



Northern Ireland  
Assembly

Committee for Regional Development

# OFFICIAL REPORT (Hansard)

Northern Ireland Water Governance and  
Funding: Ministerial Briefing

8 May 2013

# NORTHERN IRELAND ASSEMBLY

## Committee for Regional Development

Northern Ireland Water Governance and Funding: Ministerial Briefing

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**Members present for all or part of the proceedings:**

Mr Jimmy Spratt (Chairperson)  
Mr Seán Lynch (Deputy Chairperson)  
Mr Stewart Dickson  
Mr Alex Easton  
Mr Ross Hussey  
Mrs Dolores Kelly  
Mr Declan McAleer  
Mr Ian McCrea  
Mr David McNarry  
Mr Cathal Ó hOisín

**Witnesses:**

Mr Danny Kennedy	Minister for Regional Development
Mr John Mills	Department for Regional Development
Mr Richard Pengelly	Department for Regional Development

**The Chairperson:** I welcome the Minister for Regional Development, Danny Kennedy; permanent secretary, Richard Pengelly; and John Mills, the director of water policy. Gentlemen, you are no strangers to the Committee. You are all very welcome.

Minister, at the outset, I must say how disappointed we are that despite the fact that the Committee wrote to the Department, two weeks ago, requesting that the A5 project should be on the agenda and, last week, that some Translink issues should be added to it, those items will not be taken today. We have not been able to ask questions about the A5 up to this point because of the ongoing court processes and all the rest of it. The Committee has held a very tight line on that. However, £40 million or £50 million has been spent on the A5, and there is not a foot of tar in public ownership. We need to ask major questions about compensation and a whole plethora of issues that are coming out of the woodwork, not least why the Department failed to deal with the habitats directive stuff at an earlier stage. The Committee is extremely disappointed that you are not in a position to answer questions on those issues today. As Chairman of the Committee, I have to make that point strongly.

I must also say that we will facilitate a meeting sooner rather than later, and we are quite happy to do that to suit your diary. We ask that you consider our having that meeting in the next two weeks, as opposed to putting it off until June. Questions need to be asked. The Committee feels that, because of the public money that has already been spent with no results, it has a duty to question the Department on all the issues around that. So, that is my statement, made at the start of the meeting because the subject is not on the agenda today. I ask that you give that some consideration and come back to us at the earliest possible stage.

**Mr Danny Kennedy (The Minister for Regional Development):** It might be helpful, at the outset, for me to make some points. Thank you for the invitation to attend this morning and for your welcome. The issue that is before us this morning is water funding and governance, and that is of significant importance. I took the view that it deserved serious and detailed consideration in its own right. Let me assure you that there has never been any reluctance on my part to engage with the Committee or to talk about the issues surrounding the A5 and other related matters. Indeed, as you will confirm, I have sought to keep you, as Chairman of the Committee, abreast of the issues. My door remains open on the issue. I have had the benefit of representations from the road construction industry and the firms affected and of some political engagement on the issue. I am perfectly happy and content to come back to the Committee, in detailed forum, to discuss those issues. However, I felt that the issue of water governance and funding deserved its own place in the sun at today's meeting.

**The Chairperson:** I understand that, and I accept that you have given briefings to me as Chairperson and to the Deputy Chairperson. We have reported those matters to the Committee. However, other members of the Committee obviously want to ask questions. The fact is that the Confederation of British Industry (CBI) and everyone else is in a muddle now about the A5, and the Committee feels strongly that it needs to ask questions. We need to know exactly where we are on all those issues. However, that is enough said about that. I am happy for you to carry on with the briefing on Northern Ireland Water.

**Mr Kennedy:** Thank you very much, indeed, Chairman. Again, I thank members for the invitation, and I welcome the Committee's interest in water governance and funding issues. I am happy to provide an update on the issues currently being considered by the Budget review group.

The deferral of the introduction of water charges means that NI Water cannot act as it was originally intended; that is, as a regulated utility with an independent income stream from customer charging, operating at arm's length from government. The Bill to extend the subsidy in lieu of customer charges to March 2016 was, as you know, recently passed by the Assembly and has now received Royal Assent. The continuance of majority public funding means that NI Water is treated as a non-departmental public body (NDPB) for the purposes of public expenditure, and the result is that NI Water has to be two things at the same time.

