

Ibec policy brief

ISSUE 03 · August 2015

Reforms to water and wastewater tariffs

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How will they impact on you?

Irish Water's tariffs for business customers have remained fixed since the company was established in 2013. However, we can expect that by next year, the regime will very likely be 'all changed, changed utterly'. This briefing paper explains what is in store for commercial water users and why it is happening. It also explores ways of minimising any adverse impacts.

The most important objective from a business perspective is that supplies of water remain clean and secure. However, they must be internationally competitive. Any increase in the average tariff could threaten Ireland's attractiveness for inward investment. It seems inevitable that prices will become more uniform across the country, even if the new arrangements stop short of a single nationwide tariff structure. Some Ibec members may actually benefit from this, at least in the short term. Others, however, will experience sharp price increases. In other words there will be winners and losers even if the total amount being collected by Irish Water doesn't change. In this regard it is not unlike the revaluation process for commercial rates.

Businesses will need to resist becoming burdened with an ever-increasing share of the overall system cost. Appendix 1 overleaf summarises how Irish Water's revenues are raised and spent. Domestic water users, unlike business customers, receive a state subsidy in the form of free allowances. This support will be under pressure due to the Government's ambition to get the company's borrowings off the national balance sheet, notwithstanding a recent adverse assessment from Eurostat.

Unfortunately, much of the infrastructure that Irish Water has inherited is ancient and creaking. A multi-billion euro capital investment programme will be needed to upgrade it over the next decade. Poorly-treated sewage is still being discharged into our rivers and coastal waters. Thousands of homes remain on boil-water notices. The

Dublin and Mid-East region in particular experiences problems with inadequate wastewater treatment and also faces a looming water supply shortage.

Irish Water's tariffs are subject to regulatory approval. The Commission for Energy Regulation (CER) is the economic regulator of Ireland's public water system. It can adjust the current value of Irish Water's Regulated Asset Base (RAB) if it deems the company's assets to be undervalued. Any material increase in the RAB would directly impact on Irish Water's annual revenue.

Why the need for change?

In the past, each local council made a judgement about its funding needs for water and wastewater services, and how much the business community could afford. The underlying costs were difficult to glean from published accounts.

The new legislation governing Irish Water now mandates a national Water Charges Plan showing how the tariffs for each type of customer are calculated, and the underlying costs. As Appendix 2 shows, businesses are on a wide variety of published tariffs. The most expensive is double that of the cheapest, even though they were set by adjacent local authorities. The observed variation cannot be explained by differences in delivery cost.

If all these tariffs were simply adjusted to a weighted average, businesses in some areas would be hit with increases of circa 25%. This is not the whole picture though. There are also several hundred unpublished tariffs in force. Some of these could include negotiated discounts to the standard price. Others may instead be based on the concentration of specified pollutants in the effluent stream. Presumably some of these site-specific arrangements are covered by long-term contracts. However, Ibec understands that a number of major water users lack such protection. In these cases, a forced move onto the published tariff could be financially crippling.

Because of the complexity involved in getting to grips with the customer data, CER directed Irish Water to maintain the prevailing business tariff structures and arrangements until an enduring framework is put in place. The company will shortly be starting work on the design of a new tariff regime, likely to be based on principles of:

- fairness;
- cost reflectivity;
- cost recovery;
- price stability;
- tariff simplicity; and
- encouraging water conservation.

Tough regulatory choices

To develop the enduring framework, CER plans to hold a number of stakeholder consultations on commercial water charges over the coming years. These will include:

- fleshing out key tariff principles;
- examining possible tariff structures; and
- proposing a 'glide path' towards full cost reflectivity.

Arguably, the most important question to address is how to allocate the recovery of Irish Water's operating, financing and depreciation costs across different types of customer. Consider, for example, future infrastructure investment in Dublin and Mid-East region. Domestic customers currently account for roughly 60% of water end-use but according to projections published by Irish Water, they will account for a far lower share of the projected *growth* in demand out to 2050. Ibec has questioned whether this projection is plausible. Nevertheless, the balance of supply and demand is currently on a knife-edge and it cannot be fixed by water conservation and leak-repairing alone. An additional source will be required before the end of the decade. The infrastructure will cost hundreds of millions of euros. How should the burden be allocated between businesses, farmers and householders?

