

CER Review of Irish Water Revenue (2017 to 2018)

Consultation Paper

Summary Information Note

The Commission for Energy Regulation (CER) is the independent economic regulator of Irish Water. The CER works to protect the interests of customers by ensuring Irish Water provides a reliable supply of clean drinking water and efficient wastewater treatment. The CER is now seeking views from interested parties on the level of revenue it is proposing that Irish Water should be allowed to recover to run its business for the period 2017 to 2018, a process known as IRC2. This follows a review and detailed analysis of submissions from Irish Water. The CER is seeking to protect customers of Irish Water by ensuring that Irish Water only recovers efficient costs while delivering necessary improvements in service and performance over time.

The CER is proposing to allow Irish Water a total revenue of €1,852m (2015 prices) to fund capital investments and operations for the years 2017 to 2018. This represents a saving of €156m against Irish Water's request to the CER.

The consultation period for this proposal ends on 14 November. The CER will review the responses received and then issue a decision paper in December. This information note summarises the CER's proposals within the CER's consultation paper (CER/16/267).

Context of this Revenue Control

The public water and wastewater services sector in Ireland is undergoing unprecedented change. In 2013 Irish Water was established as the single national, public utility for the provision of public water and wastewater services in Ireland. This replaces the previous model of service delivery by 34 local authorities and city councils. The challenge for Irish Water is to deliver a national approach to the delivery of these services to significantly improve the quality of service, compliance with standards and environmental obligations, increase the cost efficiency associated with water and wastewater services provision and conserve our national water resource.

The role of the CER is to balance the level of operating cost efficiency required from Irish Water while at the same time ensuring Irish Water has sufficient funding to deliver service improvements for customers alongside a significant programme of investment in new and refurbished infrastructure.

Irish Water inherited an asset base which has been acknowledged as suffering from historical under investment. With ageing and poor quality infrastructure in some areas, substantial investment is required to bring the standard of the assets up to the needs of a modern economy.

Irish Water has previously estimated that 49% of treated water is lost through leaks. The Environmental Protection Agency (EPA), the environmental regulator, has reported that during

2014 there were 199 boil water notices and 15 water restriction notices active in 17 counties affecting 205,516 people. 121 supplies, serving 937,247 people, were classed as requiring remedial action by the EPA at the end of 2014. In the same year, sewage was being discharged at 44 locations across the country with either no treatment or preliminary treatment only and over 150 wastewater treatment plants were overloaded.

In the first Irish Water revenue control (IRC1), the CER challenged Irish Water to reduce controllable operational costs and uncommitted capital expenditure by 13.5% by the end of 2016. Irish Water has forecasted that it will broadly remain within the costs allowed while delivering key outputs during IRC1 (such as 79 new or upgraded wastewater treatment plants and approximately 500km of new or rehabilitated water pipes).

Regulatory Process

The CER has carried out a detailed analysis of Irish Water's IRC2 submission. The CER audited a sample of Irish Water's capital projects and programmes. The CER also benchmarked Irish Water's costs and performance against international best practice of other water utilities.

The process followed for this review is similar to that undertaken by the CER in electricity since 1999 and gas since 2002 and by other utility regulators (including water) worldwide.

Proposed Revenues

<i>Revenue Allowance</i>	<i>Irish Water Request</i>	<i>CER Proposal</i>	<i>Saving</i>
Total revenue for 2017 to 2018, €m	2,008	1,852	156

The CER currently proposes to allow Irish Water a total revenue of €1,852m (2015 prices) for the two-year period. This represents a reduction of €156m relative to Irish Water's request. This includes an allowance for operating costs, depreciation and return on capital costs, and an adjustment for revenue relating to IRC1.

For the coming revenue control, it is noted that domestic water and wastewater charges are suspended until at least 31 March 2017. The CER is working on the basis that the revenue for 2017 and 2018 will be recovered through a mix of funding sources. In this context, the CER acknowledges the work currently underway by the recently established Expert Commission and its forthcoming recommendations for the sustainable long-term funding model for the delivery of domestic water and wastewater services by Irish Water. The enduring funding model for Irish Water will be determined by the Oireachtas and is expected to be decided in 2017.

Proposed Operating Costs

<i>Operating Cost Allowance</i>	<i>Irish Water Request</i>	<i>CER Proposal</i>	<i>Saving</i>
Total revenue for 2017 to 2018, €m	1,523	1,395	128

The CER has reviewed Irish Water's submission and benchmarked its costs against comparable water utilities elsewhere. Irish Water's costs (inclusive of Service Level Agreement costs) are significantly higher than those of established utilities in other jurisdictions. The CER expects Irish

Water to drive efficiencies at a level that is broadly comparable to those achieved by other utilities elsewhere.

The CER's proposal represents a saving of €128m (or 8.4%) relative to Irish Water's request. The CER has required that Irish Water delivers efficiencies of circa 20% within its base controllable operating expenditure over the period from the start of 2015 to the end of 2018.

Proposed Capital Costs

<i>Capital Cost Allowance</i>	<i>Irish Water Request</i>	<i>CER Proposal</i>	<i>Saving</i>
Total capex for 2017 to 2018, €m	1,287	1,232	55

Irish Water has adopted a risk-based approach to the development of its Capital Investment Plan. The approach takes into account a number of constraints that Irish Water faces. The approach also considers customers' preferences.

The CER considers that Irish Water should be challenged to deliver the outputs and outcomes of its investment plan more efficiently. The CER proposes an efficiency challenge of €51m for the IRC2 period. Given the need for capital investment in water services, the CER is proposing to allow Irish Water to spend the €51m arising from the proposed efficiency challenge to invest in necessary capital infrastructure. To ensure that Irish Water is delivering efficiently for its customers the CER will monitor Irish Water's capital expenditure and the delivery of associated outputs and outcomes and overall investment targets during the IRC2 period.

The CER proposes a Weighted Average Cost of Capital (WACC) of 5.2% for Irish Water. This is intended to cover the financing cost associated with capital expenditure. The WACC is used to derive a fair return for Irish Water on its efficiently incurred capital investments.

Further information regarding the CER can be viewed on www.cer.ie. For further information on the above please see the CER's consultation paper (CER/16/267).
