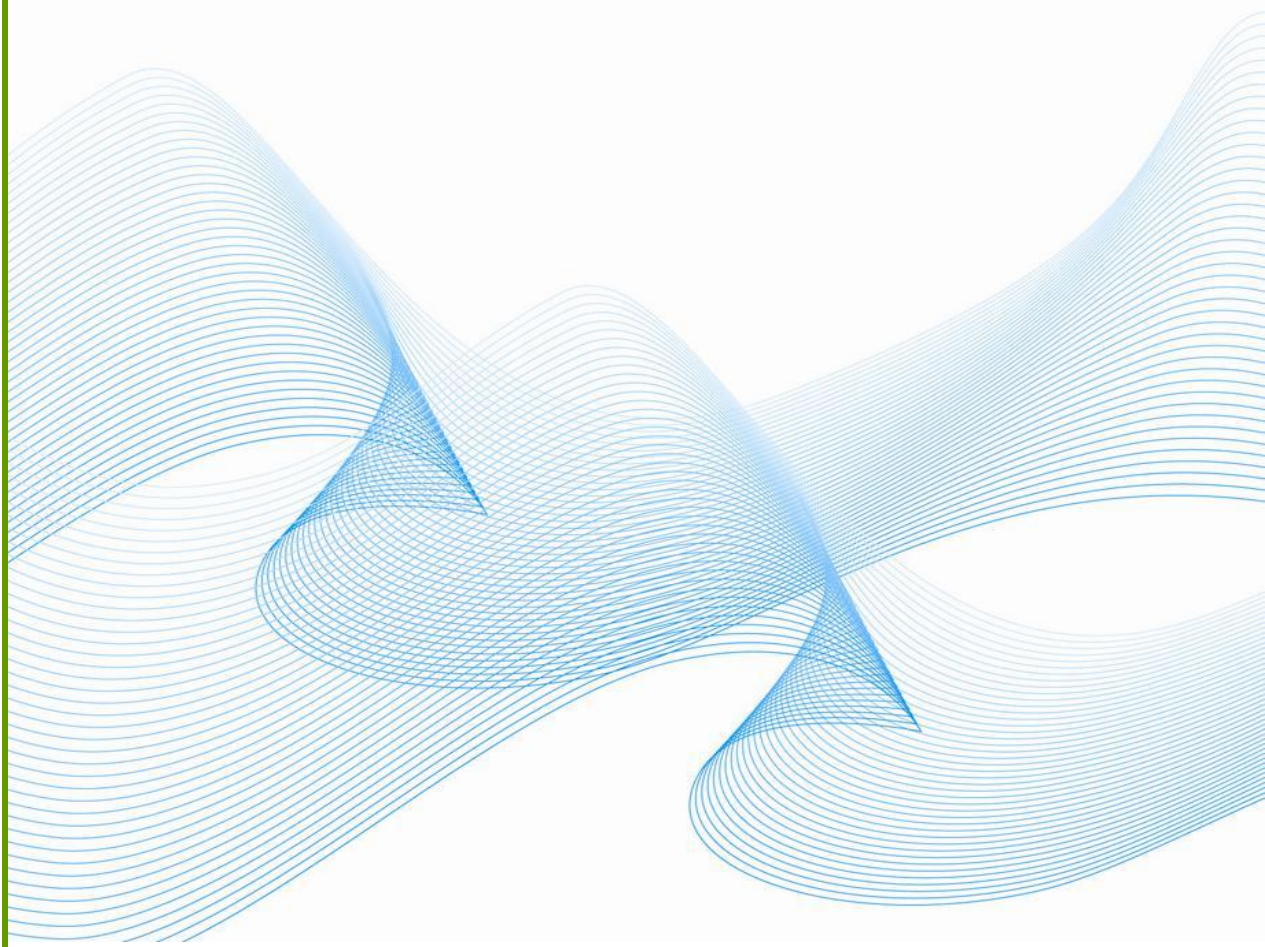




Water and Sewerage Service Price Control 2013-2015

PC13 Overall Approach

October 2011



Water and Sewerage Service Price Control 2013-15

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1 Foreword

The Regulator's primary role within the Northern Ireland water industry is to promote and protect the interests of the consumer. One of our most important regulatory processes is that of the price control which ensures that consumers receive the best value for money. The price control results in a contract between the Regulator and the company, it sets out the money which the company requires and is allowed to charge. Currently the charge which is attributable to domestic consumers is provided by Government subsidy.

A critical starting point for the price control is advising the Regional Development Minister on the amount of revenue that NI Water needs to meet the Minister's strategic objectives and direction. These strategic objectives are detailed in Ministerial Social and Environmental Guidance. This guidance is informed by (i) the quality regulators – addressing statutory compliance issues; (2) the consumer body – representing consumers' priorities; (3) the Utility Regulator – balancing costs, efficiency and levels of service; and (4) the Department – advising on policy matters. The guidance is required under the Water and Sewerage Services (NI) Order 2006, to be laid in the Assembly and it is also subject to public consultation.

However the absence of domestic charges or other ring fenced income stream has resulted in the reclassification of NI Water as a Non Departmental Public Body. This has meant that NI Water's annual budget allocation for this price control period has been determined by the Executive's comprehensive spending review. This therefore is the starting point for the price control. The budget is fixed on an annual basis and so the outputs from the price control will have to match what can be delivered for the money. The consequence of this is the potential deferment of significant projects. There is also a negative impact on the delivery of efficiencies.

The dual status of NI Water, being treated as a Government Owned Company and a Non Departmental Public Body, adds complexity. It is essential that long term funding arrangements for NI Water are resolved to support a strategic and sustainable approach.

Our vision is for a water industry which takes account of the economic, social and environmental impacts of the sector, while addressing the key sustainable development challenges ahead, and which delivers high quality, best value and safe services to NI consumers.

