



An Coimisiún
um Rialáil Fóntas
**Commission for
Regulation of Utilities**

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Commission for Regulation of Utilities

Irish Water 2019 Revenue Control

Information Paper

Reference: CRU/17/332

Date

07/12/2017

Published:

www.cru.ie

Executive Summary

The Commission for Regulation of Utilities (CRU) is the independent economic regulator of Irish Water, the provider of public water and wastewater services.

The Water Services (No. 2) Act 2013 (“the Act”) sets out the functions and powers of the CRU as the economic regulator of Irish Water. Under legislation, the CRU is responsible for setting the total level of revenue which Irish Water can receive, through Government subvention and from customers, to cover its efficiently incurred costs. The CRU does this through a process which involves reviewing Irish Water’s submissions, engaging with the utility, benchmarking its proposed costs against comparator companies, completing a public consultation process, and thereafter setting appropriate revenue allowances for operating costs, capital costs and other items. Since the CRU began regulating Irish Water, it has periodically reviewed costs and set allowed revenues through short interim revenue controls. The first of these covered the period October 2014-December 2016. The second CRU decision (IRC2) ([CER/16/342](#)) covered 2017-2018 and was published in December 2016. Allowed revenue for the 2017-2018 period was set at €1,843m (2015 monies) in this decision.

Subsequent to this decision, the Water Services Act 2017 was enacted on 17 November 2017. Under this legislation, additional steps need to be completed in advance of the CRU’s decision on the revenue that Irish Water can receive through Government subvention and charges. These steps include the development of a Water Services Policy Statement (by the Minister) and a Strategic Funding Plan (by Irish Water), and will provide some certainty regarding the level of Government funding that will be available to Irish Water over a multi-year period. The CRU’s revenue control decision also needs to be in place in sufficient time in order to feed into the Government’s budgetary process (i.e. by Q2 of the preceding year).

To allow the CRU complete its normal regulatory process, it has decided to extend the current revenue control (IRC2) by one year, so that it will cover the period from the start of 2017 until the end of 2019. This means that the next revenue control would start from January 2020 and it is envisaged that this will cover a five or six year period and will comply with the process set out in the Water Services Act 2017.

The recognised regulatory process undertaken by the CRU in setting Irish Water’s 2019 revenue requirement will follow a similar form as earlier revenue control decisions by engaging with and reviewing submissions from the utility and challenging it to deliver efficiencies in how it provides services to customers. This information paper sets out the CRU’s high-level approach to setting allowed revenue for 2019. The exact detail of the extension will be consulted upon following a

submission from Irish Water in early 2018. As is standard regulatory practice, the CRU will then publicly consult and will then publish a decision having carefully considered the views of stakeholders.

The below table outlines the proposed timeline for the process of deciding Irish Water’s allowed revenue for 2019.

Table 1: Timeline for deciding Irish Water’s allowed revenue for 2019.		
		Indicative Date
	Publish information paper on approach for extending IRC2 to include 2019 (this paper)	December 2017
	Receive submission from Irish Water regarding its proposed costs for 2019	January 2018
	CRU to review submission from Irish Water	February 2018
	CRU engagement with Irish Water regarding its submission	Ongoing during Q1 & Q2 2018
	Publish consultation on Irish Water’s 2019 Allowed Revenue	March 2018
	Publish decision on Irish Water’s 2019 Allowed Revenue	Q2 2018
	CRU publish updated Water Charges Plan for 2019	Q2 2018
Note: This CRU decision will feed into the Government’s budgetary process for 2019		

The CRU intends that the next revenue control (from 2020) will be in place for a five or six year period. This longer revenue control (together with the development of the Water Services Policy Statement and the Strategic Funding Plan) will provide a level of certainty to the utility regarding the approved revenue for five or six years. This will help Irish Water to plan for and complete the work necessary to drive cost efficiencies and service improvement over a number of years. This is important for Irish Water because a longer revenue control period allows the utility time to make appropriate capital investment to deliver efficiencies over a multi-annual period.

In this information paper, the CRU sets out its high-level approach to extending IRC2 to cover 2019.

