



NI Water Response to the PC21 Mid-Term Review Draft Determination

Main Report

27 June 2024

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1 EXECUTIVE SUMMARY

We welcome the opportunity to respond to the Utility Regulator's PC21 Mid-Term Review (MTR) Draft Determination (the Draft Determination). The Draft Determination sets out the Utility Regulator's initial views on the matters we identified in our MTR submission sent to them on 29th September 2023.

We have carefully considered the Draft Determination and welcome many of the adjustments and changes which the Utility Regulator has proposed. There are however a number of matters which we are seeking the Utility Regulator to reconsider. These are set out in this response alongside additional evidence which is intended to support further assessment by the Regulator.

The key themes of our response are summarised below.

Outputs

The Utility Regulator has, in the main, accepted our proposed changes to outputs arising directly from changes to the capital investment programme. The Draft Determination also accepts changes agreed by the CM/Sat working group.

In our MTR submission, we proposed closure of seven development outputs, the Utility Regulator has agreed that all but two of these can be closed. In addition, this response identifies three further development outputs for closure.

The Draft Determination also proposes an increase in the DG2 removal target. We believe this increase is reasonable. (Note: we have submitted a revised version of Table 4.4 - annex 5.8 - to reflect some minor changes.)

Operating Costs

We welcome that the Utility Regulator has recognised the need to increase operating costs allowance going forward to reflect the impact of rising power prices on our cost base. We are however disappointed the Utility Regulator have decided not to allow NI Water to recover the significant cost increases it experienced in the first half of PC21. It is the Utility Regulator's view that the MTR should be forward looking rather than retrospective. We disagree as we believe the decision should be based on merit rather than timing.

Capital Investment

In our submission we identified that capital price inflation was more than RPI in Years 1 and 2 (+7.2% Year 1, +10.5% Year 2) of PC21. While the Utility Regulator agreed that inflation had risen significantly, they considered that we hadn't provided sufficient evidence to justify an increase above RPI.

Nine additional triangulation points to justify an increase above RPI have been provided in this response. The average of these points (+9.4% Year 1, +11.7% Year 2) supports the indexing above inflation requested in our MTR submission. Thus, we continue to support the original indexation method being of the view that during the period 2021-2023 capital prices increased by much more than prevailing RPI inflation.

This report provides further evidence from additional NI Water internal analysis and an independent report by Jacobs ChandlersKBS to support our claim for an RPE adjustment.

In addition to his RPE assessment, the Reporter also identified two key areas where additional evidence was required to support our PC21 MTR submission:

- £1 Cost Curves – Validity of specific cost lines without a dedicated IPAC regulated cost curve.
- Other Miscellaneous Costs – Associated with Reporter findings through scrutiny of a sample of scope certainty projects.

Based on the additional evidence provided, we consider an adjustment of 1.25%, solely applied to scope certainty projects, is appropriate.

Price Limits

The overall increase in revenues allowed by the Utility Regulator is £58m lower than we had proposed. The shortfall is largely attributable to the Utility Regulator's view that the MTR should be forward looking rather than retrospective. We disagree with this approach.

NI Water had no option other than borrowing in order to fund these running cost increases. This has reduced our Capital Loan Note headroom and could lead to a situation whereby NI Water is unable to access borrowing for legitimate purposes.

The Draft Determination rejects our revenue 'true up' proposal on the basis that it would be unfair to introduce new mechanisms at this stage. The concept of a post period 'true up' is not new. In previous price controls we have adjusted revenues retrospectively to reflect variances in revenue recovery and business transformation costs for example. Our submission proposed that the post price control 'true-up' calculation should be expanded to include any adjustments agreed as part of the MTR process. We believe this is a sensible approach and we would ask the Utility Regulator to reconsider their position.

CONCLUSIONS

We are keen to work constructively with the Utility Regulator to ensure the Final Determination is appropriately balanced. As such, NI Water provides evidence and comprehensive analysis to support this position in the remainder of this response.

NI Water is confident that our response will provide the Utility Regulatory with the information and confidence it needs to arrive at a Final Determination that will be deliverable by NI Water and acceptable to the wider water stakeholder group.

2 INTRODUCTION

2.1 STRUCTURE OF THE RESPONSE

2.1.1 This chapter outlines the structure of NI Water's response to the Utility Regulator's Draft Determination proposals.

2.1.2 Subsequent chapters deal with the following matters:

- Chapter 3 deals with outputs;
- Chapter 4 deals with operational expenditure;
- Chapter 5 deals with capital investment;
- Chapter 6 deals with price limits, public expenditure and other financial matters;
- Chapter 7 proposes next steps.