Jo Aston
Director of Water Regulation

2 Background to the Utility Regulator, Principal Stakeholders and PC13

2.1 Introduction

- 2.1.1 The Northern Ireland Authority for Utility Regulation, otherwise referred to as the “Regulator” exists to promote the interests of water and sewerage consumers. One of the ways in which we ensure that consumers receive best value for money is by setting prices which allow NI Water to deliver water quality, environmental and customer service objectives at the lowest reasonable overall cost.
- 2.1.2 Overall limits on how prices can rise (or by which they are required to fall), married to outputs, are set through a process referred to as a Price Control. However, given that direct charging of domestic consumers has been deferred, NI Water is dependent for over 70% of its funding from a government subsidy. This circumstance therefore requires the regulatory Price Control process to start with the public expenditure budget allocation, ensure that paying consumers’ contribution is proportionate and that outputs and improvements are maximised and clearly defined to deliver best Value for Money for all consumers.
- 2.1.3 Particular challenges for this Price Control will be the need to assess and take account of the impact on the company’s ability to deliver efficiencies and prioritise outputs. A dominant issue to acknowledge when working with a public expenditure regime is the need to ‘fit’ the capital programme to allowed funding within individual financial years, rather than to suit the priority of projects and delivery, over the price control contract period. The absence of flexibility of expenditure between years will have a negative impact on NI Water’s ability to deliver strategic priorities and to maximise efficiencies. Additionally, its ability to aggressively close the current operational efficiency gap to the best performing water and sewerage companies will be to some extent impaired by the absence of financial incentives to outperform which apply to the rest of the industry.
- 2.1.4 In acknowledgement of the unique circumstances applying to NI Water, and its dual status as a Government owned company in legislation and classification as a Non-Departmental Public Body¹, the Department for Regional Development (DRD) and the Regulator worked transparently with the principal stakeholders and signed a Memorandum of Understanding (MoU)². This MoU set out how DRD and the Regulator would work together in discharging respective functions as defined in the Water and Sewerage Services (NI) Order 2006. Both parties agreed that the Regulatory Price Control process would continue to be applied.

¹ NI Water’s reclassification as a NDPB applies so long as more than 50% of its funding remains provided by government.

² MoU NIAUR/DRD, November 2010 and MoU NIAUR/DRD - Consequent Written Agreement, November 2010

- 2.1.5 This document defines our overall approach to the two year price control for the period 2013 to 2015, referred to as PC13.

2.2 The Utility Regulator and NI Water Regulation

- 2.2.1 The Utility Regulator was established as the economic regulator of Northern Ireland's water industry under the Water and Sewerage Services (NI) Order 2006 on the 1st April 2007. Our primary duties under legislation are:-

- to protect consumer interests;
- to ensure NI Water carries out its functions properly; and
- to ensure NI Water is able to finance its functions

- 2.2.2. In discharging these duties we apply the five principles of better regulation, accountability; consistency; proportionality; targeting and transparency.

- **Transparency and Accountability**

The price control regime together with our annual reporting of costs and performance evidences the application of an accountable and transparent approach. In publishing our Cost and Performance Report 2007-10 we were pleased to report NI Water's progress in closing the operational efficiency gap from 49% to just under 40%³ alongside delivery of the funded capital programme and an improvement in its overall performance assessment (OPA) from 98 to 121. However, pressure must be sustained to ensure that the consumers & taxpayers of N Ireland do not receive a level of service that is significantly lower than the England & Wales average, reflected in an OPA score of 290⁴ while paying much higher operating costs, reflected in the 40% operational efficiency gap. Given that domestic consumers do not pay directly for their water, public expenditure allocation to water impacts directly on allocations available for other services.

The continued application of a formal Price Control approach that clearly defines outputs and performance expectations married to funding levels is essential so that a transparent and accountable regulatory process is able to be applied and that NI Water continue to close the gap in costs and performance with that of an efficient English, Welsh or Scottish water provider.

³ The 2009/10 Cost and Performance Report estimated a 40.5% efficiency gap which meant operational costs in 2009/10 were some 68% higher than they would otherwise be at the benchmark or 'frontier' of the industry. This estimate was subsequently confirmed as 39.7% applying to 2009/10 financial year.

⁴ The Regulator's current OPA measurement includes comparison of just 11 measures against comparable performance measured in the rest of the industry by 17 OPA measures.

- **Consistency and Targeting**

There have been many data issues arising over the period of our economic regulation of NI Water. This is not entirely surprising for a company new to economic regulation and previously working within the public sector. We have targeted our efforts in a number of areas ie capital investment monitoring to ensure that expenditure is linked to outputs and confidence can be build around both delivery of the programme and its costs. We have also applied our regulatory enforcement powers regarding data issues and continue to monitor the delivery of formal undertakings targeted at improving the quality of data both its reliability, accuracy and consistency. With a monopoly supplier, benchmarking of performance can be a very effective regulatory tool in challenging performance. We require the company to make annual information returns (AIRs), which are consistent for benchmarking with the English, Welsh and Scottish water companies. Whilst financial incentives to outperform are largely absent from the current model, the reputational incentives upon NI Water and its senior managers remain a very strong incentive to meet whatever efficiency challenges are set within each price control.

The continued application of a formal Price Control approach reinforces and maintains the pressure on NI Water to improve its data, to develop a capital programme whose estimates and delivery can be realised. Realistic and realisable planning of the capital programme, is even more important when constrained by the annual public expenditure budgetary regime.

- **Proportionality**

Economic regulation in the water sector in Northern Ireland was only introduced in 2007. There remains much to do in relation to developing data systems and quality information. In such circumstances, particularly where the operational efficiency gap remains so significant (currently of the order of up to 40%), it is necessary to apply intensive and robust regulation to ensure efficiencies are achieved and the asymmetry of information between company and regulator is addressed. There is however an opportunity in one to one regulation, to lessen the regulatory burden by aligning regulatory information requirements and internal company data systems and processes which inform the development of internal company business and operating plans. A key challenge for PC13 is to be proportionate in our application of the regulatory process for this two year price control. The additional governance and reporting requirements arising from NI Water's NDPB status must also be acknowledged and accommodated.

Ensuring that PC13 is proportionate in its approach, so as to sustain NI Water's momentum in improving its data systems, planning and delivery is a key challenge. It is crucial that the process acknowledges the demands placed on the company from its NDPB status and does not jeopardise the priority of the forthcoming more strategic five year price control 2015 -20.

