Price control for water and sewerage services
2015-21

Our overall approach

October 2012
About this document

This document sets out our approach to PC15 as follows:

- Section 1 outlines our role and the roles of the other principal stakeholders.
- Section 2 provides context, covering: economic regulation of NI Water; the impact of NI Water’s governance arrangements and how we work within public expenditure limits.
- Section 3 provides an overview of previous price controls and sets out the case for a six year duration for PC15.
- Section 4 sets out our approach to some key areas which must be addressed as we develop and deliver PC15 including: consumer engagement; delivering sustainable outcomes; targeting investment and managing risk; the scope for efficiencies; finance and tariffs; information requirements; and how we will work with principal stakeholders.
- Section 5 sets out the key stages and timeline for PC15.
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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 consumer. One of our most important tasks is determining price controls that make sure consumers receive the best value for money. Our price control process results in a contract between the Regulator and the company which agrees the money the company requires to provide efficient services and how much it is allowed to charge. For domestic users that charge is met by Government subsidy but minimising the cost is just as important.

Price Control 2015 to 2021, referred to as PC15, will be our third price control for NI Water. While closing the efficiency and performance gap between NI Water and its comparator companies remains a dominant issue, we are pleased to also be addressing longer term sustainability issues within this six year price control. This strategic approach is facilitated by the Long Term Water Strategy developed by the Department for Regional Development working with other principal stakeholders. In this context we expect NI Water to set out a clear business strategy that addresses any shortfalls in its water and sewerage infrastructure and service levels. We also expect NI Water to continue to improve information systems and asset maintenance practices. That means sustainability of service will be critical and they will need to focus on preparing for more frequent extreme weather conditions which threaten, interruptions to services and flooding.

Consumers remain at the centre of our consideration and we look to the Consumer Council working with NI Water to elicit consumers’ views to inform and influence policy and investment decisions.

Jo Aston
Director of Water Regulation
1 Introduction

1.1 Our role in protecting consumers’ interests

Our role is to promote the interests of water and sewerage consumers. One of the ways in which we do this is by setting prices that allow NI Water to deliver water quality, environmental and customer service objectives at the lowest reasonable overall cost.

Our primary duties, which are defined in law, are to:

- protect the interests of consumers;
- ensure that NI Water carries out its functions properly; and
- ensure that NI Water is able to finance its functions.

We are a non-ministerial government department, accountable to the NI Assembly; we work closely with the Department for Regional Development. We hold ourselves accountable to consumers by consulting on our work and publishing information and reports on NI Water’s performance. For this price control we also intend to hold consultation meetings on our draft determination to inform consumers, to take feedback and encourage responses to the consultation.

Overall limits on how prices can rise, or are required to fall, are set through a process called price controls. At the price control we also set out the outputs that NI Water is required to deliver.

At present, domestic consumers are not charged directly for water and sewerage services and the decision to change the arrangements has been deferred. As a result, NI Water is dependent on government subsidy for more than 70% of its funding. The company raises around 20% of its revenue from direct charges to industry, with the remaining 10% coming from charges for road drainage.

The price control process must therefore start with the public expenditure budget allocation. Working within that budget allocation, we must ensure that the contribution from consumers is proportionate and that outputs and improvements are maximised and clearly defined. In doing so, we seek to ensure that NI Water delivers best value for money for all consumers.

In carrying out price controls we follow the five principles of better regulation. These are accountability, consistency, proportionality, targeting and transparency.
1.2 Other principal stakeholders

When we carry out price controls we do not operate in isolation but work closely with a range of other stakeholders. In this section we briefly outline their roles and how what they do impacts on water and sewerage consumers. In Chapter 4 we outline our proposals for stakeholder engagement in the PC15 process.

Northern Ireland Water

NI Water is responsible for providing water and sewerage services in Northern Ireland. It is a statutory entity, wholly owned by the government. The Minister for Regional Development acts as both the sole shareholder and policy maker.

NI Water is the only statutory water company in Northern Ireland; it operates in accordance with company legislation and is subject to economic and quality regulation.

Before April 2007 water and sewerage services were provided by the ‘Water Service’, an agency that came under the remit of the Department for Regional Development. When NI Water was established it was intended that domestic water charges would be introduced and that by 2010 the company would be fully funded by direct income. However, as domestic water charging has been deferred, NI Water continues to rely on government subsidy.

The Minister for Regional Development

The Minister for Regional Development provides overall policy direction and is responsible, through the Assembly, for the legislative framework for the water industry. The Department for Regional Development is responsible for paying a subsidy to NI Water in lieu of domestic customer charges.

The Shareholder Unit within the Department has responsibility for overseeing NI Water, and the company is directly accountable to the unit for its performance.

The Department also includes a Water Policy Unit. The unit’s primary function is to support the Minister’s role in providing policy, guidance and directions as part of a robust regulatory framework.

In advance of a price control the Department publishes ‘Social and Environmental Guidance’. This is intended to inform forthcoming priorities and objectives. At PC15 the guidance will be further enhanced by a ‘long-term water strategy’. The strategy takes a holistic approach by considering all aspects of water management and by involving a number of other departments.

CCNI

CCNI is the consumer representative for water and sewerage customers. Its role is to ensure that policymakers take consumers into account when making decisions. It does this by providing information, undertaking education campaigns and research, and by producing
relevant publications. It also helps individual consumers to resolve complaints which they have not been able to resolve directly with NI Water.

**The Drinking Water Inspectorate (DWI)**

The Drinking Water Inspectorate, which is a unit within the Northern Ireland Environment Agency, is responsible for regulating drinking water quality for public and private supplies.

Its role is to ensure the supply of safe and clean drinking water by monitoring its quality and advising and enforcing on remedial actions and infrastructure investment when necessary.

**Northern Ireland Environment Agency (NIEA)**

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. The Agency carries out a range of activities to support the government’s key themes of sustainable development, biodiversity and climate change. Amongst the primary functions of NIEA are the regulation of both abstractions and discharges under the relevant legislation.

Its overall aims are to:

- protect and conserve the natural heritage and built environment;
- control pollution; and,
- promote the wider appreciation of the environment and best environmental practices.
2 Context

2.1 Economic regulation of NI Water

Where a monopoly exists, consumers are not able to change supplier in order to receive better prices or service levels. In the absence of such competitive pressures, natural monopolies may act against consumer interests by:

- becoming or remaining inefficient, passing higher costs on to consumers in higher charges than would otherwise be necessary;
- accepting poor levels of service rather than seeking innovative or challenging ways to improve performance while reducing costs.

By subjecting monopoly service providers to external benchmarking and challenge, independent economic regulation helps ensure that they continue to act in the consumer interest.

Economic regulators also impose budgetary constraints on the regulated company or companies (while at the same time making sure that they are adequately financed). These constraints are based on direct challenge of the company’s proposals, supported by external benchmarking of cost and service to establish the company’s relative efficiency and performance.

The provision of water services tends to be a natural monopoly that is delivered by a single supplier over a defined geographic area. As the only statutory water company in Northern Ireland, NI Water operates as such a monopoly.

As NI Water is a monopoly service provider a regulatory framework has been put in place to protect the consumers who use its services. In our role as economic regulator, we take action if we consider that the company is performing less well or operates less efficiently than its peers and we set challenging but achievable targets for improvement.

To ensure that a strong regulatory contract is in place between us and NI Water, we also establish a clearly defined set of outcomes that NI Water must deliver. When selecting these outcomes we aim to strike a balance between outcomes that are clearly defined while allowing NI Water the flexibility it needs to deliver them in the most effective way.