Public/ Customer Impact Statement

- This information paper sets out the CRU's approach to extending the current revenue control period to include 2019;
- The extension means that the CRU will set Irish Water's allowed revenue for 2019, ensuring that Irish Water will also recover only efficiently incurred expenditure for that year;
- As regulator of Irish Water, the CRU seeks to ensure that Irish Water is run as efficiently as possible while providing appropriate water and wastewater services to the public;
- It is accepted that it will take time for Irish Water to reduce its costs to a level that is comparable to established mature water utilities elsewhere, however, the CRU expects Irish Water to do this while in parallel improving the service which it provides;
- During 2019, the CRU will continue to monitor Irish Water's performance across a wide range of metrics. This is to ensure that the utility targets service improvements and efficiency in delivery of water and wastewater services to customers;
- All of Irish Water's obligations to deliver its services will remain in place for 2019. Furthermore, incentives and efficiency challenges will also continue to be placed on Irish Water for this period.
- For the extended IRC2 period (2019), domestic and non-domestic customers of Irish Water will continue to realise benefits through:
 - The delivery of continuous improvements in how Irish Water handles customer queries and complaints;
 - The supply of clean, safe and reliable drinking water to customers;
 - Improved compliance with the highest environmental standards as set out by the Environmental Protection Agency(EPA) ;
 - A more robust security of supply of water to homes and businesses;
 - Effective management of the wastewater system;
 - Scope for social and economic growth within communities in relation to water and wastewater services; and
 - Irish Water's investment in the future of the water and wastewater networks.

- The CRU will also commence a project to set Irish Water's revenue for the next revenue control period (RC3) for a five or six period during 2018. This project will comply with the requirements set out in the Water Services Act 2017 and will relate to the period after 2019. The CRU will initiate a full review of Irish Water's costs for the period up to 31 December 2019 as part of the next full revenue control period.

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1. Introduction

1.1 The Commission for Regulation of Utilities

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

The CRU is the regulator of Irish Water as the national utility for the provision of public water and wastewater services. The CRU'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 that Irish Water operates in an economic and efficient manner.

In October 2017, the CRU changed its name from the Commission for Energy Regulation (CER). This name change was brought about under the Energy Act 2016 and reflects the broadened remit of the organisation and its functions over the last two years, i.e. its role as regulator of public water services.

For the avoidance of doubt, the overall functions and duties of the CRU remain exactly as before. Further information on the CRU's role and relevant legislation can be found on the CRU's website at www.cru.ie.

1.2 Background

The CRU is responsible for setting the level of revenue which Irish Water can receive, through Government subvention and from customers, to cover its efficiently incurred costs. The CRU does this through a process which involves reviewing Irish Water's submissions, engaging with the utility, benchmarking its proposed costs against comparator companies, completing a public consultation process, and thereafter setting appropriate revenue allowances for operating costs, capital costs and other items.

The CRU published its decision on Irish Water's allowed revenues for 2017-2018 in December 2016 ([CER/16/342](#)). This decision outlined the allowed revenue which Irish Water could collect from (a) non-domestic customers and (b) in relation to the domestic sector, through charges¹ and Government subvention to deliver services to the customers.

¹ Irish Water can currently charge domestic customers for new connections, meter tests and meter reads. Under the Water Services Act 2017, domestic customers will also be charged for excessive usage of water. It is expected that these charges will not commence until 2019.

Subsequent to this decision², an Oireachtas Committee was established to examine the future funding of domestic water services. The committee, formed of several TDs and senators, met throughout January and February 2017 to deliberate on the funding of the water services. It invited submissions and presentations from a range of stakeholders including the CRU.

The Oireachtas Committee published its report on future funding of domestic water services in April 2017. The report dealt with funding; the role of regulators and compliance with EU law; equity and fairness; metering; conservation; and public engagement and transparency.

Legislation was then put in place to reflect the Committee's report. To this end, the Water Services Act 2017 was enacted on 17 November 2017. This new legislation has an impact on the timing of the CRU's regulatory review process, as will be discussed in the next sections.

1.3 Changes to Legislation

The Water Services Act 2017 sets out additional steps which will be completed in advance of the process through which the CRU decides on the level of revenue Irish Water can receive through charges and Government subvention. These include development of a Water Services Policy Statement (by the Minister) and a Strategic Funding Plan (by Irish Water).

The CRU's revenue control decision also needs to be in place in sufficient time in order to feed into the Government's budgetary process (i.e. by Q2 of the preceding year).

