



Commission for Energy Regulation
An Coimisiún um Rialáil Fuinnimh

Irish Water

Second Revenue Control

2017-2018

Response to Comments Paper

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Regulating Water, Energy and Energy Safety in the Public Interest

Executive Summary

This 'Response to Comments' paper provides a summary of the submissions received in response to the Commission for Energy Regulation (CER) recent consultation on Irish Water's second revenue control for the 2017 to 2018 period ([CER/16/267](#)). The paper also documents the CER's response to those comments. This response paper should be read in conjunction with the CER's decision on this matter (CER/16/342), which has been published alongside this paper.

Related documents

The following documents are related to this Response to Comments paper:

- Irish Water Second Revenue Control Decision Paper 2017-2018 (CER/16/342);
- Irish Water Second Revenue Control Consultation Paper 2017-2018 ([CER/16/267](#));
- The Environmental Protection Agency's (EPA) response to the consultation (CER/16/348);
- Irish Business Employers Confederation's (IBEC) response to the consultation (CER/16/349);
- Irish Water's response to the consultation (CER/16/350);
- Limerick City and County Council's response to the consultation (CER/16/351);
- The National Federation of Group Water Schemes' response to the consultation (CER/16/352);
- The Public Water Forum's response to the consultation (CER/16/353).

1. Introduction

1.1 The Commission for Energy Regulation

The Commission for Energy Regulation (CER) is Ireland's independent energy and water regulator. It was established in 1999 and has a wide range of economic, customer protection and safety responsibilities in energy.

In 2014 the CER was appointed as the economic regulator of Irish Water, the utility responsible for the provision of public water and wastewater services in Ireland. The CER's role is to protect the interests of water and wastewater customers, ensure water services are delivered in a safe, secure and sustainable manner and ensure that Irish Water operates in an economic and efficient manner.

Further information on the CER's role and relevant legislation can be found on the CER's website at www.cer.ie.

1.2 Background to and structure of this paper

On 30 September 2016, the CER published a consultation paper ([CER/16/267](#)) on the second revenue control for Irish Water. The paper invited submissions by 14 November 2016 on a wide range of matters relating to Irish Water's proposed allowed revenues for the 2017-2018 period. This paper provides a summary of the submissions received to the consultation paper along with the CER's response. The structure of the paper is as follows:

- Section 1 of the paper provides some brief background information;
- Section 2 provides a summary of the views put forward by stakeholders in response to the CER consultation on this matter. It also provides the CER's response to each of these comments;
- Section 3 provides a conclusion to the paper.

This paper should be read in conjunction with the decision paper ([CER/16/342](#)) which is published alongside this document.

1.3 Publication of responses

The CER received six submissions to the consultation paper. The six responses have been published alongside this 'Response to Comments' paper. No respondents requested that their response be treated as confidential.

This paper sets out the CER's response to the comments received. Please note that publication of these submissions does not mean that the CER agrees that all information put forward in the submissions is correct.

2. Submissions received

2.1 Introduction

The CER received six submissions from the following stakeholders:

- The Environmental Protection Agency (EPA) (CER/16/348);
- Irish Business Employers Confederation (IBEC) (CER/16/349);
- Irish Water (CER/16/350);
- Limerick City and County Council (CER/16/351);
- The National Federation of Group Water Schemes (CER/16/352);
- The Public Water Forum (CER/16/353).

All of these responses are published alongside this paper.

The content of the submissions is summarised in Sections 2.2 to 2.6. The comments are grouped in the following categories for ease of reference:

- Review of Irish Water's 2014-2016 costs;
- Review of 2017-2018 Irish Water costs;
- Incentives and monitoring of Irish Water;
- Calculation of revenue requirement for Irish Water;
- Other relevant comments.

An overview of the comments received is provided for each category, with the CER's response to the comments thereafter.

2.2 Review of Irish Water's 2014-2016 costs

2.2.1 Review of IRC1 opex comments

2.2.1.1 OVERVIEW OF COMMENTS

Four respondents commented specifically on Irish Water's operating expenditure for the 2014-2016 period and the CER's proposals in this regard.

Two respondents acknowledged that Irish Water broadly achieved the 7% per annum cumulative operating efficiency savings sought by the CER.

Two respondents noted the CER's treatment of insurance costs during the first interim revenue control. In the consultation paper (and previous revenue control decisions) the CER had deemed these costs to be within Irish Water's control, which means that Irish Water is expected to manage these costs appropriately. This differed from Irish Water's view of Insurance as an uncontrollable cost. This resulted in the CER disallowing a requested adjustment of €12.7m.

The respondents accepted that this is a complex issue. They noted that the Central Bank, as insurance regulator, is primarily concerned with solvency rather than cost competitiveness. The respondents stated that Irish Water might be able to mitigate against insurance cost increases by carrying a greater portion of the risk.

Two respondents also said that in the long term the biggest opportunity for cost savings for Irish Water appears to be in the area of operating cost per customer connection. The respondents pointed to the findings of the CER's consultancy support, NERA, and stated that the report said that these costs were roughly twice as high as a typical mature water utility in Britain.¹

One respondent stated that it has sought greater clarity from the CER regarding specific data on the actual cost components of the production of a unit of water.²

Another respondent noted that Irish Water's scope to reduce operating costs may be hindered because of its long-term contractual obligations with Local Authorities under Service Level Agreements (SLAs). This respondent queried why the first SLA review has been deferred.³

2.2.1.2 CER RESPONSE TO COMMENTS

The CER's response to each of the matters raised in Section 2.2.1.1 is outlined below.