2.2 Overview of the price control process

Within a regulatory regime, the determination of a constrained budget to deliver a defined set of outcomes over a set period is achieved through the price control process.

The principal aims of the price control are to ensure that:
• prices are set at the lowest level that is consistent with delivering objectives in line with the overall strategic direction that the Minister for Regional Development sets for NI Water;
• NI Water’s day-to-day running costs are kept as low as possible; and,
• NI Water invests efficiently and effectively and so delivers the desired environmental, public health and customer service improvements at value for money prices.

We also challenge the company to improve its efficiency and performance relative to the water and sewerage companies in England, Wales and Scotland.

The wide-ranging price control process includes a number of distinct stages:
• We engage with consumers and work with the principal stakeholders to identify and prioritise the outcomes that NI Water should deliver.
• NI Water prepares a business plan that sets out its assessment of the funding necessary to deliver these outcomes.
• We assess the business plan to arrive at a determination of a challenging and achievable level of funding by benchmarking efficiency and performance.

2.3 **NI Water’s governance arrangements**

We are preparing the PC15 price control against a background of uncertainty concerning future governance arrangements for NI Water.

NI Water is a government-owned company. Because it relies on government funding for the majority of its revenues, it is also classified for public expenditure purposes as a non-departmental public body and it is subject to the rules that govern public expenditure. This hybrid arrangement adds complexity and funding is uncertain from year to year. The Minister for Regional Development is currently considering future arrangements for sustainable, secure governance, funding and regulation of the water sector within the context of a long term water strategy.

We have developed our approach to PC15 on the assumption that the current arrangements for governance and funding will continue. The fundamental building blocks of our price control (clear outputs; a determination of efficient expenditure; a robust plan for delivery; and a focus on consumer service – all supported by robust benchmarking) will continue to be essential components of any good governance model.
2.4 Working within public expenditure limits

While the hybrid governance arrangements remain in place the alignment of the regulatory price control process with the public expenditure process remains a key issue to be addressed in our approach to Price Controls.

Public expenditure budgets are set through the Comprehensive Spending Review (CSR) process which typically cover 3 or 4 years. The current CSR covers a four year period up to 2014-15 and this timescale was a key consideration for the duration of the 2013-15 price control. PC13 will run to the end of the current CSR.

We recognise that a primary constraint on the price control will be the level of funding available to NI Water from public expenditure. We will ask the Department to provide a working assumption for the annual capital and resource budgets for the price control period as part of the draft Social and Environmental Guidance (which is due to be published in March 2013). We will ask for these working assumptions to be updated to inform our draft and final determinations.

The programme for future Comprehensive Spending Reviews is not certain. However, it is likely that a price control period for 2015-21 will cover at least two Comprehensive Spending Review periods. We hope that it will be possible for the Department to provide funding assumptions for the first half of the PC15 period with a reasonable level of confidence. We recognise that funding assumptions for the second half of PC15 will be the subject of a subsequent Comprehensive Spending Review and could change. To accommodate this we propose a planned review of our determination part way through the PC15 period which would take account of the outcome of any subsequent CSR.

We will ask NI Water to submit its business plan in March 2014 and we will reach a draft determination in July 2014. This is earlier than at previous price controls. It will enable the draft determination to inform discussions on the Comprehensive Spending Review. It will give the company and other stakeholders longer to respond to our draft determination and allow our final determination to take account of the development and agreement of the Comprehensive Spending Review.

Public expenditure is also subject to annual monitoring rounds which can result in reductions in planned expenditure or additional funding being made available. At the PC10 price control, we developed a Memorandum of Understanding with the Department for Regional Development supported by a Consequent Written Agreement which outlined how we would deal with changes in funding levels. NI Water’s operating licence was modified to reflect the memorandum. We have agreed to review the Consequent Written Agreement, with the Department for PC13 and will review it again for PC15 to address any changes in governance or to take account of lessons learnt from operating the MoU through PC13.
3 Overview of our price controls

3.1 PC10 (covering 2010-13)

NI Water is currently part way through its first regulated price control, PC10, which covers the period 2010-13. This short, three-year period, was agreed with stakeholders because there were concerns about data quality which would impact on the quality of the company’s business plan, creating uncertainty and the risk of subsequent change. A short price control was adopted to allow time for the company to improve its data and capability to increase confidence in future Business Plan submissions.

In the first year of the price control period (i.e. 2010-11) NI Water outperformed its target for operational efficiency. The company has continued to outperform in 2011-12 and it is likely to outperform the challenging efficiency targets we set for PC10 as a whole. Despite these improvements, the company remains inefficient when compared to benchmark water and sewerage service providers in England & Wales.

NI Water under-spent its PC10 capital budget for 2010-11 and the Comprehensive Spending Review (CSR) for 2011-15 reduced the level of investment available to the company in 2012-13. Because of this, the company will invest less capital in PC10 than our determination envisaged and will deliver less as a result. The PC10 outputs were reviewed in 2011 to reflect the revised budget and the company is now working to deliver these revised outputs.

The company has also reported improved performance in terms of its ‘overall performance assessment’ score (OPA). This is the measure we use to monitor the service provided to consumers. However, the company failed to meet the target we set for 2010-11 when extreme winter conditions had an impact in a number of key performance areas relating to water supply and consumer contact.

3.2 PC13 (covering 2013-15)

At present we are preparing the second price control which will cover the period 2013-15 (PC13). We are currently reviewing the company’s business plan and we published our draft determination for PC13 in September 2012 for consultation. We will reach our final determination for PC13 in December 2012.

A two year duration was agreed with stakeholders for PC13 because there was reasonable certainty of funding up to 2014-15. It provided time to review governance arrangements within the current NI Assembly mandate and to develop a Long Term Water Strategy.

We adopted an approach to PC13 which was proportionate for the short, two year, price control. We agreed with all stakeholders that the Social and Environmental Guidance and
consumer engagement associated with PC10 would form the basis for PC13. We have relied on processes and data used for the PC10 price control where these could be extrapolated with some confidence. For example, we have not repeated the detailed efficiency benchmarking carried out for PC10. We adapted our information requirements to build continuity with developing reporting mechanisms which take advantage of one-to-one regulatory relationships.

While this approach was proportionate for PC13, we will have to revisit and refresh key components of our price control (such as efficiency benchmarking and consumer engagement) for PC15.

3.3 PC15 – an opportunity for a longer term strategic view

A three year duration for PC10 and two year duration for PC13 are shorter than the price control durations adopted for the water industry in GB, where four or five year price controls are the norm. A series of short duration price controls for NI Water risks compromising long term planning and efficient delivery.

There is also a growing need for a more holistic, more strategic approach to the management of all aspects of the water and sewerage industry. Long term planning and investment are essential to deliver the right level of service efficiently. Climate change is increasing the frequency and severity of extreme weather events. Long term decisions must be made to both mitigate climate change and adapt our infrastructure to changes which may now be unavoidable. The delivery of sustainable improvements in water management will depend on contributions from a wide range of stakeholders and a holistic, integrated approach will be required to deliver effectively.

The Department for Regional Development is leading the development of a long-term water strategy with a 24 year horizon which will address these issues. Such a long term strategy can only be effective if supported by challenging long and medium term delivery plans committed to and implemented through the regulatory price control process. To support the development of longer term investment plans, we propose to increase the duration of our price controls and provide a more stable and predictable framework for efficient service delivery and, perhaps more importantly, delivery of long-term outcomes.