The relative pricing of water supply and wastewater disposal is obviously important for sites that source their water from a river or private well. The same applies to businesses that use water as an ingredient in their product. The principles for pricing of water and wastewater services ought to be similar across all customer categories. A fully cost-reflective tariff would probably mean charging substantially less for water supply than for wastewater treatment. This is fine in theory, but could be difficult to implement in practice. Irish Water currently charges households for water supply and sewage treatment at exactly the same price per litre. Any alteration to the domestic tariff structure at this point would require political agreement as well as regulatory approval.

What should be done to minimise adverse impacts?

At a minimum, CER should include a detailed impact assessment as part of its stakeholder consultations. Where businesses face the prospect of upward price shocks, they must be given time to adjust. In extreme cases, however, it simply may not be possible to adjust, even over a period of years. The new regime must therefore be sufficiently flexible to deal sympathetically with genuine hardship. This is especially relevant if the choice of location for a manufacturing plant was influenced by attractive commercial terms for water and wastewater services.

Businesses should not be asked to cross-subsidise other categories of water user. The CER must therefore put sufficient data into the public domain to allow business customers to be confident that they are not being unfairly disadvantaged.

The value of the regulated asset base should not be larger than necessary. A recent CER consultation on Irish Water's future revenues hinted at the idea of eventually setting the RAB based the estimated *replacement* cost of the company's assets. Ibec has sought assurances from CER that this would not apply retrospectively to existing assets. Otherwise, the RAB could be several billion euros higher than the figure that is currently provided.

The current level of state subvention should certainly be maintained. It could also be supplemented by alternative financing mechanisms such as PPPs. Irish Water should be encouraged to improve its operational efficiency to offset some of the increase in capital costs. It should therefore be allowed to leverage the expertise of the private sector. Clever procurement would help to drive down operating costs and could also encourage innovative service delivery.

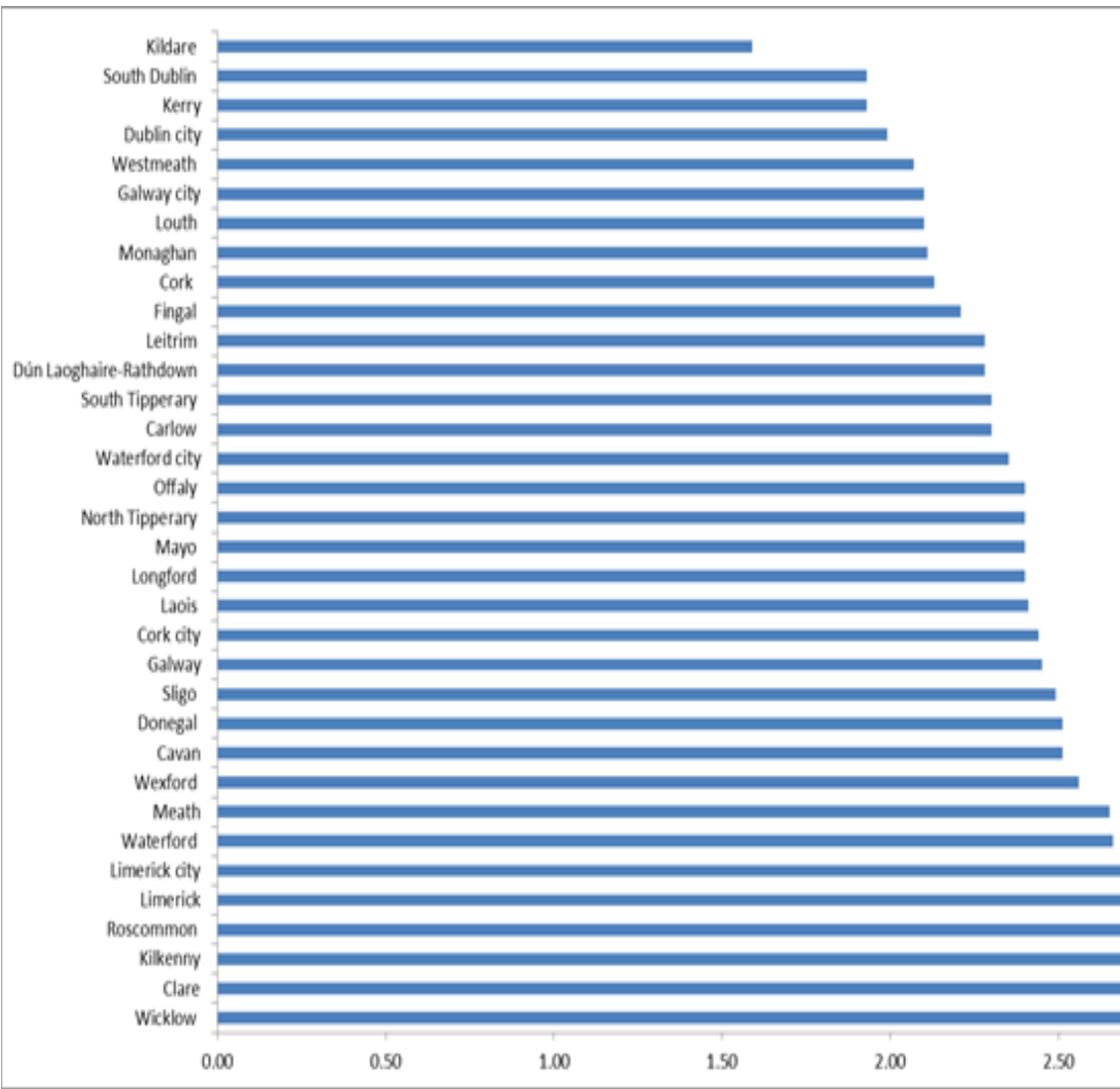
Ibec's Infrastructure Unit was recently approached by CER regarding the establishment of a Large Water Users (LWU) Forum. Ibec welcomes this proposal, viewing it as complementary to Irish Water's national stakeholder forum. In particular we foresee the need for a technically-competent group of business representatives to provide CER with insights on the particular needs and concerns of large water users. Ibec will also seek to be directly represented on the Forum in order to ensure a balance of views.

