

**Joint Response by
Forfás/Enterprise Ireland/IDA Ireland
to the CER's Consultation on the
Economic Regulatory Framework for the Public
Irish Water Services Sector (CER/13/246)**

November 2013



Approximately three quarters of Ireland's exports of goods and services in 2011 were by development agency client companies in the internationally trading sectors. Agency-assisted companies operating in Ireland provide almost 300,000 direct jobs, a similar number of indirect jobs; 40 per cent of national GVA; €33 billion through payroll, materials and services purchases (which represents about 25 per cent of GNP); and three-quarters of all corporation tax.

Summary of the Key Issues for Enterprise

- The provision of adequate, reliable, competitively priced water services (water and waste water), at appropriate quality levels, is critical for enterprise development and job creation, particularly in key growth sectors such as food, pharmaceuticals and ICT.
- Although Ireland has made substantial investments in water and waste water infrastructure in recent years, further investment is required to ensure Ireland can continue to meet enterprise needs. In particular, we need a strategic medium to long term approach to investment planning that delivers an adequate supply of quality water services while also ensuring that Ireland is cost competitive.
- Regulatory certainty is critically important for efficient investment and well-functioning markets. A fundamental element of regulatory certainty is the independence of the regulator. It is also important that the regulatory framework is sufficiently flexible to anticipate and respond to conditions as markets evolve.
- The enterprise agencies are concerned that the consultation on the new water regulatory framework is being undertaken in the absence of the legislation, which will set out the mandate for the CER in respect of water regulation. In particular, the Government policy statement on economic regulation requires that a hierarchy of policy/regulatory objectives are explicitly set out in sectoral legislation to provide greater clarity on how to weight different policy priorities.
- We believe that the primary objective of water regulation should be to ensure end users (business and residential) with competitively priced access to quality services while also providing a sustainable level of long term investment.
- Some of the key regulatory principles set down in the Government policy statement on economic regulation need to be explicitly addressed in the water services regulatory framework, namely effectiveness, transparency and accountability.
- We support the proposed focus on cost efficiency in the regulatory framework. Rigorous regulatory scrutiny to drive efficiencies in water services provision is critical for Ireland's cost competitiveness and its ability to compete successfully in international markets. However, the enterprise agencies are concerned about the implications of the proposed 12 year service level agreements between Irish Water and the local authorities for improving operational efficiencies and attracting capital investment at least cost to the consumer.
- Putting clear and consistent mandates and frameworks in place is not by itself sufficient to deliver effective economic regulation. As highlighted in the Government policy statement, effective mechanisms should be put in place to rigorously assess whether policy objectives are being achieved and to determine if these mechanisms are sufficient to protect consumer interests and promote investment. In particular, Ireland's performance needs to be benchmarked against that of key competitor and comparator countries to ensure that all necessary steps are taken to bring costs within the State's control into line with best international practice.
- The CER and Irish Water 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.

The enterprise agencies (Forfás, Enterprise Ireland and IDA Ireland) welcome the opportunity to input to the consultation by the Commission for Energy Regulation (CER) on its consultation paper on the economic regulatory framework for the public Irish water services sector (CER/13/246).

Ireland's economic growth depends on the ability of businesses to trade successfully in increasingly competitive global markets. The availability of a competitively priced world class infrastructure (energy, telecoms, transport, waste and water) and related services is essential to support enterprise development, competitiveness and job creation.

The provision of adequate, reliable, competitively priced water services (water and waste water), at appropriate quality levels, is critical for enterprise development and job creation.

Importance of water services for enterprise development

Water services play a key role in supporting economic activity and job creation, particularly in key growth sectors such as food, pharmaceuticals and ICT¹. In particular, enterprise needs access to secure, competitively priced, quality water services:

- Water is an important input to many business processes. We need to ensure that water and waste water services are competitively priced;
- Although Ireland has made substantial investments in water and waste water infrastructure in recent years, further investment is required to ensure that Ireland can continue to meet enterprise needs. In particular, we need a strategic medium to long term approach to investment planning that delivers an adequate supply of quality water services while also ensuring that Ireland remains cost competitive.
- While drinking water quality in Ireland is generally high, a continued focus on ensuring it remains so is required as contamination of water supplies can have a major impact on enterprise, particularly in the food and biopharma sectors; and
- We also need to ensure that other quality and reliability measures of particular relevance to enterprise are monitored and improved where necessary. These include minimising disruptions to service and ensuring minimum pressure levels.