The optimum duration of a price control is a matter of judgement that needs to balance:

- the advantage of allowing as much time as possible to plan and deliver the service; against,
- the ability to foresee future consumer needs and legislative requirements and how these will affect the level of funding required.
It must also take account of the external drivers and constraints that inform the overall level of funding available and determine the standards NI Water must comply with. In particular, it must consider:

- the duration of the PC13 price control;
- the cycle of development and delivery of key European legislation (including measures being developed under the Water Framework Directive, the Floods Directive and the Marine Strategy Framework Directive);
- the cycle of Water Resources Management Plans used to identify the long-term needs for investment in water resources; and
- the likely milestones for the Comprehensive Spending Review, which will determine the level of government funding that is available to NI Water.

Figure 1 below provides a high level view of how these key drivers and constraints align.

**Figure 1: Key drivers and constraints at the PC15 price control**

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Having considered the alignment of these drivers, we concluded that a six-year price control provides the best balance of time to plan and deliver against certainty of outcome. We also concluded that we should make provision for a planned review part-way through a six-year price control to realign the determination with future Comprehensive Spending Reviews. As
well as allowing for managed changes in funding, a mid-term review would provide an 
opportunity to implement innovative and sustainable solutions that might develop from the 
strategic studies and pilot projects which NI Water will carry out in the early part of the price 
control period.

A key risk of this approach is that a planned mid-term review will reduce the commitment to 
developing a business plan and determination for the full six years. There is a risk that the 
mid-term review then becomes a full price control in itself which will increase regulatory 
burden and undermine the objective of long term planning. This is not our intention. We will 
continue to engage with stakeholders on the scope of a mid-term review and the process by 
which it would be conducted. We will set out our approach to a mid-term review in the draft 
determination for PC15.

3.4 Aims for PC15

Our aim is that the PC15 process will:

- Clearly identify what consumers want and identify their priorities for water and 
  sewerage services and show how these will be delivered and over what 
  timescale.

- Provide a strong foundation for the long term funding of water and sewerage 
  services, delivering long term improvement in service to consumers.

- Convert the outcomes identified in the Long Term Water Strategy to clear 
  medium term goals and milestones which can be delivered by NI Water.

- Challenge NI Water to improve its efficiency and performance at an achievable 
  and sustainable rate.

- Promote sustainable action to deliver affordable protection of water quality, the 
  environment and natural resources through a holistic catchment based approach 
  to water and sewerage provision.

- Embed climate change adaption and mitigation in the delivery of existing services 
  and the development of future infrastructure.

- Promote long term planning and risk management in the Business Plan which 
  will enable continuity of investment between years and between price control 
  periods.

- Assess the ‘right’ long term level of investment in key areas such as asset 
  maintenance, water main replacement, sewerage renovation, reducing flooding 
  risk and demand management.

- Recognise the need for a flexible approach to asset delivery which will allow time 
  to study, develop, plan and deliver sustainable, integrated, interventions with 
  contributions from a range of stakeholders (including working and partnering with 
  other water sector organisation and the community/voluntary sector) where this 
  offers the best solution.
• Ensure proportionate regulation, including maximising the advantages of one-one regulation through the use of shared data sets which are used consistently and provide a clear, common point of reference for all stakeholders in the development and delivery of the price control.
4 Our approach to key areas

4.1 Introduction

At the PC15 price control we will set NI Water’s price limits for the six-year period. We will do so in a way that ensures that the company’s operational and investment costs can be met and ministerial objectives delivered effectively and efficiently, providing best value for money to consumers.

All aspects of NI Water's business will be considered and the objectives to be delivered will be tailored in light of the needs of consumers, the environment and cost. While we will focus on the six-year period, we will also consider the planning work necessary to support the effective and efficient delivery of service in the longer term.

In the previous sections we have made the case for a longer duration for PC15. We have identified the constraints of NI Water’s governance model and funding arrangements. We have outlined high level aims for the price control. In this section we outline our approach to some key areas which will be particularly important in light of the longer term, more strategic nature of PC15.

- **Consumer engagement** - NI Water and CCNI are best placed to undertake consumer engagement to support the strategies and priorities adopted by NI Water in its business plan.

- **Strategic direction supporting a sustainable water industry** - The Department for Regional Development is leading on the development of a long-term water strategy that takes a holistic approach to all aspects of water management. We fully support this approach, which will inform the Social and Environmental Guidance for PC15. We will expect NI Water to set out clearly how its own longer term strategy and the outputs and milestones for PC15 align with both the long-term water strategy and Social and Environmental Guidance.

- **Targeting investment** – We will ask the company to develop its assessment of the ‘right’ level of long term investment in key areas such as asset maintenance, water main replacement, sewerage renovation, reducing flooding risk and demand management. We would expect the company to demonstrate that its plans for investment have considered the condition, performance and potential deterioration of its existing assets and identified the optimum means of maintaining and improving service.

- **Delivering efficiencies together with improved services** – A significant efficiency gap remains between NI Water and equivalent service providers in England, Wales and Scotland. NI Water states that its governance model, particularly its classification as a non-departmental public body, hinders its ability to deliver efficiencies. We will continue to benchmark NI Water’s performance
and efficiency with that of the other companies and will consider the case NI Water makes with regards to the rate at which the efficiency gap should be closed.

In closing the efficiency gap we also expect NI Water to close the performance gap. In this regard we also intend to review how we might improve the overall performance assessment mechanism.

- **Information requirements** – We will build on the PC13 information requirements to maintain and develop a continuity of approach. We will use the price control information requirements as the basis of future annual reporting where this is practical.

- **Finance and tariffs** – We intend to continue to use the financial model developed for PC10 and used in PC13. We will make changes to the model if this is necessary to incorporate emerging issues such as tax payments. We will consider whether a revenue cap would be more appropriate than the current price cap.

- **Working with the principal stakeholders** – The Water Stakeholder Steering Group (WSSG) and Water Investment Coordination Group (WICG) provide established forum through which the principal stakeholders can work together on PC15 and other issues. At PC13, a WICG working group supported by bilateral engagement, allowed stakeholders to work together effectively. We propose to continue this approach for PC15.

### 4.2 A proportionate approach

In addressing these key areas, we are mindful of the need to keep the regulatory burden to a minimum while addressing the information asymmetry that exists between us and the company.

We will apply a number of principles to ensure that our approach is proportionate.

We will adopt a light touch approach if:

- there is evidence to show that the company is comparatively efficient;
- past costs are a strong indicator of future costs;
- there is insufficient data to support a more robust approach.

We will adopt a more detailed approach if:

- the company is comparatively inefficient;
- past costs are a weak indicator of future costs;
- data is available for econometrics, serviceability measures, outputs and so on.
We would expect NI Water to develop the data necessary to support a robust assessment of expenditure and outputs. Where it is necessary to adopt a light approach because there is insufficient data, we would adopt an approach to funding which is prudent but conservative until the company can develop a robust approach based on sound data.

4.3 Consumer engagement

The views of consumers on the type and level of service they expect, and the prioritisation of delivery of these services within reasonable funding limits, is an important component of this price control.

At PC10, CCNI, in conjunction with NI Water, carried out a survey of consumer views and priorities for water and sewerage services. It published the results in ‘Tapping into consumer views’. This work informed the Social and Environmental Guidance, NI Water’s business plan and our determination of the outputs for PC10 and PC13.

