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27 November 2013

Jamie Burke
Analyst – Water Regulation
Commission for Energy Regulation
The Exchange
Belgard Square North
Tallaght, Dublin 24.


Dear Jamie,

RE: The CER and Water Regulation in Ireland (Oct 2013) and Economic Regulatory Framework for the Public Irish Water Services Sector

Please see below my comments on the above documents, they reflect my experience and position as adviser on water and wastewater to many of the larger US multi-national sites in Ireland. As you will note from my email address, I am also a guest lecturer at Trinity College Dublin on Water and Wastewater, and my comments reflect my technical experiences of the current Irish Water and Wastewater System.

I have been teaching on this course for the last 15 years and have talked in my lectures for many of those years about the improvements which can be made in the Irish Water and Wastewater system and I welcome the opportunity that Irish Water offers to make those improvements.

CER have stated that “our primary goal – the protection of the water services customer” Acting for significant water users, I wish to use the opportunity to raise the risks of (i) unknown future water and wastewater costs and (ii) a significant rise in water and wastewater costs on the business of significant water users. CER have stated that are preparing and advisory document for the Minister for Environment on the regulatory policy to be adopted. In preparing this advice the CER expects to undertake consultation with stakeholders over the coming months.



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CER have described how they promote competition in the electricity and natural gas sectors. As Irish Water is a single supplier there is a risk that lack of competition could result in high price increases rather than reduction in management and operation costs due to integration of the individual to a single Water Services Authority. CER must ensure that best price is obtained for the customer as no competition exists.

I support the document where it states *Unregulated monopolies may be inefficient and impose prices that are too high on consumers. As a result, regulation is required to uphold the welfare of consumers.*

I would ask that specific regard be given to large water users by CER and that they be dealt with as a separate class of customer, who must 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 wastewater to a large efficient wastewater treatment plant.

It is obvious that investment is needed to manage and improve the network and service. However there is a need to provide a mechanism to manage undue price increases while making the Irish Water operation attractive to outside investment funds, which will be expected to lend money to Irish Water.

The CER document has stated that the role of the regulator is to ensure that this investment is efficient, is properly focused and provides value to the customer.

I submit that Value should include providing a medium to long-term pricing structure to allow business planning.

Table 10 of the document shows that significant reductions in capital investment have occurred in the past few years and as such the system will be prone to failure and higher maintenance costs.

CER will need to show how better regulation will provide continuity of supply for business and domestic users while reducing costs.

Penalties have been mentioned but dependence on penalties in other sectors has not proved successful.

To protect the business customer, CER need a pricing strategy for 5 -10 years. The document states that Tariff Principles and structure are planned for March 2014. Further information on planning for tariffs is required. The CER has operated to date, in the energy sector, price control periods of five years in length.

I note (on page 20 of The Document CER and Water Regulation in Ireland):

Efficiency gains

Water sector reform will bring savings in the average costs associated with the operation and development of the water network (e.g. eliminating tasks that are previously duplicated across the 34 councils, more efficient procurement due to scale, etc.). These savings and increases in productivity will lower costs. It is the duty of the regulator to ensure that the utility has an incentive to seek out these efficiencies and to ensure that these efficiencies are passed on to the customer either in terms of lower bills or excellent customer service"

I would ask CER how it is intended to ensure this happens and how these savings can be passed on.

I would ask CER to set out how it will drive efficiencies and reduce costs.

If there is a large water treatment plant supplying one or more large industrial users, and that plant achieves greater efficiencies, how can this be passed on to those large industrial users, instead of just being used to subsidise less efficient plants in other parts of the network?

I invite CER to consider and explain how this would work.

I invite CER to share their plan with us as to how they will undertake a cost accounting exercise for each large water treatment plant, in order to determine what the actual cost of water is for those plants, so that the individual large industrial customers

Under CER's expected Role, I propose the following should be included:

Ensuring a mechanism is in place for dealing with significant water users

Ensuring the definition of significant water user is agreed with Irish Water and Significant Water Users (SWU) in Ireland.

Can CER advise how the economic framework will be structured to as to ensure "ensure that only reasonable and appropriate costs for the provision of water services by Irish Water are charged to customers" , as their document states?

How will "reasonable and appropriate" be benchmarked? I propose that for SWUs, this be based on the cost of supplying water from the treatment plant or network supplying the SWU.

CER deliverables and work-streams should include a line item "define SWU and agree mechanism to ensure SWUs continue to receive value for money when purchasing water, and wastewater services"

Document : Economic regulatory framework for the public Irish water services sector

How will CER determine what an "efficient well run utility" is?

Is it not reasonable to argue that Irish Water is not set up to be such a utility, as from "day one" the Local Authorities will be operate under sub-contract to Irish Water to manage water and wastewater infrastructure, and they in turn have sub-contracted the operation of many plants to private sector contractors, whereas an efficient, well run utility would have operators employed directly by the utility to operate and manage plants, not the two layers of additional management proposed under Irish Water?