2.3 Working with the Principal Stakeholders

- 2.3.1 In developing PC13 and determining outputs, overall funding and charges for NI Water it is important that we do not work in isolation but seek to co-ordinate the roles of other principal stakeholder in the PC13 process. We have therefore engaged with and sought the views of the principal stakeholders in the water and sewerage industry in developing our approach to PC13 and are committed to working with them to secure a successful outcome.
- 2.3.2 In conducting our first regulatory price control PC10, we engaged with and sought the views of the principal stakeholders in the water and sewerage industry, we are committed to reinforcing this approach for PC13. Upon the completion of PC10 we conducted an internal review of the process, and invited an open discussion with the principal stakeholders to ensure that lessons were learnt and would, where feasible, be applied in future price controls. The lessons identified from the PC10 process are summarised in Annex A.

Northern Ireland Water

- 2.3.3 NI Water is responsible for the provision of water and sewerage services in Northern Ireland. NI Water is a statutory entity, wholly owned by the government with the Minister for Regional Development acting as both shareholder and policy maker for water. NI Water is the only statutory water company in Northern Ireland; it operates in accordance with company legislation and is subject to economic and quality regulation.
- 2.3.4 Prior to April 2007 water and sewerage services for NI were provided by Water Service, which was an Agency under the remit of the DRD. At the time of its establishment it was intended that domestic water charges would be introduced and that by 2010 the company would be fully funded by direct income. However with the deferment of domestic water charges, the company is dependent for over 70% of its funds from a government subsidy administered by DRD.
- 2.3.5 NI Water's dependency for more than 50% of its revenue from government has resulted in its reclassification as a Non-Departmental Public Body. One of the key challenges for PC13 will be to assess the impact of constraints and the lack of flexibility in budget between years on NI Water's ability to deliver efficiencies.

The Consumer Council for Northern Ireland

- 2.3.6 The Consumer Council is the consumer representative for water and sewerage customers. Its job is to 'speak up for consumers and give them a voice'. The Consumer Council ensures that policy makers in Northern Ireland hear that voice and take it into account when they are making decisions that affect consumers. It does this by providing information, undertaking education campaigns and research and by producing relevant publications.
- 2.3.7 Another important function is the assistance it provides to individual consumers in striving to resolve complaints where NI Water has failed to satisfy a complaint.

The Drinking Water Inspectorate (DWI)

2.3.8 The Drinking Water Inspectorate is a unit within the Department of the Environment, responsible for regulating the drinking water quality in Northern Ireland under the Water Supply (Water Quality) Regulations (N) 2007; the Private Water Supplies Regulations (NI) 1994; and the Water Supply (Domestic Distribution System) Regulations (NI) 2010.

2.3.9 The Drinking Water Inspectorate:

- Regulates drinking water quality in Northern Ireland for public and private supplies;
- Assesses drinking water quality against regulatory standards;
- Carries out detailed inspections of water sampling and analytical processes, and assesses water treatment and distribution policies and practices;
- Publishes an annual report containing an overview of drinking water quality in Northern Ireland;
- Develops policy and regulation on drinking water issues, in association with other UK Drinking Water Regulators; and
- Deals with complaints from consumers and incidents which affect or could affect drinking water quality.

Northern Ireland Environment Agency

2.3.10 The Northern Ireland Environment Agency (NIEA) is an agency within the Department of the Environment.

2.3.11 NIEA takes the lead in advising on, and in implementing, the government's environmental policy and strategy in Northern Ireland. The Agency carries out a range of activities, which promote the government's key themes of sustainable development, biodiversity and climate change. Its overall aims are to protect and conserve Northern Ireland's natural heritage and built environment, to control pollution and to promote the wider appreciation of the environment and best environmental practices.

2.3.12 NIEA as the environmental regulator of NI Water:

- Regulates all discharges to waterways under the Water (NI) Order 1999;
- Carries out inspections and audits of wastewater sampling and analysis;
- Publishes a report on compliance of discharges with environmental standards;
- Investigates pollution incidents associated with NI Water assets;

- Regulates abstraction and impoundment of water through licensing system; and
- Applies NIEA's Enforcement and Prosecution Policy.

The Minister and the Department for Regional Development

- 2.3.13 The Minister for Regional Development is in charge of DRD. In this capacity he provides overall political direction and is responsible, through the Assembly, for the legislative framework for the water industry. He is also the sole shareholder in NI Water.
- 2.3.14 Within DRD there is a Shareholder Unit who works directly with the company and to whom the company is accountable to for its business performance.
- 2.3.15 Within DRD there is also a Water Policy Unit whose primary function is to serve the Minister thus enabling him to provide clear policy, guidance and directions in support of a robust regulatory regime. This normally manifests itself, for the purposes of a price control, in the issue of Social and Environmental Guidance to inform the priorities and objectives for the price control period.
- 2.3.16 An additional key role for PC13 associated with DRD, resulting from the deferment of domestic water charges, is the allocation and monitoring of the government subsidy accounting for over 70% of NI Water's funding over the period.

3 Key Issues and Overall Approach

3.1 Working with Public Expenditure

- 3.1.1 A key issue is aligning the regulatory price control process with the public expenditure budgetary process. Indeed, this short two year price control, spanning from April 2013 to April 2015, has been set in consideration of the Public Expenditure Comprehensive spending review (CSR). The CSR has defined the funding level for the period as £720m, as summarised below:

Table 1: Public Expenditure 2013/14 to 2014/15

	Capital (£m)	Resource (£m)	Total (£m)
2013/14	£151.3	£194.2	£345.4
2014/15	£180.0	£193.7	£373.7
Total	£331.3	£387.9	£719.2

- 3.1.2 In setting efficiency targets for NI Water, we will take into consideration the constraints and implications of the company's classification as a NDPB. Factors to be considered include:-

- **No 'End of Year flexibility'** - This in effect means that the budget allocation for a specific year must be spent in that year as it cannot be carried forward but is lost to the water industry if not spent in that year.

This is far from ideal for a capital intensive industry, which involves the delivery of large scale projects to comply with European Directives, avoiding the risks of infraction. It encourages spend on smaller scale projects, such as watermains and sewers, which while necessary may not be the priority.