The enterprise agencies strongly support the Department of the Environment, Community and Local Government (DECLG)'s water reform plans. The timely implementation of those plans, including the development of an effective economic regulatory framework, is critical to deliver the adequate supply of competitively priced, quality and reliable water services required to support enterprise development and job creation.

¹ In 2008, Forfás assessed Ireland's performance in meeting the water and waste water needs of enterprise, in terms of capacity, costs and quality for the National Spatial Strategy gateways and hubs. See: www.forfas.ie/publication/search.jsp?ft=/publications/2008/Title,1361,en.php

Water regulation

Forfás completed a study to identify changes to the operation of sectoral regulators to enhance cost competitiveness as part of the Action Plan for Jobs 2012². While the focus of the Forfás study was on measures to enhance cost competitiveness, it also examined a range of cross-cutting issues that are at the core of effective economic regulation. These included the focus of regulatory mandates, how effective the regulator is in delivering on its mandate, the enforcement powers and sanctions available to the regulator, and the efficiency of the appeals process.

As highlighted in the CER's consultation paper, the Government policy statement on sectoral economic regulation was published in July 2013 and sets out the strategic framework for sectoral economic regulation. It is vital that the new economic regime for water services is informed by the Government policy statement to ensure that it reflects agreed best practice and that economic regulation is as consistent as practical across the various sectors. We acknowledge the focus in the consultation paper to align the new regulatory framework with the objectives set out in the Government policy statement. However, there are a few areas where greater consideration needs to be given to the statement's requirements - e.g. the key regulatory principles of effectiveness, transparency and accountability are not explicitly addressed in the CER consultation paper.

In summary, the enterprise agencies believe the main steps in developing the economic regulatory framework for water services are:

- Ensure the CER's mandate is clear, consistent and provides regulatory certainty;
- Create a hierarchy of objectives which prioritises the protection of consumer (business and residential) interests; and
- Develop a performance measurement process to set appropriate targets and assess the outcomes achieved by the regulator.

The enterprise agencies are concerned that the consultation on the new water regulatory framework is being undertaken in the absence of the legislation, which will set out the CER's mandate in respect of water regulation³. In particular, the Government policy statement on economic regulation requires that a hierarchy of policy/regulatory objectives are explicitly set out in sectoral legislation to provide greater clarity on how to weight the different policy priorities. Ofwat, the economic water regulator in England and Wales, has primary and secondary objectives, which may be a useful approach to consider⁴.

2 Forfás, Sectoral Regulation: study to identify changes to sectoral regulation to enhance cost competitiveness, April 2013

3 The detailed Water Services Bill setting out the functions and duties of Irish Water and the regulators is expected shortly.

4 Ofwat's primary objectives are to protect the interests of consumers, wherever appropriate by promoting competition, ensure that the companies properly carry out their functions and ensure that the companies can finance their functions. Its secondary duties include promoting economy and efficiency and contributing to the achievement of sustainable development.

As highlighted in the consultation paper, the CER can draw on the experience already developed through its regulation of the energy market to inform the development of the water regulatory framework. Combining this with new water sector expertise should ensure the CER is well placed to understand the complexities of regulating water services. In addition, the CER has an established relationship with the Northern Ireland Utility Regulator which has responsibility for the regulation of electricity, gas and water in Northern Ireland. This will be of assistance in the management of cross-border water resources.

That said, the enterprise agencies recommend that the CER elaborates on the similarities and differences between regulating energy markets and water services. This will be useful in the context of the more detailed consultations on the regulation of the water sector planned for 2014 (e.g. the interim revenue review; consumer protection measures).

As highlighted in the Government policy statement and the Forfás sectoral regulation report, the existence of several (often) competing objectives can create tension. The lack of clarity on how to weight different functions could lead to suboptimal regulatory decisions. A simpler mandate, containing a single objective – or a mandate providing a hierarchy of objectives – would simplify the regulator’s role and could lead to greater accountability.