Insurance as a pass-through cost

The CER notes the points raised by the two respondents on this matter. The CER remains of the view that only licences, levies and rates should be treated as uncontrollable cost items. That decision at IRC1 was consistent with the CER's approach to defining uncontrollable costs in its regulation of the energy sector.

¹ It should be noted that the NERA reports, ([CER/16/268](#) and [CER/16/269](#)) published alongside the CER's consultation paper do not refer to operating costs per customer connection or use this metric to compare Irish Water to a typical mature utility in Britain, as indicated in the response.

² The CER has since clarified that the respondent has made this request to another stakeholder and not the CER. Therefore, this point is not addressed further in this paper.

³ The query implied that the CER was responsible for carrying out reviews of the SLA itself, but this is not the case. The review referred to relates to work undertaken by Irish Water.

Irish Water is expected to manage insurance costs appropriately and therefore the CER (consistent with its IRC1 decision) has not allowed Irish Water additional revenue in IRC1 to cover this increased cost.

Operating costs per customer connection

The CER notes the respondents' views that Irish Water has an opportunity to make cost savings on an operating cost per customer connection basis. However, the reports produced by the CER's consultancy support (NERA) and published alongside the consultation paper do not refer to opex costs per customer connection or use this metric to compare Irish Water to a typical mature utility in Britain, as indicated in the response. However, the costs are compared on a per population served basis and the CER agrees with the general point that Irish Water's total operating costs are higher than those of mature utilities in England and Wales.

The challenge for Irish Water is to make cost savings in its operations generally rather than in regard to specific metric. Categorising opex per population or per customer connection is a means of comparing Irish Water with other utilities.

In this regard, it must be noted that the CER does not expect Irish Water to be as efficient as a mature utility at this point in its development. Its benchmarking analysis has set a glide path for Irish Water in order to become efficient over a reasonable period of time.

Service Level Agreements

The CER notes the view of one respondent that Irish Water's scope to reduce operating costs may be hindered because of its long-term contractual obligations with local authorities under Service Level Agreements. The CER's view on this is outlined in Section 5.3.4 of the decision paper.

The CER also notes the comments of one respondent regarding reviews of the SLA. The CER understands that Irish Water and the local authorities began a review of the SLA in 2015. It understands that this review has led to changes in the way expenditure is managed and controlled. These changes to the SLA have not been finalised, the CER understands, and the conclusion of the review has been deferred to allow for a better understanding of what is required.

2.2.2 Review of IRC1 capital expenditure comments

2.2.2.1 OVERVIEW OF COMMENTS

In its response the Environmental Protection Agency (the EPA) noted underspend on capital maintenance during IRC1 and slippage in the delivery of key infrastructural projects. The EPA stated that this was of concern and should not endure during 2017-18.

Irish Water stated in its response that capital investment over IRC1 will deliver clear improvements by end 2016. Irish Water highlighted a number of achievements including upgrades at wastewater treatment plants, replacement of 700km of the worst performing water mains and saving 65 million litres of drinking water per day through the Water Conservation and First Fix programmes. In addition, Irish Water has stated that the number of people on boil water notices (BWNS) has fallen to circa 6,900 and will be reduced to 4,000 by end 2016.

In November, the EPA highlighted that although there were at that point in time circa 7,000 people affected by BWNS, over 86,000 have been placed on BWNS in 2016. This is twice as many as 2015. The EPA noted the need for remedial works at the 108 “at risk” water supplies.

2.2.2.2 CER RESPONSE TO COMMENTS

Underspend on Capital Maintenance & Delivery of Key Infrastructural Projects

The CER notes that Irish Water has stated its intention to fully implement the Common Framework for capital maintenance planning, an approach that is used by water services utilities elsewhere. This risk based approach is considered industry best practice providing a more targeted, economical and pro-active approach to capital maintenance. Irish Water has proposed ramping up spend on capital maintenance towards the end of 2017-2021 as the utility invests in gathering asset information and develops a planned, national approach to capital maintenance. Using the QBEG⁴ allocation, by 2021 capital maintenance expenditure achieves the expected levels of enduring spend identified by our advisors. As detailed in section 5.4.10 of the decision paper published alongside this paper (CER/16/342), capital maintenance has been excluded from the efficiency challenge for the IRC2 period given the level of spend proposed for the period and the level of uncertainty regarding specific outcomes/outputs associated with capital maintenance programmes.

The CER expects Irish Water to carefully manage the roll out of its capital investment plan so that any temporary degradation of service to Irish Water customers can be avoided and

⁴ QBEG classification assigns capital expenditure to four broad main drivers: environmental or drinking water quality improvements (Q), maintaining current or base service levels (B), enhancing existing service levels to customers (E), and meeting growth in water or wastewater services to satisfy demand and security of supply (G). Here, spend in the major projects and national programmes categories includes a level of expenditure on capital maintenance.

managed. Irish Water has confirmed that it has reviewed the overall capital investment plan for deliverability and operability as part of its process to develop the plan and is satisfied that the capital investment plan can be delivered in the stated timelines.

The CER will monitor Irish Water's overall delivery across all categories of spend during IRC2. This will focus on delivery of outcomes and outputs for customers and key infrastructural projects within required timelines. The CER also notes that Irish Water has established its own internal governance process to ensure projects and programmes are delivering the required outputs and outcomes to schedule and budget.

