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Fiontar agus Nuálaíochta
Department of Business,
Enterprise and Innovation



Joint Response to the CRU's Consultation on RC3: Irish Water's Revenue Control (2020-2024)

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Introduction

The Department of Business, Enterprise and Innovation (DBEI), Enterprise Ireland and IDA Ireland welcome the publication of the Commission for Regulation of Utilities' (CRU) consultation paper on Irish Water's 2020-2024 revenue control and are grateful for an opportunity to provide a submission. This is a very important consultation, the outcome of which will determine the level of costs Irish Water can incur, and in turn the costs to be borne by Irish businesses. This will impact significantly on the competitiveness of Ireland's enterprise sector out to 2024.

In this submission we do not intend to comment in detail on the proposed Capital and Operational revenue allowance, but it is important to make several observations and broad points we believe are critical from the perspective of maintaining and promoting the international competitiveness of Ireland's enterprise environment. Our key areas of focus are:

- Implications for the cost-competitiveness for enterprise water customers
- The inefficiencies imbedded in Irish Water's in cost base
- A lack of ambition in the efficiency targets set by the CRU
- Risks to enterprise customers' water costs from delayed policy decisions
- A lack of investment by Irish Water in innovation and supplier development, to achieve longer-term efficiencies

Irish Water is now funded jointly by the exchequer and Irish non-domestic users, primarily enterprises, with the latter expected to contribute up to 23% of Irish Water's revenue in the coming years. It is essential, in that context, that the CRU and Irish Water give careful consideration to the impacts of water policies on Ireland's enterprise base.

Competitiveness

The consultation documents, setting out Irish Water's capital and operational spending requirements, demonstrate explicitly and robustly that Irish Water is comparatively inefficient in delivering water services to Irish customers:

- Operational costs are inflated by a cumbersome and expensive operating model, and
- Capital costs are inflated by significant non-routine project investments and asset upgrading.

The consultation documents highlight that benchmarking provided by Irish Water suggests that Irish Water's combined water and wastewater operating costs are 35 – 40% higher than the benchmark level of efficient costs. Under the new Water Tariff Framework developed by Irish Water, and approved by the CRU, this inefficient cost level will be imposed directly on Irish enterprises through their water bills, proportional to their use. This impedes the cost-competitiveness of Irish enterprises, tightens their profit margins and reduces the attractiveness of Ireland as a place in which to do business.

Water services are a key input, and cost, for Irish Industry; particularly in sectors such as food & beverage, pharmaceuticals and manufacturing. DBEI, Enterprise Ireland and IDA Ireland have on a number of occasions proposed that the CRU should include 'competitiveness' as one of its core principles in assessing Irish Water's tariff framework, and have provided a detailed justification for that view. We do not accept the CRU's interpretation as set out in the tariff framework consultation document that a consideration of competitiveness would require cross-subsidisation between customers. Furthermore, the merit of including competitiveness as a core principle is greater than

ever, given the major challenges such as Brexit and a host of other global pressures facing enterprises in Ireland in the next few years.

As we have set out in previous submissions, we fully recognise that Irish Water requires adequate resources to deliver modern, high-quality water infrastructure over the medium to long term. This is particularly important given the current pressing need for investment in water infrastructure.

The CRU has insisted that Revenue Control process and tariff design process are mutually exclusive considerations for it, as regulator. However, DBEI, Enterprise Ireland and IDA Ireland believe that the interaction between the Allowed Revenue approval process, and the Non-Domestic Water Tariff Framework, is critical to the competitiveness of prices and outcomes for water customers. As currently designed, when the CRU agrees allowed revenue budgets for Irish Water, these are automatically and formulaically imposed on Irish Water's enterprise customers. Therefore, if stakeholders are concerned about the cost of water services for Irish enterprise customers, our only recourse is to contest Irish Water's spending programmes which (while inefficient for an array of structural and legacy reasons) we understand to be essential. It is important that the CRU assess both the requirement for substantial investment in water infrastructure as well as, separately, the competitiveness of outcomes for customers. In this regard we reiterate a position we have stated in previous submissions - that a case exists for differentiating between the cost incurred by Irish Water due to 'legacy' conditions and the 'normal' long-term costs commensurate with efficiently providing water services.