It will be crucial for all stakeholders, particularly NI Water and the quality regulators, to work together to agree what can be delivered and to flag any quality and/or infraction risks arising from the need to 'fit' the capital programme to annual capital funding, rather than to suit the priority of projects or for efficient delivery.

- **Uncertainty of PE budget** – The public expenditure process operates a number of monitoring rounds during the financial year. At each monitoring round, Departments are required to assess spend and as necessary surrender excess funds. There is also the potential for funding levels to be cut or indeed increased depending on pressures or surpluses elsewhere in the Department or N Ireland budgets.

This absence of a hard budget brings much uncertainty and dilutes the pressure on NI Water to outperform the regulatory price control contract.

- **Profile of public expenditure** – NI Water must follow the public expenditure profile of funding. For Capital it is profiled as:-

2011/12 - £189.0m: 2012/13 - £147.6m: 2013/14 - £151.3m: 2014/15 - £180.0m

The large changes in funding between years (>20%), reduces the ability of the company to deliver larger priority projects which span a number of years and is inherently inefficient.

The Resource DEL⁵ is profiled as:-

2011/12 - £203.6m: 2012/13 - £194.2m: 2013/14 - £194.2m: 2014/15 - £193.7m

The levels of funding have been informed by the PC10 price control and include provision for relevant items agreed as part of the MoU between the Regulator and DRD.

A key issue will be to assess the impact on NI Water's ability to deliver efficiencies while operating within a Public Expenditure regime.

3.2 Applying a Proportionate Approach

- 3.2.1 The first regulatory Price Control, PC10, placed a significant demand on all stakeholders as we developed robust regulatory processes for the first time. However, the detailed development work carried out delivered for the consumer, resulting in a determination which amongst other things, targeted the delivery of £91m savings over the three year period.
- 3.2.2 There is an opportunity in PC13 to build on the work completed in PC10 and the development of local regulatory working practice to adopt a process which is regulation 'lite' whilst ensuring the focus remains on delivering a programme of work to match and deliver the best value outputs from PE funding. There are a number of opportunities we have considered to develop a proportionate process which will minimise the regulatory burden on NI Water:-
 - **The two year timeframe** - This is a very short duration, and when married to the PC10 3-year price control, the period reflects the preferred 5-year price control period. Much of the analyses and methodologies applied for PC10 could be projected forward for the PC13 price control. Principal stakeholders have agreed that the Social and Environmental Guidance priorities, reflecting consumer views should apply to the PC13.

⁵ Resource DEL (Departmental Expenditure Limit) includes NI Water's operational expenditure plus depreciation less non-domestic revenues plus opex relating to DRD Water Policy Division and Shareholder Unit.

- **Benefits of one to one regulation** – There is an opportunity in one to one regulation, to lessen the regulatory burden by aligning regulatory information requirements and internal company data systems and processes which inform the development of internal company business plans. The limited timeframe will not facilitate this for PC13 but the process will commence. The Regulator and NI Water have established Information Requirements Working Groups to take discussions forward in this context covering Capital; Opex efficiencies and Financials.
- **Reducing information requirements** – It remains essential that we are able to establish a baseline, measure and benchmark NI Water's delivery and performance over the period. We have however reviewed our information needs to those deployed for PC10 and concluded that we will likely require approximately 25% of the number of formal tables previously completed. We aim to make such tables simpler, requiring much less input to complete, and we shall whenever possible align our price control requirements with existing Annual Information Returns and data definitions. This may be further informed through our engagement with NI Water.
- **Additional PE constraints and reporting requirements** - The additional governance and reporting requirements arising from NI Water's NDPB status must be acknowledged and accommodated. We will continue the application of the MoU process and that relating to the associated Consequent Written Agreement⁶.
- **The more strategic PC15** - There are many challenges which the water industry has to face over the long term, including climate change, population growth and an uncertain economic environment. For such a capital intensive industry clear policy, strategic direction lending itself to long term planning is essential. It is therefore crucial that the PC15 programme, associated consumer and stakeholder engagement and more detailed process is given priority over the shorter two year PC13 price control.

3.3 Areas of Focus for PC13

3.3.1 In applying a proportionate approach to PC13 it is helpful to identify areas of focus for this Price Control:-

- **Improving data quality** - there is a need to maintain momentum in relation to NI Water continually improving its data quality. We will continue to hone in on specific areas so that justification and targeting of investment continues to improve for PC13 where possible and for PC15.

⁶ MoU NIAUR/DRD, November 2010 and MoU NIAUR/DRD - Consequent Written Agreement, November 2010.

- **Improving programme planning and delivery** - when working within the PE regime it is arguably even more critical that NI Water improves its ability to deliver outputs. We will ask NI Water to provide proportionate business cases for the investment it proposes. We will ask NI Water to assess the impact of 3rd party risk on delivery (such as land purchase or planning constraints) and agree outputs which can be delivered. We will require outputs to be clearly defined and a Monitoring Plan published prior to the start of the PC13 period. We will also continue to require regular Capital Investment Monitoring Returns.
- **PC10 Capex Review and PC13** – our PC10 review has informed our approach to PC13. The outputs we agreed for PC10 are currently subject to some re-phasing given the recent changes to Departmental budgets. In general, we are minded to agree revised phasing of outputs over a five year period (PC10 plus PC13) without revisions to our capex efficiency challenge.

We will aim to continuously improve our approach to establishing capital spend baseline for PC13. Whilst we are unlikely to adopt any radical change to the PC10 approach for PC13, this may not necessarily be the case in PC15.