IRC1 Outcomes

The CER notes that Irish Water has stated in its response to the consultation paper as above that it will have delivered a number of key outcomes during IRC1. The figures provided in the Irish Water response differ from those provided to the CER in April 2016 as they are based on more recent, updated information. Regarding the specific issue of BWNs, the CER understands that Irish Water is reporting on the reduction of people on BWNs against the Q4 2013 baseline identified in the 2015 Water Services Strategic Plan approved by the Minister for Housing, Planning, Community and Local Government.⁵ This baseline identified that 23,079 people were affected by BWNs that had been in place for more than 200 days. Irish Water has stated that by the end of IRC1 capital and operational interventions will remove 19,022 people from this baseline list. Irish Water is targeting reducing this number to zero by end 2021. Separately, Irish Water has stated that it monitors a dynamic BWN register and reports on proposed remedial measures and associated delivery timeframes as required by the EPA. Irish Water has stated that a number of external factors such as extreme weather can increase the number of people impacted by BWNs.

The above issue regarding measurement of BWNs highlights the importance of clarity of understanding by all on the definition of Irish Water's targets. The CER has published an explanatory note requested from Irish Water regarding the above alongside this paper (*Investment Plan 2017-2018: IP2 Investment Portfolio Outcomes (Table 4.8/Appendix G) Explanatory Note, CER/16/346*). The EPA and the CER are progressing a memorandum of understanding which will set out our intention to continue to co-operate on relevant public water services matters and to share information as appropriate. In addition, the CER is putting in place a monitoring framework in 2017 regarding Irish Water's delivery of capital investments in IRC2 and this will incorporate periodic, transparent reporting by Irish Water against their plan and targets.

⁵ Previously Minister for Environment, Community and Local Government.

2.3 Review of Irish Water's 2017-2018 costs

2.3.1 Operating cost allowance – comments

2.3.1.1 OVERVIEW OF COMMENTS

Three respondents commented on the request for operating cost allowances by Irish Water (as outlined in Section 5.2.7 of the decision paper⁶). Irish Water had provided an explanation of its request for increased operating expenses in a number of cost areas, and the CER proposed to approve one of these (€19.8m related to capability deficiencies) on a one-off basis for 2017-2018.

Two respondents noted the CER's assessment that Irish Water will need to invest in systems and procedures to improve its service delivery capabilities, to meet higher environmental quality standards, and to meet increased customer demand.

Both respondents said that the proposal to allow some, but not all, of the additional costs in IRC2 could potentially result in reduced customer service. These respondents noted that it remains to be seen whether the risk can be mitigated by the CER's proposal for a somewhat slower 'glide path' towards operational efficiency during IRC2 than was the case in IRC1. Both respondents also sought greater detail on the CER's assessment of the trade-offs involved.

Another respondent (Irish Water) welcomed the €19.8m additional allowance over IRC2 but was concerned at the proposed one-off nature of the allowance. The respondent said that the capabilities required are long term needs to address critical gaps in areas such as Wastewater Source Control and Licensing and regional monitoring and analysis of plant operation. The respondent said that the requirement for these skills and resources will endure beyond IRC2.

The same respondent noted that Irish Water's cost base is likely to rise over time as more assets are built and demand increases in line with economic growth. The respondent said that the CER's expectation that Irish Water can absorb these costs, while delivering an annual efficiency target, is unreasonable and will present an exceptionally difficult challenge.

Two respondents agreed that the CER's approach to Design Build Operate (DBO) contracts was reasonable, i.e. that such costs should be excluded from the proposed 5% annual efficiency challenge. The respondents said that DBO costs represent a significant portion of Irish Water's cost base, and that the approach seems reasonable provided that the DBO contracts are verifiably delivering good value for money.

⁶ These related to investing in capabilities, economic growth, additional compliance requirements, and additional compliance standards in excess of the UK.

One respondent said that the CER had placed undue weight on its benchmarking analysis. The respondent noted that selective periods in Northern Irish Water and Scottish Water's past were used for comparison without acknowledgement of a wider context. The respondent highlighted that the 5% year-on-year efficiency challenge does not take due regard of the work required to bring Irish Water's asset base and compliance to acceptable standards.

Another respondent was concerned with the additional operating costs associated with taking in charge of Group Water Schemes (GWS) by Irish Water during 2017-2018. The respondent noted that these additional costs are not mentioned in the CER's consultation paper and that it is essential that any such additional costs are catered for in order to ensure that members of GWSs are not disadvantaged or left waiting any longer for their GWS to be taken in charge. The respondent said that the CER's review should acknowledge these additional costs and clarify how they will be funded.

2.3.1.1 CER RESPONSE TO COMMENTS

The CER's response to each of the items raised in Section 2.3.1.1 is outlined below in turn.

Operating cost allowance for IRC2

The requests for operating cost allowances (as outlined in Section 5.2.7 of the decision paper⁶) attracted comment from three respondents. The CER had proposed to allow, on a one off basis, an additional €19.8m towards certain capabilities which Irish Water identified as being deficient.

One party did not agree with this being a one-off allowance, and others stated that not allowing other parts of the request could potentially result in reduced customer service.

The CER notes the points made by the respondent, but has not changed its decision in this area relative to the proposal outlined in the consultation. For the requests which the CER has not allowed, as outlined in the decision paper, the CER considers that these should either be absorbed by the utility when reducing its overall cost level or may be more relevant for future revenue controls. This is covered in more detail in Section 5.2.7 of the decision paper. The CER has approved the €19.8m allowance on a one-off basis as it considers that the costs associated with this work should, in time, either reduce (e.g. recording of data on existing assets) or be more than offset by reductions in costs in other areas.

An important consideration here is that benchmarking has shown that Irish Water's cost base is inefficient relative to mature companies in the UK. In order to become efficient, the utility will have to absorb some upward cost pressures while also reducing its overall level of costs. The CER considers that the approach it has taken strikes the balance between being consistent with other jurisdictions while also making allowances for factors that are specific to Irish Water.

