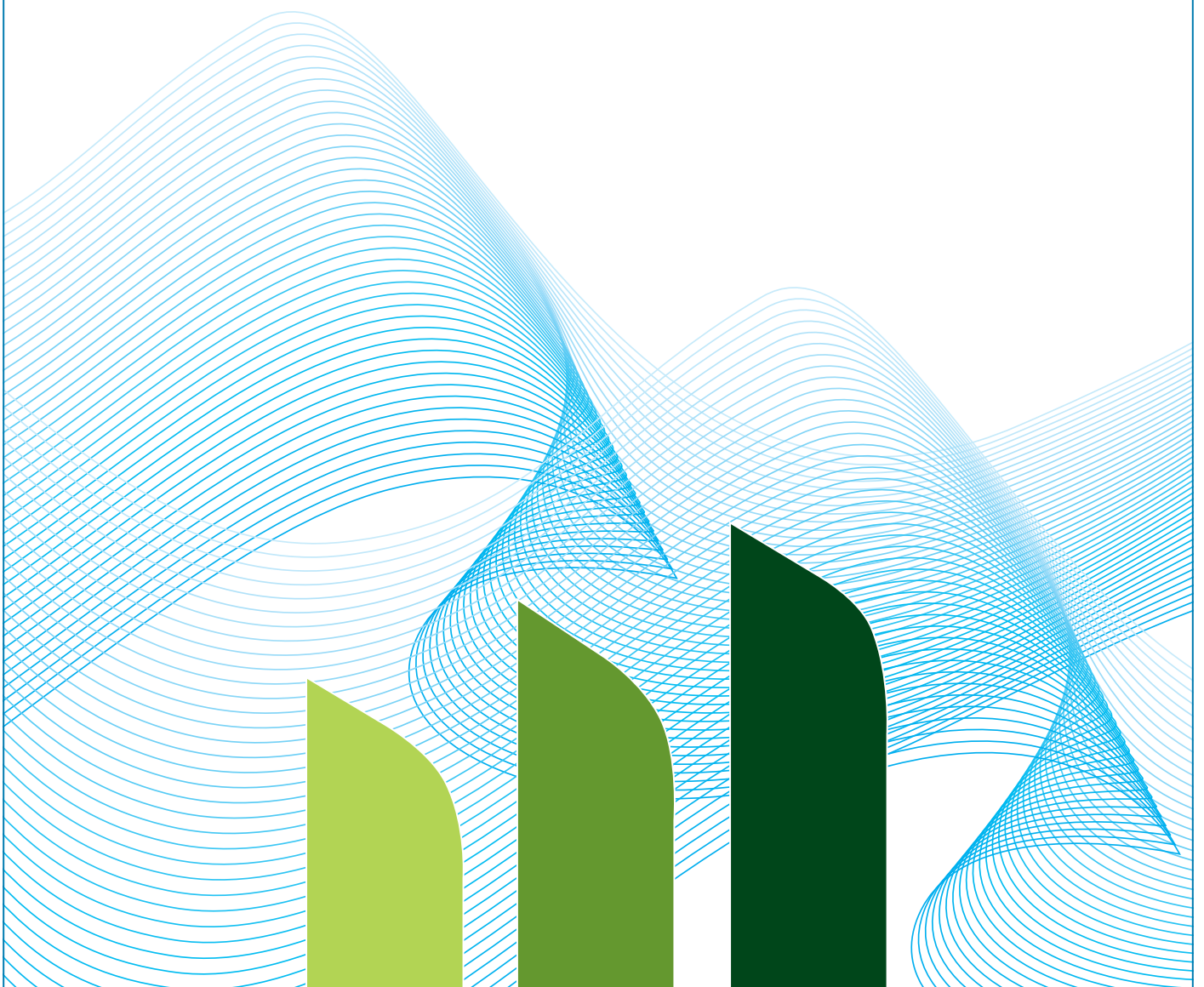


**The Utility Regulator's approach to the 2010-2013
Overall Cost & Price Control for Northern Ireland Water Limited**

January 2009



This document sets out at a high level the Utility Regulator’s approach to designing an overall cost & price control for Northern Ireland Water Limited to cover the period 2010 to 2013. Key tasks include identifying the investment needs for the provision of water and sewerage services during this period, and driving cost efficiencies. The purposes of the document are to inform all customers and stakeholders about the issues taken into consideration, the process of engagement, analysis and the programme.

In particular we wish to be transparent and outline opportunities for consultation during the process.

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The views expressed in this document are those of the Utility Regulator and reflect the regulator’s process for discharging its statutory duties as defined in the Water & Sewerage Services (NI) Order 2006. This document is not intended to anticipate the outcome of any Executive decision following public consultation on the Independent Review of Water and Sewerage Services.

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Foreword

The Regulator's primary role within the Northern Ireland Water Industry is to promote and protect the interests of the customers of Northern Ireland Water Limited. One of our most important duties is to advise the Regional Development Minister on the amount of revenue that NI Water needs to meet the Minister's strategic objectives and direction which are informed by input from all statutory policies and by formal consultation.

The Utility Regulator's work on water is necessarily subject to the NI Executive's forthcoming public consultation on the reports of the Independent Water Review Panel (IWRP). The outcome of that consultation will decide the future of water and sewerage services and hence the development of regulatory processes. Our views on the IWRP reports can be found on our website and Annex A of this document lists five key criteria that we proposed to the IWRP as being critical for a successful Water & Sewerage Industry in Northern Ireland.

It is important that the assessment of NI Water's revenue requirement and associated charges are determined through a robust and transparent process. This is why we have proceeded with defining a three year price control from April 2010 to 2013. We have developed the process alongside the engagement and briefing of the principal stakeholders. Subject to a final decision by the Executive with regard to the review of water and sewerage services, it is our intention to revert to five year price controls from April 2013 as provided for in the Water and Sewerage Services (NI) Order 2006 and NI Water's Licence.

With this first price control we view it as essential that NI Water develops its systems and planning to deliver quality data which can be trusted, openly reported on and benchmarked. This will facilitate the driving out of inefficiency and underperformance and the closing of the gap with its GB counterparts.

We welcome and are dependent upon the decisions made by our local ministers as policy makers who recognise and are focused on the value of water and the importance of managing this vital resource. Our vision is for a water industry framework for NI which takes account of the economic, social and environmental impacts of the sector, which addresses the key sustainable development challenges ahead, and which delivers high quality, good value and safe services to NI customers.

