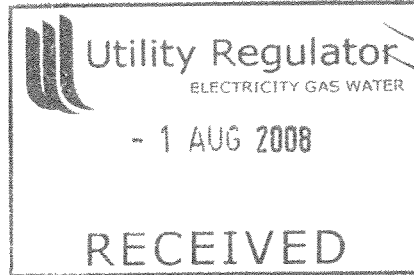


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Sarah Brady
Social & Environmental Branch
Utility Regulator
Queens House, Queen Street
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BT1 6ER

Our Ref: CMO80106

Date 31 July 2008

Dear Ms Brady

Consultation on Sustainable Development - The Regulator's Role

I would like to take this opportunity to thank you for the opportunity to respond to the Sustainable Development consultation paper. NIW take sustainability extremely seriously and welcome our continuing engagement with NIAUR on sustainability issues through the price setting process.

The central theme of the consultation was the environmental aspect of sustainability however NIW also welcomes the opportunity to play a sustainable role in the economic and societal arenas. As one of Northern Ireland's largest companies NIW are actively using our Environmental Management System to drive sustainable activity in our supply chain, biodiversity in our estate, the provision of appropriate amenities and education programmes for schools and special interest groups.

Main points we would like to draw attention to include:

- The need for customers' willingness to pay for sustainable development should be recognised and considered.
- NIW believes that the shadow price of carbon will become more relevant in future price setting but is currently taking steps to pilot the concept to facilitate future compliance.
- NIAUR are asked to note that NIW are obliged to comply with the Carbon Reduction Commitment and as such will be subject to substantial compliance costs.
- NIW would request that NIAUR provide guidance on what renewable energy projects could be progressed through regulated capital and how this should be treated.
- NIW anticipates that a long term approach will be taken when reviewing base maintenance; quality, enhancement and growth investment expenditure for price setting. It is important that future customers should not pay for underinvestment in the maintenance of long term assets.
- NIW shares the view expressed by the Utility Regulator to the IWRP (Strand 1 - September 2007), that ministerial guidance (whether directed to NIW or the Utility Regulator) should give direction on key social and environmental issues e.g. metering, compliance with environmental standards and sustainability.

The response provided outlines our current position on sustainability issues. I would however ask you to note that work in this area is progressing, not least through the current price setting process, and that NIW reserves the right to reassess this position as circumstances change.

Yours faithfully

A handwritten signature in black ink, appearing to read 'D.M. y'.

Darren Mawhinney
Strategic Advisor

Consultation Response Pro Forma

Chapter 1

1.1 Respondents to the consultation are asked to comment on whether or not they think any of the proposals in this paper would impact on equality of opportunity or good relations for any of the Section 75 Groups.

The Independent Water Review Panel highlighted the potential impact on water charging on vulnerable customers so any costs incurred while implementing sustainability initiatives need to be carefully examined.

It is Northern Ireland Water's (NIW's) belief that NIAUR sustainability policy should be reviewed during each price control process to ensure that Section 75 Groups are not adversely affected.

Chapter 3

3.1 Respondents are asked to comment on the balance between present and future climate change costs.

Climate change is already impacting on costs with respect to NIW operations, asset maintenance, planning and investment decisions. Planning in terms of adaptation and managing (mitigating) climate change for the future will drive costs up. Increasingly stringent consent standards invariably increase energy consumption.

'The Sustainability Strategy for Northern Ireland - First Steps Towards Sustainability, May 2006' included a number of strategic objectives and key targets. Those which relate to Climate Change are listed in Chapter 4 'Climate Change and Energy'. Of these, the objectives and targets that relate to NIW are as follows:

Strategic Objective 1: 'Reduce greenhouse gas emissions, principally by promoting energy efficiency and the use of renewables'. A key target is to reduce greenhouse gas emissions by 25% below 1990 levels by 2025. This will require a change in approach to lower energy treatment solutions and/or an increase in generation of renewables.

Strategic Objective 3: Plan and prepare for climate change impacts in Northern Ireland.

The UK Climate Change Bill is scheduled to receive Royal Assent in spring 2008. The NI Executive has achieved legislative consent from the NI Assembly (December 2007) that the Bill will apply to Northern Ireland. The draft Bill includes provisions for both mitigation and adaptation, with the sections on adaptation having been strengthened to include a framework for the preparation of climate change impact reports and on the reporting of progress.