The CER also notes the respondent's comment that the CER's setting of a slower glide path towards operational efficiency could mitigate a possible reduction in customer service. The CER expects that its efficiency challenge and implied glide path towards efficiency will not have any impact on Irish Water's customer service levels.

Greater detail was requested regarding the trade-offs involved when deciding whether to allow Irish Water's requests for additional opex costs in IRC2. In this regard, the benchmarking which has been completed shows that Irish Water cost base is inefficient relative to comparators. This is covered in Section 5.3 of the decision paper. The CER considers that Irish Water should in general reduce its costs at a rate which is comparable to that achieved elsewhere. The efficiencies realised elsewhere were achieved while absorbing certain upward costs pressures. Where Irish Water face similar upward costs pressures the CER considers the utility should also absorb these while reducing its costs. In cases where the CER considers Irish Water is different, it has made allowances both by choosing a value at the lower end of the range and also providing a specific one-off allowance. Detail on this is provided in relevant sections of the CER decision paper and the NERA document published alongside the consultation on this matter.

Design Build Operate contracts

The CER notes the view of two respondents who stated that the approach to Design Build Operate (DBO) contracts was reasonable (i.e. that such costs should be excluded from the proposed 5% annual efficiency challenge) provided that the DBO contracts are verifiably delivering good value for money.

The CER notes this point, but would like to clarify that it is not stating that the DBO contracts represent value for money (and that this is the reason for their exclusion from the efficiency challenge). Rather, the CER has excluded DBO contracts as it may not be possible for Irish Water to reduce the costs of these contracts significantly over the next two years. As outlined in Section 5.3.4 of the decision paper, the CER will consider this point further for subsequent revenue controls.

Benchmarking

The CER does not agree with the view of one respondent that it placed undue weight on its benchmarking analysis. Benchmarking is a way of determining how well a company is performing compared with similar companies elsewhere. It is one tool used by the CER in assessing the efficiency of Irish Water and determining a glide path towards efficiency. Comparing Irish Water to similar utilities in Northern Ireland and Great Britain is a valid technique in order to set an appropriate efficiency challenge.

The CER remains of the view that the benchmarking studies undertaken by both the CER and provided by Irish Water indicate that Irish Water's cost base, inclusive of its SLA costs, is inefficient relative to established comparators in other jurisdictions.

However, the CER has also taken into consideration the unique challenge that has faced Irish Water and the relatively short timeframe in which it has been required to commence operations and function as an efficient utility. The CER considers that by choosing an efficiency value at the lower end of the recommended scale, by applying this to controllable costs excluding DBO costs only, and by providing a one-off allowance for some activities, it has provided appropriate allowances for factors that are specific to Irish Water.

The CER also undertook a bottom-up review of Irish Water's business plan, and identified areas where future costs improvements could be realised by Irish Water. Overall, the CER is of the view that for Irish Water's operating costs it is appropriate to set a global efficiency challenge, leaving the decision on how Irish Water realises the efficiency target up to the utility.

Taking in charge of Group Water Schemes

The CER notes the points regarding the operating cost allowance covering any operational costs related to the taking in charge of GWSs in the 2017-2018 period. Irish Water's submission did not include a request for additional operating costs associated with the taking in charge of GWSs. Irish Water has noted that the level of such a requirement would be dependent on a number of factors, including the pace at which GWSs are taken in charge. If there will be a material additional operating cost requirement for the taking in charge of GWSs over IRC2, the CER will consider this at a later date. The CER does not propose at this point to increase Irish Water's operating cost allowance in its IRC2 decision on account of taking in charge costs.

2.3.2 Capital expenditure efficiency challenge

2.3.2.1 OVERVIEW OF COMMENTS

The CER received three responses regarding the efficiency challenge that the CER proposed to impose in relation to Irish Water's capital investment submission for the IRC2 2017-2018 period and related matters.

In its response, Irish Water stated that it hoped that it had provided sufficient evidence during the consultation period that the application of the 13.5% efficiency challenge to proposed IRC2 capital expenditure was not warranted.

Two respondents agreed with CER's assessment that there was little if any scope for efficient deferral and that efficiency savings should be used to fund additional outcomes over the period.

2.3.2.2 CER RESPONSE TO COMMENTS

Application of 13.5% Efficiency Challenge

In the consultation paper ([CER/16/267](#)) the CER stated that the review of the projects and programmes within Irish Water's capital investment plan suggests that they may have been costed in a manner that did not incorporate expected efficiency improvements over the period 2014-2016. In that context, the CER noted that, in order to arrive at an appropriate global efficiency, a 13.5% efficiency challenge could be applied as a starting point across the uncommitted elements of Irish Water's proposed capital investment plan in addition to the 5% p.a. challenge proposed for 2017 and for 2018.⁷ Irish Water contested this and submitted further information to the CER on this matter.

The CER reviewed this information and engaged further with Irish Water on this issue during the consultation period. Based on the evidence provided and the CER's review, the CER considers that the application of a 13.5% efficiency challenge as a starting point in relation to uncommitted capital expenditure proposed for the IRC2 (2017-2018) period is an appropriate method to determine the global efficiency challenge for capital expenditure. The CER has not applied the efficiency challenge to capital maintenance, as detailed above. In addition, the CER has excluded Irish Water's Network Extension programmes from the efficiency challenge. These programmes are in the very early stages of development and have been included in support of the Government's *Action Plan for Housing and Homelessness*.⁸ The outputs and outcomes from the Network Extension programmes will be informed by the outcomes of on-going engagement between the Department and key stakeholders regarding the implementation of the Government's policy. The resulting efficiency challenge applied to Irish Water's capital investment plan during IRC2 is €129m. Irish Water has stated that it considers it will be able to achieve efficiencies of €103m plus efficiencies from standardisation of design as yet unquantified during IRC2. Please see section 5.4.7.3 of the IRC2 decision paper (CER/16/342) for further detail.