2.1.3 This main response document focuses on responding to the main issues identified in the Utility Regulator's PC21 MTR Draft Determination. For some themes the response and/or further supporting detail is provided in Annex documents.

2.2 PRICE BASE

2.2.1 In line with the Draft Determination, all costs referred to in this Response are in 2018/19 prices unless otherwise stated.

3 OUTPUTS AND OUTCOMES

SUMMARY

This chapter deals with the Utility Regulator's proposals in relation to changes to the outputs and targets.

NI Water acknowledges that the Utility Regulator has, in the main, accepted our proposals for outputs which are linked to our capital investment programme.

While the Draft Determination has proposed an increased DG2 removal target, NI Water considers this adjustment reasonable.

In our MTR submission, we proposed closure of seven development outputs. The Utility Regulator has accepted that all but two of these can be closed.

We have continued to make progress on the remaining development outputs. As a result there are three (DO18, 19 and 20) further development outputs which we are now recommending for closure.

We have highlighted some inconsistencies between figures reported in tables (ie Table 3.9 v Table 3.14 and Table 3.7 v Table 3.15). We would ask the Utility Regulator to clarify which version is correct.

3.1 INTRODUCTION

3.1.1 In our MTR submission we set out proposed changes to a number of PC21 outputs or outcome targets. The changes were needed to:

- Ensure nominated output targets were aligned with changes made to the PC21 capital investment plan to reflect the outcome of the scope certainty process;
- Reflect other changes which have occurred since the PC21 FD;
- Reflect further planned refinement of consumer measures recommended by the CM/Sat working group;
- Account for the outcome of development objectives which NI Water have completed in the period since the PC21 Final Determination;

- Reflect change controls which had been agreed by ORG;
- Address errors.

3.1.2 In their Draft Determination, the Utility Regulator has accepted most of the changes we had proposed.

3.2 CUSTOMER SERVICE OUTCOMES

3.2.1 We welcome that the Utility Regulator has accepted changes proposed to Key Performance Indicators (Unwanted Contacts, First Point of Contact Resolution and Net Promoter Score) in line with the recommendations of the CM/Sat group. This will ensure they align with the definition used by GB water utilities.

3.2.2 The Utility Regulator has also agreed to fully retire Overall Performance Assessment (OPA), DG6, DG7 and DG9 in line with the recommendations of the CM/Sat group. We agree with this decision and confirm that NI Water will continue to capture DG6, DG7 and DG9 data for the remainder of the PC21 period.

3.2.3 We look forward to continuing to work with the Utility Regulator and other stakeholders on the CM/Sat working group towards the development of new measures for the next price control.

3.3 NOMINATED OUTPUTS

3.3.1 We note that the Utility Regulator has amended PC21 targets to reflect our scope certainty submissions and change controls.

3.3.2 NI Water welcomes the Utility Regulator's proposal to engage further between the Draft and Final Determinations on the need for adjustments to the large wastewater treatment percentage compliance targets as a consequence of the change in the number of nominated outputs.

3.4 OTHER OUTPUT ADJUSTMENTS

3.4.1 The Draft Determination has proposed an increase to the DG2 (properties at risk of low pressure) removal target. NI Water considers this adjustment

reasonable.

3.4.2 We note the Reporter's recommendations regarding the employment of logging and analysis best practice to monitor network pressure. NI Water will address this in the PC27 business plan.

3.5 **DEVELOPMENT OUTPUTS.**

3.5.1 In our MTR submission, we proposed closure of seven development outputs. We note the Utility Regulator has agreed that five out of the seven proposed are complete. We are content that development outputs 1 (consumer engagement) and 2 (consumer protection/care registers) will remain open and we will continue to progress both with oversight from CmSAT working group in advance of the next price control.

3.5.2 Since our submission, work on the remaining development outputs has continued. As a result of progress made since our submission we now propose the closure of three more development outputs listed below.

- **DO18 Culmore DA KL554 - Skeoge Link Road**

The purpose of this Development Output is to provide a solution to convey flows from Skeoge Link Road development area to the treatment works at Culmore. The required regulatory business case was submitted in October 2023. NI Water considers that the Development Output portion is complete and request closure of DO18 as Capital Delivery is outside the DO scope.

- **DO19 LWWP Networks**

The purpose of this Development Output is to develop optimum solutions to resolve the water quality, UID and DG5 issues following the completion of modelling, including IEM, and site-based investigations.

Nine business cases for solution, including costs and justification, were submitted to the Utility Regulator for determination as part of the MTR process. NI Water considers that the Development Output portion is complete, as Living with Water governance is now embedded within the company procedures.