As set out in the Government policy statement, Government views the promotion of consumer interest (business and residential) and national competitiveness as key national objectives that should be prioritised by sectoral departments when setting out their sectoral objectives in primary legislation. Consumer interest is defined as providing end users (business and residential) with competitively priced access to quality services while also providing a sustainable level of long term investment. The enterprise agencies support this important development. It is critical that the water regulatory framework is finalised in the context of the hierarchy of policy/regulatory objectives committed to in the impending water services legislation.

Another broad issue that needs to be carefully considered in the development of the economic regulatory framework is the relationship between the economic regulator (CER) and the environmental regulator (EPA). Conflicts may arise for example where environmental regulations imply significant additional investment needs that will result in substantial price increases for users. It will be important that the roles and responsibilities of the two regulators are clearly set out in Ireland’s water policy and in legislation. In England and Wales, a memorandum of understanding has been developed between Ofwat and the Environmental Agency to provide clarity regarding roles and responsibilities and to avoid conflict between the two regulators⁵. It sets out how the regulators will work with one another. The enterprise agencies recommend the development of a similar agreement between the CER and the EPA.

Putting clear and consistent mandates and frameworks in place is not by itself sufficient to deliver effective economic regulation. As highlighted in the Government policy statement, effective mechanisms should be put in place to rigorously assess whether policy objectives are being achieved and to determine if these mechanisms are sufficient to protect consumer interests and promote investment.

5 www.environment-agency.gov.uk/static/documents/Research/eaofwatmou_1901043.pdf

Water pricing

One of the key issues for enterprise is to ensure that businesses have access to competitively priced water and waste water services. Under the existing regime, water and waste water charges vary considerably across the country - from €1.49 per cubic metre in Kildare to €3.04 in Wicklow. Irish water prices (based on the average cost) are relatively competitive but comparable data is not available for waste water costs. It is difficult to determine at this point, what the impact of the proposed changes to the delivery of water services will have on water prices for enterprise. This is a concern for the enterprise agencies. We note that the CER is planning a number of water pricing related consultations during 2014 and we look forward to engaging further on this very important issue at that stage.

From an enterprise perspective, the key principles that should underpin water pricing policy are:

- All users should pay for water services i.e. the user pays principle should be central to water pricing policy. While water is free, we currently spend €1.2 billion per annum on treating and transporting water;
- Water and waste water charges should be fully cost reflective and passed on to all customers in a fair and transparent manner;
- We need to drive for efficiencies in the delivery of water services – in particular, we need to bring operating, maintenance and capital into line with international best practice;
- It will be important that while the Government sets water pricing policy, that the application of that policy is left to the regulator; and
- Cross-subsidisation of domestic water charges by enterprise should be avoided. In particular, we are concerned that the introduction of a free allowance could lead to enterprise subsidising domestic water costs.

While the free allowance for domestic users is not directly relevant to enterprise, we are concerned about its potential impact on business water costs. The 'free allowance' will not be free – it will require a payment from the State to compensate Irish Water and/ or higher charges on consumers who use more than the free allowance and/ or additional charges on business. A free domestic allowance does not appear to be in line with the 'user pays principle' and does not encourage efficient water usage.

Given the Government decision to introduce a free allowance, we recommend that it be set as low as possible as a broad base will support lower charges per unit of water for all.

Consultation paper questions

The remainder of the paper will address the specific questions of relevance to enterprise in CER's consultation paper.

Q1: Do you agree with the proposed principles of the regulatory framework? If not, then please explain why.

The enterprise agencies broadly support the principles set out in the consultation paper. However as mentioned above, it is critical the primary objective of the water regulatory framework is to ensure that end users (business and residential) have access to quality services at the least cost, both now and in the future. Requiring competitively priced access to quality services now and in the future should ensure that the regulatory framework promotes timely and efficient infrastructure investment as well as providing the appropriate signals to potential investors.

The regulator also needs to promote innovation to ensure that Irish businesses benefit from early access to technological developments that deliver more sophisticated and cost competitive products and services.

We agree with the CER that regulatory certainty is critically important for efficient investment and well-functioning markets. Regulatory uncertainty means greater risk for infrastructure investors, which results in a higher cost of capital for the end users. A fundamental element of regulatory certainty is the independence of the regulator. We believe it is also important that the regulatory framework is sufficiently flexible to anticipate and respond to conditions as markets evolve.