The following provides a summary of the sequence of these steps, brought about by the Water Services Act 2017:

- The Minister shall prepare a Water Services Policy Statement (within six months of the commencement of the legislation). This sets out policy objectives and priorities of the Government regarding the provision of water services. Thereafter, this Statement shall be prepared from time to time as determined by the Minister.
- The Water Services Policy Statement needs to have regard to the River Basin Management Plan and any EU Directives.
- Irish Water will prepare a Strategic Funding Plan within three months of the publication of the Minister's Water Services Policy Statement.
- The Strategic Funding Plan will detail costs likely to be incurred in the provision of water and wastewater services, the recovery of these costs, estimated income of Irish Water and estimated opex and capex.

² Domestic charges were also suspended in 2016, which meant that a larger portion of the allowed revenue came from Government subvention instead of charges to domestic customers.

- The Minister shall approve/refuse to approve the plan within one month of its submission. The approved plan will then be used as the basis for a draft Water Charges Plan.
- Irish Water will then prepare a Water Charges Plan which is submitted to the CRU. The CRU will then determine efficient levels of cost and income and will approve a Water Charges Plan which reflects that efficient level.
- The CRU's review process involves reviewing Irish Water's submissions, engaging with the utility, benchmarking its proposed costs against comparator companies, completing a public consultation process, and thereafter setting appropriate revenue allowances for operating costs, capital costs and other items.

The CRU's revenue control decision needs to be in place in sufficient time in order to feed into the Government's budgetary process (i.e. by Q2 of the preceding year). To allow time for the CRU's normal process to be undertaken prior to the next revenue control, the CRU has decided to extend the current revenue control, IRC2, by one year, so that it will cover the period from the start of 2017 until the end of 2019. This means that the next revenue control (Revenue Control 3, RC3) would start from January 2020.

The further steps to the review process, as outlined above, also impact on the anticipated timing of project milestones.

1.4 One-year extension of IRC2 (Irish Water Revenue Review 2017-2019)

The CRU has decided to extend the current revenue control (IRC2) by one year due to the introduction of the Water Services Act 2017. This is because, as set out above, the Water Services Act 2017 introduces additional steps to be carried out in advance of the revenue setting process. Therefore, there is insufficient time for the CRU to carry out a Revenue Control process to be in place for 1 January 2019.

In this paper, the CRU sets out its approach in setting allowed revenue for 2019. Once Irish Water makes its regulatory submission, the CRU will analyse the submission and publicly consult upon its proposals, before reaching a decision in Q2 2018. Comments from any interested parties and stakeholders will be welcome on any aspect of the revenue control for 2019 at that stage.

This extension is necessary to allow for the development of a Water Services Policy Statement (by the Minister) and Strategic Funding Plan (by Irish Water) in advance of Irish Water making its regulatory submissions to the CRU for the next revenue control.

The decision to extend IRC2 to cover 2019 also allows time for the CRU to complete its normal regulatory process for the third revenue control period (RC3), prior to making a decision by Q2 2019 on the efficient level of revenue for Irish Water (for the five or six year period from 2020 onwards). This decision, which is due to be completed by Q2 2019, allows the CRU's decision to feed into the Government's budgetary process for 2020.

This decision means that the current revenue control will cover the period from the start of 2017 until the end of 2019. The 'next' revenue control, RC3, will start from 2020 onwards.

The CRU has carried out two revenue controls to date. The CRU set the initial review period to cover 1st October 2014 – 31st December 2016. When deciding that relatively short duration, the CRU was conscious that Irish Water, as a newly-formed utility, may not have been able to provide relevant data to facilitate a longer revenue control period. Subsequently, the CRU put in place a second revenue control period (IRC2) to cover the period from 1st January 2017 - 31st December 2018. The CRU considered the shorter two-year period appropriate as there may still be a lack of available data to facilitate putting in place a robust revenue control for a longer duration.

The CRU intends that the next revenue control will be for a relatively long period that is similar to the regulatory approach for electricity and gas network utilities. This longer revenue control (together with the development of the Water Services Policy Statement and the Strategic Funding Plan) will provide a level of certainty to the utility regarding the revenue it will receive. This will allow it to plan for and complete the work necessary to drive cost efficiencies and service improvement over a number of years. The one year extension gives time to complete the work to put in place this longer revenue control which will run from 2020 onwards.