- **DO20 LWWP WwTW**

The purpose of this Development Output is to develop the 'straw man'

solutions into final Strategic Drainage Investment Plan solutions to resolve water quality issues following the completion of modelling, including IEM, and site-based investigations.

Seven business cases for solution, including costs and justification, were submitted to the Utility Regulator for determination in March 2023. Three further business cases, for Belfast WwTW, were submitted in October 2023.

NI Water considers that the Development Output portion is complete, as Living with Water governance is now embedded within the company procedures.

3.6 CLARIFICATIONS REQUESTED

3.6.1 MTR Draft Determination Table 3.9 (DG2 – properties removed from low pressure register) uses outturn figures for years 1-3, which results in a different cumulative total to that set out in Table 3.14, which uses PC21 Final Determination figures in years 1-3 and amended MTR figures for years 4-6. We assume that Table 3.14 sets out the Utility Regulator’s intended MTR targets, but we request that the Utility Regulator confirms this.

Table 3.1: DG2 - Comparison between DD tables 3.9 and 3.14.

		2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	PC21
DG2 props. removed as result of company action	Table 3.9	176	143	200	158	188	263	1,128
	Table 3.14	147	145	143	158	188	263	1,044

3.6.2 Likewise, there appears to be an inconsistency between MTR Draft Determination Tables 3.7 (number of economic constraint areas eased) and corresponding line in Table 3.15 . Whilst the six-year PC21 cumulative totals are the same, we would request that the Utility Regulator confirm the annual targets.

Table 3.2: DG2 – Economic constraint areas eased - Comparison between DD tables 3.7 and 3.15.

		2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	PC21
Economic constrained areas eased	Table 3.7	0	0	0	1	0	9	10
	Table 3.15	0	0	1	2	1	6	10

3.7 WwTWs Upgraded to Comply with PPC Regulations.

We would encourage the Utility Regulator to consider amending the target description from “WwTWs upgraded to comply with PPC Regulations” to “WwTWs assessed and/or upgraded if required to comply with PPC Regulations”. This would more accurately reflect the process followed, which involves a number of steps:

1. Assess whether the WwTW requires a PPC permit (with sludge production >50m³/day);
2. Confirm if permitted sites require upgrades in order to comply with the PPC permit;
3. Undertake upgrades necessary for compliance with PPC permit.

4 OPERATIONAL EXPENDITURE

SUMMARY

This chapter responds to the Utility Regulator's proposals with respect to adjustments to operational expenditure allowances.

Our submission had identified £65.8m of net opex increases which occurred in years 1 – 3. The Utility Regulator has taken the view that the MTR should be forward looking rather than retrospective and has therefore not considered these.

Our submission also included evidence to support an increase of £56.5m to opex forecasts for years 4 -6. This was a net figure comprising increases in power, chemicals, IT and insurance offset by reductions in rates and PPP costs.

As the other cost increases and decreases broadly offset each other, the Utility Regulator have only considered our power cost claim and have allowed an increase of £54.2m to reflect the impact of higher power prices in years 4 - 6. While nearly £9m less than we claimed, the adjustment is in line with more up to date market forecasts and appears reasonable.

4.1 OVERVIEW

4.1.1 In our PC21 Mid-Term Review submission, we identified £122.2m (2018/19 prices) of net opex increases over the PC21 period, of which, £65.8m related to years 1 – 3 and £56.5m in years 4 – 6. Whilst the increases were primarily related to Power costs, we had also sought adjustment for increases in chemical, ICT Cloud and insurance expenditure offset by reductions in PPP and Rates.

Table 4.1: Comparison between NI Water’s claim and DD allowance

(2018-19 £m)	Years 1-3			Years 4-6			Years 1-6
	NI Water Proposed	DD Allowed	Variance	NI Water Proposed	DD Allowed	Variance	Variance
Power	82.5	-	(82.5)	62.8	54.2	(8.6)	(91.1)
Chemicals	5.8	-	(5.8)	7.9	-	(7.9)	(13.7)
Cloud Implementation	8.8	-	(8.8)	12.3	-	(12.3)	(21.1)
Rates	(19.8)	-	19.8	(22.3)	-	22.3	42.1
PPP	(14.4)	-	14.4	(7.5)	-	7.5	21.8
Insurance	2.8	-	(2.8)	3.2	-	(3.2)	(6.0)
Total	65.8	-	(65.8)	56.5	54.2	(2.3)	(68.0)

4.1.2 We welcome that the Utility Regulator has allowed a significant adjustment to Power costs in years 4 – 6. While the proposed adjustment is £8.6m lower than our submission, the Utility Regulator have indicated that this reduction merely reflect latest market forecasts. Following our own updated market assessment, this appears reasonable. The Utility Regulator noted all remaining costs in years 4 – 6 were broadly offsetting, this approach appears reasonable in maintaining the integrity of the PC21 FD.