Jo Aston
Director of Water Regulation

Chapter 1: Background to NIAUR and Principal Stakeholders

Introduction

The Water Directorate of the Northern Ireland Authority for Utility Regulation (NIAUR) exists to promote the interests of water and sewerage customers. One of the ways in which we ensure that customers receive best value for money is by controlling costs and setting prices which allow NI Water to deliver water quality, environmental and customer service objectives at the lowest reasonable overall cost.

Overall limits on how prices can rise (or by which they are required to fall) are set through a process referred to as Price Control. Overall cost & price controls are normally carried out every five years. However, given that we are in a transition phase between a publically funded water company and a self-financing utility prior to a final decision by the Executive, our first overall cost & price control will cover a three year period.¹ This document outlines our approach for this Overall Cost & Price control for the three years 2010 – 2013 referred to as PC10.

The principal aims of an Overall Cost & Price Control are to ensure that:

- Costs are optimised and prices are set at the lowest level that is consistent with delivering the objectives in line with the strategic direction for NI Water set by the Minister for Regional Development;
- NI Water invests efficiently and effectively and consequently will deliver the desired environmental, public health and customer service improvements at value for money prices; and
- NI Water narrows the gap between its performance and that of the English, Welsh and Scottish water and sewerage companies.

This will be our first Overall Cost & Price control and the process is essential to help to determine revenue requirements and associated charges to meet ministerial objectives and priorities to support a sustainable water and sewerage service in Northern Ireland.

In carrying out the price control we intend to follow the five principles of better regulation. These are:

- accountability;
- consistency;
- proportionality;
- targeting; and
- transparency

¹ This will require an amendment to the Instrument of Appointment (the Licence) through which Northern Ireland Water (NIW) has been established as the water and sewerage undertaker under the Water & Sewerage Services (NI) Order 2006. NIAUR is currently preparing this amendment for consultation in the early part of 2009.

NIAUR and NI Water Regulation

April 2007 saw not only the creation of NI Water as a government owned company, but also saw the remit of Northern Ireland's gas and electricity regulator extended to embrace water. The new Northern Ireland Authority for Utility Regulation, NIAUR, has been building a Water Directorate team and developing regulatory processes for NI Water since April 2007.

With regulation comes improvements in transparency and accountability which benefit all stakeholders and customers. There are two main sets of data submissions from the water company to the Regulator that provide the basis for regulation. These are the Annual Information Returns (AIR) and the submissions relating to overall cost & price controls (PC), which are the subject of this document.

The Annual Information Return is the principal information submission that NI Water makes to us. The return includes information about customers, assets and financial performance. It also covers progress on the agreed investment programme. NI Water's AIR for 2007/08 was submitted to us on the 22 August 2008; following detailed analysis we will publish a cost and performance report on the company in February 2009. The AIR for 2007/08 (referred to as AIR08) and the AIR09 will underpin our draft determination for costs and charges for PC10.

In developing PC10 and determining the costs and charges for NI Water, we want to ensure that the process is as transparent as possible. The significant review of water reform by the IWRP, which we welcomed, has impacted the programme for this price control. We regret the late release of this document, but are keen to inform all stakeholders of the overall approach now being applied, with the engagement of all statutory partners.

It is important that we do not work in isolation but seek to co-ordinate the roles of other principal stakeholders in the PC10 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 PC10 and are committed to working with them to secure a successful outcome.

Principal Stakeholders for PC10

The Water and Sewerage Services (Northern Ireland) Order 2006 and the Instrument of Appointment of Northern Ireland Water Limited ("Licence") set out the roles and responsibilities of the various organisations including NI Water (NIW), the Consumer Council for NI (CCNI), the NI Environment Agency (NIEA), the Drinking Water Inspectorate (DWI) and the Minister for Regional Development.

The Utility Regulator Water Directorate

The Utility Regulator is the economic regulator responsible for the regulation of Electricity, Gas and Water in Northern Ireland. The Water Directorate within the Utility Regulator has responsibility for the development of the economic regulation of NI Water.

The core duties of the Utility Regulator are:

- to protect customer interests;
- to ensure NI Water carries out its functions properly as respects every area of Northern Ireland; and
- to ensure NI Water is able to finance its functions.

In discharging these duties, we:

- set revenue requirements and associated charges to meet the strategic objectives and direction set by the Minister for Regional Development to support a sustainable water and sewerage service in Northern Ireland;
- consider and approve NI Water's annual scheme of charges;
- determine on complaints which are not resolved by the company or CCNI working on behalf of the customer with the company;
- monitor and report to the NI Ministers on NI Water's annual costs and performance;
- protect customer benefits from proceeds of disposal of protected lands;
- contribute to sustainable development;
- provide advice, when requested by the NI Ministers, on a range of matters relating to the impact of NI Water on its customers.

As a non-Ministerial department of government, the Utility Regulator is accountable to the NI Assembly. We do however, work closely with the Department for Regional Development under the Minister Conor Murphy who provides the strategic direction for the water industry.

We also consider ourselves to be accountable to the customers of NI Water. This accountability is achieved through a range of consultation forums and meetings, as well as through the publication of information and reports on NI Water's performance. It is our principle to publish material where appropriate and we are in the process of improving our website.

Northern Ireland Water

NI Water is responsible for the provision of water and sewerage services in Northern Ireland. NI Water is a statutory water and sewerage company in Northern Ireland and is wholly owned by the Government with the Minister for Regional Development, acting as both shareholder and policy maker for water and sewerage. It operates in accordance with company legislation and is subject to the economic and quality regulation relevant to water companies in the United Kingdom.

Prior to April 2007 water and sewerage services for NI were provided by Water Service, which was an agency under the remit of the Department for Regional Development.

The Consumer Council for Northern Ireland

In April 2007 the Consumer Council took on the legal role of consumer representative for water and sewerage customers. Its job is to 'speak up for consumers and give them a voice'. The aim of the Consumer Council is to ensure 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. Another important function is the assistance it provides to individual consumers in striving to resolve complaints where the company has failed to satisfy a complaint.

In recognising the important role CCNI has, we have sought to engage them in the development of the PC10 process and encouraged their research into customers' views.

The Drinking Water Inspectorate (DWI)

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

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; and,
- Develops policy and regulation on drinking water issues, in association with other UK Drinking Water Regulators.

Northern Ireland Environment Agency

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

It takes the lead in advising on, and 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. NIEA as environmental regulator of NIW;

- regulates all discharges to waterways under the Water (Northern Ireland) 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 NIW assets;
- regulates abstraction and impoundment of water through a licensing system; and
- applies the NIEA Enforcement and Prosecution Policy.