1.5 Purpose of the Paper

The purpose of this paper is to:

- Inform stakeholders and the public that the CRU has decided to extend the current revenue control by one year and the reasons why this approach is necessary;
- Set out the proposed high-level approach for the CRU in setting Irish Water's allowed revenue for 2019; and
- Set out the timing for the third revenue control period (RC3).

The CRU has decided that an extension of IRC2 to 2019 is necessary for the reasons set out above. It is now outlining its proposed approach to specific details related to that extension.

1.6 Structure of this Paper

The structure of this paper is outlined in this section.

- **Section 1** details background information on the CRU, the context for the review of Irish Water's costs and the extension to the current review period. It also outlines changes to the funding of Irish Water and the structure of the paper.
- **Section 2.** outlines the regulatory approach to the extension of IRC2 to cover 2019 and the CRU's proposed treatment of several key areas within the extension to the revenue control. Further detail on this will be provided and comments invited when the CRU publicly consults upon Irish Water's allowed revenues for 2019; and
- **Section 3.** provides a conclusion and outlines the next steps.

In December 2016 the CRU published its decision paper on Irish Water's allowed revenues for IRC2 (2017-2018). The following documents, published as part of this decision, may be useful as reference points in reading this paper:

- The CRU Decision Paper on Irish Water's Second Revenue Control ([CER/16/342](#))
- A CRU Response to Comments paper ([CER/16/343](#)) to address the responses to the CRU's consultation paper and provide the CRU's view on the matters which attracted comment.
- An information note summarising the CRU Decision on Irish Water Revenue (2017 to 2018) in this paper ([CER/16/341](#)).
- The CRU revenue model used to calculate the revenue requirement for the 2017-2018 period (CER/16/344).
- Irish Water's Water Charges Plan ([CER/16/347](#)) for 2017-2018.
- Irish Water's Capital Investment Plan Submission (CER/16/345).

2. Approach to Setting 2019 Revenue

2.1 Introduction

The next full regulatory review period will not start on 1 January 2019, as was originally planned (See Section 1.3-1.4 above). Instead, the CRU has decided to extend the current revenue control to cover 2019. The next full revenue control will therefore now commence on 1 January 2020.

Furthermore, the CRU intends that the next revenue control will be for a longer period as is the case for electricity and gas network utilities. This will provide a level of certainty to the utility (regarding the revenue it will receive) which allows it to plan for and complete the work necessary to drive cost efficiencies and service improvement over a number of years. The one-year extension to IRC2 will allow sufficient time for the CRU to complete the work to put in place this five or six year revenue control which will commence in 2020.

Section 2.2 of this paper provides information on the timetable for the CRU's decision on its approach to extend the current revenue control to cover 2019 and implementation of that decision. Section 2.3 to 2.8 provides information on how specific aspects of Irish Water's costs would be dealt with for 2019. In general, it is proposed to maintain the principles established in previous water revenue controls.

The following items, and the proposed approach for agreeing them, are considered in turn in Sections 2.3 to 2.8 below:

- Timetable
- Revenue Cap and Calculation of Allowed Revenue
- Operating Costs
- Capital Costs
- Use of a WACC
- Adjustments relating to pre-2019
- Incentives

The remainder of this section provides high-level detail on each of the points listed above and the proposed process which the CRU will follow when deciding each of these as part of the revenue allowance for 2019.

2.2 Timetable

The below table outlines the timeline for implementation of the CRU's decision to extend IRC2 by one year:

Table 2: Timeline for deciding Irish Water's allowed revenue for 2019		
		Indicative Date
	Publish information paper on approach for extending IRC2 to include 2019 (this paper)	December 2017
	Receive submission from Irish Water regarding its proposed costs for 2019	January 2018
	CRU to review submission from Irish Water	February 2018
	CRU engagement with Irish Water regarding its submission	Ongoing during Q1 & Q2 2018
	Publish consultation on Irish Water's 2019 Allowed Revenue	March 2018
	Publish decision on Irish Water's 2019 Allowed Revenue	Q2 2018
	CRU publish updated Water Charges Plan for 2019	Q2 2018
Note: This CRU decision will feed into the Government's budgetary process for 2019.		