- **Streamlining engagement with NI Water and reducing regulatory burden** – we will ask the company to present its business plan to us, and address queries face to face, in advance of adopting a formal information query process. We will also adopt a reciprocal process for the Draft Determination.
- **Applying the 80:20 rule to opex** – our focus on NI Water’s baseline will be determined by the largest items of expenditure, such as power, Voluntary Early Retirement costs, for example. Additions to baseline will be subject to the same transparent approach we employed at PC10. The twin tests for “newness” and “exogeneity” will be applied at PC13.
- **Recognising good progress on the opex efficiency gap** – We have already discussed with the company the process and timetable for submission of their Special Factor claims, which have in the past allowed them to argue for an efficiency target which takes account of the different operating conditions locally. The company has to date made successive improvements on its operational efficiency gap to the best performing companies in the rest of the industry and we intend recognising this fact by re-calibrating our analysis around the 2010/11 base-year for PC13⁷.
- **Local context and the impact from NDPB status** – in setting efficiency targets, both operational and capital, we will seek to assess and reflect the impact of local circumstances on NI Water’s ability to deliver. The company’s work on its Special Factor claim may inform our thinking in this regard.

⁷ Other factors remaining constant, we expect this to reduce the eventual opex efficiency target for NI Water compared to that applied during PC10.

- **PC10 regulatory commitments** - various commitments were included within the PC10 Final Determination documentation, both for the Regulator and NI Water. Given the two year nature of PC13 not all of these commitments will prove possible. Where any PC10 commitments are unable to be developed in time for PC13 it is our intention to return to these at PC15 after appropriate and further consultation with stakeholders.
- **Overall approach to PC13** - we recognise the requirement to begin early planning for our next price control PC15, early in 2012. This is important, as 2012 will represent a situation where we will be drawing PC13 to a close while increasing momentum on PC15. Hence the need to deliver a proportionate PC13 without losing sight or failing to deliver on the remaining regulatory principles.
- **Preparing for PC15** – we recognise the need to plan for continuity between Price Controls to promote long term planning and efficient delivery. We expect the PC13 Business Plan to include the investment necessary to develop projects which will allow continuity of investment in the first years of PC15. We would also encourage the company to include proposals for investigatory work to allow it to develop strategic, sustainable and risk based solutions which require time to develop but offer the opportunity to maximise the long term value obtained from investment in water and sewerage services.

4 Key Stages for PC13

4.1 Principal Stakeholder Engagement

- 4.1.1 Consideration of the PC13 programme commenced with a range of options being considered in conjunction with lessons learnt from PC10 at a principle stakeholder workshop on the 14 December 2010. The intention at this stage was to progress PC13 from early 2011, however the major Freeze/Thaw incident of 2010/11 delayed initiation. The Regulator subsequently held bi-lateral meetings with all the key stakeholders and there was general agreement that a two year PC10 extension process be adopted.
- 4.1.2 A number of meetings were held with the company to initiate discussions on the detail of the programme and general approach. A further Stakeholder workshop was held on the 22nd September at which the general principles and approach to PC13 were agreed.

Table 2: PC13 Engagement to date

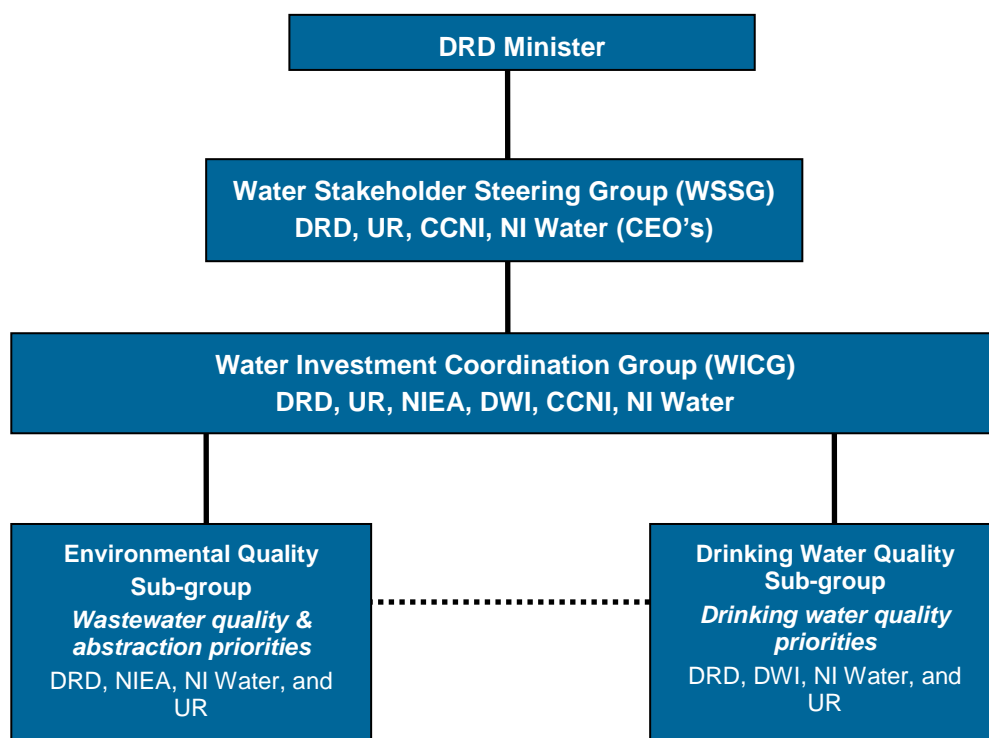
PC13 Engagement	Stakeholder	Date
PC10 Lessons learned & PC13 programme options	NI Water, DRD, CCNI, NIEA and DWI	14 th December 2010
Process, Programme and engagement	Bi-lateral – NI Water	29 th July 2011 and 5 th September 2011
Process and indicative programme	Bi-laterals with DRD, CCNI, NIEA and DWI	wc 20 th June 2011
PC13 Stakeholder Workshop	NI Water, DRD, CCNI, NIEA and DWI	22 nd September 2011

- 4.1.3 Following the PC13 workshop on the 22nd September a first draft of the Regulator's PC13 Overall Approach document was forwarded to all of the principal stakeholders to further consider our approach and provide written feedback for consideration by the Regulator.
- 4.1.4 Engagement through the remainder of the Price Control process will generally be facilitated via the working group structure which operated successfully through the PC10 price control and was endorsed as an approach by all stakeholders in identifying lessons from PC10.

