



Northern Ireland
Assembly

Committee for Regional Development

OFFICIAL REPORT (Hansard)

Water and Sewerage Services (Amendment) Bill:
Northern Ireland Authority for Utility Regulation
Briefing

16 January 2013

NORTHERN IRELAND ASSEMBLY

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Members present for all or part of the proceedings:

Mr Jimmy Spratt (Chairperson)
Mr Seán Lynch (Deputy Chairperson)
Mr John Dallat
Mr Stewart Dickson
Mr Ross Hussey
Mr Declan McAleer
Mr Ian McCrea
Mr David McNarry
Mr Cathal Ó hOisín

Witnesses:

Ms Jo Aston	Northern Ireland Authority for Utility Regulation
Mr Shane Lynch	Northern Ireland Authority for Utility Regulation

The Chairperson: Jo Aston and Shane Lynch, you are both very welcome. You are no strangers to the Committee; you know the form. You have 10 minutes in which to make a presentation and, then, leave yourself open to questions.

Mr Shane Lynch (Northern Ireland Authority for Utility Regulation): Good morning, Chairman and Committee members. I do not think that we will need 10 minutes. We wrote to the Committee Clerk on 4 January 2013. I just want to reiterate what we said in the correspondence. We support the Bill, in particular two aspects of it; first, the extension of the initial period, which allows a government subsidy to be paid in lieu of customer charges for another three years until 31 March 2016; and, secondly, the second amendment in the Bill, which requires the undertaker to register their intention to carry out certain works on private land in a statutory charges register. We fully support that measure, which will make information about Northern Ireland Water's (NIW) intention to lay a water pipe or sewer and its location more accessible and publicly available. That further improves transparency surrounding the work of the undertaking, and we consider that it will benefit private landowners.

In conclusion, we support the Bill. Jo, do you want to add anything?

Ms Jo Aston (Northern Ireland Authority for Utility Regulation): The Bill is just a next step, really. Our concern rests round the fact that the Bill extends to April 2016. We fully support that. We understand the timing with regard to elections, and so on. Our dominant concern is that we are already working into the next period with regard to our regulatory role. We are very keen to embrace more strategic and longer-term planning for the company, particularly with regard to climate change and more extreme events. You need to plan and solve those problems early. Therefore, the

continuing uncertainty about funding beyond March 2016 is a concern for us, for the price control. I guess that we would very much encourage the debate on the funding of Northern Ireland Water and, indeed, the consultation on its governance to ensure that we have married them when we take forward the strategic approach, so that we have sustainable solutions to such events as the freeze and thaw that we had, and the flooding, and so on.

I suppose that one other thing to mention to the Committee is that we understand totally the hardships that communities face and the reticence with regard to funding and charging. I suppose that there has always been a lot of protection in the water industry with regard to tariffs, and so on. I am very happy to provide the Committee with additional information if that would be helpful. I am not saying that that is the only way to solve the problem; it is more about certainty of funding.

The Chairperson: Thanks very much. I just want to take up your last points, Jo, on 2016. Can you explain to us how restrictive the uncertainty over extending the subsidy period to 2016 is for you and, indeed, to Northern Ireland Water?

Perhaps Shane could pick up on my second question. Last week, the Irish Congress of Trade Unions was in front of the Committee. We noted that it levied criticism at the perceived absence of transparency with regard to Northern Ireland Water's capital investment and revenues. Do you agree with it on that? I am interested to hear your views on that issue.

Ms Aston: OK. I will deal with the restrictions first. Perhaps I should discuss our experience to date with difficulties due to the uncertainty of funding. For price control 2010-2013 (PC10), you assume a certain level of capital investment. You try to establish a tight contract to ensure that Northern Ireland Water delivers and has responsibility to deliver. Then, you have restrictions on the public expenditure that comes in, with the withdrawal of £50 million in any one year and the capital profile changing dramatically. That is extremely difficult in a capital-intensive construction industry, in that you cannot just ramp up and ramp down. You can do it to a degree. However, you start doing what is not critically needed. You start laying water mains or sewers instead of treating your waste-water treatment works to ensure that you have development capacity and compliance with Europe. That is a real problem for us.