Appendix 1. How much does Ireland’s water/wastewater system cost?

Ibec understands the annual consumption (excluding leakage losses) by Irish Water’s customers to be in the region of 300 million cubic metres (m³). Roughly 60% of this is domestic and 40% non-domestic. Irish Water’s Water Charges Plan submission sought €1 billion of total revenue per annum for the period October 2014 to December 2016. CER approved just over 90% of this amount. Somewhat more than half of the revenue will be to cover operational expenditure, the remainder being for depreciation and return on capital employed. It should be noted that this capital provision is rather less than will be needed in future years, hence the importance of offsetting it through reduced operational costs.

The state subvention is very costly. A family of four on the capped domestic tariff currently pays circa €1.00 per m³ after adjusting for free allowances and capping of annual bills. One constraint on Exchequer support is that unless it accounts for less than 50% of Irish Water’s annual revenue, the company will not be classified by Eurostat as a Market Corporation. Hypothetically, if Irish Water were funded entirely through volumetric charges, the average unit cost for domestic customers would be around €3.00 per m³. Business users, on average, pay a volumetric tariff of just over €2.00 per m³. At present there is insufficient information for the CER to determine whether this represents full cost recovery. One factor to consider is that a substantial portion of Irish Water’s costs relate to fixed assets. Arguably it is a customer’s peak demand (daily or seasonal), rather than its annual consumption, that drives these costs in the long term. Further analysis will be needed in order to inform the forthcoming consultations.

Appendix 2. Combined tariffs (€/m³) for commercial water and wastewater.



The role of Ibec's Infrastructure Unit in influencing policy and regulation

Our Infrastructure team represents Ibec members across a diverse range of industry sectors. We aim to be the national voice of business in policy areas such as:

- regulated network utilities
- water and wastewater services
- industrial cost competitiveness
- resource efficiency and sustainability
- spatial planning for critical infrastructure
- environmental licensing and enforcement
- effective and efficient climate change mitigation
- promotion of energy efficiency and renewables
- All-Island and European markets for energy

With respect to water sector reforms, the Ibec Environment Policy Committee has engaged with legislators and policymakers ever since the idea of a nationwide water utility was first proposed. We have hosted stakeholder workshops, and have responded to numerous regulatory consultations with support from the Committee's Water Working Group. We regularly invite representatives from CER, DECLG and Irish Water itself to address the Policy Committee and to meet with members.

To find out more about the issues in this paper, or to get involved with the Environment Policy Committee, please contact:

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