible) and ultimately lead to furthering the interests of the water services customer.

The CER recommends that the revenue cap (RPI-X) model should be implemented as it is the revenue framework that the CER believes best meets the needs of stakeholders (including Government, Uisce Éireann and water services customers)².

The revenue cap (RPI-X) framework should be made up of separate building blocks that will allow the CER to estimate a level of revenue sufficient to finance an efficient, well-run utility. This revenue must also include an adequate return on the capital employed in the business so as to ensure continued efficient investment in the water services infrastructure. One of the main building blocks is the allowance for Operational Expenditure (Opex) – the day to day running expenditure of Uisce Éireann. To derive an Opex allowance the CER proposes that it should use a combination of three inputs (i) benchmarking against other comparable companies, (ii) the use of efficiency/productivity trends evident in the Irish economy and (iii) the advice of industry experts.

Another building block is the allowance for the Capital Expenditure (Capex) undertaken by Uisce Éireann, an allowance which must promote a level of investment in the water services infrastructure that is correct, appropriate and fully justified. The CER notes that Uisce Éireann will need to invest in many areas of the water services infrastructure to improve quality of service and compliance with EU water Directives. The CER recommends that the process of identification and prioritisation of investment projects is undertaken by Uisce Éireann in a transparent and consultative manner, which acknowledges the views of all relevant stakeholders. The CER notes that such consultation by Uisce Éireann on its water services strategic plan and investment plans is provided for under the *Water Services (No 2) Act 2013*. The review of capital expenditure requires co-ordination between the respective roles and responsibilities of the CER as economic regulator of the water services sector, Uisce Éireann in fulfilling its various legal obligations, the EPA as environmental regulator, and the Government as the provider of state subvention and of the need to ensure that capital investment plan takes into account Government's spatial strategy and economic development strategies. This coordination will be an important element of the administrative cooperation arrangement to be agreed between the CER and EPA under section 43(3) of the Act.

² See Appendix A. for background on Revenue Cap (RPI-X) model.

A third important building block is the Regulatory Asset Base (RAB) of Uisce Éireann. At any point in time, the RAB is a measure of the net value (Gross spend minus depreciation) of a utility's allowed assets used in the operation of its regulated activities. Only efficient capital spend on assets should be allowed to accrue in the RAB and it should only include assets that are required to provide the regulated services.

The RAB construct will allow Uisce Éireann to receive a proper and fair return on the capital investments it has made in water services infrastructure. The CER recommends that only efficient spend on assets is added to the RAB and that those assets are valued through the Indexed Historic Cost methodology. The CER also recommends that models, such as the Capital Asset Pricing Model, are used in aiding the CER to derive a fair return on the Uisce Éireann RAB. Furthermore, at this time the CER believes it appropriate to implement a straight-line approach for the depreciation of Uisce Éireann assets, a depreciation profile which will depend on the average lifetime of the asset in question.

A key question when discussing the RAB is its opening asset value ('Opening RAB'). As this involves the transfer of the water infrastructure assets from the State to Uisce Éireann as the semi-state company, the CER is of the view that any decision by Government should be taken in the context of (a) various assets and liabilities being transferred to Uisce Éireann from Local Authorities, (b) what effect it will have on the charges faced by the water services customer, (c) the equity investment in Uisce Éireann planned by the Government (and the subvention level) and (d) the ability of the water utility to raise debt to fund future investments in the water services infrastructure.

The CER suggests that there are three options:

- (1) Set the Opening Uisce Éireann RAB later:
- (2) Set the Opening Uisce Éireann RAB based on future funding requirements:
- (3) Set the Opening Uisce Éireann RAB based on Uisce Éireann expenditure and liabilities transferred from the Local Authorities.

The CER proposes that specific revenue incentives are put in place for Uisce Éireann. The intent of these incentives would be to improve the utility's performance in the delivery of its responsibilities, particularly with regard to quality, efficiency and timeliness of service delivery to the water services customer.

Finally the CER suggests that it adopts a cash-flow approach to calculate the cash requirements of Uisce Éireann over the course of the revenue control and that a 'k-factor' methodology is applied to over or under recoveries from the pre-determined level of allowed revenues.

1. Overview of the Consultation Process

1.1 Background

On October 30th 2013 the CER published a consultation paper – “*Economic regulatory framework for the public Irish water services sector*”³ (the ‘Consultation Paper’) – which sets out its proposals for the economic regulation of Uisce Éireann (or Irish Water)⁴ to apply post the establishment of the CER as the independent economic regulator for the sector⁵. The purpose of the Consultation Paper was to provide the public and interested stakeholders the opportunity to comment upon and input into the CER’s proposals for the economic regulation of the sector before the CER provided advice to the Minister for Environment, Community and Local Government (the ‘Minister’) on those matters under section 27 of the *Water Services Act (No 1) 2013*⁶.

In the Consultation Paper the CER proposed the following:

- Establishing a regulatory framework similar to that in place for the energy sector built on the principles of stability, predictability, sustainability and cost efficiency.
- Applying the revenue cap (RPI-X) model to the public Irish water services sector allowing the CER to estimate a level of revenue sufficient to finance an efficient, well-run utility. This proposed model would be comprised of separate building blocks including (i) an allowance for operational expenditure (opex); (ii) an allowance for capital expenditure (capex); (iii) establishing a regulatory assets base (RAB) for Uisce Éireann.
- Adding only efficient spend on assets to the RAB and valuating these assets through the Indexed Historic Cost methodology.

³ The CER also published an information paper CER/13/245 “*The CER and Water Regulation in Ireland*” alongside the Consultation Paper.

⁴ On 1 January 2014 the newly established national water utility Uisce Éireann (or Irish Water), assumed responsibility for the provision of public water services from 34 county and city councils as part of the Government’s water reform programme. For more information on Irish Water please visit www.water.ie

⁵ This is part of the Governments water reform programme. For more on information on the Government’s water sector reform programme please visit:

<http://www.environ.ie/en/Environment/Water/WaterSectorReform/>

⁶ See <http://www.oireachtas.ie/documents/bills28/acts/2013/a613.pdf> .

- Implementing a straight-line approach for the depreciation of Uisce Éireann assets.
- Using the Capital Asset Pricing Model to aid the CER deriving a fair return on the Uisce Éireann RAB.
- Implementing specific performance based revenue-incentives for Uisce Éireann in order to improve the utility's performance in delivering its responsibilities.
- Adopting a cash-flow approach to calculate cash requirements for Uisce Éireann and applying a 'k-factor' methodology to over and under recoveries from the pre-determined maximum allowed revenues.
- Creating a 2-year interim revenue control period before moving to a series of six year price reviews.
- Sharing achieved efficiency gains in one control period with customers in the next revenue control period, as is the norm in the Irish energy sector.

The CER received sixteen responses to the Consultation Paper as set out below⁷:

1. AWN Consulting;
2. Carers Association;
3. Chambers Ireland;
4. Dublin Chamber of Commerce;
5. Dublin City Council;
6. Fingal County Council;
7. Forfás / Enterprise Ireland / IDA Ireland;
8. Katalyst21 / Keith Stallard;
9. IBEC;
10. Intel Ireland;
11. Irish Congress of Trade Unions;
12. Irish Water;
13. Local Authorities' Water Services Transition Office (LAWSTO);
14. National Consumer Agency;
15. Paul Hunt; and
16. River Shannon Protection Alliance (RSPA).

⁷ The CER also met four of the respondents at their request.

The above responses are published alongside this paper.

1.2 Water Services (No.2) Act 2013

Since the publication of the Consultation Paper in October 2013, the legislation underpinning the CER's new economic regulatory role has been published and enacted. The *Water Services (No. 2) Act 2013* sets out the functions and powers of the CER in the economic regulation of the water sector. The CER shall:

- Direct Uisce Éireann to submit a water charges plan. The CER will review that document and approve (with or without modifications) or reject it. The water charges plan will specify how charges are calculated and the costs incurred by Uisce Éireann in the performance of its functions.
- Approve or refuse to approve an agreement between a customer and Uisce Éireann for the charging of that customer for the provision of water services.
- Approve or refuse to approve codes of practice designed to secure the interests of Irish Water's customers.
- Advise the Minister for the Environment, Community and Local Government in relation to the development and delivery of water services.
- Request information from Uisce Éireann to facilitate the CER performing its functions under the Act. Uisce Éireann must comply with such a request as soon as practicable.