A primary purpose of the working group structure is to agree and prioritise outputs and provide advice up to the DRD Minister to assist in the preparation of Social and Environmental Guidance. However, given that the PC10 Social and Environmental Guidance will apply for PC13, the working groups focus will be on the prioritisation of projects, outputs and any other issues arising, such as the review of the Consequent Written Agreement.

- 4.1.5 Taking account of the duration and scope of PC13 and building on established working practice we believe that it should be possible to simplify the working group structure. At the PC13 workshop on the 22nd September, stakeholders encouraged simplification, building on the experience of the PC10 Capex Review. A simplified working group structure is depicted in Figure 1 below:

Figure 1: PC13 Working Groups



- 4.1.6 It was agreed at the PC13 workshop on the 22nd September that there was no pressing need to have working groups on:

- Consumer views
- Enhanced Service Levels (and base maintenance)
- Broader sustainability issues

That said, it will be necessary to consider reconvening these groups to develop a five year PC15 price control.

- 4.1.7 The rationale for not including base maintenance is that we will likely adopt the same methodology as deployed for PC10 for determining its funding. The working group for eliciting consumer views will be reconstituted in January 2012, to determine the approach to this important workstream for incorporation in the more strategic PC15. Similarly all other working groups will be reformed for PC15.
- 4.1.8 The WICG will play a key role in co-ordinating, discussing and concluding on stakeholder views on priority and delivery of the capital programme outputs for PC13. Final endorsement of the PC13 outputs and priorities will be sought from the WSSG as at PC10. The environmental quality and drinking water quality sub-groups will undertake the detailed technical assessment of outputs and review the prioritisation and deliverability of outputs, as considered necessary, given the level of carry over of the capital programme from PC10) to inform the WICG's decisions. The agreed outputs of this process will underpin development of NI Water's PC13 Business Plan and forms a key early output in the overall development of the Price Control.
- 4.1.9 The principal stakeholder PC13 workshop on the 22nd September discussed the overall approach and the need for it to be proportionate. A number of significant key issues were discussed and agreed and key assumptions for our approach to PC13, namely:-
- A two year PC13, 2013 to 2015 will be adopted;
 - The current Social & Environmental Guidance for PC10 will apply for the PC13 period reflecting the fact that much of capital programme for PC10 extends into PC13; and
 - That no further consumer engagement will take place for PC13, given the short duration of this price control and that the Social & Environmental Guidance would not be revisited. Consumer engagement will however be an important aspect for PC15.

4.2 Minister for Regional Development determines charging policy and objectives for the industry

4.2.1 Legislation allows the Department for Regional Development the discretion to consult with stakeholders including the Utility Regulator, the Consumer Council, the Department of the Environment, other relevant stakeholders and persons they consider appropriate to consult in relation to the issuing of Ministerial guidance. Draft guidance must then be laid before the Assembly with the statutory period for consultation being applied.

4.2.2 This procedure was completed for PC10 with the Department publishing 'Social and Environmental Guidance for Water and Sewerage Services for 20010-13' in May 2010. The document set out the Executive's key strategic investment priorities, which were:-

- **Affordability** – provide affordable cost effective services for customers and taxpayers;
- **EU compliance** – meet our European legal obligations in relation to drinking water quality, waste water discharges into the environment, and contribute to flood risk management with other Agencies;
- **Service delivery and improvement** – maintain current service levels and work towards improvements that provide customer benefits in areas such as sewer flooding and interruptions to water supply; and
- **Sustainability** – improve our infrastructure to reduce leakage, cut unsatisfactory sewage discharges, lower energy consumption and allow for future growth.

4.2.3 The document provides strategic direction and reflects consumer views as jointly elicited by the CCNI and NI Water at PC10. It also set out the funding level, both resource and capital, for the PC10 period and advised that 'account should be taken of any further decisions by the Executive on the IWRP's recommendations or on the future funding for water and sewerage services'.

4.2.4 It is DRD's and the principal stakeholders' view that the current Social and Environmental Guidance remains valid for the PC13 period. This view is informed by the following factors:-

- The reduced and altered profile of capital spend for the PC10 period has resulted in a re-profiling of the capital programme for this period. This has resulted in some of the priorities as identified in PC10 being necessarily deferred for delivery during the PC13 period.
- Time is limited, and there is general consensus by the principal stakeholders that further consumer engagement should await the more strategic PC15 price control.

- The Department is reviewing the benefits of developing a water strategy for NI which will inform revised Social and Environmental Guidance for future price controls.
 - Only around 40% of the Capital Works Programme remains to be finalised.
- 4.2.5 There is however a need for DRD to formally advise the Regulator and NI Water of both resource and capital funding levels for 2013/14 and 2014/15 as defined in the Executive Budget for 2011-15 or as otherwise amended.
- 4.2.6 Regarding future funding decisions, we note the PAC recommendation that the Department, the Regulator and NI Water, in conjunction with DFP, develop a range of options for the consideration of the Executive with a view to providing NI Water with more certainty of funding over the three year period of PC10'. We welcome this recommendation, acknowledge that DRD are taking this action forward and as required by the current guidance, confirm that the UR will take account of any future Executive funding decisions.
- 4.2.7 Stakeholders agreed at the 22nd September 2011 workshop that the Consequent Written Agreement between the Regulator and DRD would be reviewed for PC13. This will be accommodated in the programme, with any amendments being agreed as early as possible to inform NI Water's PC13 Business Plan.
- 4.2.8 Table 3 provides an indication of desirable programme timings for the Department to advise the Regulator and NI Water of funding levels and to further update on the funding options being considered.