At its meeting on 22 November, the Executive agreed, on my recommendation, that the issues and risks associated with the governance and funding of water and sewerage services be remitted to the Budget review group for detailed consideration. Work is ongoing. It is a difficult area, and some of the issues are complex, as can be seen from the briefing paper provided in advance to the Committee. The paper details various governance, accounting and efficiency issues arising from NI Water's current dual status. It also highlights the fact that changes to current arrangements have the potential to crystallise other risks around VAT, depreciation costs and EU compliance. I welcome input from Committee members on how those issues can be addressed. If I may, I will briefly cover some of the key issues outlined in the briefing paper. Though there are numerous complexities, the basic issue is the source of funding for water and sewerage services. If we can establish a position on funding, other issues can be addressed.

The current classification of NI Water as an NDPB was made in 2008 by the Office for National Statistics. Its decision stems from the fact that NI Water receives almost 75% of its revenues via subsidy from the Executive in lieu of domestic charging. NDPB status means that NI Water does not have the freedoms and flexibilities normally available to a company. It cannot hold reserves to deal with unexpected costs or raise its own capital, and it has no end-year flexibility, so it must arrange its capital and resource budgets to ensure that there is no overspend and that there is a minimum of underspend. That is inefficient and leads to stop-start contracting. These constraints are not faced by the GB companies against which the regulator benchmarks NI Water, and it seems unlikely that, under the current governance arrangements, NI Water could ever be as efficient as those companies. The classification of NI Water is outside the control of the Executive and, therefore, cannot be reversed by them. However, the classification could change if the majority of NI Water's funding was sourced through an independent income stream. I welcome members' suggestions on how an independent income stream could be provided for water and sewerage services. I know that the Committee recently visited Welsh Water. Of course, I too have met Nigel Annett and also the chair of Scottish Water. I am interested to hear the Committee's views on the Welsh mutual model, including the implications for domestic charging.

As regards the wider public expenditure environment, we must also consider that the overall outlook for public expenditure in the next Budget period continues to be difficult. That may have implications for the level of funding that the Executive have for investment in water and sewerage services. Again, I welcome members' suggestions on how we continue to fund water and sewerage services to the same level in the face of constrained public expenditure.

The case for change has merit and could address some of the issues that I have mentioned. However, it may also crystallise other risks. A number of risks could materialise because of the technical accounting and legal treatment of the chosen governance option; mainly, potentially increased costs of VAT and depreciation. Any change to the existing position would need to consider the potential impact on those. There are also EU regulatory risks from the water framework directive's article that deals with the recovery of the cost of water from those who use it. The Budget review group is actively considering those issues, and the Committee will be aware of them from its active scrutiny of the water governance issue. I welcome any suggestions that members may have on how to mitigate the risks.

Chairman, as I outlined at the outset, this is a difficult area with complex issues. I am pleased to be here to discuss and exchange ideas and views with the Committee. Of course, I will share with the Budget review group any suggestions the Committee has on addressing the issues. Thank you very much.

**The Chairperson:** Thank you for the briefing, Minister. The Committee visited Welsh Water, and you will also be aware that Nigel Annett was with the Committee. We looked at the Welsh system and saw some advantages, such as the possibility of access to private funding and the raising of bonds. However, water charging is not a decision for the Committee. That is a matter for the Executive. Our discussions have involved looking at various models, particularly models of governance. Members have been impressed with some aspects of the Welsh Water model, and we intend to look at the Scottish model at some stage. You said that you have looked at that, and there may be advantages to it, as well. No other work has been done.

I will start the questioning. When is it likely that the Budget review group will publish the possible options, which they are discussing at the moment, on the way forward for Northern Ireland Water? Will there be a wider consultation process on the options? Does the Department have a preferred option for the governance of Northern Ireland Water or does it have an entirely open mind? It might be helpful if we were to start with those two areas.