In performing its functions under the Act, the CER shall do so in a manner that best serves the interests of the customers of Uisce Éireann and have regard to the need to ensure:

- a) that the customers of Uisce Éireann are provided with the quality of service provided for in an approved code of practice,
- b) that water services are provided by Uisce Éireann in an economical and efficient manner,
- c) that Uisce Éireann operates in a commercially viable manner,
- d) the conservation of water resources,
- e) the continuity, safety, security, and sustainability of water services,
- f) that Uisce Éireann can meet all reasonable demands for water both current and foreseeable,

- g) the recovery of costs of water services in accordance with Article 9 of the EU Water Framework Directive,
- h) that Uisce Éireann performs its functions in a manner that will enable the achievement by the State of the environmental objectives of that Directive,
- i) that Uisce Éireann performs its functions in an open and transparent manner.

1.3 Structure of this paper

In the Consultation Paper, the CER sought comments on ten questions.

1. The proposed principles of the regulatory framework;
2. Further principles to consider to form part of regulatory framework;
3. Agreement with the proposed regulatory framework;
4. Advantages / disadvantages to the proposed framework;
5. Setting a revenue cap (RPI-X) framework for the Irish water sector;
6. Agreement on Uisce Éireann RAB, revenue based incentives, opex, capex and rate of return;
7. Other approaches for consideration;
8. Interim revenue control;
9. Initial valuation of the Uisce Éireann RAB; and
10. Sharing achieved efficiency gains.

A number of respondents commented directly to these ten questions – a summary of those comments and the CER responses hereto are set out in section 2.0.

Respondents also raised a number of more general comments which can be summarised into the following areas:

- Tariff structure and methodology;
- Customer protection;
- CER information note on water regulation in Ireland;
- Funding in the Irish water system;
- Consultation Processes;
- The role of the Local Authorities in Irish water services; and
- The role of regulation in Irish water services.

A summary of these general comments are outlined in section 3.0 of this document. The CER has addressed part of these issues during the consultation processes in April and will be further addressing a number of these in the water charges plan consultation in July 2014⁸. Section 4.0, the final section of this paper, sets out a summary of the CER's advice to the Minister for the regulatory framework for public water services in Ireland.

⁸ <http://www.cer.ie/document-detail/Information-Paper-on-Water-Consultation-Plan-2014-Timelines/940>

2. Responses to the Consultation Questions

2.1 Proposed Principles of the Regulatory Framework

In the consultation paper, the CER asked “*do you agree with the proposed principles of the regulatory framework? If not, then please explain why*”. Nine responses to this question were received.

Responses received

One respondent (Uisce Éireann) expressed that it is “fully supportive” of the proposed regulatory framework, referring to the successful operation of this framework in the Irish energy sector.

Four respondents (IBEC, Intel, Chambers Ireland, Forfás / Enterprise Ireland / IDA Ireland) broadly agreed with the proposed regulatory framework, however identifying a number of issues for further consideration. Four respondents (Intel, Chambers Ireland, Forfás / Enterprise Ireland / IDA Ireland, Fingal County Council) highlighted the appropriateness of incorporating sufficient flexibility in capital expenditure (capex) to enable Irish Water to respond to evolving market conditions and emergency planning. As argued by these four respondents, flexibility in capex will facilitate the regulatory framework for water provision supporting business planning, economic development and creation of jobs. For this reason, respondents agreed that the CER assume some responsibility or oversight role for network development and strategic planning. Similarly, two other respondents (LAWSTO and Chambers Ireland) advised that the regulatory framework should support sustainable development of communities, including regional development.

One respondent (IBEC) supported the overall framework, subject to the proposed principles of the regulatory framework being expanded to include fairness, equity and transparency.

Another respondent (Dublin City Council) advocated that the regulatory framework for gas and electricity only be used as a very general guideline in recognition of water’s unique and irreplaceable importance in society. Similarly, one respondent (Dublin Chamber of Commerce) argued that the water services sector differs significantly from the electricity and gas sectors and therefore ought not to be subject

to the same regulatory framework. This view was echoed by a final respondent (Paul Hunt), who perceives water's technical and economical features as different from those of electricity and water, and therefore strongly objected to the proposed regulatory framework.

CER View

The CER notes that the majority of respondents are broadly supportive of the proposed regulatory framework. This framework is a model which has successfully been applied to the energy sector in Ireland and is trusted among investors.

The CER acknowledges that a number of differences exist between water and energy sectors. For example, water is recognised by the UN as a basic human right, is essential to the hygiene, health and dignity of people, is impossible to substitute with other sources, and is (unlike electricity) heavy and costly to transport. However, the business of delivering water services is similar to the electricity and gas network businesses. Energy and water sectors both have a network infrastructure comprising long-life assets and require on-going heavy capital investments to ensure that they are maintained and extended. Both sectors in Ireland are, moreover, run by public utilities whose efficient operations are essential to both households and businesses. Within the gas and electricity sectors in Ireland the proposed revenue cap RPI-X model has successfully delivered on its objectives; e.g. decreasing operating costs in real terms, improving Key Performance Indicators, increasing customer welfare and facilitating efficient capital investment to improve and extend the networks. In light of the abovementioned similarities and the previous success of the RPI-X model, the CER is satisfied that the RPI-X regulatory model is consistent with the provisions of the Act and will be appropriate for and applicable to the public Irish water services sector in successfully driving improved performance.

The suggestion made that the CER should allow scope for capex responding to evolving market conditions and emergency planning has been noted. Under the Act, Irish Water is required to prepare and submit to the Minister a 25 year water services strategic plan in addition to developing an investment plan setting out the investment in water services infrastructure that it considers necessary for effective performance

of its functions.⁹ This investment plan must be submitted along with Irish Water's proposed water charges plan for the CER to consider. Consideration will be given to future demand requirements when approving the Irish Water's revenue requirement.

⁹ In relation to the investment plan the CER advises that stakeholders contact Irish Water regarding future demand requirements to ensure that these are considered in its investment plan.

2.2 Further Regulatory Principles to be Considered

The second question in the consultation paper asked: “*Are there any further principles of a proper regulatory framework that the CER needs to consider / or principles that need to be removed from the above list? If so, please provide an explanation for inclusion/exclusion.*” Eight respondents proposed further principles to be considered.

Responses received

The principle noted most frequently by respondents for further consideration was **sustainability**. Six respondents (AWN consulting, Dublin City Council, Forfás / Enterprise Ireland / IDA Ireland, Dublin Chamber of Commerce, Katalyst21, Chambers Ireland) proposed both environmental and social sustainability/continuity of supply as a further principle to be considered within the regulatory framework, bearing reference to water being a non-replaceable natural resource. In relation to this, two respondents (Dublin City Council and Dublin Chamber of Commerce) call for close cooperation between the CER with the Environmental Protection Agency (EPA) as part of economic regulation, while another respondent proposed that the CER adopts a long term view when regulating the public Irish water services sector (Dublin City Council).

Three respondents (Intel, Katalyst21 and Forfás / Enterprise Ireland / IDA Ireland) proposed the additional consideration of **international competitiveness** as a further principle to consider. Two of these (Intel and Forfás / Enterprise Ireland / IDA Ireland) suggested that the CER introduce maximum annual unit price increases to reduce the threat of uncontrollable charge increases damaging industry in the coming years, which two respondents (AWN Consulting and Intel) identified as a risk. In order to prevent industry from carrying unreasonable financial burdens for water services, one respondent (IBEC) proposed **fairness** as an underpinning principle of the regulatory framework.

Another principle proposed for consideration is that of **accountability**. In relation to this, two respondents (Chambers Ireland and Forfás / Enterprise Ireland / IDA Ireland) pointed out that the consultation paper contains little information on consumer protection measures, mechanisms to process consumer complaints and

the division of responsibilities among Irish Water, Local Authorities, the CER and the EPA.

Transparency was also suggested as a further principle for the CER to consider. One respondent (IBEC) requested greater transparency on the financial consequences of local authorities being unable to meet their contractual obligations to deliver improved operational efficiency. According to this respondent the CER should not require water users to either (i) underwrite financial liability of local authorities unless in very specific circumstances or (ii) pay for historic fixed assets without associated economic cost for Uisce Éireann. This same respondent presented the confidential nature of the SLAs between Uisce Éireann and local authorities as constituting a transparency issue¹⁰. Three respondents (Forfás / Enterprise Ireland / IDA Ireland, IBEC, Chambers Ireland) moreover focused on transparency on behalf of consumers. Here it was suggested that the CER publish explanatory notes on key consultations, adopt consultation with all concerned stakeholders as a principle, that transparency guide water utility costs and that transparency underpin customer complaints procedures.