Table 3: Indicative dates for DRD and Ministerial Guidance

Key Dates for Price Control	Indicative Dates - TBC
DRD Minister letter/guidance advising of (i) status of current S&EG in the context of PC13 and (ii) availability of Resource and Capital funding	1 st December 2011
DRD Minister letter/guidance confirming (i) final principles and objectives for PC13 and (ii) available Resource and Capital funding – if altered from that issued on 1 st December 2011.	February 2012

4.3 NI Water submits its Business Plan

- 4.3.1 While NI Water is advised of its level of funding and strategic objectives, its business plan is the means by which NI Water advises its Board, Shareholder and the Regulator of its strategy for the future, both in terms of investment plans and the resultant prices it wishes to charge.
- 4.3.2 It is important that NI Water take ownership of its PC13 Business Plan to ensure it meets not only our needs but also the needs of its Board and Shareholder. We will however define our information requirements to ensure that we continue to be able to robustly determine outputs and ensure Value for Money for all water and sewerage consumers.
- 4.3.3 One of the lessons from PC10 was to adopt the more traditional approach of having the company submit both a draft and final business plan. This was thought to provide a better opportunity for exposure and discussion of issues between stakeholders and afford more discussion prior to final decisions. This is not feasible given the timeframe for PC13. We discussed in Chapter 3.0 how we intend to take a proportionate approach to information needs and the engagement of wider stakeholders to address the absence of a draft Business Plan.
- 4.3.4 Table 4 below provides key dates for engagement between the Regulator and NI Water leading to the submission of the company's business plan:

Table 4: NI Water Information Requirements and Business Plan Submission

Key Dates for Price Control	Date
Capex, Opex efficiencies and Financials IRWG inform PC13 information requirements, looking forward to PC15	September through December 2011
Regulator issues guidance to NI Water on PC13 Information Requirements	13 th December 2011
NI Water submits Capital Investment Plan to principal stakeholders for discussion in working groups and ultimately Water Investment Co-ordinating Group (WICG) for endorsement	Final CIP submission to Regulator December 2011
Regulator, following final DRD Ministerial letter on principles and objectives for PC13, issues any further guidance to NI Water on its PC13 Business Plan as required	February 2012
NI Water submits PC13 Business Plan	21 st May 2012

4.4 Utility Regulator determines PC13 contract, outputs and price limits to align with PE budget allocation

- 4.4.1 It is our statutory role to determine the revenue and set price limits which reflect the lowest overall costs of delivering Ministerial objectives for NI Water. We do so by analysing NI Water's business plan and other regulatory submissions and making comparisons of the proposed costs with those that would be incurred by an efficient service provider elsewhere in the industry. We will also consider the implication of NI Water's current status as an NDPB and the impact of any associated constraints on its ability to drive our efficiencies.
- 4.4.2 We will where appropriate, and to reduce the regulatory burden, apply the same principles and methodologies from PC10. We will adhere to the MoU between the Regulator and the DRD and the Consequent Written Agreement. We will consult on our draft determination and have regard to any representations made, before making our final determination.

Table 5: Regulator's PC13 Key Publications

Key Dates for the Price Control	Date
Regulator publishes PC13 Overall Approach	19 th October 2011
Regulator publishes and consults on Draft Determination of revenue & price limits	13 th September 2012 to 8 th November 2012
Regulator publishes Final Determination of revenue & price limits	13 th December 2012

5 The Price Control 2013 Programme

5.1 Programme Timetable

- 5.1.1 The limited time available to prepare an overall cost and price control, compounded by the Freeze/Thaw incident of 2010/11 and the need to take into account the funding limits as set out in the NI Executive Budget for 2011-15, determined the two year timeframe for this Price Control.
- 5.1.2 The Regulator tabled a proposed timetable and outline process with NI Water on the 29th July 2011 and in its response to the workshop, discussions indicated that 'it broadly concurred with the Utility Regulator's proposed PC13 timetable'. It noted the timescales were challenging and emphasised the need to publish the Final Determination in mid-December.
- 5.1.3 A key concern for the principal stakeholders was that the PC13 process did not impact negatively on the more strategically important PC15 price control. While we have not prescribed on our approach to PC15, we have sought to review the programmes for each to ensure they are as mutually supportive as possible.
- 5.1.4 Table 6 sets out the overall timetable for PC13. The programme is dictated by the end point and the need for the Regulator to approve NI Water's Charges Scheme, required by legislation and to operate from 1st April 2013.

5.2 Communication and Consultation

- 5.2.1 We have and will continue to engage on a regular basis with NI Water and principal stakeholders as outlined in this document and as reflected in the high level summary programme shown in Table 6.
- 5.2.2 We will also publish and consult on our draft determination over an eight week period commencing on the 13th September 2012.
- 5.2.3 However, in advance of the consultation on the draft determination, we believe and would expect the company to publish a brief summary of its Business Plan for the PC13 period, 2013-15.

Table 6: Indicative PC13 Programme Timetable

Price Control Stages	PC13 Timeline
1 st PC13 Stakeholder Workshop and consultation	14 th December 2010
Bi-lateral consultation meetings	June through September 2011
2 nd PC13 Stakeholder Workshop	22 nd September 2011
Publication of PC13 Overall Approach	19 th October 2011
Regulator issues guidance to NI Water on PC13 Information Requirements	13 th December 2011
DRD Ministerial letter confirms principles, objectives and funding for PC13 period	February 2012
NI Water submit PC13 Business Plan	21 st May 2012
Regulator publishes and consults on Draft Determination	13 th September 2012 to 8 th November 2012
Regulator publishes Final Determination	13 th December 2012
Company decision	15 th February 2013
1 st year of PC13 Charges Scheme	1 st April 2013

Annex A – PC10 Lessons Learnt

Introduction

The Regulator's PC10 price control covering 2010-13 whilst not subject to intensive independent review was subjected to internal review by our Board and principal stakeholders. This culminated in a December 2010 Workshop of Stakeholders where key PC10 "lessons learnt" were discussed and then agreed between participants.

In addition the Regulator's own Internal Audit reported a similar need to address the following "lessons learnt" at future price controls, whilst concluding that the PC10 price control provided the highest level of audit assurance that,

"there [was] a robust system of risk management, control and governance which, ...ensure[d], ...objectives [were] fully achieved".

Lesson 1 - Introduce a draft Business Plan

PC10 "lessons learnt" stated, *"the introduction of a draft Business Plan should allow issues relating to scope, cost and understanding to be resolved early"*.

This is not immediately supported by PC13 due to its two year duration and its limited scope for engagement with the company.

Whilst this lesson from PC10 is better captured within a longer term five year Price Control period, we anticipate establishing at PC13 a "new approach" to engagement with NI Water post-Business Plan submission. This will allow us to examine the Business Plan and raise concerns & issues with the company much earlier than previously.