**Mr Kennedy:** The options paper is being prepared jointly by officials from the Department for Regional Development (DRD) with some assistance from the Department of Finance and Personnel (DFP). That will look at all the options that are available to us, including privatisation and mutualisation — any and all of the options that are there. That is reasonable in order to give us a detailed analysis. There is no preferred option. It is an honest attempt by officials to look at and tease out all of the issues and their implications, because, essentially, as you have rightly said, it is not a matter purely for DRD. It is a matter for the Executive to decide on, given the history and the way it has been handled in the past. We expect the options paper to be considered by the Budget review group in the autumn. No decision has yet been taken.

Obviously, members of the Budget review group will have to consider whether they want to come to a conclusion with a preferred option that would lead to further and wider consultation. There has been no decision on that yet. We are still in the foothills on this in many ways. The advantage of doing it at this point, and one of the advantages of having the legislation to tide us over until 2016 or whatever, is that we can look at the issues in a mature and reflective way, take it away from some of the more public heat and, hopefully, shed a bit of light on it. There is no preferred option. Obviously, because they are represented on the Budget review group, all the political parties will have input to that. That in itself will be interesting. Of course, I am not only Minister for Regional Development; I will also have party political considerations that will be brought to the table.

**Mr Lynch:** Minister, you spoke about crystallising other risks. What is the potential financial burden of the risk you refer to?

**Mr Kennedy:** There are issues around depreciation, for instance, that could impact on a higher asset valuation for NI Water, leading to higher depreciation costs of perhaps around £100 million. An issue like that has to be considered, as does the issue of VAT. If the revenue was to decide that NI Water could no longer reclaim input VAT because it was not providing a chargeable service, there could be

an impact. We estimate that to be about £50 million. Again, the revenue, being the revenue, could look at past years. There are issues. As well as structures, overall governance has to be considered, and for every action there will be a reaction.

**Mr Dickson:** Thank you, Minister, for joining us this morning to discuss this issue. As you will be aware, I am coming from an unashamedly charging perspective with regard to water. I think that the current policy is a gross and abject failure. There has been a litany of missed opportunities, and you have now alerted us to the fact that, if the revenue sees an opportunity to grab £50 million of VAT back off you because of the failure of the current situation, not only will it do it for last year but it will do it for as many years back as it can.

**Mr Kennedy:** To be fair, that has been in the public domain for quite a while.

**Mr Dickson:** I accept where we are. That is the reality. I am interested in the fact that the Budget review group is now, but only now, starting to work up the options. I remain disappointed. Although you put in place legislation that takes us to 2016, I have concerns that we will be sitting here in 2015 debating another one-line piece of legislation that will be another patch to carry us forward for another three or four years, or will we have genuine options put in front of us? I think that all of us around this table have an open mind about the future model. I do not think that there is a particular problem as regards our unanimity that the current model is not delivering the best value for money for the citizens of Northern Ireland when it comes to water.

What actions are you taking, Minister, to ensure that the public will have a range of equitable options put in front of them, that those options can be consulted upon in a timely manner and that we can get away from this patching up of our water service, which is not delivering for anyone in Northern Ireland? It also places unnecessary restrictions on the trading model, although you need to make it clear that full privatisation of water is at the other end of the scale from where we are, which is effectively full nationalisation of water. Full privatisation of water would simply put the profits of Northern Ireland Water into the hands of a foreign owner rather than into the ownership of the citizens of Northern Ireland.

**Mr Kennedy:** Thank you, Mr Dickson, for your contribution. You are coming, I suppose, from what is a predetermined outcome in your own mind. The useful work that has been done is to bring an important issue such as this to the Budget review group. This issue has been kicked about for quite a while and, in many ways, been used as a political football.

It is better that we take time and mature reflection to look at the governance, structural and financial issues. That is best done by looking at all the available options, giving them proper analysis and trying to seek consensus. I cannot predict whether we or anybody will be back in 2016 to extend the current legislation. My hope is that all the political representatives around the Executive table, represented on the Budget review group initially, and then the wider audience, political and otherwise, can bring these issues forward.

This does represent progress that we have hitherto not seen. I hope that by treating the issue in a serious manner, it will get serious consideration.

**Mr Dickson:** Would you not agree, Minister, that you missed a serious opportunity in the water Bill that has just received Royal Assent, and that that was an opportunity for you to put down a clear marker to say what the Department wished to do and to set targets, rather than to let things go on in a laissez-faire manner?