Page 7 – K factor, how will the K factor be set and against what benchmark will it be judged?

Can CER explain what they mean by " 2 year revenue control" – Page 7 and "six year price review"?

Can CER clarify if the revenue subvention referenced on page 8 also include reduced water charges if SWUs make financial contributions to water or wastewater infrastructure?

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The identification and prioritisation of investment makes No mention of investment to support industry and for strategic development, which is very disappointing, it merely mentions IW working closely with the EPA.

I ask CER to respond with their proposals to ensure that IW works closely with IDA and with industry to prioritise investment.

To assist CER in determining if water and wastewater treatment plant and networks are operating efficiently, CER will require in-house technical expertise to make a judgement as to what is an efficient operation and what is not.

Can CER confirm they have a strategy for recruitment in place to address this issue?

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Can the CER elaborate on “bench marking of other international water companies” – which companies and what geographies are intended to be reviewed?

The use of the OFWAT approach is dismissed quickly by CER and with little justification, apart from a reference to group water schemes as a justification, I recommend that CER consider again the yardstick approach used by OFWAT.

I would suggest that, completely contrary to the proposed CER approach, that yardstick regulation would be a very good thing for customers of Irish Water, if Irish Water were “yard-sticked” against UK water companies, who have developed efficient water and wastewater delivery mechanisms.

The fatal flaw with the RPI-X Model is that it requires CER to determine what is considered “efficient” and given the high cost base from which Irish Water is starting, where the existing model is extremely inefficient (as described by the , there is a concern from industry that the RPI-X model will not drive cost reduction within the water delivery and wastewater treatment system.

To make this judgement, CER will have to have in-house technical expertise to determine what is considered as an efficient way of delivering water supply and wastewater treatment, and I do not see any evidence that CER has this capability, therefore the RPI-X model is flawed and should not be used.

In addition to just benchmarking against other countries and utilities, I feel CER should undertake a full review of how the existing water and wastewater treatment infrastructure and network could be re-organised and re-designed, to improve efficiency.

Rather than simply benchmarking against other countries, CER should take the unique opportunity afforded by the setting up of Irish Water to ask the fundamental question “how can delivery of water and wastewater services be optimised in Ireland, by activities such as re-organisation, sub-contracting, de-manning, automation, efficient procurement, centralisation of technical and administrative functions?”

The aim should be to deliver a water services infrastructure that is not merely benchmarked against some average derived internationally, but which is best in class and lowest cost, to ensure Ireland as a country can maintain a competitive advantage over neighbouring inward investment destinations.

For reference, I quote the PWC Report of 11 January 2012, Irish Water Phase 1 Report, which states (on page 12)

Efficiency levels do not compare well against international benchmarks. Some of the key metrics include:-

o Operating expenditure per connection is more than twice the average of UK water companies;

o The level of “Unaccounted for Water” (largely due to leakage) at 41% is very high against

international benchmarks (although this would be expected to reduce as Phase III of the Water Conservation Programme is rolled out);

o Staffing levels are higher than comparable UK water companies on an employee per population served basis;

o The collection level for non-domestic water charges which averages 52% in 2010 is particularly low.

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Benchmarking

The document states “The first is to perform comparisons with other water utilities and to set a target for the business to achieve the same costs as the average or most efficient comparator water utility”.

I submit that CER should go further than this and be innovative, as water can give Ireland a strategic advantage to win inward investment and aid economic recovery, provided the costs of this water can be kept as low as possible. The innovative approach, I submit, should be as outlined above, where CER should seek to determine how the Irish water and wastewater delivery model could be re-organised and re-structured so as to reduce operational costs to a minimum.

Page 25 - CAPEX Priorities

Again I note with disappointment that supporting strategic inward investment and on-going support of existing inward investment industrial sites, is not called up as a specific goal of the CAPEX programme, and I submit that these items should be included as specific goals in the prioritisation of CAPEX. I welcome the reference to IDA and to large water users, but note that the CER uses the phrase “the CER expects” that IW will engage with these stakeholders, I would go further and request that CER ensure that Irish Water engage.

Waste-water – a general comment

I would ask CER how do they intend to charge for wastewater, is it intended to use the Mogden Formula or similar? I feel that the Mogden formula would be an appropriate option, as it recognises that higher strength wastewaters require more extensive treatment, and will also encourage industry to treat wastewater on their own industrial site, using on-site wastewater treatment, therefore reducing the loading on the off-site public wastewater infrastructure.

I thank you for the opportunity to submit these comments and look forward to your response and to an opportunity to engage in further discussion with CER, by way of a meeting at your convenience.

Yours sincerely,



DR FERGAL CALLAGHAN
Director
AWN Consulting Ltd