Equally, indeed, there are the efficiencies that we are encouraging Northern Ireland Water to drive out. Again, there are comparisons. The 38% efficiency gap in 2010 meant that Northern Ireland Water was paying £1.62 for every £1. That is too much to carry. We need to get that out. Others have walked these roads, such as Scottish Water, which is also a public sector water company. We need Northern Ireland Water to do that. It perceives that it has a lot of restrictions. We have had a lot of discussion and debate on the funding of voluntary early retirement and business improvement initiatives through our price control. Again, that adds difficulty for the company and, indeed, for us in ensuring that it gets on with driving out and delivering the contract that we set it in our price controls.

Mr Shane Lynch: In my view, there can never be enough transparency. This is the first time that I have heard that the Irish Congress of Trade Unions had an issue on transparency, but I welcome the opportunity to address it from our perspective.

When we set price controls, the company submits to us its proposed capital expenditure programme, and, eventually, we sign off on a particular level. It is typically broken down into different categories of capital expenditure, from what we call asset replacement, which is just to keep existing assets in good shape, to quality improvement investment or environmental protection, which are largely driven by European directives. From our perspective, as a regulator, it is important that all capital expenditure is targeted and prioritised. We know what we are getting for our money, and we can measure the deliverable, so that if it is not delivered or something different is done, we can take account of that post-event.

As Jo has alluded to, going into the next price control from 2015 onwards, we want to be a lot more strategic and longer term about capital investment. It might be helpful to understand a bit more about exactly what the transparency issue is.

The Chairperson: It was recorded in the Hansard report, so the Committee Clerk will forward the appropriate section to you. I am not sure whether it is available yet.

The Committee Clerk: It is not quite available yet.

Mr Shane Lynch: We will be very happy to look at that and to meet with the Irish Congress of Trade Unions and discuss it with them.

The Chairperson: It will be available in the next few days, and we will let you have a look at that. It would be helpful to know your view on it.

Ms Aston: I have a summary of our final determination, and on the back page, we have a full breakdown of capital outputs. This is at quite a high level, but we have a capital investment chapter in our price control documentation, which talks about where the investment is going and what is needed. I would be very happy to understand the level of transparency that they are looking for, because one of our primary principles is that we want to be very transparent.

The Chairperson: It was raised last week, so if you have a look at it, it might be helpful if you come back to us on it.

Mr Shane Lynch: We are happy to do that.

Mr Seán Lynch: Thanks for the presentation. In your submission, you encourage an informed debate and consultation on the future funding of NIW. When should that take place? What are the key issues to be consulted on?

Ms Aston: It is difficult politically because you have a new election coming up. Therefore, I can understand that that circumstance might dictate some of the timetabling. If I look at how long it will take if we consult and how long it will take to implement the recommendations of that consultation, I would suggest that that might take two or three years. If you think about that timetabling, we are in danger of not getting started until the next mandate and not getting finished until the following mandate. The timing is a difficulty. Therefore, I urge that a lot of preparatory work has to be done in this mandate and then carried forward in the next one.

The key issues are around governance. Northern Ireland Water was set up as a government-owned company. There are different operating models. There is the Scottish Water model, the private model and the mutual model, so there are some fundamental issues around governance. There are also issues in respect of charging. There is a water framework directive, which requires charging down to the level of business consumer and agricultural and domestic household consumer, so there is a directive sitting there, which, in my view, we are not compliant with. Therefore, that is a discussion and debate that we must have. There are lots of things to go along with that in respect of how we protect the vulnerable and how we protect the people who cannot afford it, because water and sewerage services are fundamental for health. That is a very critical part to be covered in consultation.

Mr Seán Lynch: I have a follow-up question. Are you in favour of subsidy or charging?