The Minister and the Department for Regional Development

The Minister for Regional Development is in charge of the Department for Regional Development. 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.

The Assembly Regional Development Committee also has an important oversight role in relation to DRD including scrutiny of water and sewerage issues.

Chapter 2 Economic Regulation

Introduction

Prior to setting out the process for price control it is important to explain the wider role of economic regulation within the water industry in Northern Ireland.

Network utility industries tend to be natural monopolies because the cost of replacing the network is excessive. Customers should not have to pay higher prices or accept lower levels of service because they are unable to choose their supplier. The purpose of regulation is to ensure that monopoly businesses act in the customer interest. The behaviour of natural monopolies if unchecked may work against the customer interest in two ways:

- i. If the service is essential and the customer has no choice about where to purchase it, the monopoly has an incentive to charge an excessive or unchallenged price;
- ii. In the absence of competition the monopoly faces no incentive to innovate and improve its efficiency over time.

Economic regulators seek to establish budgetary constraints on the regulated body. This involves the establishment of clear statements defining the outcomes that the body must deliver for customers and the associated amount of money that can be spent. This can be achieved by fixing the maximum return available (unless targets are exceeded) or by limiting the total cash funds that may be consumed. In general, budgetary constraints are set at a level that can only be met by improving efficiency, hence creating incentives to improve efficiency. In some cases companies can retain the proceeds of out-performance against efficiency targets for a period, which creates an extra incentive.

The fixed budgetary constraints are designed to focus the attention of management on delivering ongoing improvements in value for money to customers. We facilitate the definition of these outcomes and associated budgets through the mechanism of overall cost and price control. We also monitor and report on performance on an annual basis. This robustness of process, monitoring and reporting of performance brings transparency and accountability to NI Water's performance.

Within a regulatory regime, the determination of the fixed budget to deliver agreed outcomes over a set period is achieved solely through the overall cost and price control process. This is the mechanism defined in the Water & Sewerage Services (NI) Order 2006 which sets out the Regulator's duties.

Overall Cost & Price Control April 2010 to 2013

This is the first overall cost & price control for NI Water. It will identify and set NI Water's revenue requirements for 2010/11, 2011/12 and 2012/13 such that the real investment needs of the industry can be met and ministerial objectives delivered. It is vital that the planned investment brings about overall improvements in water quality, the environment and service standards, for the benefit of its customers. This however, must be done efficiently and effectively, delivering best value for money to the customer.

The overall cost and price control process will be the core of the new regulatory regime for Northern Ireland Water in that it will aim to ensure that the monopoly supplier acts in the interests of customers. All aspects of the business of NI Water will be addressed and the objectives to be delivered will be tailored in light of the costs, customer needs and the environment. Although the water industry in Northern Ireland is still in transition, it is essential to lay the foundations of a robust and transparent price control process even at this early stage.

In promoting customer interests we aim through PC10 to:

- set price limits consistent with the delivery of statutory obligations, addressing historic under-funding and ensuring that future generations are required to pay only for the service that they receive;
- further advance the introduction of management information parameters, which will allow for consistent efficiency targets to be set for NI Water and for proper comparisons to be drawn for benchmarking purposes;
- advance the development of a common asset management process to provide transparency and allow the customer to be confident that best value in procurement and maintenance is achieved;
- assist in the creation of a customer service vision where the needs of individual customers are met to a greater extent than before.

PC10 includes consideration of the issues critical to the water industry at its present stage of development. The critical issues identified include:

- sustainability, balancing the needs of the customers of both today and tomorrow;
- scope for environmental improvements;
- scope for efficiencies;
- reliability and comparability of data;
- the management of risk.

It must also embrace policy decisions from the NI Assembly, critical issues include:

- Financing NI Water – Charging policies
- Affordability – Social policies
- Water Reform – Review of the public sector model

PC10 creates a framework within which annual charges are proposed by NI Water, and approved or otherwise by the Utility Regulator. The charging statement covers standard water and sewerage infrastructure charges and road drainage charges for the year in question.

NI Water needs to collect sufficient revenue from its customers (or government in the absence of domestic charges) to finance its operating expenditure and its capital investment programme for the three year period 2010 to 2013.

The process for determining revenue and setting overall cost and price limits

NI Water needs to be able to finance its operating expenditure and its capital investment programme. It also needs to continue to finance previous capital investment through the return the company earns on its Regulatory Capital Value (RCV). In addition like any other company it needs to pay tax. The sum of these costs is the revenue requirement.

The annual percentage difference between the revenue requirement and the base year revenue expected from customers is the price limit. We will check that the outcome of this calculation provides annual price limits that will enable NI Water to obtain the capital it needs to deliver the improvement required.

The general approach to setting price limits is depicted in Figure 1. It is a simple representation of the financial model that we will use to determine revenue requirements and set price limits.