2.3 Revenue Cap and Calculation of Allowed Revenue

The CRU published its decision on Irish Water's allowed revenues for 2017-2018 in December 2016 ([CER/16/342](#)). This decision outlined the allowed revenue which Irish Water could collect from (a) non-domestic customers and (b) in relation to the domestic sector, through charges and government subvention.

In general, for network utilities which the CRU regulates, this allowed revenue can be viewed as an allowance to cover operating costs and depreciation and return on capital expenditure. In most cases, this allowed revenue is lower than the total opex and capex in a given period and the utility is expected to finance any difference through a mixture of debt and equity. These arrangements (i.e. in relation to debt and equity) are slightly different for Irish Water³, but the concept remains the same.

³ Under the new funding model which underpins the Water Services Act 2017, Irish Water will no longer borrow to fund the domestic portion of its revenue. It may only use debt sources to fund the non-domestic sector.

Further details on this approach are contained in Section 7.5 of the CRU's IRC2 decision ([CER/16/342](#))

The CRU intends to continue the same general approach when implementing the extension of IRC2 and will publicly consult on this, following receipt of Irish Water's regulatory submission.

2.4 Operating costs

2.4.1 Introduction

Irish Water incurs ongoing operating costs in carrying out its day-to-day activities. To cover these costs, the CRU sets an operating cost allowance for Irish Water before a revenue control period begins. By setting an appropriate allowance for these costs, the CRU requires the utility to drive efficiencies while still delivering an appropriate level of service.

Operating costs can be broken down into two categories:

- **Controllable:** These are operating costs over which the CRU considers the utility has control, such as staff costs, consumable materials, etc.
- **Uncontrollable:** These are operating costs that are by definition not directly controllable by the utility, such as levies and rates.

This is an important differentiation, as generally once the CRU accepts that a cost is uncontrollable, the CRU will include a placeholder (or estimate of the cost) within the forecast costs for the period, but will correct for the actual costs when completing the ex-post review. This ensures that if these costs are higher than expected, the utility's revenue is adjusted upwards to ensure it covers these costs. On the other hand, if these costs are lower than expected the utility's revenue is adjusted downwards to ensure it only receives enough revenue to cover these costs.

This approach is consistent with that outlined in the CRU's advice to the Minister regarding the Economic Regulatory Framework for the public water services sector in Ireland (CER/14/076). It is also consistent with the approach taken by the CRU for the regulated electricity and gas network utilities.⁴

2.4.2 Background

As part of the process to make its decision on IRC2, the CRU carefully considered Irish Water's operating costs for 2017-2018 and reviewed submissions provided by Irish Water. This included

⁴ The CRU can also implement a cost-sharing mechanism if it considers that some costs are partially, but not fully, uncontrollable.

a review of Irish Water's expenditure proposals in specific areas, the business case presented, and any supporting evidence.

The CRU also commissioned a comparative benchmarking exercise to assist its assessment of Irish Water's operational expenditure. This benchmarking includes a comparison of Irish Water relative to UK utilities. The CRU considers that the operating costs met by these companies represent the target that Irish Water should move to over time.

Benchmarking studies in 2016 indicated that Irish Water's operating costs were significantly higher than an efficient utility. This highlights the need for the CRU to place challenging efficiency targets on Irish Water over a period of time while still allowing the utility sufficient funding to run its business under such constraints.

2.4.3 Controllable operating costs

2.4.3.1 BACKGROUND

For IRC2, the CRU imposed a cumulative 5% per annum efficiency challenge across Irish Water's controllable operating costs for 2017 and 2018, with the exception of Design Build Operate (DBO) costs. The IRC2 decision meant that Irish Water was challenged to achieve a cumulative 20% reduction in its operating costs over the period 2015 to 2018.

When removing DBO costs from the efficiency challenge, the CRU stated that that approach would be reviewed for subsequent revenue controls. The CRU understands that the DBO contract life (inherited from local authorities) is approximately 20 years. Over time, these contracts will come to an end and the CRU may expect Irish Water to realise greater efficiencies upon renegotiation (or by taking operations in-house).

The efficiency challenge for IRC2 was set cumulatively – i.e. 2017's operating cost allowance was set at 5% lower than the 2016 projected allowance and 2018's allowance was set at 5% lower than 2017's.