As there is a five-year gap between PC10 and PC15 it is appropriate for further consumer engagement to be undertaken. The findings will inform the development of priorities and the determination of outputs for the six-year PC15.

We are mindful that consumer engagement and more quantitative consumer research can meet a wide range of strategic and tactical objectives. For example, it can:

- inform the development of the long-term strategy for the development of water and sewerage services;
- help identify strategic consumer priorities that will form the basis of the price control;
- allow consumers to identify the qualities of service that they value and that are relevant to their needs;
- generate information on preferences and willingness to pay that can inform the prioritisation of outputs in NI Water’s business plan;
- provide a basis for addressing practical questions concerning delivery (this might include, for example, helping prioritise general activity on sewers and water mains and delivering the recommendations that were made in our report on the 2010-11 freeze thaw event);
- support the development of improved measures of consumer priorities which can inform investment and shape the targets and output measures used to monitor the development of the price control;
- provide a benchmark against which the business plan can be explained to consumers and tested for consumer acceptance – this should ensure that consumers are willing to pay for the plan as a whole.
We believe that NI Water and CCNI are best placed to undertake the consumer engagement necessary to identify consumer priorities for PC15. However other stakeholders, including the Utility Regulator, have an interest in shaping the engagement and understanding and how consumer preferences and priorities are identified and applied to inform the Business Plan. Therefore, we propose that a consumer engagement oversight group should operate as a sub-group of the Water Investment Coordination Group, to advise and be informed on the development and application of consumer engagement for PC15.

**Developing more meaningful consumer measures**

A better and deeper understanding of consumer needs and priorities, informed through consumer engagement at PC15, can support the development of improved outcomes for consumers and targets for delivery and reporting.

For example, the targeted reductions in discoloured water or the taste and odour of water may be more meaningful to consumers and a better driver for improvements than the aggregated compliance targets based on statutory water quality monitoring we currently use. The company already reports almost 100% compliance against the consumer contact measures used for PC10 and PC13. Measures of how the company has responded (rather than how quickly it has responded) may provide a better objective measure of what consumers want.

We will review alternative consumer measures, including the development of the Service Incentive Mechanism (SIM) within the industry in England and Wales, which could promote improved consumer outcomes as well as a better use of the company’s resources. We will review the continued use of the overall performance assessment (OPA) in light of the move to alternative aggregate consumer measures and incentives in the water industry in GB.

### 4.4 Delivering sustainable outcomes

The water industry’s primary function is to deliver a secure, wholesome supply of potable water, unrestricted at the point of use. It then collects and treats the wastewater before discharging it back to the environment. The development of these services has brought sustained improvements in health and well being, underpinned economic development and limited the impact of urbanisation on the environment.

In the past, water service providers have delivered improvements by investing in new assets which they could define, construct and operate. Service providers operated in a relatively stable environment where a knowledge of historical climatic conditions provided a reasonable guide to the future and a sound basis for design standards. However the challenges of delivering water and sewerage service today and in the future are changing:

- Climate change is increasing the variability and unpredictability of rainfall, increasing the risk of flooding and increasing water scarcity. New ways of
working will be required to lower our carbon impact by reducing energy consumption and realising opportunities to generate renewable energy.

- Increasing awareness of the ‘value’ of water will increase the pressure to use water wisely and abstract less in order to maintain the quality of the aquatic environment and sustain biodiversity.

- Rising consumer expectations, improved understanding, new European directives and an awareness of the economic value of a clean environment (and the potential impacts of climate change) all drive the need for higher discharge standards. New ways of working will be required to ensure that these improvements can be delivered in ways that are not disproportionately expensive or have significant carbon impacts.

It is unlikely that the best solutions to these emerging issues will be provided by NI Water in isolation. For example:

- better drinking water quality might best be achieved by land management and pollution control to improve river water quality, rather than extending treatment processes;

- improvements in environmental standards might best be achieved by managing diffuse pollution within an integrated catchment plan, rather than constructing energy-intensive treatment processes to deliver progressively marginal reductions in pollution from point discharges of wastewater;

- increasing demand for potable water might best be addressed by reducing leakage and introducing demand management measures that reduce waste, rather than by increasing water abstraction, treatment and transfer – all with an associated energy demand; and,

- increasing flood risk might best be addressed by managing storm water locally through careful urban design and the use of sustainable urban drainage systems, rather than providing progressively larger sewerage systems.

In the face of these challenges, there is an opportunity to move from asset-based solutions that are delivered in isolation by NI Water, to integrated, sustainable solutions developed by a range of stakeholders with a shared interest in the outcomes and which carry shared risk.

The long-term water strategy provides a forum for considering these issues and establishing a framework within which integrated sustainable solutions can be delivered.

Work on the strategy will also provide a forum for principal stakeholders to develop medium-term targets for the PC15 period that will contribute to the longer term outcomes required by the strategy. These targets will form the basis of the Social and Environmental Guidance. To ensure that NI Water can develop its business plan effectively in 2013, we will ask the Department to provide a draft Social and Environmental Guidance for PC15, including draft objectives, by March 2013.

Other regulators have asked utility companies to develop long-term strategic plans (typically 25 years) to ensure that the objectives of medium-term price controls consider long-term
economic, environmental and social sustainable development. These are underpinned by consumer views and promote ownership by the company of its plans to maintain and develop the services it provides.

Work on the long term water strategy helps fulfil the same broad objective. However, NI Water must retain ownership of the long-term strategic development and delivery of service to its consumers. We will ask the company to set out its strategic vision for the long-term development and delivery of services in its PC15 business plan. This should demonstrate that the outputs and activities it proposes to deliver in the medium term provide the best route to delivering the outcomes of the long-term water strategy.

A key barrier to the implementation of integrated sustainable solutions is the time it takes to:

- undertake the strategic studies and pilot trials that provide confidence that innovative solutions can be delivered;
- address any regulatory barriers and amend legislation and regulations to allow innovative and shared solutions to be implemented;
- allocate actions for delivering innovative solutions across different stakeholders and secure funding to ensure co-ordinated delivery;
- allow the benefits of each stage of development to be assessed before the next stage of implementation begins.

Therefore, the development of integrated sustainable solutions increases the need for:

- careful planning of strategic investigations, trial projects and solution development (including planning permissions and land acquisition) leading up to project delivery;
- a more flexible and responsive approach to solutions allowing a phased approach where this is appropriate;
- funding for innovative development with uncertain outcomes; and,
- the willingness to accept that some solutions will not perform as expected and further investment will be required to secure the desired outcome.

At the PC13 price control, we focused on the need to plan the early stages of project development, consider risks to project delivery, and profile investment accordingly. We also asked NI Water to plan for investment in the first two years of PC15 and ensure that adequate funding was included in PC13 for project development to support continuity of investment into PC15.

It will be necessary for the company to develop this approach when planning PC15 to identify the funding and programme required for the development of innovative or integrated solutions. This may include the funding of trial projects and work with other stakeholders to identify solutions.
The development and delivery of integrated sustainable solutions will require a fresh approach to outcome regulation. Too prescriptive an approach can constrain the amount of choice the company has to delivery when a more flexible and responsive approach is required.

In PC10 we defined a range of outputs of different degrees of certainty or flexibility as appropriate:

- service level outputs – which measure the impact of investment on the level of service that consumers experience;
- nominated outputs – such as specific environmental discharge or drinking water quality standards that are defined by the quality regulators;
- general activities – such as a rate of replacement of water mains, where it was not possible to establish a clear link to service level outputs in the short term.