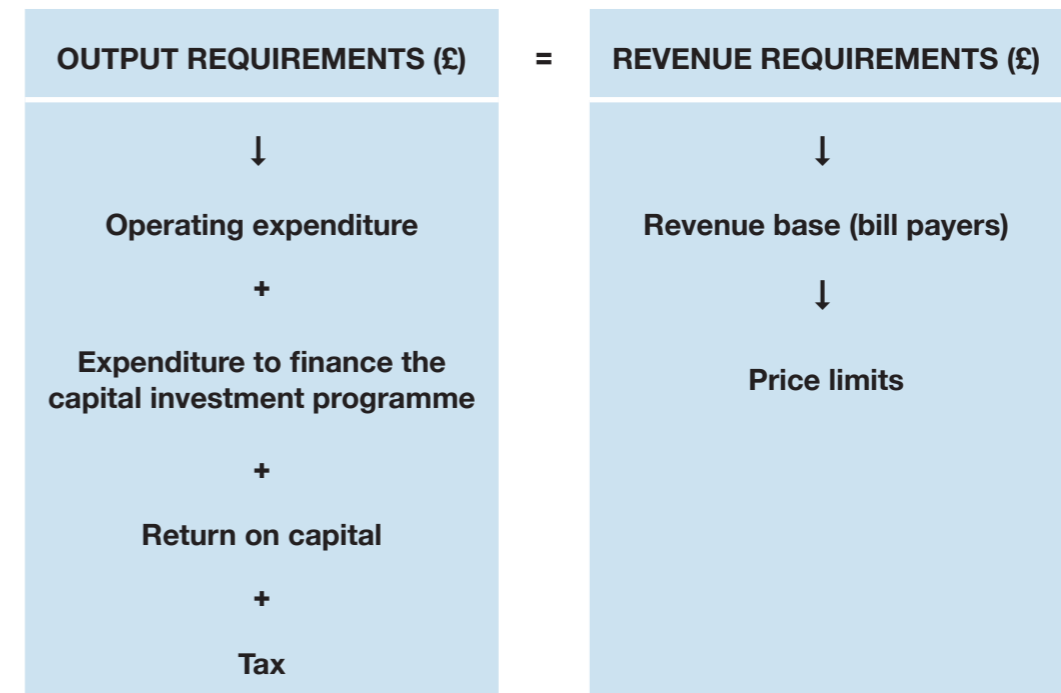


Figure 1 Approach to determine revenue and associated price limits

We will, for purposes of ensuring no undue discrimination between the various customer groups and for benchmarking continue to apply this broad approach to the setting of price limits.

We will, however adjust our financial model to reflect charging policies when, following consultation they are agreed by the NI Executive. Some of the factors which may have to be considered include:-

- Payment for Road Drainage;
- Social Policy based on principles of affordability;
- Partial introduction of domestic charging.

Determining NI Water's Revenue – The Roles of the Minister for Regional Development and NIAUR

While NI Water's revenue need is in simple terms, the sum of its operating and capital expenditure requirements, these in turn are dependent upon the objectives the company must deliver over the PC10 period and the level of efficiency it is set to achieve.

These objectives will be set in line with guidance on key social and environmental priorities provided by the Minister for Regional Development in consultation with statutory partners. It is expected that this guidance will outline the priorities for investment for the PC10 period and detail the principles which should be applied in setting tariffs for customers.

The Utility Regulator determines the maximum level of costs and charges that NI Water can expend and apply by;

- examining NI Water's Business Plan and detailed regulatory information submissions;
- assessing the soundness of the company's strategy to deliver the objectives set by the Minister and the robustness of its business plan;
- benchmarking its costs; and
- setting the efficiency targets.

The maximum costs and charges are determined by the Utility Regulator ensuring that the Minister's strategic objectives and directions are met. The current PC period has to take account of the continued subsidy being paid on behalf of customers by the Executive.

It is important that the objectives for PC10 and the principles of charging set by the Minister are cohesive with the maximum level of overall costs and charges determined through the overall cost and price control process.

We are accountable to the Competition Commission for our overall cost and price control. NI Water has the right to refer our determination to the Competition Commission in an appeal. If this happens the Competition Commission will review NI Water's plans and our determination, to reach its own conclusion on appropriate costs and charges.

Figure 2 illustrates our proposals for the basic regulatory regime between the Minister, NIAUR and NI Water post April 2010.

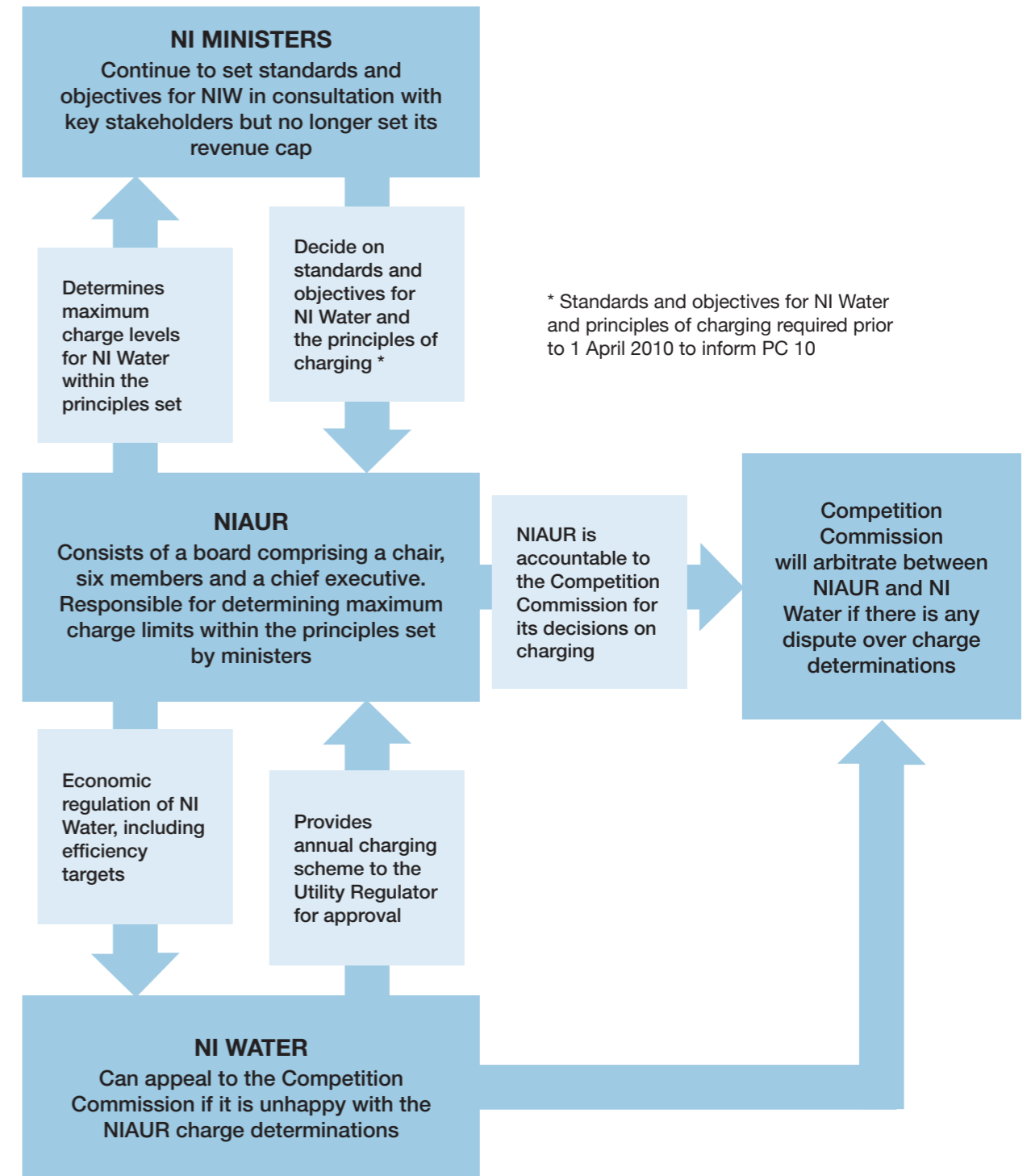


Figure 2 – NIAUR Proposals for Economic Regulation for NI Water from 2010

Chapter 3 Key Stages of the Price Control 2010

PC10 aims to deliver best value to customers by setting out what the industry should achieve for customers over a specific time period, and then reaching decisions about how this can be done at the lowest overall reasonable cost. To be successful, the process requires effective consultation and a collaborative approach from all stakeholders in the industry.