**Mr Kennedy:** No, because I know that this issue will, properly, be a collective decision taken by the Executive. Therefore, it is brought through the various channels and avenues that are available to us. We have created that opportunity by bringing it through the Budget review group. I have no doubt that your party colleagues in that group and on the Executive will make their views known to us.

**Mr Dickson:** That means that your Department is taking a back seat, with no view on the matter.

**Mr Kennedy:** No, it does not mean that. I will have a view, and the Department will have a view. However, you are aware that it is such a contentious decision that it is considered to be of strategic importance to the overall Executive. Therefore, one single view, no matter how worthy — even your view — is not likely to prevail.

**Mr Dickson:** The opportunity was to work up a range of models, not one view.

**Mr McNarry:** Welcome.

**Mr Kennedy:** There is a vacancy at Manchester United.

**Mr McNarry:** Benitez is getting it. *[Laughter.]* On a more important matter, Minister — *[Laughter.]*

**The Chairperson:** The Committee Clerk thinks that that is very important.

**Mr McNarry:** Well, he would, wouldn't he?

Have you had any contact from the European Commission expressing concern to the Department about the water framework directive?

**Mr Kennedy:** No. We are aware of the issue and the impact that that would have. It is my understanding that no action has been initiated by the EU, but we have to remain aware of the issue.

**Mr McNarry:** Do you think that it has noticed it? You have flagged it up here. I have not seen it, and my colleagues in Europe who have some access to what goes on there have not, despite serious endeavour, seen anything in the European Commission that points to what is being flagged up here in respect of Northern Ireland. What I am saying is that, at the moment, it does not appear to be an issue, although it probably will be now that it is being discussed here. That said, should the European Commission come at the Department, what would be your response? If you are anticipating that, what would you say?

**Mr Kennedy:** Let me say that we not inviting infraction proceedings from Europe, and, clearly, we would defend our actions hitherto. However, it is fair and part of the spirit of openness for genuine discussion to take place. We have to be aware that these issues and dangers exist. We would obviously seek to defend our position should proceedings be initiated against us. Like anybody in our position, we would not be keen for such proceedings to be an initiated against us, and we would seek to defend that position. I do not think that it is unfair or unreasonable for us to be aware of this as an issue in looking at the future governance and structures of NI Water.

**Mr McNarry:** I accept that, and I think that it is fair that you are aware of it. I just have my doubts about attracting attention to it, which this might do.

On your point about the spirit of openness, is there any substance to the suggestion that, at this moment, the Department holds — and has held for some time — an open file with a brief to consider the introduction of domestic water charges by 2020?

**Mr Kennedy:** It is news to me, so —

**Mr McNarry:** I am only asking the question.

**Mr Kennedy:** Yes, and it is a very good question. It is very well asked and very well answered.

**Mr McNarry:** Of course, you would not be the first Minister to say, "It is news to me". We recently had a Minister say that things were news to him because his officials were doing some things. So, it may be news to you, but is it news to your officials?

**Mr Kennedy:** No. As I outlined, the Department, under my leadership, is bringing this discussion to the Budget review group for a wider discussion on the implicit understanding that it is a cross-cutting issue, is potentially controversial and is, therefore, an Executive decision. I think that that is wise and prudent. We are not coming from a predetermined outcome.

**Mr McNarry:** So, if you asked for such a file, there would not be one?

**Mr Richard Pengelly (Department for Regional Development):** Members will be aware that I have been in the Department since 1 January. I can categorically assure members that not a single piece

of work will take place, or has ever taken place, in the Department without the Minister being made absolutely aware of it and without his explicit authority.

**Mr McNarry:** That is in Hansard now. *[Laughter.]*

**Mr Kennedy:** You have no idea how that fills my soul.

**The Chairperson:** Let us not have any more cross-examination on this. I think that you have the answer. You have been told twice. Anything else, David?

**Mr McNarry:** No.

**The Chairperson:** You got "no" twice. I do not want that "no" for a third time.

**Mr McAleer:** At the outset, I want to say that I identify with the Chair's comments about our disappointment that the A5 issue was not raised today. I look forward to that meeting in the near future.