As the outcomes of the long-term water strategy are defined and targets for PC15 are set down in the Social and Environmental Guidance, we will review and develop our approach to output definition and monitoring. We will consider the need for a more flexible and responsive approach to the delivery of outcomes where further investigations and trial projects might allow the more innovative or integrated solutions to be delivered.

We will expect NI Water to set out a programme and identify funding for the strategic studies necessary to develop sustainable integrated solutions. We will also consider introducing separate outputs to allow this work to be monitored. We will consider proposals for funding innovation that have support from the principal stakeholders. The company should be able to show how the outcomes of investment in innovation will be assessed and how the benefits will be reported in order to support the investment it proposes.
4.5 Targeting investment and managing risk

Overview

The provision of water and sewerage services is a capital-intensive business. The network of water mains and sewers extends to 26,000 km and 14,000 km respectively. Water resources, water treatment works, pumping plant and wastewater treatment works require substantial structures, mechanical and electrical plant and instrumentation. NI Water estimates the gross replacement costs of its current assets as £8.7 billion (March 2012).

The average planned investment over PC10 is £165 million per annum and a similar level of investment is planned for PC13. The company spends £80 million a year on maintaining the current assets. A further £85 million a year will be spent to deliver quality enhancements, improve service and accommodate growth.

It is likely that current levels of asset maintenance will continue to be required in the future and the need may increase as the assets continue to age. Experience in England and Wales shows that demand for additional investment in the water sector to improve quality and service has been sustained over a 20-year period and is expected to continue at recent levels into the future.

It has not always been possible for NI Water to make a robust assessment of the right level of current and future investment which would inform long term plans. For example, at PC10 the company was unable to provide robust information to support investment in asset maintenance or the water mains activity rate it proposed. In the absence of detailed supporting information, we determined these issues using a top down approach based on comparative information. At the time the company was concerned that we might have underestimated the level of investment necessary.

For PC15 we expect the company to have assessed the long term need for investment so that its Business Plan can be set in a long term context and allow opportunities to develop integrated solutions to be identified. Formal systems of long term planning already exist for areas such as Water Resources. However, we do not have the same understanding of long term investment needs for particular groups of assets such as water mains or sewerage systems or for asset maintenance generally. The company’s plans should show that it understands the current state and performance of the assets, the potential for further deterioration and the long term need for quality or service improvements. If further data and analysis is required to develop these plans, we would expect the company to set out what is necessary to improve the link between investment and service and to set out a cost and timescale for completing this work linked to the price control cycle.

Asset maintenance investment

For the PC10 price control NI Water was not able to provide a robust assessment of future asset maintenance expenditure based on risk to service. In the absence of this assessment, we estimated a reasonable allowance for asset investment based on an econometric
comparison with asset maintenance investment in England and Wales. We have carried this approach forward into PC13 as a proportionate approach for a short duration price control.

However, since its inception in 2007 (and before), NI Water has been investing in systems and data collection that should allow it to develop a forward-looking risk based approach to asset maintenance. It is not possible to prejudge the outcome of this work. A better understanding of its assets might allow the company to reduce or delay investment. Alternatively a better understanding might show that higher levels of asset maintenance are necessary and that it will be necessary to increase investment in the medium to long term.

For PC15, we expect the company to have developed its approach to asset maintenance in a practical way, based on improving information quality. This would include:

- A self-assessment of the company’s asset management capability following the ‘asset management planning assessment process’ (or similar approach) to identify strengths and weaknesses.
- The completion of historical serviceability assessments to monitor trends in asset performance against expenditure.
- The targeted development of bottom-up risk based assessments to understand the link between asset performance and service, predict future trends and identify the best way to maintain or improve service (including capital and operational interventions).

We are aware that bottom-up risk based assessments of asset maintenance investment can generate theoretical ‘black-box’ models, which cannot always be supported by the data that is available and may generate misleading answers. We would expect NI Water to develop a practical, targeted and transparent approach to generate credible answers that can be tested and developed as information improves over time.

A robust asset valuation and current cost depreciation estimate on a ‘modern equivalent asset’ (replacement) basis can provide verification of medium to long term asset maintenance investment. The valuation brings together asset information (type, size and age of the assets) with cost data for construction or replacement of the assets. Both are core information sets which we would expect the company to have to allow it to manage its assets effectively. The quality of an asset valuation is only as good as the quality of the data available. The development of the underlying asset and costing data to support effective data management is a more critical issue than re-estimating asset value.

At this stage we will ask NI Water to assess its ability to produce a robust asset valuation. We will also liaise with other stakeholders on the need for an updated asset valuation before asking for this to be produced.

We will continue to work with stakeholders to develop our approach to asset maintenance and will issue draft proposals for consultation by 1 February 2013.
4.6 The scope for efficiencies

Assessing operational efficiency

Our approach to operational efficiency will encompass the following elements:

- We will set a challenging efficiency target for NI Water. In doing so, we will take account of the longer duration of PC15 and the scope this presents to plan for and achieve operational efficiencies within the certainty of a price control.
- We will recognise NI Water’s good progress in reducing its efficiency gap (although this continues to be materially larger than the rest of the industry).
- We will seek to incorporate the thinking we are currently developing through our project to make network price controls more consistent, by adopting cross-utility approaches, principles and standards of regulation.
- We will also consider other external developments as these may present ‘quick wins’ for us to adopt. This includes UKWIR’s total expenditure approach to cost assessment, the out-workings of Ofwat’s Future Price Limits and other benchmarking approaches that are being used or considered by other regulators.

We will ask the company to establish its baseline operating costs for 2012-13 and identify foreseeable reductions or increases in costs for future years. Our approach to base-lining of operating expenditure going forward will be to:

- adopt our twin tests of ‘newness’ and ‘exogeneity’ to establish the need for increased operational spend before we allow increased costs to be borne by consumers (and taxpayers) as part of the PC15 regulatory contract;
- ensure that consumers do not pay for investments that have already been funded under PC10 and PC13, including the SBP transition years; and,
- assess the requirement for continued funding of transformation projects alongside voluntary early retirement (VER)/voluntary severance (VS) to enhance efficiency deliverability.

We will consider the extent to which we can refresh our existing operational efficiency modelling approach taking account of the development of efficiency modelling by other regulators which could provide comparative data.

Our back-stop approach to operational benchmarking will remain centred on an econometric analysis of panel data at service level (water and wastewater). Total service expenditure enables a much richer dataset to inform statistically robust modelling.

We expect to ask for a submission from NI Water detailing its atypical or exceptional costs and a submission of any ‘special factors’ which explain why the company’s operational spend might be higher or lower than comparative benchmark costs.
We are minded to continue examining the likely extent of frontier shift across the water industry by adopting the same approach as at PC13.

We are minded to adopt the triangulated approach which we first used when advising the Minister for Regional Development of the scope to increase efficiency targets during the SBP years. We adhered to this approach during PC10. Triangulation marries detailed econometric analysis and examination of likely frontier shift to the realities of previous attempts to reduce operational spend rapidly within similar regulated industries, such as Network Rail and Scottish Water.

As outlined in our 2012-13 forward work plan, we will endeavour to develop new ways to examine the PPP contracts. Our aim will be to make sure that the costs that are passed through to consumers are appropriate and that NI Water is managing these contracts to maintain their efficiency.

**Assessing capital efficiency**

We are considering our approach to capital efficiency modelling and will publish our approach in May 2013. This will allow us to consider how Ofwat and WICS develop their approaches to capital efficiency modelling and draw on comparative data and analysis where this is available.