A short explanation of the key stages in the process, and when they have taken place or are programmed to take place for PC10, is set out below.

Principal Stakeholder Engagement

The development of the PC10 programme commenced with a series of workshops between the Utility Regulator and the principal stakeholders. The workshops outlined the Utility Regulator’s proposals and sought to draw out through discussion, individual roles and engagement in the process going forward. Following the formal workshops, meetings were held across the different stakeholder groups and a PC10 Stakeholder Group Structure developed.

PC10 WORKSHOP	STAKEHOLDER	DATE
Process, programme and engagement	NI Water	4 Mar 2008
Process, programme and engagement	DRD Policy Unit	24 Apr 2008
Process, programme and engagement	CCNI	30 Apr 2008
Process, programme and engagement	DRD Shareholder Unit	1 May 2008
Process, programme and engagement	NIEA and DWI	22 May 2008
PC10 Stakeholder Workshop	All Stakeholders above	29 Aug 2008
Process, programme and engagement	DRD Committee	17 Jun 2008

Table 1: Principal Stakeholder PC10 Engagement

The Principal Stakeholder workshop on the 29 August provided a forum for the final briefing of stakeholders on the Utility Regulator’s overall approach.

The main outcome of this workshop is the extension of the initial price control to a three year period and the creation of the Water Stakeholder Steering Group, chaired by DRD and attended by NAIUR, CCNI, and NIW (NIW will, on occasions, absent itself from the group in respect of certain items); the Output Review Group chaired by DRD and attended by NIAUR, CCNI, NIEA, DWI and on occasions NIW.

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

The legislation requires the Department for Regional Development 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 also be laid before the Assembly with the statutory period for consultation being applied.

To facilitate and inform the Minister’s consultation and decisions, statutory stakeholders have agreed a Stakeholder Group Structure involving the principal stakeholders to co-ordinate and harness their respective expertise and roles in the process. This structure and the stakeholders represented on each group are depicted in Figure 3.

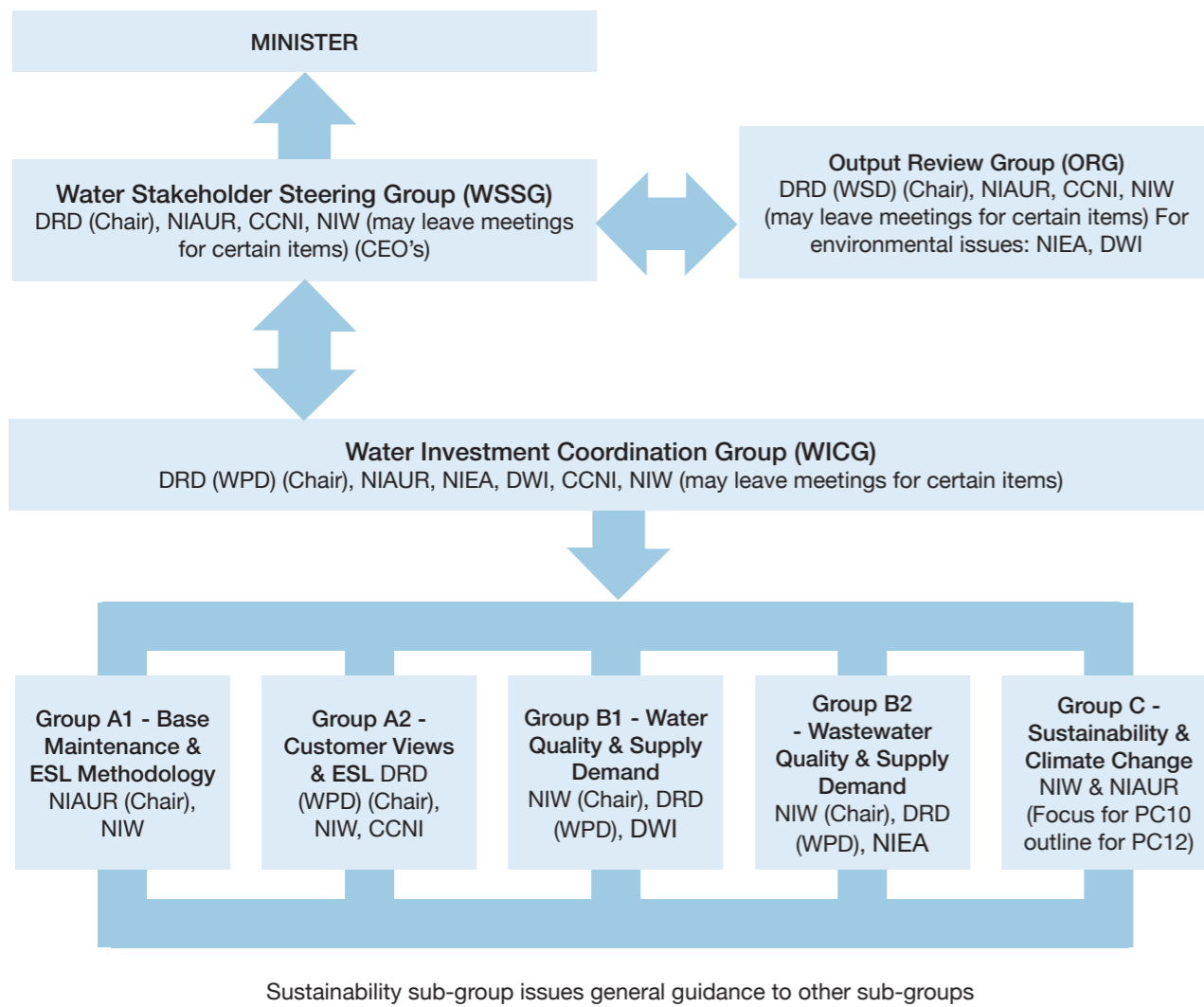


Figure 3: PC10 – Stakeholder Group Structure

These stakeholder working groups facilitate agreement of the more technical objectives and requirements which the Minister will wish to consider in defining and consulting on the priorities for investment and associated objectives to be delivered from PC10 associated with:

- Customer Service
- Investment and quality
- Supply and demand/water resources
- Capital Maintenance
- Sustainability and Climate Change

Table 2 provides an indication of the timings necessary to meet the required consultation on the draft determination to facilitate the completion and publication of the final determination in December 2009. This timing is required to ensure that the approval of charges is finalised for the continuation of non-domestic water charges and the DRD subsidy (unless domestic water charges are introduced) in April 2010.