2.4.3.2 PROPOSAL

As Irish Water is a relatively new utility and given the inefficiency that will remain within its operating cost base (including Local Authority costs) at the end of 2018, it is proposed that the CRU will again impose a cumulative efficiency challenge on Irish Water's controllable costs. This is also in keeping with the general principle of continuing (in so far as possible) IRC2 decisions into 2019. An efficiency challenge would mean that Irish Water's 2019 controllable operating cost allowance would be lower than that of 2018's.

Irish Water forecast its DBO costs to be €111m per annum in IRC2. The CRU will review Irish Water's regulatory submission to the CRU in Q1 2018 and may consider again excluding these costs from the annual efficiency challenge, in keeping with the general principle of continuing (in so far as possible) IRC2 decisions into 2019. The CRU will then initiate a full review of this approach as part of the next revenue control.

The allowance for 2017 and 2018 included an allowance for administrative costs associated with planned billing of domestic customers in those years. Given that, in general⁵, Irish Water will not face costs associated with billing domestic customers in 2019, it would be proposed that the CRU is likely to reduce the operating costs allowance accordingly.

However, the CRU will review Irish Water's regulatory submission for 2019 and will engage with the utility as well as publicly consult on all of the above prior to making a decision in Q2 2018.

2.4.4 Uncontrollable operating costs

2.4.4.1 BACKGROUND

Uncontrollable operating costs are by definition not directly controllable by the utility. Examples include levies and rates and these items are not subject to an efficiency challenge as the utility cannot change the amount that it spends in these areas.

As part of its IRC2 decision, the CRU only recognised licence fees and levies as uncontrollable pass-through costs. The CRU decided that the forecast costs for licences fees and levies (€18m) be allowed in full as uncontrollable costs for IRC2.

The CRU did not recognise insurance as an uncontrollable cost, contrary to the view of Irish Water. It also did not recognise irrecoverable VAT as an uncontrollable cost. This approach is consistent with the framework introduced at IRC1. While in its IRC1 decision the CRU had defined commercial rates as uncontrollable costs, under the Water Services Act 2014, Irish Water was not required to pay commercial rates. As rates were no longer payable from 2015 onwards, there was no uncontrollable cost allowance made for rates in IRC2.

2.4.4.2 PROPOSAL

For the extension of IRC2 to cover 2019, the CRU intends to include an estimate of uncontrollable costs related to licences fees and levies.

⁵ It is expected that some customers may face charges for usage that exceeds a threshold amount in 2019.

In addition, under the Water Services 2017 Act, Irish Water's exemption from paying commercial rates has been revoked. Subject to the commencement of the relevant provision in the Act, Irish Water will be required in due course to pay commercial rates again following this legislation. In IRC1, (prior to the exemption provided under the Water Services Act 2014) commercial rates of €59m per annum (2013 prices) were payable by Irish Water.

Any allowance for the above will be considered following a review by the CRU of Irish Water's submission in Q1 2018 and subsequent engagement with Irish Water and comments received to the public consultation. If any allowance for rates is related to costs that are currently defined as controllable, then the CRU would also consider making a related change to those controllable costs.

2.4.5 One-off allowance

2.4.5.1 BACKGROUND

The IRC2 decision also granted an allowance for Irish Water to invest in additional areas over the IRC2 period. The CRU accepted that the work outlined will bring benefits to customers and lead to increased environmental compliance. The CRU considered 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. As a result, the CRU allowed Irish Water a one-off allowance of €19.8m for the 2017-2018 period.

2.4.5.2 PROPOSAL

Given that this was a one-off allowance for 2017 and 2018, the CRU will need to consider further if it is appropriate to continue this allowance into 2019. The CRU will consider this further once the Irish Water submission for 2019 is received. The CRU will engage with Irish Water and publicly consult on this matter, prior to making a decision on how this should be treated in 2019.

2.4.6 Innovation fund

2.4.6.1 BACKGROUND

The CRU understands that there is a key role for research and development and innovation to tackle the vulnerability of Ireland's future water security and meet future demand. As a result, in the first revenue control, the CRU granted an innovation fund allowance to Irish Water of €4m in total over IRC1.

To receive this allowance, Irish Water is required to submit project proposals to the CRU outlining the origin, motivation and setting for each project. The scope and objectives of each project must

also be outlined. Following this, the CRU decides whether a project adequately meets the set criteria and if it is eligible for funding.