Whilst some elements of this Bill are already covered in the NI Assembly commitments made in the 'Sustainability Strategy for Northern Ireland - First Steps Towards Sustainability, May 2006', some will be new or more stringent and become legally binding.

NIW would welcome direction on how any elements of NI Assembly commitments that are over and above the CC Bill will be allowed for in price determinations by NIAUR. We would anticipate that NIAUR would seek to facilitate compliance with the CC Bill and CRC through their actions.

3.2 Respondents are asked to give their views on the relationship between sustainability and security and diversity of supply.

There should be an acknowledged risk between the level of investment and the security and diversity of supply. Currently, the security of supply in NI is relatively low, despite the adequacy of water resources, due to low historic investment in strategic mains and connectivity in the network.

3.3 Respondents are asked to give their views on the degree to which sustainability issues should drive the Utility Regulator's first NI water price review.

The water industry in NI has had a history of under investment with the condition and serviceability of assets much lower than the rest of the UK water industry. This has resulted in a lower level of service to customers in NI than GB. The first price review (PC10) should secure sufficient funding to build and maintain assets capable of complying with legislation although the primary focus should be on providing a high quality service to customers. While sustainability has to be considered in the provision of the service, the quality of the service to customers is most important in the short term. It is important the PC10 and PC12 focus on longer term sustainable considerations rather than simply lowest cost.

3.5 Respondents are asked to consider whether a monetary value of CO₂ equivalent or shadow price of carbon ought to be included within guidance on use of business cases.

In NIW's opinion the monetary value of carbon should ultimately be included within guidance on the use of business cases in the future. Defra 'Statement of Obligations' (PR09 Social and Environmental Guidance) states that carbon must be taken into consideration in the cost benefit analysis (CBA) required for business plans. This states that Water Companies must estimate carbon dioxide equivalent during:

- Building (embedded);
- Operating (operational);
- Maintaining.

They must then converted to a financial cost using the 'shadow cost of carbon' (SCC).

Ofwat have issued some guidance for PR09 on 19/12/07, stating that solutions based on this approach will be funded. However in Scotland, WIC has taken an alternative

approach and required that Scottish Water CBA is purely on the basis of lowest whole life cost.

A key issue in NI will be the consumers 'willingness to pay' (WTP), The Consumer Council for Northern Ireland (CCNI) will have a key role in this area.

NIW believes that the shadow price of carbon will be more relevant in future price setting and is currently taking steps to pilot the concept to facilitate future compliance. This is therefore an important area for NIAUR to give NIW early guidance.

3.6 Respondents are asked to indicate their preference for inclusion of "carbon footprint" monitoring and target setting within the new regulatory contract at the first NIW price review.

The inclusion of carbon footprint monitoring and target setting would require a significant resource input. For example Scottish Water has made allowance for £1M to be spent over the next few years to build carbon accounting into their accounting systems as part of their overall climate change strategy. A key issue in NI will be the consumers 'willingness to pay' (WTP).

NIW believe that guidance on this issue will be needed for future Annual Returns and funding to carry out this work will need to be factored into price limits. If so we would welcome the requirement to use a common methodology with Scotland, England and Wales to allow comparative regulation.

3.7 Respondents are asked to consider the benefits of going beyond the "Economic Level of Leakage", possibly by the inclusion of the carbon shadow price in calculations.

Refer to comments on Section 3.5 and 3.6. NIW welcomes the Utility Regulator's intention to study the full cost of Economic Level of Leakage – including CO₂

3.8 Respondents are asked to consider the degree to which NIW should be incentivised to increase its uptake of renewable energy and reduce its non-CO₂ gas emissions and mechanisms by which this might be achieved.

As Northern Ireland's largest energy user (in 2007 it was £21M, representing circa 240 GWh) NIW endeavour to follow a sustainable approach through the production and procurement of green electricity. We have sought to align our strategy with local and national government policy. We are currently exceeding our 2008 target of using 8% green energy. **NIAUR are asked to note that NIW are obliged to comply with the Carbon Reduction Commitment and as such will be subject to substantial compliance costs.**

NIW are currently looking at the options available to us to produce more energy in-house through the use of hydro and wind turbines. There is potential for both near-term single wind turbine and longer-term large scale wind farm type developments on NIW land although this would require capital investment.