Mr Shane Lynch: As we are largely an economic regulator, promoting value for money is embedded in our statutory duties. For us, the key consideration in any open-space debate is which model produces the most value for society as a whole. Which model would allow us to run Northern Ireland Water at least cost to drive operational efficiencies and at least cost to finance the organisation? Are there better models than the current hybrid model that we have that might free up money to be used in other sectors? We think that that is where a healthy debate can and should happen, and, from our perspective, the sooner the better.

The Chairperson: You could join the political scene any day, Shane.

Mr Shane Lynch: As Jo said, there are key issues that need to be dealt with, such as protecting vulnerable consumers.

Ms Aston: There is also a sustainability issue around the water environment. The way in which you connect with your domestic consumer base is difficult without some form of charge and consciousness of a need to pay for a service. I am just saying that as a matter of fact rather than an opinion, because how we go forward with charges is very much a policy decision for the Executive, and we fully accept that. Equally, it is important that we put that information on the table in respect of driving down levels of consumption and getting the best value.

Mr Seán Lynch: Do you have a preferred model?

Mr Shane Lynch: I will give you a bit of context first, and then I will answer the question. It would be a model that allows the company to deliver a long-term strategic plan with confidence. In other words, it would not be subject to the volatility of funding year on year, and it can finance it at least cost. You do not necessarily have to have water charges to achieve that model. You can get creative and do it without water charges, but it would be a challenge. For us, that is the fundamental thing. It is causing a delay in closing the efficiency gap.

In relation to ownership, let me make a few general comments about whether it matters who owns the company. We say that it does not really matter. Whether it is in public ownership, whether it is a mutualised business or whether it is in private ownership, the bottom line is that the business that we refer to is a natural monopoly, so you can never rely on competition to protect consumers. It is a natural monopoly, and it has to be regulated for that reason. Our experience of natural monopolies elsewhere in the world is that they work very well for consumers if they are well regulated. It is very important that you have good regulation. You can have privatised natural monopolies that are very efficient and drive out a lot of inefficiencies, but the distribution of that wealth is largely to shareholders rather than to consumers, because they are not well regulated. That is an important point. You need good effective regulation in whatever model you have.

The Chairperson: We have a domestic model at present. My understanding is that it is around £169 per domestic ratepayer. The charges for business, and I am even thinking of my constituency office, are fairly substantial in some cases. So, there already are charges, let us face it. Obviously, you are saying that those charges are not efficient.

Mr Shane Lynch: The bottom line is that some consumers are paying money, and the rest of society is paying the rest of money through the block grant. Our view is that, in total, taxpayers or consumers could be paying significantly less. In our current price control, we have set the company, in our final determination, a target to close some of that inefficiency gap. However, it still will not be anywhere near where its peers are in GB. The current model creates some restriction in how quickly it can close that gap. We have talked a little about that in our final determination.

Ms Aston: Crucially, the current model does not give the most effective delivery either, particularly because of the capital restrictions, because you do not know for certain how much capital you will get and you are restricted to spending your capital in one year. That pulls the company away from delivering what is strategically important and gives priority to delivering what the company can deliver in that year. That is not good for the industry or for consumers.

Mr McNarry: Some very interesting comments have been made, and I look forward to looking at them in detail in the Hansard report. I always have to get clear in my own mind who decided the policies of regulators and whether you are overextending your remit or wishing to overextend your remit by becoming a policymaker. I welcome and value the input that you have made on the basis of your experience and your comment that the taxpayer could pay less. That is a key matter that you have brought into this discussion.

I am still not convinced that water charges will or will not be introduced after 2016. I am just not convinced either way. I notice in the fourth paragraph of your letter that you encourage the Committee to organise an informed debate. In light of what you just said and what you said in previous answers to the Chair and the Deputy Chair, can you enlighten us as to how the debate could be structured as an informed debate when, really, we are struggling for information and where we go after 2015 is restricted? That is the crunch issue. We are likely to be going into an election with no Executive decision on what will happen. There is a cover for that, which is that a new Executive will make the decision. Manifestos might decide what will happen. I would be very interested to hear how you think such a debate could be set up. I agree with you that there should be a debate, but we, as a Committee, would struggle with organising a debate, because we do not have all the information. Hopefully, the inquiry will help us to put together enough information to allow us to do so.