In addition, it was proposed (by Forfás / Enterprise Ireland / IDA Ireland) that the CER creates a hierarchy of objectives and priorities under the regulatory framework and subsequently use this to guide regulation of the water services sector.

Finally, one respondent (Forfás / Enterprise Ireland / IDA Ireland) emphasised the potential implications of the power of ministerial direction for regulatory independence. This respondent expressed concern that regulatory uncertainty means greater risk for infrastructure investors, which results in a higher cost of capital for the end users.

CER View

The Act requires the CER to perform its functions in a manner that best serve the interests of customers of Uisce Éireann while having regard to the to the need to ensure:

¹⁰ Please see <http://www.environ.ie/en/Environment/Water/WaterSectorReform/> for further information on the Service Level Agreements which has been published since the publication of the Consultation Paper.

- a) that the customers of Uisce Éireann are provided with the quality of service provided for in an approved code of practice,
- b) that water services are provided by Uisce Éireann in an economical and efficient manner,
- c) that Uisce Éireann operates in a commercially viable manner,
- d) the conservation of water resources,
- e) the continuity, safety, security, and sustainability of water services,
- f) that Uisce Éireann can meet all reasonable demands for water both current and foreseeable,
- g) the recovery of costs of water services in accordance with Article 9 of the EU Water Framework Directive,
- h) that Uisce Éireann performs its functions in a manner that will enable the achievement by the State of the environmental objectives of that Directive,
- i) that Uisce Éireann performs its functions in an open and transparent manner.

It is the above statutory requirements which set the legislative framework in which the CER must carry out its water regulatory function. The CER does not have any discretion to create a hierarchy of objectives and priorities under the regulatory framework as suggested by some respondents.

As an independent body serving the interest of consumers, the CER is strongly committed to transparency. The CER is fully committed to transparent consultation processes in relation to all its decisions and endeavours to meet with stakeholders when requested. It should also be noted that the Act provides that the CER shall ensure “that Irish Water performs its functions in an open and transparent manner”. In line with the principles set out in the information note “*CER and Water Regulation in Ireland*” the CER will apply the same values to the water industry as it has done to the electricity and gas sectors: fair and transparent regulation, acting with integrity and respect, consulting with stakeholders and customers, be accountable to customers and stakeholders, and making informed decisions.

Finally section 42 of the Act provides that the Minister may give the CER ministerial direction, and that the CER must comply with such a direction. The Act sets out a clear and transparent process for the issuance of such a direction including the requirement that the Minister must give a proposed draft to the CER and the

Oireachtas and also publish the draft in Iris Oifigiúil along with a notice inviting any interested party to make comments.

2.3 Agreement with Proposed Regulatory Framework

The third question presented for consultation asked: “*Do you agree with the CER’s assessment of each of the proposed regulatory frameworks? If not, then please explain why.*” Six of the total sixteen submissions received addressed this question.

Responses received

One respondent (Uisce Éireann) expressed full support for the proposed regulatory framework, referring to how Ireland needs a robust framework and transparent regulator to gain the confidence of potential investors. Another respondent (IBEC) agreed that revenue regulation provides a sensible framework for economic regulation of Uisce Éireann and expressed support for including a revenue cap in the framework.

Three of the submissions expressed concern (IBEC, Dublin City Council and Paul Hunt) that the proposed RPI-X model does not provide enough downward pressure for Uisce Éireann to make efficiencies in its operational expenditure (opex). One of these respondents (Dublin City Council) therefore suggested that a RPI-X+U model, which allows for efficiencies while recognising inflation movement and makes provisions for catching up with required funding, instead be applied. Another (IBEC) requested the CER to reconsider whether a stable revenue regime is compatible with an equitable tariff regime.

Contrarily, one respondent (Katalyst21) favoured the adoption of a Water Sector Costs Indexed model as the proposed regulatory framework was considered too crude and simple.

One respondent (Paul Hunt) believed the proposed regulatory framework to be inherently flawed and a failure in both Ireland and the UK.

CER View

The CER disagrees with the view that the RPI-X model does not provide sufficient pressure for Irish Water to make efficiencies. The revenue cap RPI-X model has successfully driven efficiencies in both the gas and electricity sectors. When regulating the water sector, the CER will consider efficiency gains when approving IW's revenue allowance as well as integrate incentive regulation in the framework. The CER does not consider it necessary to include the proposed +U factor in the model, as the RPI framework is based on the Harmonised Index of Consumer Prices (HICP) and thus already recognises inflation movements. A k factor provision for catch up funding is likewise incorporated into this model.

The CER has made a deliberate choice to base regulatory frameworks on HICP. Previously¹¹ the CER used the Consumer Price Index (CPI) as the index to inflate revenue. However, the inclusion of mortgage interests in CPI meant that the index was affected by changes in the ECB interest rate. Recent changes to the ECB interest rate introduced significant volatility to the CPI model. This volatility has significant impacts on the charges paid by the final consumer and on the revenue that utilities require to cover their costs. The CER believes that using a consumer focused inflation index is appropriate and that the HICP, on which the RPI-X is based, is a better index to use as it is likely to be less volatile and hence of benefit to final consumers and the water utility. The CER does not intend to include the proposed 'Water Sector Index Cost' in the regulatory framework as it is believed that such a model will both be less transparent and more volatile. In addition the proposed indexes feeding into the model are not readily available in Ireland.

2.4 Advantages / disadvantages to proposed framework

After proposing its regulatory framework model, the CER in its consultation asked: *"Are there any advantages or disadvantages to any of the proposed frameworks that the CER has not considered? Please detail"*. Five respondents commented on this question.

Responses received

¹¹ The CER transferred from using the Consumer Price Index (CPI) to the Harmonised Index of Consumer Prices (HICP) at the start of ESB Networks Price Control Review (PR) 3 for 2011 to 2015.

The first respondent (Forfás / Enterprise Ireland / IDA Ireland) outlined a potential risk involved with setting returns on the regulated asset base. As explained by this respondent “it is challenging for regulators everywhere to validate the required level of investment and the costs of delivering agreed infrastructure. There are risks that regulated firms (given access to better information) will be tempted to gold plate investment or to deliver infrastructure at higher costs. In general, these higher costs either pass through to consumers (business and residential) or impact the profitability of the company, reducing the potential dividend for its owner, which is often the Government”. Two further respondents (Intel and AWN Consulting) therefore asked the CER to elaborate on how the economic framework will be structured so as to "ensure that only reasonable and appropriate costs for the provision of water services by IW are charged to customers" and how will "reasonable and appropriate" be benchmarked?

This view reflected the concerns of a second respondent (Paul Hunt), who believed the proposed regulatory model is a poor substitute for competitive market forces, characterised by a power and information imbalance ultimately resulting in too high water charges.

CER View

Access to information is a recurrent challenge for any regulator. This issue also applies to the public water services sector in Ireland, where Uisce Éireann has only recently been established and is in the process of collecting information from 34 different local authorities. The CER is aware of the risk associated with insufficient information when driving efficiencies. To mitigate this risk, particularly in the transitional period, the CER proposes to conduct an initial two year interim review (2014 – 2016), which would allow the CER to gain more information about the provision of water services, before beginning a full revenue review period.

Uisce Éireann is moreover required to complete detailed Business Planning Questionnaires setting out its expected operational expenditure as part of its revenue submission process under the water charges plan. These will subsequently be subject to rigorous analysis by the CER in order to identify appropriate operational costs as well as options for cost reductions and driving efficiencies. As part of

process, Uisce Éireann will furthermore be benchmarked against comparable utilities to verify that water services are delivered at an appropriate and efficient cost.

It should also be noted that section 43(1) of the Act provides that the CER may request Uisce Éireann to provide the CER with such information as the CER may reasonably require to allow it perform its functions. Uisce Éireann is obligated under the Act to comply with such a request.

2.5 Setting a revenue cap (RPI-X) framework for Uisce Éireann

The fifth question posed in the consultation asked: *“Do you agree with the CER’s assessment that a revenue cap (RPI-X) framework should be put in place for the Irish water sector? If not, then please explain why.”* Three respondents addressed this question.

Responses received

Two respondents (Forfás / Enterprise Ireland / IDA Ireland and Intel) expressed support for the revenue cap RPI-X model, however they suggested that the model includes scope for revision. It was argued by one respondent (Intel) that the RPI-X model should be construed to allow special agreements for large users, and specific infrastructure required for new enterprise locations that may demand increased capex and opex. The second respondent (Forfás / Enterprise Ireland / IDA Ireland) argued that the RPI-X model should be reviewed in the short term as Irish Water develops. This argument was based on the understanding that there may be prospects for large efficiency gains in the early years, which should be returned to customers. In order to assure effective performance of the model one respondent (Forfás / Enterprise Ireland / IDA Ireland) advised that the CER and Department of Environment, Community and Local Government agree on a common understanding of targets and outcomes against which performance should be assessed.

