

NI 22 09

CBI response to NIAUR Draft Determination on Water and Sewerage Service PC 2010-1013

Introduction

- 1 CBI Northern Ireland welcomes the opportunity to comment on NIAUR's Draft Determination of Price Control proposals for Northern Ireland Water over the period 2010-1013. The CBI is the UK's leading business organisation, speaking for some 240,000 businesses which together employ around a third of the private sector workforce. No other UK organisation represents as many major employers, small and medium-sized firms or companies in the manufacturing and service sectors
- 2 The CBI fully supports the NI Water's Corporate Vision and Corporate Strategy as set out in its own Price Control 2010 Business Plan. This states
 - **Corporate Vision** - Working as one team we will become the number one water utility in UK and Ireland by 2014
 - **Corporate Strategy**
 - o To become the number one in customer service in the UK and Ireland water industry
 - o To deliver the greatest efficiency improvements in the UK and Ireland water industry
 - o To deliver the greatest improvement in water and waste water quality of any water company in the UK and Ireland
 - o To be externally recognised as a great place to work

This is an ambitious plan which we fully endorse.

- 3 The provision of high quality, cost competitive water and sewerage services are a vital part of the infrastructure required to support a modern and prosperous economy. Particular sectors, including the agri-food, engineering, chemicals and drinks sectors have significant water and trade effluent requirements while the success of the tourism sector will increasingly depend on a high quality environment. In terms of priorities for the 2010-13 period the CBI is keen to see improvements in four key areas:
 - Improved efficiencies in the delivery of services
 - Improved customer service and standards, with a more responsive, customer focused organisation



Nigel Smyth, Director, CBI Northern Ireland
DL: 02890 101100 **DF:** 02890 101119 **E:** nigel.smyth@cbi.org.uk

- Continued investment in capital assets and people to meet the needs of consumers and achieve appropriate environmental compliance as well as to ensure the assets are being appropriately maintained
- Increased predictability regarding tariffs to assist companies with their forward planning and investment decisions

Specific comments on NIAUR Draft Determination

- 4 As highlighted above a key priority for CBI members is to achieve an increase in the operating efficiency of NI Water and to have 'SMART' targets in place. We expect to see a robust and fair regulatory review take place which can provide the necessary clarity and confidence in the future of NI Water and its charging policies. Our analysis of the NIAUR Draft Determination against NI Water proposals raises some significant concerns, we have highlighted below.
- 5 With regards to **Operating Expenditure** we are surprised at the size of the discrepancy between NIW proposals and NIAUR proposals, and the major variance in the baseline Operating Expenditure.
- 6 A key issue appears to be the speed at which the efficiency improvements can be achieved. On page 35 NIAUR states "*.....efficiency targets to be set which incorporate a reasonable speed of catch-up to the industry benchmarks.....*". The proposals by NIAUR go significantly further and faster which does raise concerns about significant risks this will put on the new organisation, particularly the customer service aspects.
- 7 NIAUR is proposing operating expenditure efficiencies of over 30% during the three year regulatory period, some 15% beyond NIW proposals. This includes reductions in Operating Expenditure of over 20% in the first year from NI Water's current position. We are not aware of such challenging targets being established on any other UK utility and the scale of the proposals appears unprecedented. As such this does not appear to be a '*reasonable speed of catch-up*' and clearly raises risks for the organisation which in turn could potentially impact on the business community (and indeed the wider community). While CBI members are strongly supportive (indeed demanding) of achieving efficiency savings our members do not wish to see customer service standards compromised, nor do they wish to see future volatility in charging which may result from a failure to deliver the current proposed outcomes. Businesses will make their own judgements on the 'reasonableness' of the proposed cuts and the likely outcomes. There are clearly concerns that such dramatic cuts will have negative impacts on:
 - Customer service standards, including the likelihood of interruptions – Rather than secure further improvements to customer services as we wish to see, we face a risk that customer service standards will decline
 - Environmental standards including a failure to reduce leakage
 - The sustainability of the organisation to deliver the capital investment plan
- 8 The magnitude of differences between the NI Water proposals and the NIAUR Draft Determination for additions to operating expenditure as set out in Table 17 raises concerns, and there is very little evidence provided by NIAUR to substantiate the reasoning for such discrepancies. For instance the proposed investment in ICT (which we assume is fundamental to driving operating efficiencies and delivering modern working practices) is being wholly disallowed. The power allowance is estimated to be 'wrong' by £8.9m over the period – significant, yet no explanation is given, yet this is a cost which NI Water should be able to estimate with some

degree of accuracy, albeit the likely outcome may be higher, rather than lower. The chemicals allowance has been reduced by 49% (again with no explanation) - this either indicates very poor practice on behalf of NI Water at present or a misunderstanding/mistake in the calculations, or indeed it may highlight that comparators being used for benchmarking are inappropriate.

- 9 It is essential that the outcome of PC10 delivers confidence to consumers that the Business Plan and the proposed outcomes are achievable – as currently set out the NIAUR Draft Determination fails to do this, and raises as many questions as it provides answers.
- 10 The other key issue of the Draft Determination is on proposed **capital investment**. There is general agreement that for a period of decades investment in water and sewerage assets in Northern Ireland was significantly below the levels needed to maintain and sustain a modern water/sewerage utility. Privatisation of water and sewerage companies in England and Wales resulted in a major increase in capital expenditure (capex) which has been sustained for the last two decades, with the current Ofwat Draft Determinations again suggesting increased capital investment levels. While CBI members do not wish to see unnecessary capex we are surprised at the extent to which the Draft Determination is intending to reduce capex in the PC10 period.
- 11 Again our principle concern relates to the increased risks which this may lead to in future, including:
 - The risks of a deterioration in service standards
 - The increased risk of environmental infringements/incidents – with the requirements of the Water Framework Directive starting ‘to bite’ over the next five years it is critical that the necessary investment in infrastructure continues to prevent the risk of costly infraction proceedings
 - A failure to deliver the necessary investments required if the Regional Price Base assumptions in the NIAUR Draft Determination turn out to be unrealistically ambitious – CBI construction members confirm that a figure closer to 6.6% appears more realistic than the 17% suggested in the Draft Determination
 - The longterm sustainability of a strategy where proposed maintenance expenditure of existing assets is significantly below England and Wales levels, and the impact this will have on service standards and interruptions
 - Will cutbacks in capex in the PC10 period lead to increased risk of an investment backlog in the future, thus creating more volatility in tariffs?

We do however welcome the NIAUR proposals to increase the level of capex in waste water treatment works to support economic development and reduce the risk of infraction proceedings. It is absolutely vital that capital expenditure on all high priority projects is completed within appropriate timescales.

- 12 In conclusion the best interests of CBI members and the wider community are best served by delivering sustainable quality and value, rigorously benchmarked against truly comparable service providers. It is vital that the Final Determination by NIAUR delivers the following objectives:
 - a robust, yet fair, regulatory outcome delivering ambitious but realistic efficiency savings in which consumers can have confidence
 - create an organisation delivering high, and improving, levels of customer service, together with predictable tariffs

- a capital investment programme that delivers key economic, social and environmental outcomes which can underpin a modern economy

CBI Northern Ireland
6 November 2009