KEY DATES FOR PRICE CONTROL	PROPOSED DATES
NI Executive publishes consultation on the principles of charging and water reform	Unknown: Ideally received by spring 2009
NI Executive publishes decisions on the principles of charging and water reform	
DRD supported by Water Stakeholder Steering Group submit PC10 report to the Minister	TBC
Minister issues draft guidance and consults on the Principles of charging and strategic objectives for PC10	TBC
Minister issues guidance on the principles of charging and objectives for PC10	TBC
Ministers issue Directions for 2010 to 2013	TBC

Table 2: NI Executive and Ministerial Consultation and Guidance

NI Water submits its Business Plan

We ask NI Water to submit a business plan setting out the level of operating and capital costs that it expects to incur in order to deliver the Minister’s strategic objectives. The business plan is an important element of the overall cost & price control process and is used to supplement the existing regulatory returns supplied to us by NI Water. We issue business plan information guidance to NI Water on the content and format of the plans in order to ensure that we receive the information necessary for us to determine revenue requirements and set price limits.

The business plan is the means by which NI Water advises us of its strategy for the future, both in terms of the investment it plans to make and the prices it wishes to charge.

The price review process for the English, Welsh and Scottish water companies involve the submission by the company of a draft and final business plan. This two staged approach affords more time for the Regulator to receive and the company to prepare additional information if considered appropriate. It also leads to a more refined process giving less potential for significant disparity between the draft and final determinations. Time and the current circumstances in the Northern Ireland water industry do not facilitate this preferred two staged approach for PC10.

To overcome this limitation through the working groups and discussions with NIW, the Water Stakeholder Steering Group defined the requirements from the company for an early assessment of their capital cost requirements for the three year period. NI Water submitted its assessment of capital cost requirements to DRD on 12 December 2008. This early estimate will be utilised to inform quality and standards objectives defined in the technical groups.

KEY DATES FOR THE PRICE CONTROL	DATE
Consultation with Company to inform Utility Regulator decisions regarding Business Plan Information Requirements	16 Jun to 18 Aug 2008
Utility Regulator issues guidance to NI Water on Business Plan Information Requirements.	29 Aug 2008
NI Water submits to DRD draft prioritised Capex submission for PC10 with programme lump sums, as debated by Water Stakeholder Steering Group.	12 Dec 2008
Utility Regulator with reporter’s feedback discusses Capex submission with NIW	Jan/ Feb 2009
Utility Regulator, following final Ministerial Guidance issues additional guidance to NI Water on its business plan as required.	TBC May 2009
NI Water Submits business plan	TBC 1 Jun 2009

Table 3: Utility Regulator and NIW Business Plan Requirements and Submissions

The Utility Regulator determines revenue and sets cost and price limitations

Within a regulatory regime it is our statutory role to determine the revenue and set price limits which reflect the lowest overall reasonable cost of delivering Ministerial objectives for the industry. We do so by analysing NI Water’s business plans (and other regulatory submissions) and making comparisons of the proposed costs with those that would be incurred by an efficient service provider. We will have due regard for the Reporter’s report on NI Water’s business plan and we will make use of comparable regulatory information from England, Wales and Scotland in making our assessments.

We will consult on our draft determination and have regard to any representations made, before making our final determination.

KEY DATES FOR THE PRICE CONTROL	DATE
UR Publish Overall approach to Price Control	Jan 2009
UR Publish Draft determination of revenue & price limits	3 Sep 2009
UR Publish Final determination of revenue & price limits	15 Dec 2009

Table 4: UR PC10 Key Publications

Chapter 4 Key Issues addressed by PC10

Key Areas

The key areas to be considered and costed as part of PC10 include:

- Customer Service
- Investment and quality
- Supply and demand/water resources
- Capital Maintenance
- Sustainability and Climate Change

Time for the development of systems, their population with data and subsequent analysis is limited for both the company and the Regulator for PC10. In applying the principles of better regulation it is our aim to make the process proportionate to a three year review. This will also result in us targeting our efforts to the areas of greatest expenditure and benefit to customers and to those areas most relevant to the three year period in question. Such a short term horizon is not ideal for this long term industry, so in approving capital expenditure we will consider programmes which span into the next 5 year review period, Price Control 2013 to 2018 (PC13).

A brief narrative of each of these key areas for PC10 is provided below.

Customer Service

Customers must be sure of the quality and value for money of the service. NI Water have reported their performance against Key Performance Indicators (KPI) in their Annual Report 2007/08. They have made good progress against many of the KPIs, but there is room for improvement and some KPI targets have yet to be established. We will be benchmarking NI Water costs and performance against the English, Welsh and Scottish Water (if possible at the time) Overall Performance Assessments (OPA). We will use this information together with the AIR09 submission to inform discussion on our determination decisions and drive the closing of any gaps in performance.

We will require NI Water to reflect customer views and priorities in their business plan. We support the Customer Views Research for PC10 which the company is undertaking in conjunction with CCNI. This research is a key input in the PC process and is focused on providing an understanding of customer priorities in relation to the service provided by NI Water. In particular it is asking questions on:

- What service areas do NI customers want NI Water to prioritise and improve?
- By when do NI customers want these priorities met?

The research is being carried out in two phases:

Phase One was a high level assessment of consumer priorities consisting of four strands:

- Three sessions with the Consumer Council's consumer panels
- Eight focus groups
- 16 in-depth interviews with non-domestic customers
- A pilot survey of 301 households across Northern Ireland which acted as a pilot scheme for Phase Two and provided information on ranking of service measures and service price options.

Phase Two will provide a final set of priority weightings based on a quantitative survey of over 1000 households.

Investment and Quality

DRD Water Policy Division will submit a report on the outputs to improve and safeguard drinking water quality, provide cleaner beaches and rivers and bring better service. The principal priorities for investment in quality for the period 2010 to 2013 set out in this report will help to inform the development of Ministerial Guidance to NI Water on key social and environmental priorities for 2010-2013. We will scrutinise NI Water's investment proposals to deliver the required outputs in order to make sure that they are appropriately scoped and costed and represent value for money for customers. We will also ensure that costs are appropriately allocated where there are overlaps with other areas of investment such as capital maintenance.