A third respondent (AWN Consulting) dismissed the RPI-X model for the public Irish water services sector. According to this respondent the RPI-X model will fail to drive cost reduction in the water delivery and wastewater treatment system since the CER will be unable to determine efficient costs as Uisce Éireann will start at a high and

inefficient cost base. Instead, this respondent urges the CER to reconsider the yardstick approach used by OFWAT.

CER View

The suggestion made that the CER should allow scope for capex responding to evolving market conditions and emergency planning has been addressed earlier¹². In relation to the recommendation to design the RPI-X framework to allow special agreements with large water users, the CER notes that section 23 of the Act provides that Irish Water may make an agreement with a customer for the charging of that customer for the provision of water services, subject to the approval of the CER. More generally, the CER has consulted on tariff structures in April. A separate consultation on connection charging is scheduled for Q4 2014.

As explained in the consultation paper, the CER accepts that there is scope for efficiency gains in the public Irish water sector. To date, the CER has adopted the process of sharing achieved efficiency gains in one control period with the customer in the next revenue control period. It intends to also apply this process to the water sector.

The CER does not consider it appropriate to solely rely on yardstick regulation as used by OFWAT. There will be only one water utility operating in Ireland as opposed to the 22 utilities operating in England and Wales. There are consequently no other companies operating in the same industry that would allow for a complete reliance on yardstick regulation. The CER considers the RPI-X framework appropriate for the CER to effectively regulate Irish Water, as has been its experience in the electricity and gas sectors. Based on detailed Business Planning Questionnaires from Uisce Éireann, the engagement of economic and technical expert consultants, benchmarking against comparable (and competitive) countries, the CER will achieve a detailed understanding of the Irish water services sector and the options to drive cost reductions therein.

¹² See response to question 1 in section 2 of this paper.

2.6 Opex, Uisce Éireann RAB, Capex, Rate of Return and Revenue Based Incentives

In relation to the proposed regulatory framework, the CER asked: “Do you agree with the CER’s proposed approach in each of the following areas?”

The treatment of operational expenditure;

The approach to setting the opening asset value of the Uisce Éireann RAB;

The approach to valuing assets being added to/within the Uisce Éireann RAB;

The treatment of capital expenditure;

The capitalisation policy for adding assets to the Uisce Éireann RAB;

The estimation of a reasonable rate of return on assets in the Uisce Éireann RAB;

The treatment of depreciation for assets in the Uisce Éireann RAB;

The use of specific revenue-based incentives;

How maximum allowable revenues are calculated; and

The form of the tariff adjustment.

If not, then please explain why for each particular section.

Seven of the sixteen submissions responded to parts of the question above.

The responses received to question six are provided below under the relevant headings.

2.6.1 ***The treatment of operational expenditure (opex)***

Responses received

One respondent (IBEC) argued that benchmarking, trend analysis and consulting industry experts all have shortcomings. For this reason, it is proposed that the CER gain a detailed in-house understanding of the cost structure in each local authority area and of how these are reflected in the relevant SLAs in the interim revenue review period.

The CER comment in the consultation paper that it will perform comparisons with other water utilities and set targets for the business to achieve the same costs as the average or most efficient comparator water utility was dismissed by one respondent

(AWN Consulting). Rather than striving for average costs, the CER should be encouraged to ensure Ireland a strategic advantage against competitive countries by maintaining costs of water at the lowest possible level. This should, according to the respondent, be achieved through a complete re-organisation and re-structuring of Uisce Éireann's delivery model to reduce operational costs.

The role of local authorities in the water reform programme and the associated impact that this may have on opex, was addressed by two respondents. One of these (Forfás / Enterprise Ireland / IDA Ireland) expressed concern about CER's definition of uncontrollable and controllable costs within the opex. In addition, this respondent identified the cost implications of the proposed 12 year SLAs as a concern and emphasised that the CER must drive efficiencies in all cost factors within control of the state. In order to achieve this, it was recommended that CER define which steps it plans to take to ensure the most efficient delivery of water services and to use benchmarking against both competitor and comparator countries to ensure that the necessary steps to improve efficiencies within the state's control are taken. This view was echoed by another respondent (AWN Consulting) who noted that an efficient utility would have operators employed directly by the utility to operate and manage plants, not the two layers of additional management proposed under Uisce Éireann, namely the Local Authorities and their subcontractors.

Another respondent (Dublin City Council) similarly highlighted issues related to the 12 year SLAs governing local authorities. It was specifically mentioned that restrictions on Local Authorities' resources may prove to be a problem when seeking efficiencies. It was thus proposed that CER give consideration to the Local Authorities' capabilities when benchmarking Irish Water.

Finally, when determining the economic regulatory framework for Uisce Éireann, the CER was recommended by one consultation respondent (Intel) to include a separate Mogden Formula in order to recognise breakout of unit costs for large consumers – a tool which is currently used by water and sewerage services providers in England, Scotland, Northern Ireland and Wales.

CER View

The CER agrees that the initial revenue review provides the opportunity for it to gain a detailed understanding of the cost structures for the provision of water services in Ireland.

Whilst noting the desire of some respondents to ensure Ireland a strategic advantage against competitive countries by maintaining costs of water at the lowest possible level, the CER must operate in accordance with its statutory role (as set out in section 1.2 of this paper) .

That being said, the CER will regulate Uisce Éireann in a manner to ensure it achieves efficiencies. This process will be done through (i) applying economic and industry expert judgement in reviewing costs (ii) applying an efficiency glidepath for Uisce Éireann to reduce operational costs and improve its operational efficiencies over a number of years and (iii) using the regulatory framework of RPI-X to balance what is achievable by the utility in its efficiency drive and incentivising it to achieve that level of efficiency.

To derive an Opex allowance the CER intends to uses a combination of three inputs (i) benchmarking against other comparable companies, (ii) the use of efficiency/productivity trends evident in the Irish economy and (iii) the advice of industry experts:

- Benchmarking will allow the CER to compare Uisce Éireann against comparable companies to see how efficiently services can be carried out. This method will identify areas where processes can be improved and efficiency can be gained.
- Experts will review and audit Uisce Éireann's outturn operational expenditure for each revenue control period to assess a recommended level of opex and identify key areas where efficiency savings can be made by the utility.

The use of an RPI-X framework will provide Uisce Éireann with an incentive to pursue efficiency gains in the operation of its business. Performance based revenue-incentives are a key component of revenue control regulation. The CER has driven and continues to drive year-on-year efficiencies in the electricity and gas sectors through its various revenue controls and it is envisaged that the same achievements will be made in the water sector. With respect to Service Level Agreements (SLAs),

these are a contract between Uisce Éireann and the Local Authorities. While the CER was not consulted on the development of the SLAs, the CER will regulate Uisce Éireann in a manner which ensures that efficiencies are gained while operating within the SLAs and that best service interests of customers of Uisce Éireann whilst having regard of the need to ensure:

- a) that the customers of Uisce Éireann are provided with the quality of service provided for in an approved code of practice,
- b) that water services are provided by Uisce Éireann in an economical and efficient manner,
- c) that Uisce Éireann operates in a commercially viable manner,
- d) the conservation of water resources,
- e) the continuity, safety, security, and sustainability of water services,
- f) that Uisce Éireann can meet all reasonable demands for water both current and foreseeable,
- g) the recovery of costs of water services in accordance with Article 9 of the EU Water Framework Directive,
- h) that Uisce Éireann performs its functions in a manner that will enable the achievement by the State of the environmental objectives of that Directive,
- i) that Uisce Éireann performs its functions in an open and transparent manner

Finally, consideration of applying a separate Mogden Formula to the economic regulatory framework has been noted by the CER and has been addressed as part of the consultation on non-domestic tariff criteria and structures in April 2014.

2.6.2 Setting the Opening Asset Value of Uisce Éireann's Regulated Asset Base

Responses received

In the consultation, one respondent (IBEC) expressed concern relating to the CER view that Government ultimately must decide the initial level of RAB. It was argued that the opening RAB should be principles-based rather than discretionary, and reflect past investment instead of future funding requirements. The same respondent asked for clarification on whether the transfer of certain liabilities from local authorities to Uisce Éireann includes loans taken out by LAs to fund capital investments in the water system. It was argued that it would be unfair for LAs to transfer liabilities onto Uisce Éireann that stemmed from, for example, breach of environmental licences, bad debt provisions on uncollected debt or pension fund shortfalls.