Irish Water did not spend the full €4m in IRC1, and subsequently in its IRC2 decision the CRU decided that (subject to the above requirements being met) this allowance could be spent at any point in IRC2.

2.4.6.2 PROPOSAL

The CRU proposes to continue the above approach for 2019. This means that (subject to the above requirements being met), Irish Water could spend the remainder of the €4m at any point over the entirety of IRC2 (including during 2019). However, the CRU will engage with Irish Water and publicly consult on this when consulting on Irish Water's allowed revenues for 2019.

2.5 Capital costs

2.5.1 Background

As part of the revenue control for the period 2017 to 2018, Irish Water provided the CRU with a five-year Capital Investment Plan in August 2016, covering the period 2017 to 2021. This was in recognition that capital investment planning in the water and wastewater sector requires that a longer term view is taken. The Investment Plan proposed investment of €3.588bn over the five years.

In the CRU's revenue control, the CRU applied a €132m efficiency challenge to Irish Water's capital investments in the years 2017 to 2018. The efficiency challenge was applied at a global level i.e. the CRU did not apply cost reductions to individual projects or programmes but instead required that the plan is delivered for €132m less in the years 2017 to 2018. This was in recognition of the fact that Irish Water should be best placed to manage its portfolio of projects and programmes to achieve efficiencies and cost reductions across the plan.

As part of the IRC2 process, Irish Water submitted its proposed non-network capital investments for the years 2017 and 2018 only.

2.5.2 Proposal

In setting an amount for 2019 capex, the CRU may decide to use the submission provided by Irish Water in 2016 (i.e. the Investment Plan 2017-2021), in order to set a capex amount for 2019.

However, the CRU is aware that Irish Water is not progressing delivery of its Capital Investment Plan in line with the targets contained in that plan. The CRU is aware that this plan has evolved in the period since it was published in terms of expected outputs and expenditure.

Therefore, the CRU will consider further how to approach this and will engage with Irish Water and publicly consult upon this when it has received Irish Water's regulatory submission for 2019. The CRU will continue to monitor Irish Water's delivery of outcomes and outputs for customers in respect of the allowed capital expenditure.

2.6 Use of a WACC

2.6.1 Background

The CRU has applied a WACC to calculate a rate of return on Irish Water's investment in the water network in each of the past two revenue controls. This is consistent with the CRU's approach to revenue controls in electricity and gas, and is an important part of the calculation of the allowed revenue. At IRC2 the CRU decided to set the overall WACC to 5.2%.

2.6.2 Proposal

If the CRU decides that it is appropriate to apply a WACC to Irish Water's assets in 2019, it may be decided to continue using the same rate of return for Irish Water as was applied in IRC2, setting the WACC at 5.2% for 2019.

Please see Section 7.3 of the CRU's IRC2 decision paper ([CER/16342](#)) for further information on the setting of the WACC for IRC2.

With regard to the use of a WACC, the CRU is aware that businesses, including regulated utilities, compete on national and international markets to finance their capital projects. The WACC approach is commonly used by regulators to estimate the cost of capital. The WACC allowed by a regulator in setting the revenue control should reflect the opportunity cost of the funds invested in assets.

However, given recent legislative changes, the CRU will give consideration as to whether a WACC or an appropriate alternative value should be used when calculating the allowed revenue. The CRU will consider this issue further when it receives Irish Water's regulatory submission for 2019 and engage with Irish Water along with carrying out a public consultation.

2.7 Incentives and other areas

For 2019, the CRU intends to continue to use performance incentives (and/or penalties) as utilised in IRC2.

Please see Section 6 of the CRU's IRC2 decision paper ([CER/16342](#)) for further information on the performance incentives (and/or penalties) relating to IRC2.

2.8 Adjustments relating to pre-2019

When regulating utilities, in addition to setting targets and allowances in advance, the CRU completes ex-post reviews of the utilities expenditure, revenue and performance.

These ex-post reviews result in the CRU making adjustments to the utilities revenue.

When implementing the decision to extend IRC2 to cover 2019, the CRU will consider whether to complete a full review of pre-2019 expenditure, revenue and performance now, or alternatively to wait and complete this review as part of the project to set the next full revenue control, RC3.