The consultation paper suggests that the water services legislation will provide the Minister with more extensive powers to give directions to the CER in relation to its water regulatory functions than is the case with energy. While ministerial directions can be useful when carried out in a transparent manner, the implications for regulatory independence and certainty need to be carefully considered. The enterprise agencies recommend a consistent approach to ministerial directions in terms of the process across sectors (e.g. who to notify; the length of the consultation period; publication of submissions).

We agree with the CER that while reducing prices as low as possible today may seem an attractive proposition, it could ultimately lead to higher costs for end users. Keeping prices artificially low in the short term means that the investment required to meet future needs will not be made, which will lead to shortages/capacity constraints and higher prices/lower quality services. For example, there was very little investment in electricity in Ireland in the 1990s as prices were kept artificially low. As a result, Ireland was reliant on inefficient, old and expensive to run plant to keep the lights on during the 2000s.

We support the proposed focus on cost efficiency in the regulatory framework. Rigorous regulatory scrutiny to drive efficiencies in water services provision is critical for Ireland's cost competitiveness and its ability to compete successfully in international markets. However, the enterprise agencies are concerned about the implications of the proposed 12 year service level agreements between Irish Water and the local authorities for improving operational efficiencies and attracting capital investment at least cost to the consumer.

Q2: Are there any further/alternative 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.

Effectiveness, transparency and accountability are among the four key principles set out in the Government policy statement on economic regulation⁶. To ensure the effective regulation of water services in Ireland, the enterprise agencies believe that these three principles need to be explicitly included in the principles underpinning the new economic regulatory framework.

Effectiveness

Putting clear and consistent mandates and frameworks in place is not by itself sufficient to deliver effective economic regulation. As highlighted in the Government policy statement, effective mechanisms should be in place to rigorously assess whether policy objectives are being achieved and to determine if these mechanisms are sufficient to protect consumer interests and promote investment.

An adequately resourced regulator is critical to ensure regulatory certainty and cost effective investment and services. From a cost competitiveness perspective, delays in decisions that increase investor risk or inadequate monitoring of market rules can lead to higher prices for business and residential customers. Effective economic regulation requires significant technical and economic expertise both in the CER and the Department to produce the best outcomes for end users.

Accountability

Effective performance measurement is essential to determine if the regulator is delivering on its mandate. As recommended in the Government policy statement "who is responsible for what must be clearly articulated". In particular, the statement requires DECLG and the regulator to agree appropriate performance indicators for Ireland which will be benchmarked against key competitor countries on an annual basis.

The enterprise agencies recommend that Ireland's performance is benchmarked against that of key competitor countries for trade and investments as well as a selection of comparator countries – i.e. the selection of countries used in Forfás and National Competitiveness Council benchmarking studies.

⁶ The fourth is predictability, which the CER includes among its principles for water services regulation.

The performance indicators used by Ofwat in the UK and referenced in the 2011 PwC report for DECLG offer a useful template and adoption of this approach would enable comparison between Irish Water's performance and water services providers across Great Britain and Northern Ireland⁷.

Scrutiny of performance of the regulator to ensure they are accountable will require adequate resources and expertise within the Department to review its performance against agreed targets.

Better performance measurement will allow the Oireachtas to probe the regulator on progress on key functions and objectives.

Transparency

Transparency is one of the key principles underpinning best regulatory practice internationally. It is important that the regulator operates in a transparent manner at all times and that decisions are reached in a manner free from inappropriate external influence. In terms of enforcement, it is imperative that where undertakings are agreed or sanctions are imposed, that they are done in a transparent manner also.

The CER plans to consult on all water regulatory decisions and publish detailed consultation and decision papers, as it does on energy issues and decisions. However, the documents are often very technical and legalistic and not readily accessible to business and domestic customers. In many cases, formal regulatory consultations and decisions need to be technical and legalistic to ensure that industry players are clear on what precisely is being proposed or has been decided, and to reduce the risk of litigation. However, to ensure that the regulator delivers on its mandate to promote consumer interests, it should publish explanatory notes for information purposes on key consultations and decisions of relevance to consumers (business and residential). The publication of a separate information note to accompany this consultation paper is a step in the right direction.