In contrast to this view, one respondent (Paul Hunt) argued that the responsibility for setting Uisce Éireann's opening RAB should fall upon Government and expressed significant concerns at the value of asset bases previously set by the CER for the gas and electricity sectors.

A third respondent (Forfás / Enterprise Ireland / IDA Ireland) encouraged the CER to reassess its proposed RAB valuation approach, placing particular focus on protecting the interests of both current and future water users. This same respondent favoured that the opening RAB be set at a level facilitating bond market funding for investments.

CER View

As set out in the consultation paper, the RAB is an important concept in the construction of an effective regulatory framework, with the decision on the opening asset value ("Opening RAB") particularly key. Given the transfer for statutory responsibility for water services to Uisce Éireann under the Water Services Act (No. 2) 2013, and the associated transfer of the water infrastructure assets from the State to Uisce Éireann, it is appropriate that the overall approach is ultimately a decision for Government.

The CER note the differing views of respondents, and believe the 3 options set out in the consultation paper are valid: each with advantages and disadvantages. The 3 options include:

1. Set the Opening Uisce Éireann RAB later.
2. Set the Opening Uisce Éireann RAB based on future funding requirements.
3. Set the Opening Uisce Éireann RAB based on IW expenditure and liabilities transferred from the Local Authorities.

The CER recommends that any decision by Government should be taken in the context of (a) various assets and liabilities being transferred to Uisce Éireann from Local Authorities, (b) what effect it will have on the charges faced by the water services customer, (c) the equity investment in Uisce Éireann planned by the Government and (d) the ability of the water utility to raise debt to fund future investments in the water services infrastructure.

2.6.3 Capital Expenditure (capex)

Responses received

In relation to Uisce Éireann's capital allowance, it was suggested by one respondent (AWN Consulting) that the CER adopt a medium-long term strategy when setting the allowance. This respondent simultaneously urged the CER to accept support of inward investment and business as a specific capex priority and ensure that Irish Water engage with IDA and large water users.

The CER was asked to clarify whether it expects the EPA to have an oversight role in the prioritisation or governance of Uisce Éireann's capital expenditure allowance by one respondent, who highlighted the importance of giving equal consideration to ensuring security of supply as to improving environmental standards (IBEC).

CER View

As set out in the consultation paper, the CER intends to adopt 6 year revenue control periods after the initial 2 year interim revenue review. It should also be noted that under section 33 of the Act, Uisce Éireann shall upon consult with the CER, the EPA, each Local Authority and each regional body prepare and submit a water services

strategic plan to the Minister detailing its objectives of meeting projected demand for quality water services over a 25 year period. Uisce Éireann will thus be required to adopt a long term capital investment strategy. In addition, section 34 of the Act requires Uisce Éireann to develop an investment plan which must set out the water service infrastructure that Uisce Éireann considers necessary for the effective performance of its functions. The investment plan must take account of:

- The water services strategic plan
- Any river basin management plans, local areas plan, development plans, regional planning guidelines and strategic development zones which are in force.

Under the Act, Uisce Éireann must submit the most recent investment plan when submitting a water charges plan to the CER, which the CER will consider when deciding to approve the water charges plan (with or without modification) or refuse to approve the water charges plan.

The review of capital expenditure requires co-ordination between the respective roles and responsibilities of the CER as economic regulator of the water services sector, Uisce Éireann in fulfilling its various legal obligations, the EPA as environmental regulator, and the Government as the provider of state subvention and of the need to ensure that capital investment plan takes into account Government's spatial strategy and economic development strategies. This coordination will be an important element of the administrative cooperation arrangement to be agreed between the CER and EPA under section 43(3) of the Act.

2.6.4 Rate of Return

Responses received

Support for the WACC approach was expressed by one respondent (IBEC). When deciding the value of the WACC this respondent furthermore suggested that the Asset Beta applying to Irish Water's asset should be set at a low level, similar to that of BGE's network business.

Another respondent (LAWSTO) advised that the rate of return should allow for proactive replacement of obsolete infrastructure and an investment programme to encourage economic development and improved environmental standards.

CER View

The value of the WACC and the associated functions influencing this calculation will be consulted upon separately as part of the water charges plan consultation scheduled to be published later in July 2014.

As detailed above, Uisce Éireann will be required to prepare an investment plan detailing the investment in water services infrastructure that Uisce Éireann considers necessary for the effective performance of its functions. This investment plan will be submitted to the CER along with a water charges plan. Consideration will thus be given to the replacement of obsolete infrastructure when setting Uisce Éireann's revenue allowance and rate of return.

2.6.5 The use of Revenue Based Incentives

Responses received

The CER proposal to use specific performance based revenue-incentives in order to improve Uisce Éireann's performance in the delivery of its responsibilities was commented upon by two respondents (AWN Consulting and Intel). Both organisations asked the CER to clarify how it intends to set the K factor and to explain which benchmark this factor will be judged against.

CER View

The proposed k factor within the regulatory framework is a mechanism which corrects inaccuracies in the inflation and demand forecasts. The k factor is calculated annually and allows for Irish Water to correct revenues that exceed or fall short of the allowed revenue. Where IW recovers more than the allowed revenue in a year, the k factor will adjust the amount collected in the following period by reducing the allowed revenue by k. Where IW does not meet its allowed revenue, the revenue allowance in the following year will be increased by k. In other words, the k factor is not set: it will correct for inflation and demand and will vary accordingly.

2.7 Other Approaches to Consider

Following the discussion on the proposed approach to opex, capex, RAB and rate of return the CER asked: *“Are there any other approaches to each of the areas detailed in this section (section 4) that the CER has not considered? Please detail why they could be considered superior to this CER approach.”*

Responses received

One respondent (Intel) argued that “some recognition of the significant differences between revenue harmonisation for domestic customers and industrial customers from disparate sectors some of whom are Significant Users must be enshrined as basic principles in the Regulatory Framework”.

A second respondent (Forfás / Enterprise Ireland / IDA Ireland) referred to the review of regulation of airport charges at Dublin airport in 2009 and supported the introduction of an explicit link between the level of price cap and the quality of service provided. It was suggested that the CER, in an attempt to improve quality standards over time, give consideration to quality indicators of issues most relevant to enterprises such as water quality, service disruption levels, water pressure levels etc. when regulating Uisce Éireann.

CER View

All matters related to tariff structures and charges for industrial and domestic customers has been consulted upon separately in April 2014.

2.8 Interim Revenue Control

The eighth question published for consultation focused on the proposed interim revenue control by asking: *“Do you agree with the need to introduce an interim revenue control? If not, then please explain why”*. Six respondents commented on this question.

Responses received

The first of the four responses received (IBEC) expressed full support for the CER introducing an interim revenue control period, referring to how this would enable

better understanding of Uisce Éireann's capital investment programme and opex structure before implementation of efficiency incentives.

A second respondent (Forfás / Enterprise Ireland/ IDA Ireland) agreed with the need for an interim revenue control, primarily due to limited available data to make informed decisions about the opening RAB etc. The respondent did, however, also believe that other interim arrangements will be required. In particular, they asked how the CER and Uisce Éireann would determine that existing legal and standing arrangements are honoured under the new structures for water services and develop mechanisms to transfer these agreements to Irish Water where relevant.

Thirdly, two respondents (AWL Consulting and Intel) asked how the two year interim revenue control and six year price review will be structured. One respondent considered the current proposal of a six year price review too short, as it does not reflect the lifespan of water assets (Dublin Chamber of Commerce).

One respondent (Intel) supported both an interim revenue period of two years and a longer term six yearly pricing cycle, however noting that in the interim an annual price cap expressed on a percentile basis will be needed to protect enterprises from unsustainable rise in water costs and to allow for appropriate business planning. This respondent also highlighted the importance of the CER putting in place a mechanism to deal with standing and future water agreements between water suppliers and large industry consumers.

Finally, a fifth respondent (Chambers Ireland) understood the rationale for an interim revenue control but emphasised that such a period must "be strictly time tabled with milestones to assure that full revenue control is attained in a medium term period".

CER View

The CER notes the support for an interim revenue period.

The CER proposes a 2 year interim revenue control period (until the end of 2016) to allow the CER and IW to gain a better understanding of the needs of the Irish water services sector and to adjust the set revenue accordingly. International experience suggests that a price review period of 5-7 years is best practice. A price review period of 6 years is proposed as it aligns with the River Basin Management Plans.