We are of the view that an overall assessment of the competitiveness or 'value-for-money' of outcomes and prices for enterprise water customers – a product of both revenue control and the tariff framework – is the only way that the CRU can deliver on its mandate to advocate for customers and ensure competitive water services delivery.

In addition, the CRU in its consultation document relies heavily on UK utilities as the appropriate cost competitiveness benchmark. It is correct to only compare Ireland with other countries with a regulated structure similar to Ireland's. However, we remain unconvinced that UK utilities necessarily represent international best practice.

Efficiency

DBEI, Enterprise Ireland and IDA Ireland would challenge the CRU to seek greater efficiency measures and more ambitious cost savings from Irish Water over the period, while also improving on the quality of service delivery.

A number of key assumptions around the delivery of key structural changes to Irish Water's operations are necessarily included in the proposal. These include the continued transformation of the water services sector to a single public utility through WIOF (the Water Industry Operating Framework programme), the reduction of services purchased through Service-Level Agreements with Local Authorities and roll-off of Design, Build Operate (BDO) contracts.

Given the inefficiencies currently in Irish Water's costs, and assumptions made in the Revenue Control proposal around structural reform that can be achieved in the period, the efficiency targets set by the CRU of 2% - 6% over the four years seem less than ambitious.

Clarity for Enterprise Customers

While it is understood that the Revenue Control consultation relates exclusively to costs that Irish Water is permitted to incur, stakeholders and water customers will also assess the proposal in light of the costs it will ultimately impose on businesses. In this regard, the consultation documents are relatively opaque. The consultation document does not provide any clarity for customers on exactly what revenue will be raised in each year specifically from Non-Domestic customers. As stated in previous submissions to the CRU, consultation documents will have multiple audiences and, as non-domestic water users are the only customers facing direct financial implications, the CRU should be especially conscious of how they communicate policy decisions such as proposed Revenue Control with enterprises.

In this respect, it is critical that the CRU provides confirmation that the revenue table on page 167 of the consultation document is indicative and doesn't accurately reflect the percentage of revenue to be recouped from enterprises in each year. This table gives the impression that the non-domestic sector's contribution will rise to almost 25% by 2024, which would be disproportionate.

The speed and efficiency with which major water infrastructure and organisational change are implemented is a critical factor in determining total costs. Assumptions made about large CapEx projects and OpEx components such as WIOF, are a central feature of this revenue plan, and any delay or change to the assumed timelines will impose costs and uncertainty on Irish enterprises. The CRU should clearly highlight the risks attached to such assumptions, and make efforts to highlight to policy makers the costs that will be placed on enterprise customers in the event of delays.

Investing in Innovation for Long-term Sustainability

We welcome the proposal to allow Irish Water the additional €4m to fund innovation projects approved by the CRU within the RC3 period. However, we note that similar Revenue provided during the RC2 period was not fully spent. In order to achieve greater cost efficiency in the medium term, investment in innovation projects, and research that would support more efficient delivery of water services, is essential. International water utilities use innovation as a key aspect of their communication with customers¹, yet Irish Water's innovation agenda is not currently visible or inclusive of Irish industry.

The National Development Plan will drive significant infrastructure development in Ireland over the next decade. Irish Water's proposed capital investment plan incorporates large scale projects, the successful delivery of which will be contingent the development of a sustainable Irish supplier base through meaningful engagement with suppliers, researchers and innovative product designers. The development of a competitive supply chain to source engineering and efficiency solutions will be key to Irish Water's efficiency, cost effectiveness and customer responsiveness in the medium-term. DBEI, Enterprise Ireland and IDA Ireland would encourage the CRU to further require Irish Water to make progress in this regard.

¹ Examples of innovative Water sector projects: <https://globalambition.ie/water-sector-innovation/>; <https://www.epa.gov/water-innovation-tech/examples-innovation-water-sector>

Conclusion

DBEI, Enterprise Ireland and IDA Ireland welcome the publication of the Commission for Regulation of Utilities' (CRU) consultation paper on Irish Water's 2020-2024 revenue and are grateful for an opportunity to provide these comments in the interests of delivering the best outcome for Irish Water's non-domestic customers.