To ensure that the information/explanatory notes are easily accessible to all consumers (business and residential), the regulator, perhaps through the economic regulators' network, could work with the National Adult Literacy Agency (NALA). NALA provides professional services to help organisations remove literacy-related barriers to customers accessing their services. Many of the regulator's consultations/decisions will not be of relevance to consumers (business and residential). In deciding when an information/explanatory note should be issued, the regulator could consult with the Department.

As mentioned previously, it is important for regulatory certainty and investor confidence that ministerial directions are carried out in a transparent manner.

⁷ Ofwat does not regulate Scottish Water or Northern Ireland Water, however, data collected by their relevant regulators is benchmarked against data collected by Ofwat.

Q3: Do you agree with the CER's assessment of each of the proposed regulatory frameworks? If not, then please explain why.

Q4: Are there any advantages or disadvantages to any of the proposed frameworks that the CER has not considered? Please detail.

Q5: Do you agree with the CER's assessment that a revenue cap (RPI-X) framework should be put in place for the Irish water services sector? If not, then please explain why.

The analysis of the advantages or disadvantages of the different approaches to the regulatory framework for water services in an Irish context is useful and informative. However, the enterprise agencies believe that the assessment of the merits of the different approaches should be done in the context of the hierarchy of objectives for water services provision – which has yet to be finalised.

We acknowledge that the CER's analysis does consider the implications of the different approaches for the consumer. However, we believe that the final assessment of the best approach for the Irish water regulatory framework would benefit from a more explicit consideration and articulation of which option is optimal from the consumer interest perspective - where consumer interest is defined as providing end users (business and residential) with competitively priced access to reliable, quality services now and in the future.

As important as the selection of the best approach for the water regulatory framework is its implementation. Rigorous regulatory scrutiny to drive efficiencies in water services provision is critical to meet Ireland's water needs now and in the future. The lessons that the CER has learnt from its energy regulation experience in this regard should be of significant benefit to water users.

DECLG also needs to ensure that the regulator is sufficiently rigorous in driving efficiencies and reducing costs in the water services sector. For example, in terms of setting returns on regulated assets, 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 on the profitability of the company, reducing the potential dividend for its owner, which is often the Government. This represents a major challenge for regulators mandated to prioritise consumer interests.

Putting clear and consistent mandates and regulatory frameworks in place is not by itself sufficient to deliver effective economic regulation. As highlighted in the Government policy statement, effective economic regulation requires the appropriate technical and economic expertise in the sectoral regulators and their parent policy Departments to produce the best outcomes for end users. An adequately resourced regulator is critical to ensure regulatory certainty and cost effective investment and services - delays in decisions that increase investor risk or inadequate monitoring of market rules can lead to higher prices for business and

residential customers. DECLG also needs to have the capacity in-house to set appropriate targets for, and assess the outcomes achieved by, the CER.

As mentioned in our response to Q2 on regulatory principles, effective performance measurement is essential to determine if the regulator is delivering on its mandate and to provide the levels of transparency required of best practice economic regulation.

To ensure that the regulator and DECLG have a shared understanding of the goals and objectives that they are working towards, they need to agree predefined targets and outcomes against which performance should be assessed (as required by the Government policy statement) – while recognising that policy makers and/or regulators do not have full control over all outcome metrics. Effective performance measurement depends on how well outcomes can be measured, in particular those outcomes that are controllable. DECLG and the regulator need to identify indicators and milestones that are easy to quantify. We recognise that this will be easier to do for some of the regulator’s functions than for others.

Q6: 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 IW RAB;***
- ***The approach to valuing assets being added to/within the IW RAB;***
- ***The treatment of capital expenditure;***
- ***The capitalisation policy for adding assets to the IW RAB;***
- ***The estimation of a reasonable rate of return on assets in the IW RAB;***
- ***The treatment of depreciation for assets in the IW 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.

Q7: Are there any other approaches to each of the areas detailed in this section that the CER has not considered? Please detail why they could be considered superior to this proposed CER approach.

See also response to Q3 - Q5 above.

The enterprise agencies support the CER’s proposal to align the comprehensive revenue review with the River Basin Management Plans cycle i.e. every six years.