The issue concerning the treatment of existing standing arrangements which large industrial customers have in place with local authorities will be addressed by Uisce Éireann when it submits its proposed water charges plan. Following this submission the CER will launch a public consultation on water charges, which will address new tariff structures and the issue of honouring standing agreements.

2.9 Initial Valuation of the Uisce Éireann RAB

For the purpose of determining the initial RAB valuation of Uisce Éireann, the CER asked: “*Which of the three approaches to the initial valuation of the IW RAB do you consider most appropriate for the Irish water services sector? Please explain your reasoning.*” Four submissions commented on the question above.

Responses received

One respondent (Intel) emphasised the importance of water services providers being required to respond to changing or expanding water supply and treatment needs in line with national economic interest. It was consequently proposed that the initial valuation of Uisce Éireann’s RAB include scope to respond to changing demands, and that Irish Water- under the supervision of the CER- should be obliged to meet such changing demands.

Three other respondents focused on the role of government in relation to valuating/influencing Uisce Éireann’s RAB. The first of these three respondents (Paul Hunt) argued that the CER should continue to push for direct government financial support of Uisce Éireann’s RAB and WACC. In line with this view, another respondent (Dublin City Council) proposed that the CER should not accept withdrawal of government subvention in the future since the presence of government will give reassurance to markets. In contrast hereto, a fourth respondent (IBEC) expressed deep concern about the initial RAB being a government decision. Instead, it was argued, the opening RAB should be principles-based and reflect previous investment. This fourth respondent consequently dismissed the second option of valuating the RAB (in which the opening RAB is partly based on future funding requirements). Instead, this respondent favoured either option 1 “*provided that it led to a transparent and fair determination of opening RAB*” or option 3 “*provided that*

revenues earned in each Control Period are sufficient to cover the financing of the transferred liabilities plus Uisce Éireann's recent capital expenditure".

CER View

Section 33 of the *Water Services (No. 2) Act 2013* sets out that Uisce Éireann, upon consultation with the CER, shall prepare and submit a water services strategic plan to the Minister, detailing the objectives of Uisce Éireann in relation to, among others, the existing and projected demand for water services. Hereby, the CER has been granted a consultative role in relation to strategic planning and network development.

In relation to the level of Governmental engagement in Uisce Éireann's initial RAB and WACC, a decision to be made by the Government and is ultimately outside the remit of the CER. The Government will similarly have full authority over the length and value of any subventions to Uisce Éireann.

2.10 Sharing Achieved Efficiency Gains

Finally, the CER asked for comments on its proposed approach for sharing efficiency gains: *"Do you agree with the CER's proposed approach for sharing achieved efficiency gains in one control period with customers in the next revenue control period? If not, then please explain why."* One out of the total sixteen submissions commented on this question.

Responses received

The response received (Intel) to question ten pointed out how achieved efficiency gains may be a direct result of industrial consumers implementing Best Available Techniques (BAT) or other enterprise changes benefitting the larger network. If a Mogden Formula based system, which would reward/incentivise BAT requirements, is not introduced for the public Irish water services system, the respondent suggested that flexibility in negotiated pricing for Significant Users should be allowed.

CER View

The CER accepts that efficiency gains may be results of investments made by industry. Whether or not such gains should lead to a corresponding price reduction

for large water users will be dealt with separately as part of the forthcoming consultation later in July focusing on water charges.

3. General Comments

Respondents also raised a number of more general comments which can be summarised into the following areas:

- Tariff structure and methodology;
- Customer protection;
- CER information note on water regulation in Ireland;
- Funding in the Irish water system;
- Consultation Processes;
- The role of the Local Authorities in Irish water services; and
- The role of regulation in Irish water services.

3.1 Tariffs Structure and Methodology

Respondent Views

A number of respondents commented on the accessibility of information regarding tariffs. The following points were made:

- Further information on planning for tariffs is required (AWN Consulting).
- The CER should fully define the water customer categories (AWN Consulting; Intel).
- Charges should be easy to understand and there should be transparency on how revenue is being spent (National Consumer Agency).
- Tariff changes should be clearly communicated to consumers along with information as to how they can best manage their usage to reduce costs as consumers will require an understanding of the components that result in their total water service bill to modify their water usage to reduce costs (National Consumer Agency).

Questions and comments were received over the composition of the tariffs as follows:

- Does the CER envisage that Uisce Éireann would recoup its costs through water charges or would it continue to receive state support (Irish Congress of Trade Unions)?

- Water is a free resource and so consumers should not be charged for it but only charged for the cost of delivering it (RSPA).
- The utility's objective should be to recoup its costs of extraction and delivery from its users and not the generation of profits for itself or the state (RSPA).
- If water is seen as a means of bringing in revenues, it can lead to over-extraction, profligacy, and eventual degradation of water resources (RSPA).

Two submissions suggested how the tariffs should be set. The first respondent (Irish Congress of Trade Unions) noted that it is of the opinion that the price of water should be set by the Oireachtas as part of the annual budget process and not by the CER. The second respondent (The Carers Association) suggested using the United Nations Development Programme (UNDP) calculation that water costs should not exceed 3% of household income.

A number of the submissions commented on the potential for a Government contribution to the end user tariff as it will ultimately need to be paid. The following comments were received:

- The Government subvention referenced in the Information Note is being treated as a dividend inappropriately as the subvention is from money collected from tax payers and consequently, the vast majority of water customers (Paul Hunt).
- A free domestic allowance is not in line with the "user pays principle" and does not encourage efficient water usage (Forfás / Enterprise Ireland / IDA Ireland).
- A free allowance is not free but could be ultimately paid by the business customer (Forfás / Enterprise Ireland / IDA Ireland).
- A free allowance should be set as low as possible as a broad base will support lower charges per unit of water for all (Forfás / Enterprise Ireland / IDA Ireland).
- Users should be allowed a generous amount of water free of charge and should only be charged the given unit cost once they have exceeded that amount (RSPA).
- Meters are a necessary device for the effective operation of a water utility, and a useful means of eliminating serious and unnecessary waste/leakages (RSPA).

Several submissions raised the point that business customers should be considered differently from domestic users and from businesses of different sizes:

- Water tariffs in Dublin are generally lower due to economies of scale and efficiencies and so it would be unjust to apply a national tariff on non-domestic water customers as it would mean that those in Dublin are compensating for the costs incurred by other businesses. Therefore, it is suggested that a tariff be applied to the Dublin region based on the cost base of providing water to that region (Dublin City Council).
- The CER should implement targeted bands for different geographical areas such as: large urban areas, large towns, and rural areas (Dublin Chamber of Commerce).
- The definition of significant water user should be agreed with Uisce Éireann and Significant Water Users (SWU) in Ireland (AWN Consulting).
- Large water users should be dealt with as a separate class of customer who benefit from the economies of scale inherent in the purchase of large volumes of water from a large efficient water treatment plant and in the discharge of water to a large efficient wastewater treatment plant (AWN Consulting).
- Domestic bad debts and the capital costs of domestic meters should be borne solely by domestic customers (IBEC).
- Will the revenue subvention also include reduced water charges if SWUs make financial contributions to water or wastewater infrastructure (AWN Consulting)?
- Efficiencies of individual plants should be passed on to the direct customers as opposed to using efficiencies to subsidise less efficient plants in other parts of the network (AWN Consulting).

CER View

At this time tariff structures, and the methods that will be used to calculate them, have not been established. Tariff structures and principles have been consulted on in April 2014. According to Section 22 of the Water Services (No. 2) Act 2013, Uisce Éireann must submit a Water Charge Plan to the CER for approval. This plan will specify the manner and method by which charges will be calculated. All elements of the Water Charges Plan will be published for consultation later in July prior to a

decision being taken by the CER in September 2014. The above issues raised by respondents will be considered throughout that process.

3.2 Customer Protection

Respondent Views

Respondents felt that the economic framework paper did not take into account water affordability and customer protection. The Carers Association noted that:

- Where water is not affordable, households may begin self-rationing which could lead to poor hygiene and ill-health.
- Water affordability strategies could include free water allowances, bill capping, budgeting tools and pre-termination polices and exemption.
- Support for households where someone has a medical condition is essential in the roll out of water charges as many medical conditions result in an increased use of water.
- Households should be able to avail of flexible payment options.
- As is the case for electricity and TV licences, water affordability measures should be provided through the mechanism of the Household Benefits Package.
- The sick and the elderly should be exempt from water disconnections.
- Uisce Éireann should offer special services to customers that require special help in the way services are delivered to them e.g. providing information in a format that they can use and understand, offering a password scheme to prevent bogus callers, offering a facility to check how water they are using at regular intervals, and move the meter to a place where it is easily accessed or provide a meter reading service at no extra cost.