Some examples of the items which would be subject to such a review are listed below:

- Inflation: The CRU uses forecast inflation values to set revenue allowances in nominal terms. If actual inflation is different to the forecast, then this is corrected for as part of the ex-post review.
- Revenue: The CRU set the level of revenue that can be collected in relation to the domestic sector and in relation to the non-domestic sector. If more (or less) revenue is collected by Irish Water, then the revenue Irish Water can collect in later years is adjusted accordingly to ensure Irish Water only receive the amount set by the CRU.
- Underspends and overspends: The CRU reviews Irish Water's expenditure ex-post and if it has not completed the expected work, then the CRU reduces the revenue Irish Water can collect in later years to ensure Irish Water does not collect revenue to cover the cost of work it did not complete. One specific example of this is the administrative costs associated with billing domestic customers. This expected work was not completed (to the extent envisaged) and the CRU will adjust Irish Water's revenue accordingly (to reflect this reduction in costs from 2016 to end 2018).

The CRU will consider these and other potential adjustments when implementing the extension of IRC2 to cover 2019. Following receipt of Irish Water's submission, the CRU will engage with Irish Water and carry out a public consultation. Reviews and adjustments will either be completed as part of this extension or alternatively as part of the project to set the next full revenue control.

2.9 Summary & Conclusion

In this section the CRU has outlined its proposed approach to certain areas which require consideration as part of the extension of IRC2 to cover 2019. The section has outlined the CRU's proposed process for implementing its decision to in relation to:

- Timetable

- The CRU has decided to extend IRC2 by one year to now cover the period 2017-2019. The next full revenue control, RC3, will commence in January 2020.
- Revenue Cap and Calculation of Allowed Revenue
 - The CRU proposes to continue same general approach as at IRC2.
- Operating Costs
 - The CRU proposes to again set a cumulative efficiency challenge on controllable costs.
 - The CRU will again allow an estimate for uncontrollable costs, once satisfied that the costs proposed are not within Irish Water's control.
 - The one-off allowance for 2017 and 2018 may not be appropriate for 2019.
 - The innovation fund allowance will remain available to Irish Water.
- Capital Costs
 - The CRU may decide to use the submission provided by Irish Water in 2016, i.e. the Investment Plan 2017-2021, in order to set a capex amount for 2019.
 - The CRU would determine the appropriateness and efficiency of the capex spend for the outputs delivered during 2019 as part of the ex-post review at RC3.
- Use of a WACC
 - The CRU may be decided to continue using the same rate of return for Irish Water as was applied in IRC2.
- Adjustments relating to pre-2019
 - The CRU may consider adjustments to inflation, revenues and any underspends or overspends when implementing the extension to IRC2.
- Incentives and other areas
 - The CRU intends to continue to use performance incentives (and/or penalties) as utilised in IRC2.

3. Conclusion and Next Steps

3.1 Conclusion

This paper has set out the following:

- Following the publication of the Water Services Act 2017, the CRU has decided to extend IRC2 to cover 2019. The CRU will then undertake a third revenue control for the period commencing in 2020;
- The CRU set out its proposed approach to implementing its decision to extend IRC2 to cover 2019. It should be noted that:
 - This extension will see all of Irish Water's obligations to deliver its services remaining in place.
 - Incentives and efficiency challenges will remain in place at IRC2.
 - Customers of Irish Water should continue to receive a minimum standard of service as per the Irish Water Customer Handbook and the Codes of Practice.
 - The CRU intends to continue monitoring Irish Water's performance across a wide range of metrics to ensure that the utility targets service improvements, efficiency and effectiveness of water and wastewater service delivery to customers for revenues received.
- The allowed revenue figure must be fed into the Government's budgetary process. This means that the figure is required to be finalised by Q2 of the preceding year. Therefore, the figure for 2019 will need to be decided by Q2 2018.

The CRU intends that the next revenue control for Irish Water will be for a period of five or six years. This longer revenue control (together with the development of the Water Services Policy Statement and the Strategic Funding Plan as required by the Water Services Act 2017) will provide a level of certainty to the utility regarding the revenue it will receive. This will allow it to plan for and complete the work necessary to drive cost efficiencies and service improvement over a number of years. The one year extension gives time to complete the work to put in place this longer revenue control which will run from 2020 onwards.

3.2 Next Steps

Once the CRU receives the regulatory submission from Irish Water for 2019, the CRU will review and analyse this submission. It will then engage with Irish Water and publicly consult before reaching a final decision on the allowed revenue for 2019.