We will also consider replicating the approach we took at PC10. This was informed by a triangulated approach where we compared various estimates of need from different methodologies. It used Ofwat's retired comparative capital efficiency models as well as comparative analysis using the cost base. This may be best used as a cross-check against NI Water's historical capital maintenance expenditure.

We will consider whether or not a more forward-looking risk-based assessment of NI Water’s capital maintenance needs might identify the optimal volume of work. This approach could then be combined with the company’s capital scheme costs (for example, as identified in a cost base submission) to calculate another pre-efficiency allowance.

We are likely to require NI Water to construct a refreshed cost base of standardised construction costs which might be compared to a re-based cost base from PC10. Since this would require re-basing over many years subsequent to our PC10 analysis, we would be able to use this information, alongside information from the other methodologies, to inform our view of NI Water’s capital efficiency.

We will build on our previous development of a regional price adjustment at PC10. This allows us to examine the cost differences resulting from the comparative advantage in Northern Ireland where cement, aggregates and construction wages cost less. This aspect will inform any assessment of NI Water’s cost base.

Finally, we will consider whether the cost base might usefully be complemented by an engineering-economic review of NI Water’s procurement processes. Given the weaknesses
of the cost base as a measure of comparative efficiency, this might help distinguish NI Water’s real procurement efficiency from the noise in the data, especially from atypical costs.

**Impact of the public expenditure regime**

In previous regulatory submissions NI Water has highlighted the impact that the public expenditure regime has on its ability to deliver efficiency improvements. The company has noted, for example, that it has not been able to adopt an integrated ‘alliance’ to deliver its capital programme which water companies in Scotland, England and Wales credit with delivering capital efficiencies. The company also feels constrained in the rate at which it can deliver operational efficiency improvements.

We will continue to benchmark NI Water against water and sewerage service providers in Great Britain. We would expect the company to identify and provide evidence to quantify the impact that public expenditure constraints have on the level of efficiency improvement that can be delivered or the rate at which it can be achieved.

**4.7 Finance and tariffs**

**A price limit or a revenue cap?**

At present we set price limits for the company. For PC15 we will review the alternative of moving to a revenue cap and we will consult on the pros and cons of this alternative approach with the Department, NI Water and CCNI.

**The calculation of price limits**

We undertake detailed analysis to assess overall revenue and set price limits and developed a financial model in PC10 to facilitate this. This has proved to be robust and was used for PC13. At this stage we expect to continue to use the same financial model for PC15. However, when we have completed the PC13 determination we will review this decision and take account of any issues which might have arisen before finalising our approach for PC15.

We will make decisions about issues such as:

- the appropriate cost of capital and financial ratios;
- the number and type of current and future customers; and,
- the costs that will be legitimately incurred by NI Water in running its business.

It is possible that some issues, such as the treatment and payment of tax, will require changes to the financial model. If these changes are significant it may become necessary to reissue the financial model at a later date and we will discuss the programme for doing so with the company.
Tariff calculation

We expect NI Water to be in a position to provide estimates of historic, current and future customer numbers and volumes with its business plan which are consistent with its Annual Information Returns and provide a robust and reasoned estimate of forward projections.

We consider it important that tariff differential checks are in place before PC15 so that any cross-subsidy can be unwound over the price control period.

Alignment of regulatory and public expenditure figures

There are differences in the approach that we take to accounts, inflation and the basis for stating expenditure figures for a regulated company compared with the approach that is taken for public expenditure. For PC13 we will reconcile the regulatory determination to the public expenditure capital and resource allocations. We will also publish the determination in nominal terms so that comparisons with public expenditure budgets are easier to make. We will continue this approach for PC15, taking account of any further lessons learned at PC13.

4.8 Information requirements

We will continue to ensure that the information we require from NI Water for PC15 is proportionate but sufficient to:

- allow NI Water to communicate its business plan to us in a clear and effective manner; and,
- ensure that we can submit the plan to effective and focused scrutiny.

For PC13 we simplified the business plan information requirement data tables. Our aim was to reduce the regulatory burden on the company, align with established local practice and improve communication between stakeholders. For example, we:

- continued to use the established PC10 financial model and reviewed the data submission to remove duplicate data;
- aligned the capital investment submission with the established capital investment monitoring submission which now forms the core of the submission and the basis for all summary tables;
- focused the capex submission on the production of clear business cases for investment which demonstrate that the investment proposed is well supported and the risk of delivery has been carefully considered;
- introduced a detailed outputs submission with summary tables which will form the delivery monitoring plan;
- introduced reconciliations between real and nominal expenditure to improve transparency between regulated expenditure and public expenditure accounting;
developed a defined ‘sub-programme’ structure for the capital submission to aid development, assessment, monitoring and communication of investment and associated outputs; and,

simplified the opex submission by adopting an 80:20 focus and ensured that tabulated data more closely aligns with our own approach to modelling of efficiencies which recognises more recent evidence of efficiency delivery when setting targets going forward.

For PC15 we will:

- continue to use and build on the information requirements that we developed for PC13, maintaining the key objectives of continuity and simplicity;
- draw on the lessons learned from the PC13 submission and determination to clarify and simplify the information requirements;
- add additional information requirements where necessary, for example to support efficiency assessments and capture information on issues such as carbon-footprint or energy use where this is appropriate to support new targets for the company;
- discuss opportunities to seek further alignment between price control submissions and other processes; and,
- consider whether further amendments are necessary to ensure clarity and reconciliation between the price control determination and NI Water’s public expenditure funding.

We will issue a first draft of our information requirements by 15 March 2013. These will be finalised by 15 May 2013. Before we issue the draft information requirements, we will consult NI Water to identify opportunities to improve the requirements, align them further with existing processes where possible and learn lessons from PC13.

4.9 Working with the principal stakeholders

We are committed to working with principal stakeholders in the water and sewerage industry to secure a successful outcome for PC15.

Established stakeholder groups – the Water Stakeholder Steering Group and the Water Investment Coordination Group – provided the forum for successful stakeholder involvement and cooperation at our earlier PC10 and PC13 price controls.

For PC13 much of the stakeholder engagement has taken place at an operational level through a working group of the Water Industry Coordination Group. This was supported by bilateral engagement between stakeholders on specific areas of responsibility. This approach allowed specific issues, such as environmental quality and water quality priorities, to be developed through established processes without the need to create additional
structures and meetings. We will continue this approach in PC15. However, for PC15 we which is of longer duration and greater scope, we see the need to re-establish sub-groups of the WICG to address Environmental Quality, Drinking Water Quality and Consumer Engagement. These sub-groups will provide an initial focus to develop strands of work necessary to identify outputs and co-ordinate the detailed work already carried out through existing bilateral arrangements.

The work to develop a long-term water strategy already provides a forum for stakeholders to develop objectives and outputs for PC15. Specifically, Work Package 4 of the strategy provides a forum for stakeholder engagement on the development of the PC15 Social and Environmental Guidance. The Water Stakeholder Steering Group and the Water Investment Coordination Group will continue as the forum for stakeholder engagement specific to PC15 Social and Environmental Guidance, environmental priorities, consumer engagement and the balance of expenditure between different strands of investment.