Three other respondents noted the following points with regard to consumer protection:

- The CER should be given powers to resolve disputes between IW and its customers to ensure that consumers are adequately protected (National Consumer Agency).

- Little detail is currently available as to how consumer protection will be implemented in practical terms within the economic regulatory framework (National Consumer Agency).
- A hierarchy should be established so that it is clear to domestic and business customers who to contact when they have an issue (Dublin Chamber of Commerce).
- A harmonisation of the different stakeholders within the structure with clearly defined roles and responsibilities (Dublin Chamber of Commerce).
- A person who genuinely cannot pay should be accommodated fairly and equitably and not left without water (RSPA).

CER View

The CER agrees that water affordability is an important and real issue. The CER will regulate IW to ensure fair and reasonable tariffs are in place. As mentioned previously, tariff structures and principles have been the focus of a separate consultation in April 2014. The specific issue of the introduction of targeted water affordability measures is a matter for Government.

The Act does not provide the CER with explicit powers relating to dispute resolution. However, section 32 of the Act states that the CER will approve IW's codes of practice. The Act states that these codes of practice should include information on how customers may communicate with IW and how they may make complaints. The Act gives the CER the power to state any other matters that should be included in the codes of practice that the CER considers necessary and appropriate to secure the interests of customers of Irish Water. All codes of practice will be subject to public consultation in Q2 prior to approval. It is the CER intention that a voluntary dispute resolution process will be put in place prior to introduction of domestic water charges in October 2014 as an interim measure. The CER will liaise with the Department to put in place a statutory underpinning for this dispute resolution process in forthcoming additional legislation for water services sector.

In relation to the disconnection of customers in the case of non-payment, Section 21(7) and 21(8) of the Act permit Uisce Éireann to apply a reduction in pressure to a domestic customer where a bill remains partly or wholly unpaid for a period of time

that will be approved in the Water Charges Plan but may not disconnect a domestic customer either temporarily or permanently.

3.3 The CER Information Note on Water Regulation in Ireland

Respondent Views

An information note titled “*The CER and Water Regulation in Ireland*”¹³ was published by the CER alongside the consultation paper.

One respondent (Dublin City Council) notes that while the Information Note does state that the Water Service Authorities (WSA) ‘matching funds’ comprise of user contributions, development levies, borrowings and revenues from non-household water customers, ratepayers have been omitted from the list. The paper references water infrastructure assets that are currently owned by the State; however the respondent feels that this is not accurate as Dublin City ratepayers have funded water assets throughout the city and region.

In addressing the reasons for non-uniform funding requirements across the 34 WSAs, the respondent felt that the higher demand for water in Dublin as a result of higher population density as a basis for higher funding values has not been addressed.

CER View

The CER notes that the respondent feels that ratepayers have been omitted when describing the composition of the WSA matching funds. It was intended that the term “user contributions” would encompass ratepayers however the CER acknowledges that this may have been ambiguous and will take this comment into account in future publications.

The Information Note refers to a number of reasons for non-uniform funding requirements across the WSAs including the population within each WSA. One of the reasons that the funding requirements are higher for the Greater Dublin Area is its higher demand as a result of its higher population density. This higher demand

¹³ To access the full note please visit [here](#)

results in an increase in infrastructure costs, for example more network requirements and larger treatment plants. As stated in the Water Services Investment Programme 2010 – 2012, there continues to be consideration of the options for a scheme to provide a new long-term source to service growth in demand in the Greater Dublin Area.

3.4 Funding in the Irish Water System

Respondent Views

A number of submissions referred to the need for investment in the Irish water network and how such investment will be funded. The following comments were submitted:

- The CER should note that severely limited borrowing restrictions were applied to Local Authorities as part of the public sector reforms which restricted capital investment (Dublin City Council).
- The cost of private financing to Uisce Éireann in the medium run will be higher than the cost of financing available to the Local Authorities through the HFA and the objective of Uisce Éireann is to achieve private funding rather than a lower cost of capital (Dublin City Council).
- The Government retains shareholder responsibilities to finance investment as and when is necessary. When it fails to do this, it imposes an unnecessary and excessive burden on final consumers and service users. The Government should either behave as a responsible shareholder or dispose of the business (Paul Hunt).
- Water rights (ownership) must be retained by the state, and the functions of administration and distribution must be the sole responsibility of the publicly owned utility. The involvement of private interests as possessors of water rights and/or utility operators can and does lead to over exploitation and degradation of water resources, and higher unit cost to consumers (RSPA).
- The question of ownership of assets which have been or will be capitally funded by industry and the consequent treatment of depreciation and operational liabilities are not yet addressed (Intel).

CER View

The CER notes the above points. As set out earlier, section 34 of the Act requires Irish Water to submit its investment plan setting out the investment in the water services that Uisce Éireann considers necessary for effective performance of its functions with the Water Charges Plan. The initial investment plan will set out the planned investment until the end of 2016.

3.5 Consultation Process

Respondent Views

A number of comments were received in relation to the CER and consultation. These included:

- The CER should adopt a consultative approach involving engagement with all concerned stakeholders. In particular the respondent suggested consulting with: Uisce Éireann and Local Authorities; regulatory bodies that have responsibility within the Water Services industry and which have an impact on costs including the EPA and HSE; development agencies including the IDA and Enterprise Ireland and the Local Authorities as the local Planning and Development Authority; business groups including IBEC, ISMA and local Chambers of Commerce (LAWSTO).
- Concern that the consultation on the new water regulatory framework is being undertaken in the absence of the legislation (Forfás / Enterprise Ireland / IDA Ireland).
- The consultation documents produced by the CER are often very technical and legalistic and not accessible to business and domestic customers. The respondent understands that in many cases it is necessary for the documents to be technical and legalistic and so suggests that the CER publish explanatory notes alongside the consultation paper (Forfás / Enterprise Ireland / IDA Ireland).
- The structure of the consultation document and the selection of questions for consultation is the standard approach applied by economic regulators throughout the EU to limit and channel the public debate in line with their and

their masters' agenda and to prevent engagement with substantive critiques of their structures and processes (Paul Hunt).

- There could be significant advantages gained from the establishment of a Large Water Users Group that would meet on a regular basis with the regulators (CER and EPA), IW and DECLG to discuss issues of relevance regarding water services (Forfás / Enterprise Ireland / IDA Ireland).

CER View

The CER is always open to consultation and all interested parties are welcome to engage with the CER at any point individually or represented by a group e.g. a large water users group. The CER has a strong relationship with many statutory agencies, such as the EPA, and will work closely with these bodies to ensure that the Irish water resource is managed in the safest, economical, and sustainable manner.

There will be periods of formal consultation as decisions are being made prior to the establishment of water charges in October 2014, the next of which is the water charges plan consultation. This consultation programme is set out in The Water Consultation Plan: 2014 Timelines (CER/14/005)¹⁴. The CER appreciates all feedback with regard to consultation materials. The concepts presented in this consultation paper are of a technical nature and the CER feels that they are presented in the most suitable manner for the target audience. The CER will consider the use of an explanatory document for future consultations and intends to include a non-technical summary in the forthcoming water charges plan consultation.

The CER encourages feedback in all forms. The consultation paper structure and questions are meant as a guide to stakeholders as to where they have influence over the process and also to allow the CER gain insight into specific areas that need to further examination. The CER does not intend to limit consultation in any way and reviews all comments not just those relating to the specified questions.