4.1.3 It has been accepted that global energy prices were outside NI Water control, and we welcome the Utility Regulator’s conclusion in the draft determination that our procurement processes were robust, with keenly priced contracts and that we actively sought to reduce demand.

4.1.4 Power prices do remain extremely volatile and it is worth noting that in recent weeks prices have been rising. Given the on-going volatility in the energy market, we had recommended this is included in the post PC21 ‘true up’ calculation in the event that power prices vary materially from these latest predictions. We made this suggestion not only to protect NI Water but also to ensure consumers aren’t paying too much in the event of a significant decrease. We still believe there is merit in expanding the post Price Control ‘true up’ calculation to consider movement in power prices in addition to the other changes such as revenue and business transformation spend which traditionally have been ‘trued-up’ in the past. We consider this further in section 6.

4.2 OPEX VARIANCES IN YEARS 1 - 3

4.2.1 We are disappointed the draft determination decision to exclude years 1 – 3 based solely on timing rather than merit. We continue to be of the view that this is unfair and could lead to a situation whereby NI Water is unable to access borrowing for legitimate purposes, purely due to breaching ‘Capital Loan Note’ headroom rules as a result of having borrowed to fund these excess operational outgoings in years 1 – 3. We consider this further in section 6.

4.2.2 At the time of our submission in September 2023, our adjustment claim for years 1 – 3 included a forecast for the 2023/24 financial year. As the 2023/24 year has now concluded we are able to update our year 1-3 claim to reflect actual outturn costs - see Table 4.2 below. As a result the total adjustment for year 1 – 3 now being claimed is £13.8m less. Reductions to power account for most of the change.

Table 4.2: Adjustment claim for years 1 - 3 revised for 2023/24 outturn

(2018-19 £m)	MTR submission Sept 2023	Actual outturn	Variance
Power	82.5	73.2	(9.3)
Chemicals - NIW	5.8	3.8	(2.1)
Cloud Implementation	8.8	7.9	(0.9)
Rates	(19.8)	(22.1)	(2.3)
PPP	(14.4)	(13.8)	0.6
Insurance	2.8	3.0	0.1
Operating Cost Claim	65.8	52.0	(13.8)

5 CAPITAL INVESTMENT AND EFFICIENCY

SUMMARY

This chapter deals with the Utility Regulator's proposals in relation to the Capital Investment Programme for PC21.

NI Water acknowledges and welcomes the opportunity to provide additional evidence to support our PC21 MTR submission.

Our response includes additional evidence from an independent expert and enhanced internal analysis to support our claim for a Real Price Effects (RPE) allowance over and above RPI in years one and two of PC21.

We have examined the rationale for applying a 3.5% challenge to all scope certainty projects. Based on the additional evidence we agree an adjustment 1.25%, applied solely to scope certainty projects, is reasonable.

5.1 OVERVIEW

5.1.1 The MTR Draft Determination proposes a revised capital expenditure allowance of £2.4bn compared to £2.75bn which we indicated was needed in our MTR submission. This is a reduction of £350m, which increases to £450m if we adjust for differences in inflation assumptions.

5.1.2 This reduction results from:

- disallowance of the Real Price Effect (RPE) adjustment (c£370m) on the basis that we have not provided sufficient evidence to validate our claim.
- deduction of 3.5% (c£100m) from all scope certain scheme costs arising from a review of sample projects by the Reporter.
- inclusion of 3 change control projects (+c£13m for Derg, Ballinrees and Beltoy /Unagh WPS)

5.2 REAL PRICE EFFECTS

Our MTR Submission requested the following capital indexation.

Table 5.1 – summary of NI Waters MTR RPE claim.

Inflation Index	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
RPI %	2.6	1.2	5.8	12.9	6.4	1.2	1.0	2.0
RPE (Over RPI)	-	-	7.2	10.5	-	-	-	-
Proposed Indexation	RPI Only	RPI Only	RPI + RPE	RPI + RPE	RPI Only	RPI Only	RPI Only	RPI Only

5.2.1 We continue to be of the view that during the period 2021-2023 capital prices increased by much more than prevailing RPI inflation and in line with the figures set out in Table 5.1.