Supply and demand /water resources

The Water Framework Directive introduces important changes to the way the water environment must be managed across the European Union. It sets a framework which should provide substantial benefits for the long-term sustainable management of water. Articles 70 and 73 of the Water and Sewerage Services (NI) Order 2006, which require the company to prepare and maintain a water resources management plan, have not been commenced. While we commend the company for progressing work to facilitate this important area, we will not, for PC10 require NI Water to submit a formal water resource management plan. Security of supply elements will be required and we will also expect a reduction in leakage. We will be reviewing methodologies and setting targets for achievement of NI Water's economic level of leakage. Ministerial guidance will set priorities in this area.

Capital Maintenance

The water industry is an asset-intensive business. Capital investment allowed for in the Strategic Business Plan 2007-2010 to maintain and replace these assets is around £90million a year. NI Water must demonstrate that it is able to target this investment effectively, based on a clear understanding of how best to manage existing assets and make new investment.

Data reliability and trended information on customer service and serviceability of the assets is crucial to evidence this investment need. Methodologies applied by Ofwat have advanced over several price reviews. English and Welsh water companies are now required to justify capital maintenance on the basis of current and forecast probability and consequence of asset failure with and without investment. We must however accept that NI Water do not currently possess such trended and reliable data. We are working with the company to define a methodology for PC10 and a forward look to data needs for a more robust methodology to be applied to PC13.

Sustainability and Climate Change

In line with Government's vision for corporate social responsibility, we expect NI Water to take account of the economic, social and environmental impacts of its business. We expect it to act to address the key sustainable development challenges based on its core competencies wherever it operates.

We are not however requiring NI Water to submit and publish a Strategic Direction Statement setting out its vision and demonstrating how it is addressing the effects of climate change and developing a more sustainable service for the PC10 period. We will however require this for the five year PC13 review. We are aware of the forward thinking NI Water is already progressing and of its advanced environmental management system and look forward to seeing such advancements in the context of its business plan.

Key issues for debate and resolution

There are many issues in this first overall cost & price control review which require consideration and resolution in the early stages of the process. The uncertainties around charging policies and aspects of water reform have the potential to impact decision making on these vital issues. The issues are mentioned in this overview document but will be debated with the requisite stakeholders as appropriate to enable the overall Cost & Price Control to proceed. Consultation in a wider forum will also take place as considered necessary and viable within the overall programme. Some key issues may be revisited and consulted on to inform future Price Controls.

The issues being referred to include:

- Governance and incentives
- The calculation of revenue and prices
- The scope for efficiency

The calculation of revenue and setting of prices

To set overall cost and price limits, we undertake complex and detailed analysis and we are developing a financial model to facilitate this analysis. We will make decisions about issues such as the appropriate cost of capital, the role of financial ratios, the number and type of current and future customers, the costs that will be legitimately incurred by NI Water in running its business and how Ministerial objectives are delivered for the lowest overall reasonable cost.

We will be reflecting on some of the principles and assumptions applied to NI Water's Strategic Business Plan 2007 to 2010 and the projections beyond 2010 for the 2010/11, 2011/12 and 2012/13 periods. We will be considering the impact of the mitigation issues from the re-apportionment of costs between customer groups, the final Executive decision on recommendations from the IWRP, the financial treatment of base maintenance and the adequacy of the financial buffer weighted against the risk to the customer and service.

The Scope for Efficiency

NI Water are striving to improve both their operating costs and capital expenditure efficiency. Indeed, if we benchmark their costs to the English, Welsh and Scottish water companies, there is considerable scope for additional efficiency and thus better value for money to be delivered for the customers of NI. We will assess how much more NI Water can achieve by looking at the levels of performance achieved by other water companies together with the specific circumstances of NI Water.

Other important issues which will be discussed through the period of PC10 include:

- Financing NI Water and associated charging and subsidy policies
- Affordability and associated social policies
- Aspects of Water Reform and the public sector model

Chapter 5 The Price Control 2010 Programme

The Price Control 2010 Timeline and Programme

The limited time available to prepare an overall cost & price control, the relatively early stage of development of some of NI Water’s data systems and the uncertainties associated with the Executive’s consultation on Water Reform, have reinforced the decision to adopt a 3 year price control rather than the normal and legislated 5 year period. Additionally the offsetting of Price Controls from the English, Welsh and Scottish timeframes brings industry benefits, smoothing out the demands for construction and consultancy support.

The Utility Regulator tabled a proposed timetable and outline process with NI Water on the 4th March 2008 in the form of a workshop. Early engagement, prior to the development of papers was considered crucial to define a viable process. The means to facilitate NI Water input in the form of working groups was outlined and the company given four weeks to respond to material presented.

Significant issues remain regarding the Utility Regulator’s ability to tie down aspects of the programme including, the timing of the:

- NI Executive’s consultation on the reform of the water industry
- "Confirmation of dates" for consultation on Ministerial guidance

Nevertheless we considered commencement of the process an imperative to enable us to define information requirements and for NI Water to plan the preparation of their Business Plan and associated submissions to the Utility Regulator. It was also critical to progress matters as it takes time to develop robust and transparent processes.

Consultation is fundamental to the development of an open and transparent process. In acknowledgment of the impending NI Executive consultation on water, we proceeded to engage with the principal stakeholders in initiating the overall cost & Price Control process. We held PC10 workshops in March, April and May.

It is important that people and organisations have enough time to consider the issues, consult with others where necessary and formulate their responses. Good practice guidance suggests that people should be allowed 12 weeks to respond to a consultation. Our draft timeline allows 8-10 weeks for the Utility Regulator consultation on the draft determination. It is our aim to accommodate the 12 week consultation period in future 5 year price controls. Clearly the timing of Ministerial guidance is a matter for the Minister. The inclusion of a timeline in this document reflects our assumptions.