Ofwat has expressed a desire for water companies to maximise renewable power generating potential and Yorkshire Water have recently (Jan 2008) opened a windmill at a treatment works near Selby. Ofwat has noted that this could form part of water companies' strategies to reduce their carbon footprint and is therefore currently seeking to determine activities in this area as guidance is needed on how this should be treated when setting price limits, reported in Annual returns and regulatory accounts.

The UK Government has introduced the Climate Change Levy (CCL), an energy tax applied to UK businesses who consume more than 12,000 kWh per year. The levy is a regulatory requirement. In April 2007 the rate was increased to 0.441p/kWh and in April 2008 to 0.456p/kWh on the amount of electricity used. The balance will be that as the CCL increases that NIW will have to find alternative sources of power, self generate or develop low energy technologies for our assets.

NIW would request that NIAUR provide guidance on what renewable energy projects could be progressed through regulated capital and how this should be treated. Guidance is needed on NIW's submissions to allow the purchase of carbon allowances that will be required under the proposed UK Carbon Reduction Commitment (CRC) Regulations.

Chapter 4

4.1 Respondents are asked to rate the following existing instruments from 1-10 (1 being poor 10 being excellent) for the following characteristics:

A Profile (do enough people know about the work)

B Ability to protect customers

C Ability to influence consumers to be more energy / water efficient or change to a lower carbon fuel

Measure	Profile	Ability to protect customers	Ability to influence
The NIE SMART Programme			
Gas Industry Promotion			
The Energy Efficiency Levy			
Price Controls		We have no comment to make.	
Key Pad Metering			
Energy Efficiency Advice Provision			
NIW Sustainability Report	5	5	6
NIW Environment Management	7	9	7

System			
NIW promotion of water efficiency	4	8	8

Chapter 5

5.1 Respondents are asked to comment on the balance of the Utility Regulator's duty to protect present and future customers.

NIW supports the assertion, made by the Utility Regulator to the IWRP (Strand 1 – September 2007), that the results of investment in NIW's infrastructure (and indeed, the positive impact of economic regulation on NIW) must be assessed over the long term. A longer term approach allows organisational optimisation and the development of procurement and asset management strategies to ensure compliance with environmental standards; capacity development to match growth and delivery of improved service to NIW's customers. Given the history of under-investment in NIW's infrastructure, the above are necessarily long term goals and consequently a difficult balance must be struck between the achievement of these goals for future customers and the need to limit costs for customers in the present.

NIW is encouraged by the Utility Regulator's previous public statements on the importance of adopting a long-run framework for a financially, socially and environmentally sustainable water industry in Northern Ireland.

NIW anticipates that a long term approach will be taken when reviewing base maintenance; quality, enhancement and growth investment expenditure for PC10 / PC12. NIW believes that the above should be considered when determining the cost to current customers of benefits for future customers. It is an important principle that future customers should not pay for the failure to invest adequately now in the maintenance of long term assets.

5.2 Respondents are asked to comment on the appropriate role of and nature of statutory guidance from Ministers to the Utility Regulator.

Statutory guidance is necessary to set the policy objectives and provide a framework within which NIW can operate. Statutory guidance will also be used to help develop longer term direction statements. Given the long term challenges facing NIW and the requirement for longer planning horizons, NIW will welcome the direction provided, by statutory guidance, to it from Ministers.

NIW shares the view expressed by the Utility Regulator to the IWRP (Strand 1 – September 2007), that ministerial guidance (whether directed to NIW or the Utility Regulator) should give direction on key social and environmental issues e.g. metering, compliance with environmental standards and sustainability. It is important that guidance is sufficient to allow NIW to plan to achieve the objectives set out in guidance. The guidance must be delivered on time.

5.3 Respondents are asked to highlight actions that they consider might be appropriate or necessary, but that could not be taken under the Utility Regulator's existing powers.