5.2.2 Our original evidence was based on a PAFI approach provided by the NI Water CPMO. This response builds on that and includes additional internal analysis provided by NI Water’s CPMO (Annex 5.1) supported by an independent report prepared by Jacobs ChandlersKBS (Annex 5.2).

5.2.3 All told, there are nine additional pieces of analysis that we have undertaken to support the RPE claim covering Years 1 and 2 of PC21. The methods used are summarised below and the outputs compared in Figure 5.1

- **Chandlers KBS (Industry Benchmarking)** – Repricing of 40 projects using ChandlerKBS Cost Intelligence Database (CID), a water industry costing system which is totally independent from IPAC and PC21. Further information is provided in Annex 5.2.
- **Jacobs (NIW New Models)** – Repricing of 40 projects using our updated IPAC system, utilising up to 4,000 additional data points from PC21 projects. This report is attached at Annex 5.2. Further information on the updated cost curves is provided in Section 5.4 Cost Curve Visualiser and Annex 5.3.
- **Jacobs (Contractors Information Requests)** – Analysis of recent market intelligence gathered from NIW Contractors on Labour, Equipment and Materials cost increases. Further information is provided in Annex 5.2.
- **Chandler KBS (Indices Review)** – Review of industry cost indices relevant to the water and environmental construction industry. Further information is provided in Annex 5.2.
 - **BCIS Labour Plant & Materials Indices**
 - **Averaged Suite of relevant Indices**

- **Average Suite of relevant indices excluding BCIS LPMs**
- **NIW CPMO (IPAC v Tender Prices)** – Detailed comparison of nominal IPAC costs against tendered cost prices on 8 comparable projects awarded during the two-year analysis period. Further information is provided in Annex 5.1.
- **NIW CPMO (Key Materials Invoices and Quotations)** – analysis of the key material price increases, demonstrated by invoices and quotations received from NI Water Contractors. Further information is provided in Annex 5.1.
- **NIW CPMO (PAFI Approach – Updated Submission)** – updated MTR submission, adjusted based on MTR responses and latest cost data and indices. Further information is provided in Annex 5.1.

5.2.4 Figure 5.1 below summarises the findings from each of these studies.

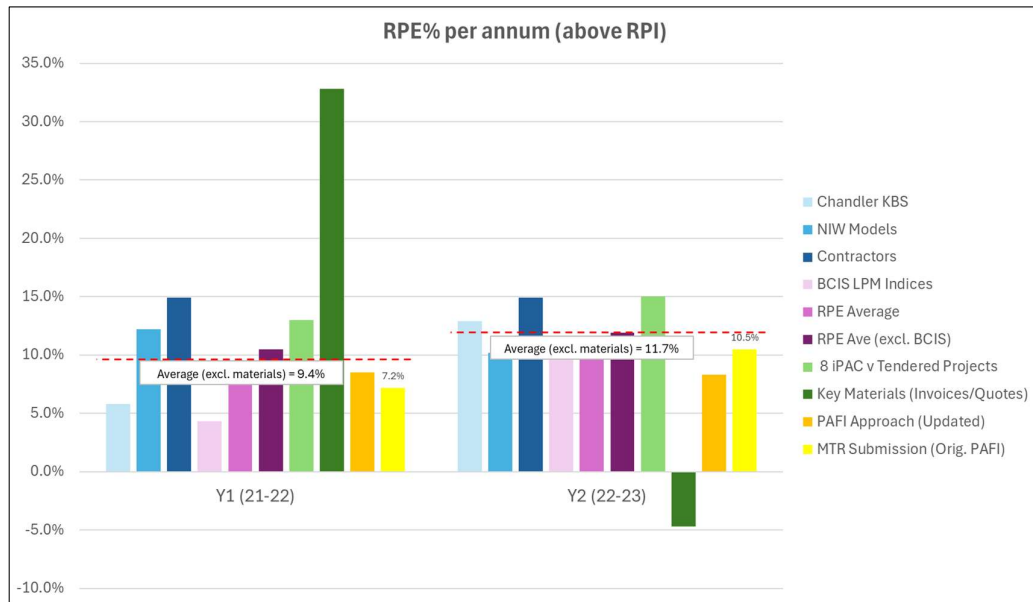


Figure 5.1 PC21 MTR Real Price Effects Analysis.

5.2.5 NI Water believe that the evidence presented is compelling and the result, taken on average, are broadly consistent with our original assessment i.e. that in years 1 and 2 of PC21 capital prices rose by 7.2% and 10.5% respectively more than inflation.