**Figure 2: Proposed PC15 Working Groups**
5 PC15 Phases and programme details

5.1 Phase 1: Our approach to PC15

Table 1 – Key milestones – Phase 1

<table>
<thead>
<tr>
<th>Key milestone</th>
<th>Date</th>
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<tbody>
<tr>
<td>UR brief Principal Stakeholders on indicative timeline for PC15</td>
<td>13 January 2012</td>
</tr>
<tr>
<td>UR issue PC15 Approach Document to Principal Stakeholders</td>
<td>21 August 2012</td>
</tr>
<tr>
<td>Principal stakeholders respond to UR PC15 Approach Document</td>
<td>14 September 2012</td>
</tr>
<tr>
<td>Bilateral discussions on the stakeholder response</td>
<td>wc 24 September 2012</td>
</tr>
<tr>
<td>PC15 Principal Stakeholder workshop</td>
<td>wc 1 October 2012</td>
</tr>
<tr>
<td>UR publish PC15 approach</td>
<td>25 October 2012</td>
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</table>

The broad outline of the programme – a six year price control with a mid-term review to align with the next Comprehensive Spending Review – was initially raised with the principal stakeholders at a PC13 workshop on 13 January 2012.

We issued our draft approach to PC15 to the principal stakeholders on 21 August 2012 to prompt discussion of the PC15 programme in more detail. We engage in bilateral discussions with the principal stakeholders in September to take feedback on our Approach followed by a workshop on the 2 October 2012.
5.2 Phase 2: Developing the building blocks of the PC15 Business Plan.

Table 2 – Key milestones – Phase 2

<table>
<thead>
<tr>
<th>Key milestone</th>
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<tbody>
<tr>
<td>NI Water and CCNI engage with consumers to elicit views to inform Social &amp; Environmental Guidance and the Business Plan</td>
<td>September 2012 to March 2013</td>
</tr>
<tr>
<td>Principal Stakeholders establish PC15 working groups and Water Investment Coordinating Group, agreeing of quality outputs and consumer priorities</td>
<td>October 2012 to June 2013.</td>
</tr>
<tr>
<td>The Utility Regulator publishes approach to asset maintenance</td>
<td>1 February 2013</td>
</tr>
<tr>
<td>Department for Regional Development provides draft Social &amp; Environmental Guidance and planning assumptions to principal stakeholders</td>
<td>1 March 2013</td>
</tr>
<tr>
<td>The Utility Regulator issues outline PC15 information requirements for discussion with the company</td>
<td>15 March 2013</td>
</tr>
<tr>
<td>The Department publishes the draft Long Term Water Strategy and draft Social and Environmental Guidance for consultation</td>
<td>1 June 2013 to 30 Sept 2013</td>
</tr>
<tr>
<td>The Utility Regulator publishes PC15 information requirements</td>
<td>15 May 2013</td>
</tr>
<tr>
<td>The Utility Regulator publishes approach to opex efficiency</td>
<td>15 May 2013</td>
</tr>
<tr>
<td>The Utility Regulator publishes approach to capex efficiency</td>
<td>15 May 2013</td>
</tr>
<tr>
<td>NI Water submits an outline view of the capex programme to stakeholders</td>
<td>28 June 2013</td>
</tr>
</tbody>
</table>

Consumer engagement

We believe that NI Water and CCNI are best placed to undertake the consumer engagement necessary to identify consumer priorities for PC15. A comprehensive survey was undertaken for PC10 and CCNI carried out further detailed work in 2012 to support the development of the long term water strategy. Key issues to be addressed for PC13 are the development of consumer preferences, develop quantitative information NI Water will need to support and prioritise schemes for the business plan and allow stakeholders to develop consumer measures which deliver the service outcomes consumers want.

A Consumer Engagement Oversight Group will be established to develop this strand of work.
Social & Environmental Guidance

The PC13 Social and Environmental Guidance is being developed as a work-package within the Long Term Water Strategy. We understand that the draft Social & Environmental Guidance will be issued to stakeholders in March 2013 and issued for consultation as part of the Long Term Water Strategy at the beginning of April 2013.

We will ask the Department to provide planning assumptions for the capital and resource DEL funding which will be available to NI Water through the PC15 period as part of the draft Social and Environmental Guidance.

Identifying environmental and water quality outputs

To support the development of the draft Social & Environmental guidance we ask that NI Water and the quality regulators – NIEA and DWI – work together to identify specific improvements to discharge standards or water quality standards and other statutory mandatory improvements which will be required in the PC15 period.

Where possible, we would expect the assessment and prioritisation of these outputs to take account of the failure to meet current standards (for example, where the assets have not been maintained and extended to cater for growth) or emerging issues identified through risk assessments such as the Drinking Water Safety Plans.

Developing our approach for PC15

In setting out our approach for PC15, we have identified the following key areas where we will develop and issue separate methodologies which will set out our approach in more detail:

- **Our approach to asset maintenance**: We have outlined our approach to asset maintenance investment in Section 4.5 above. We will liaise with the company to develop our approach to determining asset maintenance investment and set out our methodology by 1 February 2013. However, it remains for the company to develop its assessment of asset maintenance investment in a way which links investment to the current and future performance of its assets and identifies the minimum level of investment required to maintain defined levels of service.

- **Our approach to determining future efficiencies**: We set out our approach to operational and capital efficiencies in Section 4.6 above. We will discuss our developing approach to efficiency with the company from February 2013. We will issue our methodology with our Information Requirements on the 15 May 2013.

- **Our approach to revenue building blocks and financial modelling**: We set out our approach to finance and tariffs in Section 4.7 above. We expect to continue to use the same financial model for PC15. We will review the use of the financial mode with the company following the PC13 final determination to take account of any lessons learnt. We will issue the PC15 financial model with our Information Requirements on the 15 May 2013.
PC15 business plan guidance

We set out our approach to the development of information requirements for PC15 in section 4.8. We intend to follow the general approach adopted for PC13, aligning with established processes and maintaining continuity through different regulatory submissions. We will amend the information requirements to include the information required to reassess the scope for efficiency and take account of lessons learnt from PC13.

We will engage with NI Water on the development of our information requirements from January 2013 and will issue draft requirements by 15 March 2013. We will discuss the draft guidance with the company and we will issue our Information Requirements by 15 May 2013.

NI Water submits an outline of the capex programme

One of the lessons from PC10 was that a single business plan submission limited the opportunities for issues to be explored and discussed by stakeholders before final decisions were made.

With this in mind, we have considered the need for NI Water to submit a draft business plan which would allow issues to be identified and discussed before a final business plan is prepared. The management of change control in PC10 and the PC13 process has shown that one-to-one engagement between stakeholders through the WICG can provide the framework to support and scrutinise the development of the Business Plan without the need for a detailed draft.

However, the development of a robust Business Plan is an iterative process. The company requires information on objectives and targets to allow it to plan the effective delivery of outputs and estimate costs. Other stakeholders need information on costs to inform their decisions on priorities. In PC13 this process was greatly assisted by the early submission of an outline capital programme to the WICG, which prompted prioritisation of investment within work areas and delivered a broad agreement on the allocation of investment between different strands of work.

For PC15 we ask that stakeholders work with NI Water to identify and prioritise work to allow the company to develop an outline capital programme that can be shared with the Water Investment Coordination Group by 28 June 2013. This will allow stakeholders to reach broad agreement on prioritisation and the allocation of investment between different strands of work. It will allow NI Water to:

- focus its subsequent work on developing a detailed work programme that is deliverable;
- identify opportunities to develop integrated and sustainable solutions which could reduce overall cost and allow more outputs to be delivered and work with the relevant stakeholders to develop these opportunities;
- allow the WICG to confirm key outputs and consider and resolve competing demands on resources between different objectives.
To support the outline capital programme, NI Water should provide an assessment of the outputs it will deliver. The company should include information on the proposed quality outputs using the formats agreed with the relevant quality regulator. The company should outline the changes in service levels it plans to deliver over the PC15 period and highlight how this links to capital investment or changes in operational practice which it will develop through its Business Plan.