Finally, after your last meeting, are you closing the gap in budgets between yourselves and Northern Ireland Water?

Mr Shane Lynch: On the first point, you are absolutely right: we are regulators and do not make water policy. However, we are pretty well informed and experienced, and we are more than happy to offer opinions when we are asked what we think about potential policy options. That is right. We are

a key stakeholder, and other key stakeholders should contribute to that as well. We have a stakeholder forum in the water industry. It involves us, Northern Ireland Water, the quality regulator, the Department and the Consumer Council. What you have there is a collective body of experts with an interest and a stake in the future of the water industry. I do not want to speak for colleagues today without having cleared this with them, but clearly that forum is an opportunity for debate. That is one possibility. Subject to what colleagues might say, we would be happy to talk to interested individuals, including this Committee, about possible options and to do so constructively.

Your last question was about closing the gap between ourselves and Northern Ireland Water. The way that the regulatory framework works means that we have made our final determination. It is now with the company to accept or reject that, and it has until 14 February to decide. We will have to wait until 14 February.

Ms Aston: Positively, we produce an annual cost and performance report. The one that we published in early December reflected that Northern Ireland Water is meeting our previous and current price control, PC10, targets for operational efficiencies and, at the same time, is delivering improved standards of service. Its overall performance score is increasing. The company is making progress, and the gap is closing. When we started our job, the gap was 49%, and in 2010, it was down to 38%. So, progress is being made. Of course, as Shane said, we have put another challenge out to the company to accept in our current price control.

A decision to have a debate and a decision on when to have it would be very helpful. That could, perhaps, stop the manifesto decisions or statements, and it would allow hope that there will be a debate and provide an indication of when it might happen.

Mr McNarry: I do not want to get involved in an election conversation, but we all know what happened the last time. Only a very brave political party would say, from the information in front of it, "We are going to charge you for water." There is a cop-out in that. Well —

The Chairperson: Let us not get into that debate. Mr Dickson is encouraging it, but I would discourage it.

Mr McNarry: He is flag-waving over there with the wrong flag as usual.

On the debate issue, could the Committee be kept informed of what you do in the stakeholder forum that might generate something further on a political level? I would be very interested in that, and it would be very helpful.

The Chairperson: Your letter states:

"We understand the Minister has put a paper to the Executive".

We, too, understand that the Minister has put a paper to the Executive, but this Committee has not had sight of that or had any briefings on it. I just want to clarify that. There was some thought that the Committee might have had sight of that paper, but we have not, and I want to make that absolutely clear.

Mr McAleer: I want to draw the discussion back to the efficiency gap. One of the gripes that the representatives from NIW articulate when they come here is that you tend to compare NIW against a virtual frontier company. They say that that is not fair and that the gap, if it were compared to an average company, would be closer to £1.20 than to the £1.62 that you identified. How do you respond to that criticism?

Ms Aston: We talk about a notional company. The reason why it is notional is that you look at the real water company's performance in water and the real water company's performance on the sewerage side. That is what OFWAT does, and then we use that notional comparison. What you then do is look for the company that you can best compare against so that there are not anomalies due to poor information or whatever. You then take the company that is picked for having best comparison in water and best comparison in sewerage and you use that as your benchmark. That is where the notional company comes in, but it is not a made-up company; these companies do exist. The reason why it is notional is that you are taking the best for comparing in water and the best for comparing in sewerage.

In relation to Northern Ireland Water being more like £1.20, it released a statement saying that its comparison was £1 to £1.16. That included a modelling of the business activities. We do not have any transparency around that. Critical for us in benchmarking is that you are comparing like with like. When you look at business activities in Northern Ireland Water, it does not have a domestic base that is being charged. Therefore, it does not have the scale of consumer contacts that other water companies have. That business activity represents about 10% of the operational cost, and, therefore, in our previous price control, we excluded it because you could not compare like with like. That is what is skewing the result, and that is where the £1.20 comes out. If Northern Ireland Water does a benchmark similar to the one that we do, which tries, as far as possible, to compare like with like, we have a 38% gap, and it has a 34% gap. So, we are not a million miles away. The difference, even between the 38% and 34%, is because Northern Ireland Water puts special factors claims to us. We look at those, and we allow an amount of those based on our analysis. Northern Ireland Water, in its benchmarking, allows itself all of them. Therefore, that is the difference. When it comes to the gap, I do not think that we and Northern Ireland Water are a million miles away when we look at like for like.

