

9th July 2018

CRU Water Division
Commission for Regulation of Utilities
The Exchange
Belgard Square North
Tallaght
Dublin 24

Re: Irish Water response to “Irish Water Revenue Control 2019 Revenue Control 2 (2017/2018) - One-Year Extension” (CRU/18/097)

I write in response to the consultation issued by the Commission for Regulation of Utilities (CRU) on the one-year extension to the Interim Revenue Control 2 (IRC2). Irish Water (IW) acknowledges the work undertaken by the CRU in its review of our 2019 submission and we welcome its recognition of both the progress that we have made to date and the challenges which remain.

As evidenced in our 2019 submission, IW’s asset base still suffers from serious deficiencies. There is a clear compliance deficit across water and wastewater. This has resulted in EPA sanction and action against Ireland in the European Court of Justice. Significant mains bursts on ageing pipes, such as the July 2017 Staleen incident, and the service restrictions now in place across the country as a result of the current heatwave, highlight the operational vulnerability of existing infrastructure. Such compliance issues, outages and restrictions significantly impact our customers and place Ireland’s economic development and competitiveness at risk. It is our strong view that the CRU’s 2019 allowed revenue proposals will seriously impede our ability to address these critical needs.

Our 2019 submission breaks out our operational costs (opex) into controllable costs and non-controllable costs. We forecast that controllable opex will be €703m in 2019. The CRU proposal is for €654m – a €49m difference. This level of efficiency challenge will simply be unachievable in 2019 given the urgent compliance and service demands and external cost pressures.

Since establishment, IW's controllable cost base has faced year-on-year pressure. One of the main drivers has been the mandatory requirement to meet environmental compliance and health standards under EU and Irish law. These costs are incurred across wastewater compliance, drinking water compliance and the management of sludge. We are also facing cost increases from demographic and wider economic changes, such as increased demand for water services from new housing, national wage agreements and international energy price increases. Such cost increases are clearly beyond Irish Water's control.

IW cannot absorb these additional costs into our controllable opex while simultaneously addressing compliance and service needs for customers. The CRU proposal of €654m is unachievable and would result in a serious funding shortfall. Stretching to an efficiency target at the upper limit, IW is of the view that a minimum of €680m controllable opex is required in 2019 to safely operate Ireland's water services system.

IW understands and fully accepts the CRU's role in setting challenging efficiency targets and we remain committed to attaining the cost and performance levels of international peers. However, cost reductions must be carefully managed to ensure that they are sustainable. Savings of the magnitude targeted by the CRU can only be delivered through underlying transformation of industry structures and ways of working. IW has made clear progress in this regard and has completed the design of the future Single Public Utility model. Working with other stakeholders, we are seeking to move to implementation as soon as possible. However the targeted savings will not be realised until the next revenue control.

IW is seriously concerned by the CRU's 2019 opex proposals. In the absence of industry transformation, the consequences are either a funding shortfall in the order of €30m or delays to critical compliance and service work programmes. Under the Water Services (No.2) Act 2013, the CRU must have regard to the need to ensure that IW operates in a commercially viable manner. IW ask the CRU to reconsider its controllable opex proposal in this context. We are, of course, happy to engage with the CRU in a review of our 2019 opex post 2019 and provide all necessary evidence of efficient expenditure.

We note that the CRU consultation paper states that “*the CRU will review the 2017-2019 outturn opex at the next full revenue control. Through this process, the CRU will provide Irish Water with the required revenue to meet any expenditure it incurred efficiently during IRC2*”. We further ask that the CRU’s 2019 decision paper allows for flexibility in the ex-ante 2019 revenue allowance, given unavoidable cost pressures and the probability of infrastructural failures and severe weather events in 2019, which cannot be foreseen at this point.

Given the importance of this matter, senior management of IW and Ervia are available to meet with the CRU in the coming days to address any aspect of our submission.

Yours Sincerely,

A handwritten signature in black ink, appearing to be the initials 'BM' or similar, written in a cursive style.

Brendan Murphy

Ervia Director Group Commercial & Regulation