Efficient Deferral

In the IRC2 consultation paper the CER proposed not to recognise the concept of efficient deferral in the case of Irish Water.⁹ The CER notes that two respondents agree with this proposal. Consistent with the proposal in the consultation paper, the CER has decided not to recognise the concept of efficient deferral in the case of Irish Water (please see section 5.4.7.3 of the IRC2 decision paper (CER/16/342)).

⁷ Please see section 5.4.7.2, page 95 of [CER/16/267](#).

⁸ Action Plan for Housing and Homelessness, July 2016 can be found [here](#).

⁹ Please see section 5.4.7.1, page 94 of [CER/16/267](#).

Use of Efficiency Challenge Monies to Deliver Additional Outcomes

Irish Water has informed the CER that it will be operating at full capacity during the 2017-2018 investment period and, as such, it will be unable to reinvest monies arising from the application of the efficiency challenge. As outlined in section 5.4.7.3 of the decision paper the CER will therefore disallow the capital expenditure efficiency challenge arising from both the capital investment plan (€129m) and non-network capital investment (€3m). In addition the CER is disallowing the €4m of 'on-hold' and 'low priority' non-network capital investment projects. This feeds through to the revenue allowed by the CER for the period 2017 to 2018.

2.3.3 Irish Water's proposed capital investment

2.3.3.1 OVERVIEW OF COMMENTS

One respondent stated that in developing its capital investment plan Irish Water should take account of planning policy and the Strategic Integrated Plan for the Shannon Estuary. The respondent stated that the capital investment plan will not be sufficient to account for national population and economic growth or expected additional growth via the 2030 Economic and Spatial Plan for Limerick.

Two respondents expressed concern with Irish Water's upward revision of the required capital investment in the period to 2021. The EPA noted that Irish Water's investment in water and wastewater projects declines in the period 2019 to 2021. The EPA stated that Irish Water should be allowed sufficient revenue to deliver the improvement works necessary to deal with drinking water remedial actions and priority wastewater specified improvement works. Irish Water reiterated that increased levels of expenditure are required during the next investment period to improve service delivery to customers. One respondent stated that Irish Water should explore its capital investment plan to identify projects through which funds could be accessed through Public Private Partnership (PPP) opportunities. The respondent stated that this would not compromise the agreed principle that Irish Water should remain a publicly owned utility.

Two respondents stated that the CER has made provision for Irish Water to progress some very large projects during IRC2 that have not yet received approval. The respondents highlighted the Water Supply Project – Eastern and Midlands Region as an example. In addition, the respondents stated that it may be necessary for Irish Water to include Community Gain (in line with previously published guidelines) within its project plan.

The EPA has stated that it would like to see greater detail on what is included in Irish Water's National Programmes. The EPA would like an opportunity to input into the content and focus of these programmes. The EPA has stated that Irish Water should include provision for a national programme addressing supplies with persistent pesticides non-compliance.

One respondent questioned whether Irish Water had included sufficient funds to take account of increased costs associated with Irish Water taking in charge group water schemes. Another respondent noted that a number of key projects have been omitted from the list of projects and programmes published by Irish Water.

2.3.3.2 CER RESPONSE TO COMMENTS

Consideration of Planning Policy in Developing the Capital Investment Plan

The CER notes that in developing its capital investment plan Irish Water must take account of a number of matters including planning policy.¹⁰ It is noted that the twenty-five year Water Services Strategic Plan (WSSP) is the umbrella document that informs other Irish Water documents including the capital investment plan. The WSSP sets out Irish Water's objectives and priorities for the period of the plan and is approved by the Minister. The WSSP includes an objective to facilitate growth in line with national and regional economic and spatial planning policy.¹¹ The WSSP objectives provide the starting point to Irish Water's process to develop the capital investment plan. Further information regarding Irish Water's capital investment plan development process can be viewed in section 5.4.6 of the IRC2 decision paper (CER/16/342).

Consideration of Growth in Developing the Capital Investment Plan

Pending development of the new National Planning Framework and regional plans, Irish Water commissioned the Economic and Social Research Institute (ESRI) in June 2013 to prepare population projections up to 2041. The ESRI projected population and new household formation at a regional and county level. Irish Water then used the ESRI population projections at county level to estimate the average annual growth over 30 years (2011 to 2041), as a percentage of the 2011 population, for each county. Growth rate projections were applied to every agglomeration over three alternative design periods, 2015- 2025, 2015- 2035, and 2015-2040, for each county and applied to drinking water supply and wastewater projects. Irish Water has stated that further growth models will be developed as part of the National Water Resources Plan which is due to be completed in 2018.

Scale of Investment Required

Irish Water has stated that in order to meet the targets identified in the WSSP and Business Plan (2015), €4.8bn worth of investment would be required out to 2021. The CER understands that this figure is based on best available information to Irish Water regarding its asset base at the time. Irish Water's knowledge of its assets is increasing over time as it starts to leverage the

¹⁰ Please see s34 of the Water Services (No.2) Act 2013.

¹¹ Please see section 5.4.5 of the IRC2 2017-2018 consultation paper [CER/16/267](#).

process and systems put in place during IRC1 to track asset performance and monitor compliance.