NIW has many stakeholders. The development of a sustainability policy and its integration into NIW's business strategy will require the dissemination of information among; discussion with and agreement between all of NIW's stakeholders. The Utility Regulator has a unique role and a particular set of responsibilities which encompass both consumer interests and the financability of NIW. For this reason, it is suggested that the Utility Regulator is appropriately placed and qualified to adopt a co-ordination and governance role in the development of a Water & Sewerage sustainability policy for Northern Ireland.

As an unfettered independent regulator, the Utility Regulator could impartially review all aspects of a Water & Sewerage sustainability policy and determine the feasibility and timescale for implementation. This was probably not envisaged when the relevant legislation was drafted but such an approach may prove particularly opportune in the development (and streamlining) of governance arrangements for water and sewerage services.

5.4 Respondents are asked to comment on whether the Utility Regulator should seek to be designated under section 25 (1) of the Northern Ireland (Miscellaneous Provisions) Act 2006.

Section 25(1) of the Northern Ireland (Miscellaneous Provisions) Act 2006 requires ministerial departments within Northern Ireland to have a specific sustainability duty. NI Water believes that the Water and Sewerage Services (NI) Order 2006 contains sufficient existing provisions in respect of the promotion of sustainability.

It is suggested that designation under the Northern Ireland (Miscellaneous Provisions) Act 2006, is unnecessary.

Chapter 6

6.1 Respondents are asked to comment on the three main roles for the Utility Regulator identified in chapter 6 of this paper as:

- **gathering and publishing evidence,**
- **contributing to wider energy policy,**
- **regulating differently.**

Chapter 6 of the consultation appears to refer to the energy industry. Consequently, NIW has no comment.

As Chapter 7 (regulating differently) refers to both energy and water, NIW's response to each of the Utility Regulator's suggestions is as follows:

- NIW believe that compliance with existing Licence requirements and the increasing extent of other information requests represents a significant challenge for NIW and cost to its customers. The existing licence and regulatory regime are based on a privatised, multi company model developed for England and Wales. Many of the drivers and paradigms are not optimal for the regulation of a single public sector utility.

NIW suggest that there is a significant opportunity to apply a fresh approach to regulations in NI and that additional reporting requirements are unlikely to be required. NIW suggests that a review of the use of current information requirements is required.

- NIW welcomes the Utility Regulator's suggestion in respect of the provision of more and better information to customers. NIW believes that increased cost transparency will improve customer understanding of the necessary costs associated with a water and sewerage service.
- NIW welcomes the Utility Regulator's suggestions in respect of further study of the value and appropriate use of metering.
- NIW welcomes the Utility Regulator's intention to study the full cost of Economic Level of Leakage – including CO₂.
- NIW also welcomes the Utility Regulator's intention to work with NIW and the environmental regulators to consider risks and costs associated with the impact of climate change.
- Finally NIW notes the Utility Regulator's suggestions in respect of energy tariffs and awaits with interest the publication of its Social Action Plan. Clarification is requested as to whether the Social Action Plan and tariff reforms will apply to NIW and if such amendments will be informed by the IWRP Strand 2 consultation.

6.2 Respondents are asked to comment on data, which would be useful but, which is currently unavailable on a regular basis in Northern Ireland.

- (1) Energy consumption/cost of WWTW process type.
- (2) Energy consumption/cost per range of effluent consent standards

6.3 Respondents are asked to suggest innovative methods of developing and promoting the gas industry as a means of reducing Northern Ireland's carbon foot print.

We have no comment to make.

6.4 Respondents are asked how the solid fuel and oil industries could contribute to social and environmental sustainability? In addition what approach will best achieve this aim?

We have no comment to make.

6.5 Respondents are asked if the regulatory model used to develop the natural gas network could provide lessons for the promotion of efficient and coordinated heat networks? Do respondents believe that better regulation could aid the development of the community heat industry?

We have no comment to make.