3.6 The Role of the Local Authorities in the Irish Water Services

Respondent Views

¹⁴ <http://www.cer.ie/document-detail/Information-Paper-on-Water-Consultation-Plan-2014-Timelines/940>

Four respondents submitted comments on the role of the Local Authorities in the Irish water services sector. The comments were as follows:

- More regard should be given by the CER to Local Authorities' obligations to deliver sustainable development when regulating the new utility. Local Authorities' seek to meet citizens' social needs and work with the various Government Departments to have necessary social infrastructure developed in tandem with residential and commercial development (LAWSTO).
- The confidentiality of the SLAs may hinder the transparency of CER's regulatory decisions on revenue sharing (IBEC).
- There should be greater transparency on the financial consequences if some local authorities are unable to meet their contractual obligations to deliver improved operational efficiency. However, any penalties levied on Local Authorities should not be recoverable through business taxes (IBEC).
- The CER's view that the SLAs should facilitate a transition to Uisce Éireann having capacity to provide water services from its own resources and subcontractors is at odds with the "Framework for Service Level Agreements" document which references an enduring and long term relationship between Uisce Éireann and Local Authorities (Irish Congress of Trade Unions).
- The CER and Uisce Éireann need to quickly address how existing legal agreements and standing arrangements between large industry water users and local authorities are to be honoured under the new structures for water services (Forfás / Enterprise Ireland / IDA Ireland).
- The approach of establishing a twelve year SLA with the Local Authorities will facilitate a smooth transition to the new utility and will build on the knowledge, expertise and values of the Local Authorities to deliver greater value for money for the consumer (LAWSTO).
- Two of the suggested areas where efficiencies could be gained by Uisce Éireann outlined by the CER are staff costs and public tender. In response, one respondent noted that under the SLAs the staff remain in employment of the Local Authorities and as a result their pay and positions are protected under the Haddington Road Agreement (Irish Congress of Trade Unions).
- The CER should take into account that it is the respondent's (Irish Congress of Trade Unions) understanding that the Government intends to provide that

the water service infrastructure will remain in public ownership and that the operation of water service to remain with the public sector.

CER View

The CER notes the above points made by respondents. The CER also recognises that section 31 of the Act provides for the performance of functions by local authorities on behalf of Uisce Éireann, and statutorily underpins the service level agreements between Uisce Éireann and the local authorities.

3.7 The Role of Regulation in the Irish Water Service

Respondent Views

Five respondents submitted comments on the CER's role in regulating Uisce Éireann as follows:

- The CER will need to show how better regulation will provide continuity of supply for business and domestic users while reducing costs (AWN Consulting).
- Penalties have been mentioned but the respondent feels that dependence on penalties in other sectors has not proved successful (AWN Consulting).
- While the Government sets water pricing policy, the application of that policy should be left to the regulator (Forfás / Enterprise Ireland / IDA Ireland).
- The issuing of a licence by the CER to Uisce Éireann is critical to ensure that IW is regulated appropriately and consumers are adequately protected with an overarching goal to ensure that the long term benefits of the water program accrue to the end users and at the least possible cost (National Consumer Agency).
- The structure and form of the new water utility should be based on policies and objectives that will unflinchingly protect and preserve all of Ireland's water resources for the long haul, long term, for the many generations to come (RSPA).

CER View

Since the publication of the consultation, the *Water Services (No. 2) Act 2013* has been published which sets out the functions and powers of the CER in the economic regulation of the water sector including:

- Direct Uisce Éireann to submit a water charges plan, review that document and approve, approve with modifications or reject it. The water charges plan will specify how charges are calculated and the costs incurred by Uisce Éireann in the performance of its functions.
- Approve or refuse to approve an agreement between a customer and Uisce Éireann for the charging of that customer for the provision of water services.
- Approve or refuse to approve codes of practice designed to secure the interests of Irish Water's customers.
- Advise the Minister for the Environment, Community and Local Government in relation to the development and delivery of water services.
- Request information from Uisce Éireann to facilitate the CER performing its functions under the Act. Uisce Éireann must comply with such a request as soon as practicable.

In performing its functions under the Act, the CER shall do so in a manner that best serves the interests of the customers of Uisce Éireann and have regard to the need to ensure:

- a) that the customers of Uisce Éireann are provided with the quality of service provided for in an approved code of practice,
- b) that water services are provided by Uisce Éireann in an economical and efficient manner,
- c) that Uisce Éireann operates in a commercially viable manner,
- d) the conservation of water resources,
- e) the continuity, safety, security, and sustainability of water services,
- f) that Uisce Éireann can meet all reasonable demands for water both current and foreseeable,
- g) the recovery of costs of water services in accordance with Article 9 of the EU Water Framework Directive,
- h) that Uisce Éireann performs its functions in a manner that will enable the achievement by the State of the environmental objectives of that Directive,

- i) that Uisce Éireann performs its functions in an open and transparent manner.

Section 42 of the Act provides that the Minister may give Direction to the CER. Specifically, this section states that:

- (1) The Minister may, from time to time and after having considered any representations made to him or her in accordance with an invitation under subsection (4), give to the Commission such direction of a general policy nature as he or she considers appropriate.*
- (2) The Commission shall comply with a direction under this section.*
- (3) The Commission shall, upon the request of the Minister, provide the Minister with a report in writing of the measures (including the expenditure incurred by it as a result of such measures) that it has taken to comply with a direction under this section.*
- (4) The Minister shall, before giving a direction under this section—*
 - (a) give a draft of the proposed direction to—*
 - (i) the Commission, and*
 - (ii) the Joint Committee referred to in paragraph 26 of Schedule 1 to the Electricity Regulation Act 1999, and invite those persons to make representations, in writing, in relation thereto within such period (being not less than 30 days from the giving of the draft to the Commission or publication of the draft under paragraph (b), whichever occurs later) as is specified in the notice referred to in paragraph (b), and*
 - (b) publish—*
 - (i) the draft and the reasons for the Minister's proposing to give the direction concerned in Iris Oifigiúil, and*
 - (ii) a notice inviting the making of representations by interested persons in relation to the draft within such period (being not less than 30 days from the giving of the draft to the Commission under paragraph (a) or publication of the draft under this paragraph, whichever occurs later) as is specified in the notice.*
- (5) Where the Minister proposes to give a direction under this section, he or she may consult in relation thereto with such other Ministers of the Government as he or she considers appropriate.*
- (6) The Minister shall arrange for the publication in Iris Oifigiúil of each direction given by him or her under this section*

4. Conclusions and Next Steps

4.1 Conclusions

The CER has reviewed all received responses and met with a number of the respondents where requested. The submissions provided many useful contributions to the economic regulatory framework for water services in Ireland.

Following the consultation, the CER is of the view that the following economic regulatory framework is appropriate for the public water services sectors in Ireland.

- The CER will adopt a regulatory framework similar to that in place for the energy sector built on the principles of stability, predictability, sustainability and cost efficiency should be established for the public Irish water services sector.
- The CER will apply the same values to the water industry as it has done to the electricity and gas sectors: Fair and transparent regulation, acting with integrity and respect, consulting with stakeholders and customers, be accountable to customers and stakeholders, and making informed decisions.
- The revenue cap (RPI-X) model should be applied to the public Irish water services sector. This model will be comprised by separate building blocks allowing the CER to estimate a level of revenue sufficient to finance an efficient, well-run utility. Among these will be (i) an allowance for operational expenditure (opex); (ii) an allowance for capital expenditure (capex); (iii) establishing a regulatory assets base (RAB) for Uisce Éireann.
- Only efficient spend on assets should be added to the RAB and valuing these assets through the Indexed Historic Cost methodology. Furthermore the CER proposes to implement a straight-line approach for the depreciation of Uisce Éireann assets.
- The Capital Asset Pricing Model should be used to aid the CER deriving a fair return on the Uisce Éireann RAB.
- Specific performance based revenue-incentives should be implemented for Uisce Éireann in order to improve the utility's performance in delivering its responsibilities.

- A cash-flow approach to calculate cash requirements should be adopted for Uisce Éireann and applying a 'k-factor' methodology to over and under recoveries from the pre-determined maximum allowed revenues.
- An initial interim revenue control period from 2014 to the end of 2016 should be implemented before moving to a series of six year price reviews.
- Achieved efficiency gains in one control period should be shared with customers in the next revenue control period, as is the norm in the Irish energy sector.
- The Opening Uisce Éireann RAB should be determined by Government. The CER sees three possible options:
 1. Set the Opening Uisce Éireann RAB later.
 2. Set the Opening Uisce Éireann RAB based on future funding requirements.
 3. Set the Opening Uisce Éireann RAB based on IW expenditure and liabilities transferred from the Local Authorities.

The CER recommends that this Government decision should be taken in the context of (a) various assets and liabilities being transferred to Uisce Éireann from Local Authorities, (b) what effect it will have on the charges faced by the water services customer, (c) the equity investment in Uisce Éireann planned by the Government and (d) the ability of the water utility to raise debt to fund future investments in the water services infrastructure.

4.2 Next Steps

The CER will be publishing Irish Water's proposed water charges plan for a four week consultation in July 2014. This consultation will include Irish Water's revenue allowance, tariff structures and charging levels.

The CER intends to issue a timeline on the broader water programme shortly thereafter, which will include scheduled consultations on Irish Water's proposed connection charging policy and enduring non-domestic tariffs.