5.3 SCOPE UNCERTAINTY

5.3.1 The Reporter identified two key areas where additional evidence was required to support our submission:

- **£1 Cost Curves** – Validity of specific cost lines without a dedicated IPAC regulated cost curve.
- **Other Miscellaneous Costs** – Associated with Reporter findings through scrutiny of a sample of scope certainty projects.

5.3.2 Detailed backup information to support the £1 cost curves mechanism, comprising cost estimates from other similar schemes. This is summarised in Annex 5.4. This indicates that the Reporter adjustment of £36.41m [7.1%] should be reduced to £0.5m [0.1%].

5.3.3 The Reporter's draft report highlighted a number of projects where the scope risk was not applied in accordance with the methodology proposed by NI Water. The projects and details of the associated scope risk percentage are included in Annex 5.5. NI Water is content that the scope risk allocation on these projects in our PC21 MTR submission was incorrect, mainly due to the projects being wrongly categorised as Wastewater Infrastructure as opposed to Wastewater Non-Infrastructure.

5.3.4 The net impact of incorrect scope risk allocation across the Reporter sample (£512.3m) was £2.124m or 0.41%. NI Water propose that this should be reduced to £1.638m or 0.32% based on our responses in Annex 5.5.

5.3.5 The Reporter's draft report also highlighted a number of projects where the scope of the project has been changed since the FD or is incorrect. These projects are summarised in Annex 5.6.

5.3.6 NI Water has accepted that adjustment of the scope on some of the projects is valid. The net impact of incorrect scope across the Reporter sample (£512.3m) was £19.771m or 3.86%. NI Water propose that this should be reduced to £4.284m or 0.84% based on our responses in Annex 5.6.

5.3.7 Based on the additional evidence in the above annexes, this report accepts 1.25% of adjustments to scope certainty projects identified by the UR. This should be applied to scope certainty projects only.

5.4 COST CURVE VISUALISER

5.4.1 A cost curve visualiser is available to see cost datapoints arising from new projects since the start of PC21. Annex 5.3 provides examples of PC21 IPAC Cost Curves which have been uplifted by RPI. These are represented by the solid lines in the graphs. Also plotted on these graphs are new cost data points (the blue dots) which have been collected from projects delivered during PC21.

5.4.2 The new PC21 cost data points are higher than their equivalent RPI uplifted yardstick value plotted in the PC21 IPAC cost curves. For example, in Figure 5.2 for NIW324 Pump SUBMERSIBLE - SEWAGE a new 9 kW submersible pump costs more than the cost extrapolated when using the same yardstick and the PC21 IPAC Cost Curve (uplifted by RPI).

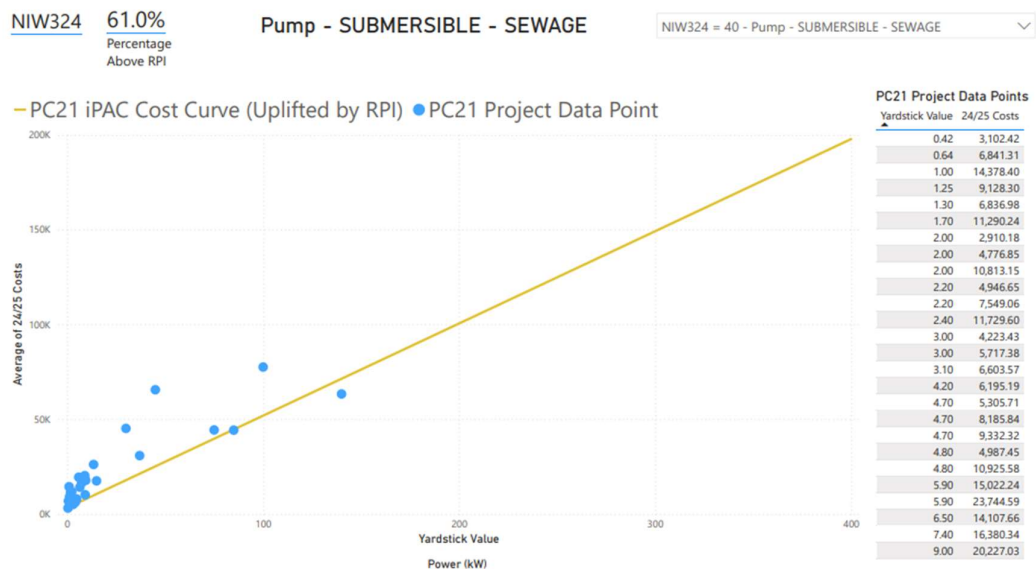


Figure 5.2 Updated Cost Curve for NIW324 Pump SUBMERSIBLE – SEWAGE.