We anticipate this approach will avoid complicated mis-understandings between ourselves and the company and help speed up the process of making our determination.

Lesson 2 - Make the reporting requirements local

PC10 "lessons learnt" stated, *"sufficient time should be allowed to develop reporting requirements which reflect the local context"*.

Our intention is to mould the existing and much shorter reporting requirements around the PC10 Capex Review. Depending on the success of this and subsequent Review of PC13, this approach may support its further development as a vehicle for sustainable Business Plan reporting at PC15 and beyond.

The same proportionate approach is expected to apply to Opex tables where any claims for additional Opex, on top of NI Water's 2010/11 baseline, will be examined in detail where they are judged material. This approach will ensure an 80:20 focus upon NI Water's activities for the PC13 period.

Lesson 3 - Need for additional time

PC10 “lessons learnt” stated, *“an initial period of consultation and development should be maintained to set a robust longer term determination”*.

This PC10 lesson is not immediately available given a two year Price Control but our intention is to fully adopt such a position at PC15.

Lesson 4 - Consumer Engagement

PC10 “lessons learnt” stated, *“broad agreement was reached at our December Workshop with principal stakeholders that the consumer consultation at PC10 worked well”*.

Given the limited scope offered by PC13 for new, robust consumer engagement, married with the fact that the current Social and Environmental Guidance will apply to PC13, it has been agreed by all principal stakeholders that there is no need or time for additional consumer research to be carried out for PC13

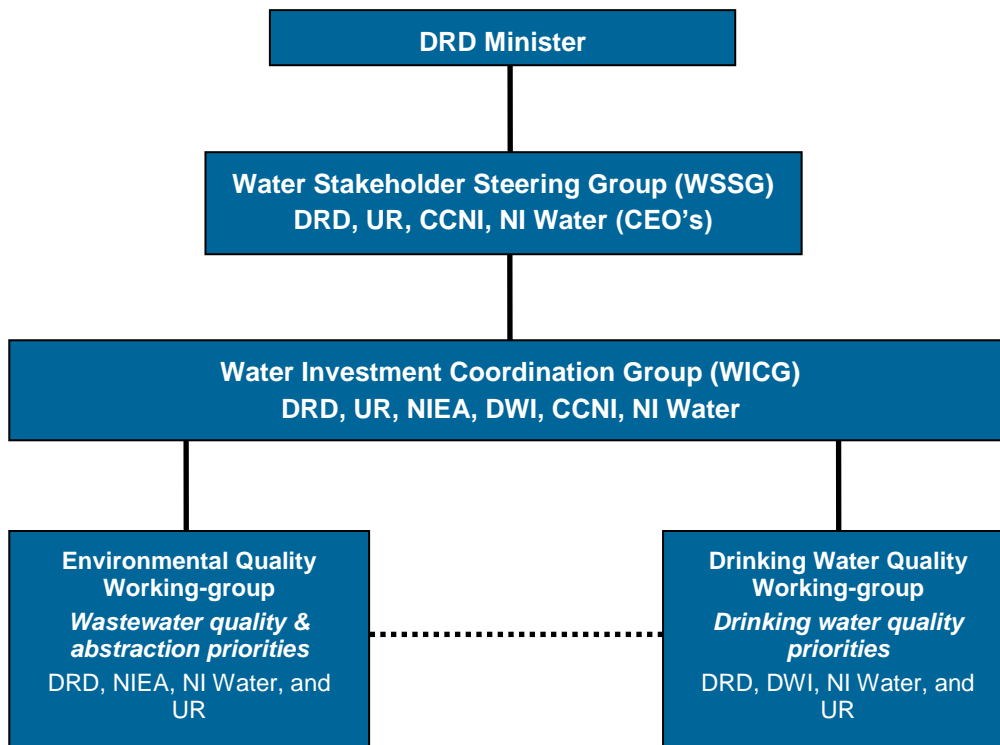
Comprehensive consumer research will be carried for to inform PC15 with a focus on both domestic and non-domestic consumers.

Lesson 5 - Working Groups

PC10 “lessons learnt” stated, *“good feedback was received from all stakeholders on the PC10 Working Groups and there was a consensus that they should be re-constituted around future Price Controls”*.

Whilst we originally intended to re-constitute the Working Group approach at PC13, with perhaps three Technical Working Groups instead of the five at PC10, we listened to our principal stakeholders at the September Workshop to amalgamate all three into a single Investment Prioritisation Group. We believe the WICG fulfils this role having playing a key role in co-ordinating, discussing and concluding on stakeholder views on priority and delivery of the capital programme outputs for PC13. Final endorsement of the PC13 outputs and priorities will be sought from the WSSG as at PC10.

However the environmental quality and drinking water quality sub-groups will still need to undertake the detailed technical assessment of outputs and review the prioritisation and deliverability of outputs to inform the WICG’s decisions. The agreed outputs of this process will underpin the development of NI Water’s PC13 Business Plan and forms a key early output in the overall development of this Price Control. Figure 1 below depicts the working group structure for PC13.

Figure 1: Proposed PC13 Working Groups

Lesson 6 - Need for PE alignment

PC10 “lessons learnt” stated, “*principal stakeholders all agree with the need for the Regulator to build PE processes and alignment with spending limits into PC13*”. The PC10 CAPEX Review is already underway so that PC10 Capex is delivered within an extended public spending five year window rather than the three years as originally anticipated at PC10. This process ought to support comprehensive and appropriate alignment to Capital Departmental Expenditure Limits (DEL) at DRD level.

The Regulator’s Memorandum of Understanding with DRD and the Consequent Written Agreement relating to PC10 has already established the mechanisms for alignment to PE spending limits. The company’s recent Relevant Items bid for additional Opex ensures the Regulator is fully involved in post-PC10 adjustments.

Stakeholders agreed that the principals of the MoU between the Department and the Utility Regulator addressed issues around the alignment of the regulatory and PE budgetary regimes and that it would apply for PC13. It was also agreed that a review of the accompanying Consequent Written Agreement should be carried out to address any areas requiring clarification and to incorporate any lessons from its application during PC10.