In developing the capital investment plan Irish Water assessed the plan to determine if it was financeable, deliverable and operable and whether it meets the needs of Irish Water's customers and stakeholders. Irish Water developed its capital investment plan and investment output targets with consideration for these constraints. Irish Water faces a number of competing priorities and has adopted a nine step, risk based process to develop its capital investment plan, drawing on industry best practice.

Irish Water itself is of the view that increased levels of investment are required for the investment period after 2017-2018 to improve services to customers. Notable here is the fact that Irish Water has advised that two large projects – the Water Supply Project, Eastern and Midlands Region and the Greater Dublin Drainage project – have an estimated combined expenditure requirement of circa €1.2bn in the years post 2021. The enduring funding model for Irish Water will be determined by the Oireachtas and is expected to be decided in 2017.

Content of the Capital Investment Plan

Irish Water's proposed spend on projects declines during the period 2019 to 2021. However, this is met with increases in spend on National Programmes and Capital Maintenance. The net result being that proposed capital investment increases to above €800m in the years 2020 and 2021. Irish Water states that its set of National Programmes aim to bring asset performance to acceptable levels of compliance and capacity nationally. Irish Water has advised that projects contributing to removing supplies from the EPA's Remedial Action List (RAL) and those addressing the European Court of Justice Infringement case regarding compliance with the Urban Waste Water Treatment Directive were tagged as mandatory during the plan balancing stage of capital investment plan development. In the latter case, Irish Water has confirmed that the capital investment plan reflects Irish Water's engagement with the Department of Housing, Planning, Community and Local Government regarding plans to address matters outlined in the infringement. Irish Water has provided a set of investment output targets to be delivered for capital expenditure. Irish Water has advised that these targets have been submitted to the Minister.

In its Investment Plan 2017 – 2021, Irish Water has provided a list of national programmes and a brief description for programmes with a value greater than €5m. The CER notes that the National Programmes aim to appropriately target investment to solve deficiencies in performance and service levels using a risk based approach reflecting customer priorities and WSSP targets. In its consultation the CER noted that the National Programmes are in the early stages of development as Irish Water continues to gather information regarding its assets and

their performance. The CER considers that while delivering on stated targets, the scale and scope of individual programmes may be refined during IRC2.

The CER notes that pesticide non-compliance is an emerging water quality issue. Irish Water has included a Pesticides Programme within its capital investment plan. The programme proposes spend of €1m during IRC2 and €2.5m in the period 2017 to 2021.

Irish Water has not included additional capital expenditure in relation to taking in charge of GWSs. Irish Water acknowledges that there may be instances where remedial works are required to maintain health standards and/or improve quality of service where it has received a request from a GWS to be taken over. Irish Water is expected to appropriately prioritise within its allowed revenues to deliver on investment outcomes and maintain service levels to customers.

Irish Water has stated that during its consultation on the Emerging Investment Plan, it received requests from the majority of local authorities for the inclusion of additional projects. Irish Water considers that the investment need in water services in Ireland exceeds Irish Water's view of an investment plan that is financeable, deliverable and operable. Irish Water has used a risk based approach to optimise the portfolio of interventions included in the capital investment plan which is considered best practice.

In respect of projects mentioned as not yet having received approval, the CER proposes to fund these projects during IRC2 to allow their progression. Irish Water considers these projects to be of significant strategic importance. Irish Water is progressing these projects in discrete phases and the CER proposes to consider further project phases at subsequent reviews beyond the 2017 to 2018 period. The CER notes that these projects are subject to Irish Water's internal governance structures and associated approvals at defined stages of development or 'gates'.¹² These projects will be included in the CER's formal monitoring regime which will be put in place during 2017.

Community Gain

Section 10 of Irish Water's Final Options Appraisal Report for the Water Supply Project Eastern and Midlands Region deals with Community Gain. Irish Water is currently in a period of public consultation with respect to its Final Options Appraisal Report and Environmental Impact Statement Scoping Report. The consultation ends on 14 February 2017.

¹² Please see section 5.4 of Irish Water's capital investment plan for further information regarding Irish Water's governance arrangements for capital investments.

2.4 Incentives and monitoring

2.4.1 Non-domestic billing incentives

2.4.1.1 OVERVIEW OF COMMENTS

One respondent noted the proposed introduction of three non-domestic revenue incentives during the IRC2 period relating to the bad debt provision, efficient billing and billing correction. The respondent stated that they were strongly of the view that these incentives are premature and should not be introduced until Irish Water has secured a stable baseline of non-domestic billing data.

The respondent (Irish Water) stated that as Irish Water had provided the CER with an estimate of its IRC1 bad debt in early 2016 in advance of the end of the IRC1 period, it believes that it would be inappropriate to not allow for an ex-post review of the bad debt percentage as stated in the CER consultation paper. This would allow for a more complete picture of the non-domestic customer base, consumption patterns, billing and payment history available.

The respondent also stated that it feels the proposal to allow a 5% non-domestic debt provision for the IRC2 period, with no correction for outturn, is unjustified. The respondent states that it feels this is an unrealistic target and one which places undue risk on Irish Water. The respondent states that it is concerned that the implementation of the bad debt incentive may affect certain provisions in the Irish Water Customer Handbook.

The respondent concludes with a request that a further consultation process is undertaken prior to the introduction of the efficient billing and billing correction incentives

2.4.1.2 CER RESPONSE TO COMMENTS

As stated in the IRC2 consultation paper, the CER does not propose to introduce the efficient billing and billing correction incentives until after the completion of the data migration project and the formation of a robust baseline of data. The CER is aware that in order for these incentives to be implementable, a firm baseline for the appropriate data is needed. However, the CER remains of the view that the non-domestic bad debt incentive would come into effect immediately. Given that fact that a bad debt provision has been requested by Irish Water for the IRC1 period, it is appropriate that the utility begin to work towards reducing its actual bad debt in the short term.