5.5 BASE MAINTENANCE

5.5.1 For reasons outlined earlier in support of our wider case for application of the full RPE adjustment, we do not agree with the Regulator’s contention that RPI should provide sufficient headroom for water sector cost rises. The outcome of the RPE analysis should be applied to Base Maintenance.

5.5.2 As a result of the demonstrated need for RPE adjustments on base maintenance funding, NI Water believe that our proposal to use the PC21

Regulatory Depreciation allowance to offset these cost pressures to ensure that customer bills are kept as low as possible, should be implemented. NI Water agree that, in line with consumer expectation and the requirements of the S&EG, the established policy is to maintain base maintenance allowances as a priority when faced with budgetary pressures.

5.6 CHANGE CONTROL PROJECTS

5.6.1 Within the MTR Draft Determination, the Utility Regulator has determined on a number of Change Control projects with a net increase of £10.6m (in 2018/19 prices). NI Water agree, in the main, with this determination and note that the continued use of established regulatory processes for formal Change Control Protocol submissions and the logging up and down process following the end of the Price Control shall be followed for any subsequent proposed changes to the programme.

5.6.2 Pilot Plant Studies have been partially accounted for, with £0.9m increased Enhancement costs (in 2018/19 prices) which relate directly to the Pilot Plant work carried out to inform Ballinrees WTW Solution. This does not include for the full Pilot Plant Programme which is replacing the previously planned Treatability Studies, the rest of which investment shall be subject to the normal logging up and down process at the end of the PC Period.

5.7 SUMMARY OF NI WATER PROPOSED AMENDMENTS

5.7.1 Table 5.3 below summarises the main amendments proposed by NI Water to the Utility Regulator’s Draft Determination.

Table 5.3 Summary of DD Adjustments and NI Water Responses

DD Adjustment Element	Reporter Proposed Adjustment for Sample Projects	DD Adjustment	NI Water Proposed Adjustment
RPE Above RPI	0%	0%	Yr1 +7.2% & Yr2 +10.5%
Scope Risk %	-0.41%	-3.5%	-0.32%
Scope Errors	-3.86%		-0.84%
Cost Curves	-7.1%		-0.10%

5.7.2 The assessment of NI Water's MTR submission included for an element of economic deferral based on the assumption that the RPE ask would be fully realised. Should this not be the case, NI Water requests that the economic deferral adjustment be removed and all projects be determined on the full business case value of PC21 investment.

5.7.3 Within the NI Water submission, a number of proposed additional schemes were included. Costs within Annex E Revision C do not appear to have been considered by the Utility Regulator. However, a number of these schemes are included for within the reset Nominated Outputs baseline. NI Water would appreciate consideration of the costs for delivery of these projects with a view to normalisation of the actual investment through the logging up and down process. This applies to the UID schemes in particular as they contribute to the programme Nominated Outputs. These adjustments have been reflected in Annexes 5.7 and 5.8 accompanying this document.

5.8 ANNEXES

Annexes related to this chapter are as follows:

- Annex 5.1 – RPE Additional CPMO Analysis.
- Annex 5.2 – RPE Independent Analysis Jacobs/ Chandlers KBS.
- Annex 5.3 – NI Water Cost Curve Analysis – Additional Evidence.
- Annex 5.4 – Additional evidence for £1 cost curve issues.
- Annex 5.5 – Additional evidence for projects with incorrect scope risk %.
- Annex 5.6 – Additional evidence for projects with duplicated scope
- Annex 5.7 – updated Table 3.3 capital project listing.
- Annex 5.8 – updated Table 4.4 nominated outputs

6 PRICE LIMITS AND PUBLIC EXPENDITURE

SUMMARY

This chapter responds to the Utility Regulator's proposal relating to Price limits and other financial matters.

The overall increase in revenues allowed by the Utility Regulator is £58m lower than we had proposed. The shortfall is largely attributable to the Utility Regulator's view that the MTR should be forward looking rather than retrospective. We disagree as we believe the decision should be based on merit rather than timing.

NI Water was faced with significant cost pressures in the first half of PC21. We had no option but borrow in order to fund these increases. As a result, this has reduced our Capital Loan Note headroom and could lead to a situation whereby NI Water is unable to access borrowing for legitimate purposes.

With only two charging years remaining in PC21, we are conscious that including an adjustment for year 1-3 could materially increase price limits. We would therefore propose spreading this adjustment over a longer period to lessen the impact for paying customers.

The concept of a post period 'true up' is not new. In the past we have adjusted revenues retrospectively to reflect variances in revenue recovery and business transformation costs for example. Our submission proposed that the post price control 'true-up' calculation should be expanded to include any adjustments agreed as part of the MTR process. We believe this is a sensible approach and we would ask the Utility Regulator to reconsider their position.