Treatment of operational expenditure

The enterprise agencies are concerned about the definition of controllable and uncontrollable costs proposed in the operational expenditure section of the consultation paper. The CER defines controllable costs as those that are within the direct control of Irish Water as opposed

to those within the direct control of national water policy. Of particular concern is the statement that *uncontrollable opex can include regulatory costs or the rates payable by the utility to the city and county councils*. While it seems fair that Irish Water would be compensated for operational costs that they cannot control, in the interests of ensuring transparent pricing and cost efficiency for water users, Irish water policy needs to recognise which costs are within the State's control and clearly identify the cost implications of policy decisions to achieve other national policy objectives.

It is critical that the CER drives efficiencies in all cost factors that are within the control of the State. We reiterate our previously mentioned concern about the implications of the proposed 12 year service level agreements between Irish Water and the local authorities for improving operational efficiencies. The CER needs to clearly set out in the water regulatory framework what steps it plans to take to ensure the most efficient delivery of reliable, quality water services to Irish customers (business and residential) over the medium term.

As highlighted in the consultation paper, benchmarking operational costs is one of the key methods to determine what an efficient level of operational expenditure is in an Irish context. The enterprise agencies believe that benchmarking the costs allowed against our main competitor countries as well as some comparator countries (i.e. similar demographic and geographic profile) is critical to ensure that all necessary steps are taken to bring costs within the State's control (including regulatory costs and the rates payable to the local authorities) into line with best international practices. We recognise the challenges in developing benchmarks for operational expenditure. The experience of other water regulators could be useful in this respect.

Treatment of capital expenditure

Issues raised in the previous sub-section on operational expenditure are also relevant to the treatment of capital expenditure. In particular, it is critical that the CER drives efficiencies in all capital cost factors that are within the control of the State. In addition, the costs allowed for capital investment need to be benchmarked against those of competitor and comparator countries.

The enterprise agencies recommend that the CER is more explicit in terms of what Irish Water's multi-annual investment plan should include. We suggest that it comprises an assessment of demand projections (broken down geographically); an audit of infrastructure and services quality; an assessment of likely gaps in terms of capacity and quality and a prioritised investment plan for the review period.

The enterprise agencies also recommend a greater focus on reducing leaks before investing in additional capacity as a means to increase supply. This should also help to reduce inefficiencies and costs.

The enterprise agencies welcome the inclusion of IDA Ireland and Enterprise Ireland among the stakeholders that Irish Water should engage with when determining its capital investment

priorities. We recommend that the nature of that engagement should be changed from *to ensure that Irish Water understands the development agencies' plans and strategies* to the following:

- IDA Ireland/Enterprise Ireland – to work with the enterprise agencies to ensure that Ireland has an adequate supply of cost competitive, reliable, quality water services, particularly in the main urban centres, to support enterprise development and job creation now and in the future.

Ireland's success to date in attracting FDI and growing export markets has involved a wide range of stakeholders working together to deliver the water services infrastructure required to support new companies and the growth of existing ones. The new water policy regime needs to ensure that Irish Water develops an efficient and strategic approach to capital investment planning that maximises the potential of Ireland's water resources at national and regional level to support enterprise development and job creation.

Consideration should also be given to including The Competition Authority in the "other statutory bodies" category.

Among the principles that Irish Water is expected to apply in determining its capital investment budgets is *to ensure that all capital works are efficiently procured and deliver value for money to the customer*. To ensure that water services in Ireland are cost competitive, the enterprise agencies advocate that the principle should be amended to explicitly require that all capital investment by Irish Water is undertaken at least cost to the consumer.

Calculating the Regulated Asset Base (RAB)

While we are not in a position to comment on the merits of the specific proposals for the calculation of the RAB, we suggest that the CER considers the lessons that can be learned from the experience of other water regulators (e.g. Ofwat, the Water Industry Commission for Scotland) and also from the CER's own experience in determining the asset value of the RAB for energy.

In terms of the merits of the different RAB valuation approaches, we agree with the CER that it very much depends on what you believe the most important factors for consideration are. The enterprise agencies strongly recommend that the different approaches be re-assessed with a particular focus on the impact on protecting the interests of the water user now and in the future.

Rate of return

The enterprise agencies recommend using similar principles to those applied to the setting of the rate of return for energy capital investment. The main challenge facing the regulator is striking an appropriate balance between providing for an efficient level of investment in upgrading the networks and minimising the costs to end users.