The following three tables divide the overall programme into three categories, namely:

- PC10 – UR and NI Water Information Exchanges
- PC10 – Ministerial Guidance
- PC10 - Consultation

PC10 – UR and NI Water Information Exchanges

EVENT OR ACTIVITY	DATE
UR Issue Cost Base Guidance	15 Apr 2008
UR Issue Capital Maintenance Economic Return Guidance	9 Jun 2008
NIW submit Capital Maintenance Economic Return	28 Jul 2008
NIW Annual Information Return 2007/08	22 Aug 2008
UR PC10 Business Information Guidance	29 Aug 2008
NIW submit draft Cost Base	10 Oct 2008
UR PC10 Updated Business Information Guidance (Version 2)	30 Jan 2009
UR issue Annual Information Return Guidance	31 Mar 2009
NIW submit final Cost Base	3 Apr 2009
NIW submit PC10 Business Plan	1 Jun 2009
NIW submit Annual Information Return 2008/09	15 Jul 2009
UR Publish Draft Determination	3 Sep 2009
UR Publish Final Determination	15 Dec 2009

PC10 – Ministerial Guidance

EVENT OR ACTIVITY	PROPOSED DATE
Stakeholder Groups meet • Financial Framework • Objectives	Sep 2008 to Jan 2009 and further as required
NIW submit view on capital programme	12 Dec 2008
Consultation on Ministerial Guidance Principles of Charging and Strategic Objectives	TBC
Issue of Draft Ministerial Guidance	TBC
Close of Ministerial Guidance Consultation	TBC
Issue of Principal Ministerial Guidance	TBC
Issue of Final Ministerial Guidance	TBC

PC10 – Consultation

EVENT OR ACTIVITY	PROPOSED DATE
UR publishes its Approach to the Price Control 2010 document	Jan 2009
NI Executive Consultation	
• Consultation Commences	TBC
• Consultation Closes	TBC
DRD Ministerial Guidance	
• Consultation commences	TBC
• Consultation closes	TBC
UR Draft Determination	
• Consultation commences	4 Sep 2009
• Consultation closes	6 Nov 2009

Chapter 6 Consultation and PC10

Consultations Influencing Price Control 2010

We are focused on being open and consultative in the execution of our duties and have engaged with the company, the Consumer Council, the Quality Regulators, the Department for Regional Development's Water Policy and Shareholder Divisions, the Regional Development Committee and the Minister for Regional Development on the structure of the PC10 process. Our PC10 programme identifies stakeholder and customer consultation opportunities which will feed into the process. We are also aware of the impact of a final Executive decision on the future of water and sewerage services which will be made in due course following public consultation.

Information on the Utility Regulator's Approach to PC10

This document sets out to explain at a high level our approach to identifying the investment needs for the provision of water and sewerage services for Northern Ireland covering the period 2010 to 2013. We seek in this document to inform all stakeholders about the process, the issues which it will address and the timelines.

Should you wish to make any comment on the document we would ask that you write or email the contact person identified in the front of this document. This is not however, a formal consultation as the programme of work has necessarily been initiated to meet the critical timeline.

NI Executive Consultation on the Principles of Charging and Water Reform

This consultation which will be managed by the Department for Regional Development, and which we hope will take place early in 2009, follows the extensive review carried out by the Independent Water Review Panel as commissioned by the Minister for Regional Development. The review examined the costs and funding, management, governance and delivery of water and sewerage services in Northern Ireland.

Consultation on Ministerial Guidance

A crucial aspect of the overall cost and price control is the prioritisation and defining of objectives to be funded and delivered for the PC10 period. This is facilitated by statutory partners working together and will inform the development of proposed ministerial guidance on key social and environmental priorities for consultation with stakeholders in early 2009.

It is crucial that NI Water receive clarity around what it has to deliver early in the process. This early guidance is essential to enable NI Water to comprehensively plan and cost associated works facilitating the submission of a robust business plan and its subsequent delivery.

Utility Regulator's Consultation on Draft Determination

Following the submission by NI Water of its Business Plan for 2010 to 2013 on the 1 June 2009, we will publish our draft determination of charges and the funding required by the company for this period. The document will outline our initial proposals for NI Water's overall cost and price limits. Following publication of the draft overall cost and price control there will be a period of nine weeks in which customers and stakeholders can make representations on the initial proposals.

This period of consultation provides the Minister with an opportunity to review strategic objectives in light of the impact of prices. We will consider all representations on the draft determination before publishing a final determination of charges.

UR Consultation Commences:	4 September 2009
UR Consultation Closes:	6 November 2009

Final Determination

The final determination is effectively a binding contract on NI Water, setting out what it must achieve and the budget it must not exceed over a given time period. As such, NI Water must carefully consider whether to accept the contract.

NI Water has the right to appeal to the Competition Commission against the determination. Should NI Water appeal the determination, the Competition Commission will scrutinise our price limits in detail. The Competition Commission has the power to accept our determination, or set price caps higher or lower than we have determined.

Summary of consultations which will inform the PC10 process

The table below summaries the programme for the consultations which will inform the overall cost & price control for the period 2010 to 2013.

KEY DATES FOR PRICE CONTROL	DATE
UR Publish Overall approach to Price Control	Jan 2009
NI Executive publishes consultation on the principles of charging and water reform	TBC
Close of Consultation	TBC
Minister issues draft guidance and consults on the Principles of charging and objectives for PC10	TBC
Close of Consultation	TBC
UR Publish Draft determination of revenue & price limits	4 Sep 2009
Close of Consultation	6 Nov 2009

Table 5: Summary of Consultations which will inform the Price Control 2010

Annex A NIAUR Response to the Independent Water Review Panel (IWRP) reports

We responded as invited by the Minister and the Regional Development committee to the two IWRP reports. In our responses we emphasised five criteria which we believe are key to support a successful water industry for NI. These are summarised below:

- i. The interests of current and future generations of consumers of water and sewerage services are paramount;
- ii. Roles and responsibilities between various stakeholders must be clear and risks must be clearly identified and allocated, ensuring that the customer does not pay twice;
- iii. Funding for water and sewerage must be obtained fairly and sustainability. Water pricing policies must ensure an adequate contribution to the recovery of costs of water services from industry, households and agriculture by 2010 as required by the Water Framework Directive;
- iv. Funding arrangements must enable long-term investment programme to be planned and executed to support environmental sustainability. This means funding must be secured/ ring fenced at least 5 years ahead, within a 25 year planning horizon; and
- v. Strong efficiency drivers are required to bear down on the cost of providing water and sewerage services. These will require:
 - a. Strong efficiency incentives, set with reference to “best in-class” performance, monitored effectively and independently; and
 - b. A long-term investment planning structure, with clear and transparent objectives associated with investment streams.

While outcomes from this consultation may not be known until early in 2009, we will where appropriate address and incorporate decisions made by the NI Assembly informed by Public Consultation.

Notes

