

John Mills  
Water Policy Division  
Clarence Court, Rm 122  
10-18 Adelaide Street  
Belfast,  
BT2 8GB

Your Ref: W/035/JA/682

Our Ref:

Date: 25<sup>th</sup> July 2011

Dear John,

**Re: Response to Consultation on Modifications to NI Water's Instrument of Appointment**

Thank you for your response of the 9<sup>th</sup> July 2011 to the recent consultation on modifications to Conditions B and F of NI Water's Instrument of Appointment.

As noted in your letter, in addition to the formal exchange of letters, there has been a number of meetings and exchanges between our teams on the detail of proposed changes which has been helpful in aiding each other's understandings.

As suggested by the Department, removal of the material in Condition B relating to the first three 'SBP years' is helpful in addressing some of the complexity. We also agree that when decisions have been made regarding the final operating model of the company by the Executive a further, broader review of Condition B would be worthwhile. It is helpful that the recent PAC Report on Measuring the Performance of NI Water, recommended that *'the Department, the Regulator, NI Water, in conjunction with DFP, should develop a range of options for consideration of the Executive with a view to providing NI Water with more certainty of funding over the three year period of PC10.'*

Our response to individual points raised in your correspondence are provided below.

### **Paragraph 5A**

DRD suggests that instead of specifying a specific date in paragraph 5A, a simpler formulation would be to link the end of the period when PE and Regulatory Price Control period to the time specified in Article 213(4) of the 2006 Order.

The specific date inserted is in accordance with the Water and Sewerage Services (Amendment) Act (Northern Ireland) 2010 which includes amendments to Article 213 (4) which states the timeline for the initial period. We understand the apparent logic of the Department's suggestion. However, we believe that any sanctioning of an extension to the initial period, under Article 213(4) by the Executive is likely to be accompanied by consideration of 'future options' which in turn may require a broader review of the licence by the UR with consultation as appropriate. Should no broader licence changes be necessitated we have provided for a date change to be made in the licence without the need for formal consultation.

### **Paragraph 5.5**

DRD have commented specifically to the date cited in paragraph 5.5 of the licence in relation to the calculation of the subsidy factor, following the end of the initial period. DRD considers that the inclusion of a date means that there is no subsidy factor carried forward from the initial period (as the calculation for a given year is based on information relating to the previous two years). DRD state that the extension of the initial period would suggest that the dates should change and that paragraph 5.5 should not contain a specific date but rather should be related to the initial period specified in Article 213(4) of the 2006 Order.

The use of dates in paragraph 5.5 simply means that the S factor is zero for the first two years of its operation. In relation to DRD's suggestion as to a linkage to the initial period specified in Article 213(4) of the 2006 Order we refer you to our above comments in respect of the paragraph 5A.

### **Competition Commission**

DRD consider that the role of the Competition Commission in arbitrating NI Water's funding should be completely suspended for the PE and Regulatory Price Control period. DRD consider that for the

period when the Executive sets the majority of the budget for NI Water the Competition Commission should have no appeal role and this should be reflected in the Licence.

We and all of the principal stakeholders agree that the Competition Commission should have no appeal role in the context of the available PE funding for NI Water as this is dominated by Public Expenditure allocation as agreed by the NI Executive. This shared view led to the drafting, agreement and signing of the MoU and Consequent Written Agreement between DRD and the UR. It is agreed that the principles reflected in these documents should be applied during the PE Budget and Regulatory Price Control period as reflected in our proposed Licence Modifications.

However, this does not and should not remove the right of NI Water to appeal the UR determinations and other decisions, if they view them to be unreasonable, e.g. the company's rejection of efficiency targets - PC10 challenges the company to deliver a saving of £91m over the 3 year period, essential to ensure the then 40% operational efficiency gap is reduced. The Competition Commission has the specialist expertise to review and challenge the substance of the regulators' decisions, for example in relation to such efficiency targets. We consider the possibility of an appeal to such an expert body a valuable part of the regulatory process, not least because it provides NIW with greater certainty about the content of the challenges it will be required to meet. We do not consider the use of PE funds to reduce the value of Competition Commission's existing role. In our view, continuing to apply NI Water's rights of appeal against the UR's decisions is in the consumers' interests.

In the interests of transparency and in accordance with standard Utility Regulator practice for consultations, we propose to publish all consultation responses and therefore request permission to publish your consultation response. It would be helpful if you confirmed your consent to this by the 28<sup>th</sup> July.

Please contact myself should you have any remaining queries.

Yours sincerely,



Jo Aston  
Director of Water Regulation

**Cc: Malcolm McKibbin (DRD)**  
**Stuart Wightman (DRD)**  
**Alan Grieve (DRD)**  
**Alan Craig (UR)**  
**Deirdre Trainor (UR)**