While borrowing costs are relatively high currently, it is likely that they will decline over the medium term. The enterprise agencies recommend that the CER introduces a mechanism similar to that used in electricity and gas which allows for interim reviews of the allowed cost of capital⁸.

Service quality

When airport charges at Dublin airport were reviewed in 2009, the regulator introduced an explicit link between the level of the price cap and the quality of service provided⁹. The targets are set according to the average score achieved by Dublin airport on between Q1 2006 and Q2 2009. The CER should consider incorporating a similar approach into the new water regulatory framework with a view to improving quality standards over time. Quality indicators should cover issues of most relevance to enterprise such as water quality, service disruption levels, water pressure levels etc.

We note that the CER plans to consult on consumer protection measures during 2014. We recommend that includes the development of a standard service level agreement between Irish Water and its customers which would cover a number of areas including commitments relating to service access and water quality, response times to service disruption and customer queries, billing arrangements and protocols for addressing failures to uphold service levels.

Q8: Do you agree with the need to introduce an interim revenue control? If not, then please explain why.

Q9: 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.

The enterprise agencies agree with the CER that an interim revenue control is needed, primarily because of the gaps in the information currently available to make informed decisions on the opening RAB and other issues.

As stated previously, the enterprise agencies share the CER's concerns about the potential implications of extending the SLAs with the local authorities beyond the transition period. It will be important that any unnecessary delays or lags in the transition period are avoided. As we move towards a transparent pricing structure that ensures full cost recovery of water services, it will be important from a national competitiveness perspective that every effort is made to mitigate the impact on the cost of water for the end user. Only when Irish Water is fully operational can the economies of scale and other efficiencies associated with the public utility model be fully realised and the cost savings passed on to customers. We support the

⁸ CER, Decision on 2011 to 2015 Distribution Revenue for ESB Networks (CER/10/198), November 2010; Decision on TSO and TAO Transmission Revenue for 2011 to 2015 (CER/10/206), November 2010; and Decision on October 2012 to September 2017 Transmission Revenue for Bord Gáis Networks (CER/12/196), November 2012.

⁹ Each quarter, the regulator publishes the quality of service monitoring at Dublin airport report. It includes thirteen service measures. The reports are available at: <http://www.aviationreg.ie/regulation-of-airport-charges-dublin-airport/compliance-papers.123.html>

CER recommendation that the water services legislation provides a flexible contractual structure between Irish Water and the local authorities to enable the CER to drive efficiencies in water services provision.

Other interim arrangements will also be required. In particular the CER and Irish Water need to determine 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. The current uncertainty is of concern to the enterprise agencies and needs to be addressed quickly. It will be necessary to undertake a thorough review to understand the agreed commitments made by both parties and to develop appropriate mechanisms and protocols to transfer these agreements to Irish Water. It is to be expected that some of these agreements will have an impact on the way the regulated price is applied to large users who have already made significant capital contributions or where existing pricing contracts are in place.

The enterprise agencies believe 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), Irish Water and DECLG to discuss issues of relevance regarding water services. This group should be established at the earliest possible opportunity to ensure the members' queries and concerns regarding the transition phase are addressed quickly. After the transition phase is completed, ongoing consultation with the group will be required to ensure the needs of these important stakeholders are catered for.

Consideration also needs to be given to how best to manage the transition for sub-suppliers from their existing relationships with local authorities to Irish Water as the lead entity in the procurement of services from the private sector. To ensure Irish Water can obtain best value for money to support its activities from the market, we recommended that a professional procurement function be resourced within the new water utility.

In line with the Government's green procurement guidelines, Irish Water should articulate a clear requirement for the water investment programme to test, trial and demonstrate green technology developments in its procurement approaches.

An effective communications strategy must be a priority area for Irish Water and the CER in the run up to, and during, the transition period. It will be necessary for Irish Water to clearly communicate the transition process to all water users and the implications of the change over from local authority provision to public utility provision. Certain high growth sectors, such as the food, ICT and pharmaceutical sectors are particularly dependent on reliable access to water services. It is, therefore, imperative that during the period when responsibility for the management of water services and ownership of the associated infrastructure is transitioning from local authorities to Irish Water every effort is made to ensure that service interruption is avoided. If service interruption is unavoidable, the nature and length of interruption should be clearly communicated to all service users in advance to allow plans to be put in place to minimise the disruption to enterprise and other users.