Following further engagement with Irish Water, in addition to the utility's response to the CER consultation paper, the CER has clarified its position regarding the details of the non-domestic bad debt incentive. In the consultation paper the CER stated that the percentage bad debt would

not be corrected for outturn (i.e. the revenue associated with bad debt would be updated if the amount billed out changed, but the percentage would remain constant). The CER has noted the respondents concern that not correcting for outturn places undue risk on the utility. The CER remains of the opinion that a non-domestic bad debt incentive is an appropriate next step even at this stage of the utility's development. The sooner Irish Water can formulate its revenue assurance activities and pursue all outstanding debt within its non-domestic customer base, the better off customers are in the long term through service improvements and greater customer engagement. In order to mitigate the risk on Irish Water, the CER has decided that following a request from Irish Water, the CER will allow an ex-post review of bad debt and allow for the recovery of the additional revenue of which Irish Water was unable to collect over the period. However, this will be subject to a capped €4m per annum penalty. For further detail please see section 6.3.2 of this decision paper.

The CER remains of the view that a 5% bad debt provision is a challenging but achievable target for Irish Water to work towards for the IRC2 period. As part of NERA's review of Irish Water costs, a benchmarking study was undertaken to compare Irish Water's costs and bad debt provisions to that of utilities in England and Wales. An average was taken across utilities in E&W resulting in a doubtful debt provision of 1.7%, with just 1.3% written off as bad debt. With this in mind, NERA recommended a bad debt provision of between 3-5% reasonable for Irish Water for the IRC2 period, given that it is expected that Irish Water's performance would initially be worse due to the fact that it is in its early years of its development.

The three incentives proposed by the CER are designed to complement each other. The sooner Irish Water can complete the data migration project, the sooner the utility will be in a position to work towards achieving the incentive payments associated with the efficient billing and billing correction incentives. The data migration project will also aid Irish Water in its efforts to reduce its bad debt as a more complete picture of the non-domestic customer base alongside billing and payment history will facilitate the utility in its efforts to collect revenue where due.

The CER notes the statement that the implementation of the incentive may affect certain provisions in the Irish Water Customer Handbook. The Customer Handbook is in place for the protection of all customers of Irish Water. The CER does not share the view that these incentives may affect the implementation of the non-domestic customer provisions negatively as the utility cannot reduce its service below the minimum standards required by the handbook.

The CER notes the request for a further consultation process when implementing the efficient billing and billing correction incentives. The CER will engage with Irish Water regarding the implementation of these incentives prior to a decision on this matter and may consult publicly if the details change significantly relative to those outlined in this decision paper (for the efficient billing and billing correction incentives).

2.4.2 Monitoring of Irish Water's capital investment

2.4.2.1 OVERVIEW OF COMMENTS

Two respondents stated that the regulatory regime should remain suitably flexible to allow for changing circumstances and priorities. The respondents stated that rebalancing decisions should be based on sound analysis and should remain consistent with the utility's rolling five year capital investment plan.

Irish Water stated that it was looking forward to implementing an appropriate monitoring framework with the CER during IRC2. The EPA supports the development of a monitoring programme to measure Irish Water's progress in implementing its capital investment plan.

Irish Water states that it developed a set of service level targets that draw on the WSSP, Business Plan and the outcomes of its customer and stakeholder engagement process. The EPA raised a number of specific points regarding Irish Water's capital investment plan targets as submitted to the CER in April 2016 and consulted upon. The EPA response is published alongside this document.

2.4.2.2 CER RESPONSE TO COMMENTS

Monitoring Irish Water's Capital Expenditure

The CER agrees that Irish Water should be afforded appropriate flexibility to allow for changing circumstances. The CER's proposed monitoring regime and ex-post review of Irish Water's capital expenditure will allow Irish Water to rebalance its investment where appropriate within the allowed expenditure whilst delivering outcomes and outputs for customers. In addition, Irish Water has established its own internal governance process to ensure projects and programmes of expenditure within the capital investment plan are being tracked and are delivering the required outputs and outcomes to schedule and budget.

The CER will hold Irish Water to account for efficiently delivering its capital investment plan. The CER will establish a monitoring framework in 2017, following a consultative process, which is transparent, accessible to the general public and fit for purpose. The framework will provide for the monitoring of Irish Water's progress in terms of service delivery against Irish Water's submitted outcomes, outputs and targets pertaining to the updated capital investment plan. The CER will also undertake a review of IRC2 outputs and costs performances during the next revenue review in order to assess efficiency of capital investment plan delivery. Information regarding the updated capital investment plan and associated targets can be viewed in section 5.4.3 of the CER's decision paper regarding Irish Water's allowed revenue for the IRC2 2017-2018 period (CER/16/342).

Capital Investment Plan Targets

The CER notes that comments received relate to the capital investment plan and related targets submitted to the CER in April of 2016 and consulted upon in September ([CER/16/267](#)). In August the CER received an updated capital investment plan and associated updated targets. The changes made by Irish Water reflect a number of issues such as the new Government's *Action Plan for Housing and Homelessness*, updated information regarding a number of projects and the inclusion of a number of wastewater projects to further achievement of compliance with the Urban Waste Water Treatment Directive (UWWTD) and facilitate provision for growth. The updated capital investment plan and targets have been submitted to the Minister by Irish Water. For further information please see section 5.4.3 of the CER's decision paper regarding Irish Water's allowed revenue for the IRC2 2017-2018 period (CER/16/342).

