Water Division,
Commission for Energy Regulation,
The Exchange,
Belgard Square North,
Tallaght,
Dublin 24.

Re: CER16/267 Consultation on Irish Water Revenue for 2017 to 2018

Dear Sir/Madam,

Irish Water (IW) would like to thank the Commission for Energy Regulation (CER) for its engagement to date on the Interim Revenue Control 2 (IRC2) review. The publication of CER/16/267 is a further step in the development of the regulatory framework for the Irish water services sector. A strong framework will allow IW to deliver on our commitment to improve services for our customers across Ireland.

Achievements in the first regulatory period

The establishment of IW in 2014 as a single water services utility has delivered real progress on some of the most critical issues that urgently needed to be addressed in the national water and wastewater infrastructure and services. Real progress has been made in both operational efficiency and capital investment activities.

By the end of the Interim Revenue Control 1 (IRC1) period (end 2016) IW will have delivered significant benefits for our customers, including:

- Achievement of c. €70m savings in core asset opex through targeted initiatives such as procurement optimisation; spend rationalisation and process improvement;
- A 70% reduction in the average time to handle customer complaints – from 11 days in 2014 to just over 3 days in 2015; and
- Successful operational management of a number of serious flood and storm events nationwide, controlling and minimising the impact on our customers.

By end 2016 we will have already invested c. €1.8bn in Ireland's water and wastewater asset base. This investment is delivering clear performance improvements, including:

- Since January 2014 the number people on boil water notices (BWNs) has fallen to circa 6,900. We expect this figure to further drop to circa 4000 by the end of 2016. IW has also reduced the number of inherited long-term BWNs to practically zero;
- Significant upgrading at numerous wastewater treatment plants including Swords, Osberstown, Galway, Clifden, Dunmore East and Clonakilty;
- Replacement of over 700kms of the worst performing watermains in terms of burst history; and

- Over 65 megalitres per day of drinking water is being saved through our Water Conservation and First Fix schemes.

IW is focused on building on these achievements and delivering further benefits for our customers in 2017/18 (IRC2).

Proposed IRC2 opex allowance

Given the need to improve performance from the outset, the opex reduction target set by the CER for IRC1 (7% year-on-year) was very difficult to achieve. While IW did deliver substantial savings of c. €70m in the period, these were not sufficient to meet the efficiency challenge. Some trade-offs were also required, resulting in the deferral of important activities. Such deferrals must be addressed in IRC2 in order to deliver the levels of service expected by our customers.

IW must also respond to growth which will arise as a result of increasing demand and new assets. Major challenges are further posed by legacy non-compliance issues, coupled with significant gaps in capability. It is in this context that IW made its opex submission to the CER, setting out a requirement for €1,523m for IRC2.

The CER's proposed IRC2 opex allowance of €1,395m is significantly lower than IW's requirement and, if ratified in the final determination, will set a very onerous cost reduction target for IW.

Within the opex section of the draft determination, there are a number of issues raised by the CER and its consultants that IW wishes to address.

1. In determining the proposed efficiency target, IW believes that the CER has placed undue weight on its benchmarking analysis.

In particular, comparisons have been made with selective periods in Scottish Water's and Northern Irish Water's past without acknowledgment of the wider context. IW fully accepts that we must close the gap to the efficiency levels of international peers, but equally we must also address urgent service and growth requirements. IW remains of the view that the proposed IRC2 cost reduction target of 5% year-on-year does not take due regard of the work required to bring IW's asset base and compliance levels up to acceptable standards.

2. The CER's proposals do not make any specific allowance for growth.

As demand increases in line with economic growth, and as assets are built under the IW capital programme, elements of our cost base will inevitably rise. The CER expectation that IW can absorb these costs, while continuing to deliver an annual efficiency target, is unreasonable and will present an exceptionally difficult challenge for the company.