On the governance of NI Water, we have heard from Welsh Water; indeed, delegations went across. We also heard about other governance models. What has been the extent of the Department's engagement around those other examples, and what have you learnt from other models?

Also, you said earlier that Budget review group will produce its report in the autumn. Can you give me an indicative timeline for when that might translate into options and decision-making?

**Mr Kennedy:** Thank you very much indeed. I am happy to confirm that I have taken time to engage with Welsh Water and Scottish Water on potential models. I have looked at them in some detail and gained benefits. I know that the recent visit to Wales was beneficial. It is helpful that we all explore what is happening in other areas, see how things work well in other areas and whether those things would work well here. Those are the issues that we have to consider.

The report to the Budget review group will be in the autumn, but it is hard to predict timing at this juncture. At that point, the Budget review group will determine the next steps that it wishes to take and whether wider consultation involving politicians and interested groups will happen. I do not want to pre-empt anything; we are taking it stage by stage. Let us have the analysis provided and the initial discussion, and let us see how the Budget review group chooses to move forward.

**Mrs D Kelly:** I apologise, Minister, for missing the beginning of your introduction. It is disappointing that we are not able to discuss the A5, given the speculation in the press that there will be discussions on how that money might otherwise be spent.

Is it possible for the Committee to have sight of the terms of reference for the Budget review group?

**Mr Kennedy:** I am happy to confirm that the group has a wide-ranging remit. All the options will be brought forward: mutualisation; privatisation; or whatever options are out there. There is no bar, if you like, everything is up for grabs. I am not sure that it was established in a way that would provide boundaries. As far as I am concerned, it will, and should be, a full and wide-ranging discussion covering all the issues around water governance, structures and finance.

**Mrs D Kelly:** With regard to the comparisons by the regulator with water companies in GB, you said that NIW would never really compare favourably because of the governance issue.

**Mr Kennedy:** As presently constituted.

**Mrs D Kelly:** Yes. In the past, however, it was managed in-house by the Department. Is there any separate analysis of how that compared?

**Mr John Mills (Department for Regional Development):** Northern Ireland Water has made considerable strides in efficiency since it was created in 2007. The gap would have been wider with regard to its predecessor, Water Service, and the regulator has confirmed that in its custom performance reports.

**Mrs D Kelly:** So, there is unlikely to be the option for it to return in-house?

**Mr Kennedy:** I think that it is not possible to effectively renationalise or recreate those circumstances.

**Mr Mills:** It would be contrary to the urban waste water treatment directive to return Northern Ireland Water to be part of government. It could be an agency, an NDPB or any of those things that the Minister said, but one would risk being infracted, as happened during direct rule, if you had the deliverer of water and sewerage services in-house in one of the Departments.

**Mr Easton:** You talked about privatisation. Have you any personal thoughts, as Minister, on privatisation of water?

**Mr Kennedy:** I have no ideological hang-up on privatisation.

**Mr Easton:** So —

**Mr Kennedy:** Others around the table —

**Mrs D Kelly:** I do.

**Mr Kennedy:** Others around the table may not share my view.

**The Chairperson:** I do not think that we will open that debate now, Minister.

**Mr Kennedy:** That is very wise, Chairman.

**Mr Easton:** So, would the introduction of water charges or privatisation have to come as a proposal from your Department to the Executive?

**Mr Kennedy:** It is a potentially cross-cutting matter because Executive decisions would impact on the current customer subsidy. I remind everybody that it is a customer subsidy, not a subsidy to NI Water. Because of that previous decision, and because of its potentially contentious nature, the remit, through the Budget review group, will ultimately go to the Executive for a final decision.

**Mr Easton:** Would the proposals to the Budget review group come from your Department for discussion?

**Mr Kennedy:** The Executive have agreed with our recommendation for the Budget review group to task DRD and DFP officials with bringing forward a paper on all the options, including an associated analysis, to better inform the Budget review group and, ultimately, the Executive, in making a final decision.

**Mr Easton:** OK. Thank you.

**The Chairperson:** We have exhausted our questions for this session, Minister. I thank all three of you for coming along today. I hope that we can meet again very shortly to discuss the A5 issue.

**Mr Kennedy:** Yes. We will attempt to arrange that. Thank you very much.