The CER notes that Irish Water's capital investment target in relation to BWNs is to remove such notices for the 23,079 people affected in Q4 2013. Irish Water is monitoring this target against a static baseline. Irish Water has projected that 19,022 people will have been removed from this list by end 2016. The outcome of the projects and programmes within Irish Water's Investment Plan 2017 - 21 is the removal of BWNs for the remaining 4,057 people of the total 23,079 by end 2021. Separately, Irish Water has stated that it monitors a dynamic BWN register and reports on proposed remedial measures and associated delivery timeframes as required by the EPA. The CER notes the issue of new BWNs being of concern. The CER has stated that it may introduce a metric in the future to monitor BWNs of a shorter duration under the performance assessment framework.¹³

The nine schemes referred to as remaining on the RAL in 2021 relate to the Vartry water supply scheme. The CER notes that in Irish Water's updates to the capital investment plan the project is now planned to be completed by 2021. The CER notes Irish Water's updated target is to reduce to zero the 121 water treatment plants included on the EPA's remedial action list (RAL) in Q4 2014. Irish Water is monitoring this target against this static baseline. During IRC1 Irish Water has stated it will remove 50 WTPs from this baseline RAL list. Investment over the period 2017-21 will remove the remaining 71 WTPs from the list

Regarding the target pertaining to lead in drinking water, Irish Water has stated that it is taking a risk based approach aimed at addressing the largest populations, at the highest risk in the shortest timeframes. The CER considers that there is a need to ensure that Irish Water's approach to lead mitigation continues to be reviewed by the utility. Irish Water needs to ensure that its approach meets the objectives and requirements of the Government's strategy and that it is delivered in the most efficient way possible over its lifetime.

¹³ Please see Appendix C, CER/16/308, 16 November 2016.

A target regarding trihalomethanes has been included in Irish Water's Water Services Strategic Plan. Here, Irish Water's target is for 93% of national samples to meet compliance requirements by the end of 2021.¹⁴

Irish Water has stated that it is targeting compliance with the Directive at waste water treatment plants that serve a combined total of more than 4,839,000 population equivalent by end 2021.

Irish Water has confirmed that within its capital investment plan it is targeting reducing from 44 to zero the number of agglomerations with no treatment or preliminary treatment only. Irish Water has advised the CER that 19 agglomerations will have no treatment by end 2018. This is reflected in the updated capital investment plan provided to the CER in August 2016.

2.5 Calculation of revenue requirement

2.5.1 Additions to the RAB during IRC2

2.5.1.1 OVERVIEW OF COMMENTS

One respondent stated that local authorities should not be burdened with excessive costs relating to storm water and that storm water separation costs should be borne by Irish Water.

2.5.1.2 CER RESPONSE TO COMMENTS

The CER notes that under the Water Services (No.2) Act 2013, all water service functions of the local authorities, passed to Irish Water on 01 January 2014, with the exception of the provision, operation or maintenance of storm water sewers, which remain within the remit of the local authorities.

The CER considers that the separation of combined sewers to create a foul and storm sewer may provide enduring benefits to Irish Water's customers by reducing the load on wastewater treatment plants. The CER has decided to allow efficient costs associated with combined sewer separation to be included on Irish Water's RAB. The expenditure will be considered efficient if Irish Water can show that the solution is economically and technically viable and offers the most cost effective solution for Irish Water's customers. Please see section 4.4.3 of the decision paper (CER/16/342) on this issue.

¹⁴ Please see Chapter 4 of Irish Water's Water Services Strategic Plan available [here](#).

2.5.2 Proposed WACC for Irish Water

2.5.2.1 OVERVIEW OF COMMENTS

Two respondents noted that the CER's use of CAPM was reasonable. Both respondents also stated that the proposed WACC was lower than a private firm in a competitive market but in line with the CER's WACC for other regulated utilities.

2.5.2.2 CER RESPONSE TO COMMENTS

The methodology adopted by the CER to determine the WACC for Irish Water during the IRC2 period 2017-2018 is consistent with the CER's Advice to the Minister on the Economic Regulatory Framework for the Public Water Services Sector in Ireland¹⁵, the CER's approach to this issue in IRC1 and the CER's approach to this matter in relation to regulated gas and electricity regulated network utilities. The parameters of the proposed WACC were determined using market data and information regarding comparable utilities. This data suggests that a WACC of 5.2% is appropriate for a water utility in Ireland. Please see section 7.3 of the CER's decision paper regarding Irish Water's IRC2 2017-2018 allowed revenue for the CER's decision on this issue (CER/16/342).

2.6 Other relevant comments

2.6.1 Overview of other relevant comments

Two respondents noted the CER's reference to the Expert Commission's recommendations on a funding model for domestic water/wastewater services. The respondents stated that the text seemed to imply that this model would help to inform Irish Water's revenue submission for IRC3. The respondent queried if this interpretation was correct.

The respondents said that that they had previously been led to understand that the approved opex and capex requirements will be determined by reference to customer demand and the need for environmental compliance, independently of the mix of funding sources.

2.6.2 CER Response to comments

The CER can clarify that the section referenced by the respondents was included to provide some context regarding the mix of funding sources for IRC2. The text was not related to future Irish Water submissions for subsequent revenue controls.

¹⁵ Please see [CER/14/076](#).

3. Conclusion

This 'Response to Comments' paper provides a summary of the submissions received in response to the CER's recent consultation on Irish Water's second revenue control for the 2017 to 2018 period ([CER/16/267](#)). The paper also documents the CER's response to those comments. This should be read in conjunction with the CER's decision on this matter (CER/16/342), which has been published alongside this paper.