IW welcomes the c. €20m additional allowance over IRC2 that will allow IW to begin to address identified capability gaps, however we are concerned at the proposed "one-off" nature of this allowance. 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 requirement for these skills and resources will endure beyond IRC2.

IW fully accepts the role and responsibility of the CER in setting challenging efficiency targets for the benefit of customers and we will strive to meet those set out in the CER's final determination for IRC2. We request that further consideration is given to the above points before this determination is made.

Proposed IRC2 capex allowance

Many decades of under-investment has led to major deficiencies in our drinking water and wastewater treatment plants and networks. The next investment period 2017-2021 requires increased levels of expenditure to improve service delivery to our customers.

Our Investment Plan 2017-2021 represents a clear shift from the legacy model. The approach adopted is consistent with best international practice and enables us to optimise investment decisions. Through this approach, we have developed service level targets to 2021 which will begin to bring our water infrastructure and services to an acceptable level. These targets draw on our Water Services Strategy Plans, Business Plan, and the outcomes of our customer and stakeholder engagement process.

Since the consultation paper was published, IW has engaged with the CER to provide further detail in relation to our approach to the costing of the Investment Plan; our projected efficiencies; and the revisions made to update the latest plan in August. We trust that this information has been of value to the CER's deliberations and has provided sufficient evidence that a reapplication of the legacy IRC1 efficiency challenge (13.5%) is unwarranted.

IW welcomes the CER's acknowledgement that we have adopted an appropriate approach to the development of the Investment Plan and we look forward to developing and implementing an appropriate monitoring framework for IRC2 with the CER.

Non-Domestic incentives

IW notes the proposed introduction of three Non Domestic revenue incentives during the IRC2 period.

- bad debt provision;
- efficient billing; and
- billing correction.

We are strongly of the view that these incentives are premature and should not be introduced until IW has secured a stable baseline of non-domestic billing data.

IW is currently in the process of migrating c. 189,000 non-domestic customers (including their consumption and billing information) from 44 different billing systems, to our own billing system. We expect this migration process to continue into IRC2.

IW provided the CER with an estimate of IRC1 bad debt in early 2016, well in advance of the completion of IRC1 and the migration process. IW believes it would be inappropriate to not allow an ex-post review of the IRC1 bad debt percentage, when a more complete picture of our non-domestic customer base, consumption patterns, billing and payment history is available.

We also believe that the proposal to allow a 5% non-domestic debt provision for IRC2, with no correction for outturn, is unjustified. The implementation of this proposal would require IW to almost halve its estimated IRC1 bad debt levels (9.39%) from the very beginning of 2017. This is an unrealistic target and places undue risk on IW. We are further concerned that the implementation of the incentive may affect certain provisions in the IW Customer Handbook.

In relation to the other two non domestic incentives proposed (efficient billing and billing correction), we ask that a further consultation process is undertaken prior to their introduction. This would enable a full consideration of the outcome of the migration process, which in turn could affect the proposed incentive parameters.

In conclusion

Over the next two years IW needs to build on the work and progress delivered over IRC1. We know that to fully address all of the deficiencies in our asset base, a multi-billion euro investment programme is needed through several investment cycles. We recognise that more needs to be done to bring our operational cost base in line with other comparable utilities and to improve service levels for customers. In IRC2, IW will begin the full transformation of our operating model in order to support the achievement of these goals.

We consider that the CER's current proposals for IRC2 will present very difficult challenges for IW. In particular, the opex allowance is significantly below IW's projected requirement. We also have concerns regarding the proposed introduction of non-domestic revenue incentives in IRC2, given the lack of a stable baseline of data and the level of bad debt risk which would be imposed on IW.

In its deliberations on the IRC2 revenue allowance, we request the CER to give due consideration to the points that we have raised above. IW recognises the benefits that a strong regulatory framework brings to the water services customer and we will endeavour to fully implement the CER's final determination.

Yours sincerely,

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Maurice Scully
Economic Regulatory Manager