Chapter 7

7.1 The Utility Regulator considers that the following are important when assessing policy proposals. Respondents are asked to score each of the proposals in chapter 7 of this document from 1-10 on the basis of their potential in relation to the following measures:

- 1 Potential Certainty of Outcome**
- 2 Potential Cost effectiveness**
- 3 Certainty for investors**
- 4 Potential to provide equity for consumers**
- 5 Potential to encourage innovation**
- 6 Good fit with other NI government departments**
- 7 Good fit with competitive energy markets**

The proposals are summarised as follows:

	1	2	3	4	5	6	7
a. Cross utility licence condition requiring licensees to have in place environmental policies.	10	5	5	5	6	5	5
b. Cross utility requirement to report annually of sustainability activities and initiatives.	4	5	4	4	4	5	5
c. Requirements on licence holders to provide customers with environmental information in relation to fuel mix in a uniform and easy to understand format, on all bills and promotional literature.	We have no comment to make.						
d. Strategic investigation into use of "Smart Meters" as a mechanism for delivering better quality and timely information to customers.	We have no comment to make.						
e. Work with energy licence holders to assess current tariff structures.	We have no comment to make.						

	1	2	3	4	5	6	7
f. Continue to work with partners and stakeholders to ensure renewable generation can be equitably accommodated on the electricity network.	We have no comment to make.						
g. Ensure price control processes take into consideration the effect of climate change on electricity and gas networks.	We have no comment to make.						
h. Carry out a full strategic review of energy efficiency delivery mechanisms	We have no comment to make.						
i. Develop a strategy in relation to gas promotion, which considers the potential benefits of common arrangements for the transmission and distribution of gas on the island of Ireland.	We have no comment to make.						
j. Developing sustainability within the NIW price control	8	9	9	9	9	9	9
k. Improving our own practices and procedures.	10	10	10	10	10	10	10

7.2 Respondents are asked to identify what they consider to be the top three priorities from the above list of proposals and rank them in order of importance.

J - Developing sustainability within the NIW price control – a wide number of sustainability issues are currently being discussed with NIAUR in PC10 Working Group 'C', dealing with sustainability issues.

K - Improving our own practices and procedures – NIW is committed to acting in a sustainable way in the economic, social and environmental arenas and continually strives to improve our own performance, taking into account the cost of sustainable policies and the customer's willingness to pay.

B - Cross utility requirement to report annually of sustainability activities and initiatives – NIW plays an active, and growing, role in the sustainable development of the Northern Ireland economy and therefore welcomes the discipline of annual reporting using it to drive our sustainability policies and initiatives.

7.3 Respondents are asked to list any further proposals which they think should be considered.

Sustainability

Sustainability is much more than an environmental issue so NIW welcomes the opportunity to play a sustainable role in the economic and societal arenas. As one of Northern Ireland's largest companies NIW are actively using our Environmental Management System to drive sustainable activity in our supply chain, biodiversity in our estate, the provision of appropriate amenities and education programmes for schools and special interest groups.

25 Year Strategic Direction Statement (SDS)

NIW invite NIAUR comments on NIW proposals to prepare a 25 Year Strategic Direction Statement (SDS) in the PC12 period, which we would propose to update prior to each subsequent price review. This would paint a picture of what 2035 might look like, the challenges we will face along the way, and how NIW will debate and agree the sustainable long term approach to benefit our customers and stakeholders. This 'long term view' will help us to set each funding and price review cycle in the context of longer term asset plans, optimising investment over time, and protecting us from potentially short term unsustainable decisions.

The benefits of this approach are not new and each English and Welsh Water and Sewerage company has embraced the Ofwat requirement to prepare a SDS as part of their planning for PR09. These are now on the OFWAT website.

As consultation with stakeholders will be key to the development of any SDS, we would invite NIAUR and CCNI, amongst others to engage with us and envisage the development of an NIW SDS during the PC12 period.

NIAUR Support for NIW Sustainable Policies

NIW have always recognised that larger footprint sites can result in lower energy requirements. This was confirmed recently by UKWIR, as illustrated below:

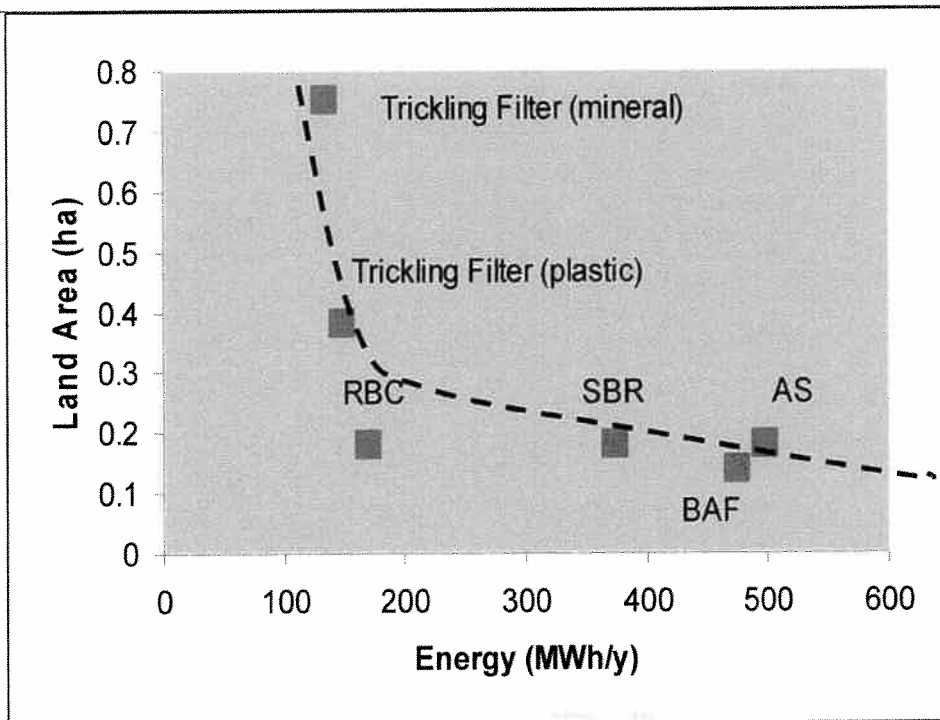


Diagram from UKWIR Report: "Tightening WwTW Emission standards". Based on WwTW treating 12,700 PE to standard of 10 mg/l SS, 5mg/l BOD, 1 mg/l Ammonia

However NIW's predecessor, DRD Water Service, was previously often constrained to work within existing site footprints due to the following:

- Under funding resulting in some works becoming overloaded and creating odours, which created a resistance to any Planning Permission needed for extensions on enlarged or new sites;
- Short term funding horizons;
- Project appraisal and procurement rules;
- A requirement to buy land at VLA rates.

In order to achieve compliance, DRD Water Service was often forced to build small footprint process solutions to fit on existing sites.

For example, at Ballyclare WwTW the energy consumption increased by a factor of 26, from £4500 p/a to £120,000 p/a, when a new MBR plant had to be built in 2005 on the existing site. Whilst the project drivers were growth and a new stringent discharge standard, the costs could have been reduced had a larger site been available.

Therefore since formation, non-infrastructure procurement has been guided by the following: *'NIW preference is that every effort is made to identify and secure sufficient land early in the project phase to give the option of the selection of larger footprint process solutions that typically result in lower operating costs, which is a significant and ongoing driver for NIW'*.

NIW would seek NIAUR support for this strategy. An example of the type of support is illustrated below. Consider example WwTW 'X' where the current SBP objective was a new works to meet a tighter discharge standard. However if land purchase is delayed due to reasons beyond NIW control, should a smaller footprint process be

built as this enables compliance, or can a time extension be granted to secure the land needed for a lower carbon option? NIW are faced with just such a scenario on one scheme now, where the smaller footprint process is forecast to consume twice the power.

Catchment Based Approach

NIW faces a huge programme of assets modernisation. This has coincided with the challenge of catching up with EU legislation just as climate change mitigation and adaptation are also needed. Whilst this represents a challenge to customers in terms of affordability, it also provides an opportunity. An old EU Directive would say 'each sewage discharge must have a prescribed quality of effluent, a *'product'*, typically requiring more treatment and energy use. The new Water Framework Directive (WFD) requires 'good ecological quality', the *'service'* we really want, across each catchment – a 'catchment based approach'. NIW would need full support for this proposed approach from both the environmental and economic regulators, by innovating together, using new modelling tools and shared better data.

The UK Water industry spend on energy has doubled since 1990. Wastewater treatment emissions have trebled since 1990, most of which has been due to the requirement to comply with end of pipe solutions. Sustainable Catchment Management Programmes aim to manage the wider catchment area in a sustainable way, therefore reducing the energy required.