Mr Dallat: The one promise that I will make, Shane, is that I will never criticise you for having a mind of your own. I welcome that. We are all sitting here this morning with jugs of water in front of us, and I would suggest that it is probably the best that you will get anywhere in the world. I say that having travelled quite a bit, and I have been in central Africa where people cannot get water.

To pick up on a point that you made earlier, Jo, is there some kind of discussion about whether money is spent on efficiencies or on capital investment? If you were to ask the public what is the most important thing about water, they would say the quality. Even today, there are people drawing water from private springs. People spend millions of pounds on bottled water, which is probably not as good as our water. At the end of the day, does the Bill provide for the money that is needed to continue to provide a quality of water that people can have confidence in? Earlier this morning, I am sure that people who eat beef burgers got their confidence well and truly shattered when they discovered that those are not right. Forget about the politics and about who will rule Ireland after 2016, can we be sure —

Mr McNarry: It will be the same rulers, John. Do not worry.

Mr Dallat: I knew that would draw a response.

Can we be sure that this glass of water will be the same quality or better, that it will protect us against infraction from Europe and protect us against any new challenges that disease throws up?

Ms Aston: Our water quality is the best that it has ever been. We have always enjoyed good water quality, and we thank Northern Ireland Water and the Water Service for that. We have a drinking water inspectorate, which samples water on a continuous basis and ensures, operationally, that it is kept compliant. Therefore, I am always reassured, and I would not buy bottled water. We have total reassurance in respect of the quality. You went on to say about it being EU compliant all the time. Standards are always going up. We have a new lead standard coming in. When we do price controls, we look at the drivers for investing, what we need to invest in and how much that will cost. Therefore, our price control process takes that on board.

We cannot do everything all the time. When we come to price controls, the list is far longer than our cut-off in what we can afford it to be. So, I cannot give you guaranteed assurance there. What is important in the price control process is that we reflect back to the Committee what the risks are, and we do that when we do our price controls in respect of the amount of investment that is being provided. Married to that, we need to know that we are getting the level of investment that we settle on to be able to manage.

Mr Dickson: Thank you for coming this morning. Is this Bill not a failure because it does not address what will happen post-2016? I am not entering into the discussion about whether we should charge for water, but the model of an organisation that we need to carry Northern Ireland Water forward and to do the things that you suggest need to be done can be done substantially more efficiently than they are being done. This is effectively two things: it is a missed opportunity to start to put in place where we should be; and it is only a sticking plaster to get us through a range of non-charging regulations.

Mr Shane Lynch: I will repeat what I said earlier. In our view, we are paying more for water than we need to as a society due to inefficiencies and suboptimality in the current model. We can demonstrate that and have demonstrated that, but we are not the policymakers; we are just regulators.

Mr Dickson: It should be asked as a comment in respect of the Bill. The Bill could have had a future model, whether it is mutual, privatised or in the style of Scottish Water. The reality is that all this will do is take us to 2016. The planning and the time requirements to get us to a new company will not happen overnight, so it is a missed opportunity. The very least this Bill could have done is to put in place an opportunity to determine a future model. We are not even having that discussion, but others have made that comment as well today.

Mr Shane Lynch: Notwithstanding the Bill, as a key stakeholder, we encourage a calm and sensible debate on the subject. Clearly, there are sensitivities because consumers are struggling quite a lot. Outside the Bill, we think that debate can happen, and we are keen to encourage it.

The Chairperson: OK. Thanks very much for coming along. I am sure that it will not be too long before we have discussions again.