5.3 Phase 3: NI Water’s business plan

Table 3 – Key milestones – Phase 3

<table>
<thead>
<tr>
<th>Key milestone</th>
<th>Date</th>
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<tbody>
<tr>
<td>NI Water submits draft efficiency and cost data to the UR</td>
<td>31 October 2013</td>
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<tr>
<td>UR provides initial feedback on NI Water’s draft efficiency and cost data</td>
<td>30 November 2013</td>
</tr>
<tr>
<td>NI Water submits draft special factors claims to the UR</td>
<td>20 December 2013</td>
</tr>
<tr>
<td>NI Water submits PC15 business plan to the UR</td>
<td>24 March 2014</td>
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<td>The Department publishes final Social &amp; Environmental Guidance for PC15 and confirms budget assumptions for the PC15 period</td>
<td>1 April 2014</td>
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NI Water’s business plan submission

We will ask the company to provide its Business Plan by the 24 March 2014. This is earlier than in our previous price controls and will provide:

- for constructive dialogue with the company to understand and challenge the business plan before we reach our draft determination;
- more time for consultation with stakeholders on the draft determination;
- the opportunity for our draft and final determination to inform and respond to any Comprehensive Spending review during that year; and,
- the opportunity for us to complete our final determination earlier in December 2014.

We will ask the company to provide early draft submissions on two key issues: its special factors claims and efficiency metrics.
Draft special factors

A critical issue for NI Water is the extent of the efficiency gap with water and sewerage service providers in England and Wales. The company has highlighted a number of special factors that might explain some of this efficiency gap and has indicated that it will develop these further for PC15.

As the company closes the efficiency gap, the identification and quantification of robust special factors will become more important. To allow us to respond effectively to this element of the PC15 business plan submission, we will ask the company to make an initial submission on any special factors it is considering by 20 December 2013. This submission should include the sources of data the company has used to assess the special factors and its initial conclusions on the impact of the special factor on its comparative efficiency.

Draft efficiency metrics

In Section 4.6 we outlined how we will develop our approach to assessing efficiencies for PC15. We will review the approaches used for PC10 and consider what other benchmark data is available from other regulators or wider comparative analysis.

Our comparative efficiency analysis will continue to require a range of yardstick data and general and standard cost data from NI Water. We will ask the company to submit initial data by 31 October 2013. We will assess this data and provide initial feedback by 30 November 2013 to allow the company to review and refresh the data for its business plan submission.

5.4 Phase 4: We determine the PC15 contract, outputs and price limits to align with the public expenditure budget allocation

Table 4 – Key milestones – Phase 4

<table>
<thead>
<tr>
<th>Key milestone</th>
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<tr>
<td>NI Water submits PC15 Business Plan</td>
<td>24 March 2014</td>
</tr>
<tr>
<td>UR publishes Draft Determination for consultation</td>
<td>10 July 2014 to 15 October 2014</td>
</tr>
<tr>
<td>UR publishes Final Determination</td>
<td>10 December 2014</td>
</tr>
<tr>
<td>NI Water accept or reject Final Determination</td>
<td>10 February 2015</td>
</tr>
<tr>
<td>First year of PC15 Charges Scheme applies</td>
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</tr>
<tr>
<td>NI Water publishes PC15 Monitoring Plan</td>
<td>1 April 2015</td>
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It is our statutory role to set price limits that reflect the lowest overall cost of delivering ministerial objectives for NI Water. We do so by analysing NI Water’s business plan and other regulatory submissions. We also make comparisons of the proposed costs with those that would be incurred by efficient service providers elsewhere in the industry. We will also consider the implications of NI Water’s status as a non-departmental public body and the impact of any associated constraints on the company’s ability to drive out efficiencies.

Our approach to determining price limits for PC15 is as follows:

- We will assess and challenge the company’s business plan to arrive at a draft determination. We will engage with the company to ensure that we have a clear understanding of the business plan. Where necessary we will use a formal query process to ensure that we have the information necessary to reach a determination.

- We will reach a draft determination by 10 July 2014. We will publish our initial response to NI Water’s business plan and our draft determination of future price limits for consultation.

- We will ask for consultation responses to be returned by 15 October 2014. This will allow stakeholders time to consider and respond to our draft determination. During this period we will also engage with NI Water to discuss our assessment of its business plan.

- We will issue our final determination by 10 December 2014, having regard to representations made during the consultation process.

We will adhere to the memorandum of understanding between us and the Department for Regional Development and the consequent written agreement. We will liaise with the Department on the need to update these agreements throughout the PC15 process. We would publish proposed changes to the memorandum and written agreement with our draft determination and we will finalise these agreements by the time we issue our final determination.
Table 5 collates the key milestones for PC15.

**Table 5 - PC15 key milestones**

<table>
<thead>
<tr>
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<tr>
<td><strong>PC15 phase 1: Our Approach to PC15</strong></td>
<td></td>
</tr>
<tr>
<td>UR brief Principal Stakeholders on indicative timeline for PC15</td>
<td>13 January 2012</td>
</tr>
<tr>
<td>UR issue PC15 Approach Document to Principal Stakeholders</td>
<td>21 August 2012</td>
</tr>
<tr>
<td>Principal stakeholders respond to UR PC15 Approach Document</td>
<td>14 September 2012</td>
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<tr>
<td>Bilateral discussions on the stakeholder response</td>
<td>wc 24 September 2012</td>
</tr>
<tr>
<td>PC15 Principal stakeholder workshop</td>
<td>wc 1 October 2012</td>
</tr>
<tr>
<td>UR publish PC15 approach</td>
<td>11 October 2012</td>
</tr>
<tr>
<td><strong>PC15 phase 2: Developing the building blocks for the PC15 Business Plan</strong></td>
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<tr>
<td>NI Water and CCNI engage with consumers to elicit views to inform Social &amp; Environmental Guidance and the Business Plan</td>
<td>September 2012 to March 2013</td>
</tr>
<tr>
<td>Principal Stakeholders establish PC15 working groups and Water Investment Coordinating Group, agreeing of quality outputs and consumer priorities</td>
<td>October 2012 to June 2013.</td>
</tr>
<tr>
<td>The Utility Regulator publishes approach to asset maintenance</td>
<td>1 February 2013</td>
</tr>
<tr>
<td>Department for Regional Development provides draft Social &amp; Environmental Guidance and planning assumptions to principal stakeholders</td>
<td>1 March 2013</td>
</tr>
<tr>
<td>The Utility Regulator issues outline PC15 information requirements for discussion with the company</td>
<td>15 March 2013</td>
</tr>
<tr>
<td>The Department publishes the draft Long Term Water Strategy and draft Social and Environmental Guidance for consultation</td>
<td>1 April 2013 to 28 June 2013</td>
</tr>
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<tr>
<td>The Utility Regulator publishes approach to capex efficiency</td>
<td>15 May 2013</td>
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<tr>
<td>NI Water submits an outline view of the capex programme to stakeholders</td>
<td>28 June 2013</td>
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<td><strong>PC15 Phase 4: Price Control Determinations</strong></td>
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