6.1 OVERVIEW

6.1.1 In our MTR submission we sought an increase of £112.4m to revenues to reflect actual and anticipated net increases in opex offset by a 'refund' of higher than expected revenues and a lower tax payment. While the Utility Regulator has allowed an adjustment to revenue, they have limited this to forecast increase in power costs. As a result, the increase in revenues allowed by the

Utility Regulator in the Draft Determination is £58.2m (2018/19 prices) lower than we had proposed.

Table 6.1: Adjustment to NI Water’s revenue requirement (2018/19 prices)

	NIW MTR submission	UR MTR Draft Determination
Opex increases years 1 - 3	£65.8m	No
Opex increases years 4 – 6 (<i>post efficiency</i>)	£54.5m	£54.2m
Refund of revenue over recovery/ Tax / Alpha	(£7.8m)	No
Total	£112.4m	£54.2m

6.1.2 The Draft Determination allows revised price limits of 4.6% (real) p.a. to be applied in the last 2 years of PC21 whereas we proposed price limits of 4.3% to be applied in each of the last 3 years. While slightly higher on an annual basis, cumulatively the Utility Regulator’s increase is c3% lower.

6.2 IMPACT OF NOT ALLOWING YEARS 1 – 3.

6.2.1 We are disappointed with the Draft Determination decision not to consider years 1 – 3 as this is based solely on timing rather than merit. We continue to be of the view that this is unfair and ignores the fact that NI Water were left with no choice but to borrow from Dfl via our ‘Capital Loan Note’ to cover these additional running costs.

6.2.2 The variances only materialised after the PC21 Final Determination was published. As price limits had been set NI Water had no choice but to absorb them. More than 100% of the claim in years 1 – 3 relates to Power, following the energy crisis, which has been accepted as outside NI Water control.

6.2.3 While RDEL Budgetary cover was eventually secured this does not come with additional cash. Unlike other privatised water utilities in England and Wales, NI Water, as a Non-Departmental Public Body (NDPB), cannot retain profits in reserves to deal with financial shocks such as these. Our inability to recover the excess opex costs through price limits, in the normal way, therefore meant the additional cash could only be generated by increasing our capital loan note borrowings.

6.2.4 NI Water have the following concerns with the draft decision on years 1 - 3:

- Significant under recovery of operating costs for years 1 – 3 which were outside NI Water control. In E&W, Ofwat introduced a cost sharing mechanism to ensure that the risk of cost shocks can be reasonably shared with customer and company. The mechanism in place for NI Water is the MTR.
- NI Water had to borrow in the form of loans, the purpose of which is to fund capital enhancement, to pay the increase in years 1-3 power costs. Without the ability to recover the opex costs through price limits, NI Water has no mechanism to repay the loan.
- This loan will incur interest in perpetuity due to our inability to repay. As the loans were not used to fund capital enhancement and therefore not added to the RCV, the loan interest also cannot be recovered by customers, leaving NI Water with a stranded loan and interest payments.
- As NI Water had no option but borrow in order to fund these increases in running costs. This had reduced our Capital Loan Note headroom and could lead to a situation whereby NI Water is unable to access borrowing for legitimate purposes.

6.2.5 We would ask the Utility Regulator to reconsider its position in relation to these variances.

6.2.6 At the time of our submission in September 2023, our adjustment claim for years 1 – 3 included a forecast for the 2023/24 financial year. As the 2023/24 year has now concluded we are able to update our year 1-3 claim to reflect actual outturn costs - see table 6.2 below. The total adjustment for year 1 – 3 now being claimed is £18.7m less. Reductions to power account for most of the change.

Table 6.2: Final outturn for years 1-3.

MTR Revenue Claim (2018-19 £m)	NI Water Proposed Yrs 1-3 £m	NI Water Actuals Yrs 1-3 £m	Variance
Power	82.5	73.2	(9.3)
Chemicals - NIW	5.8	3.8	(2.0)
Cloud Implementation	8.8	7.9	(0.9)
Rates	(19.8)	(22.1)	(2.3)
PPP	(14.4)	(13.8)	+0.6
Insurance	2.8	3.0	+0.2
Reduction in Alpha credit	6.2	4.2	(2.0)
Revenue over recovery	(13.2)	(16.2)	(3.0)
Tax under recovery	(3.8)	(3.8)	-
MTR Revenue Claim	54.9	36.2	(18.7)

6.2.7 We are conscious of the impact of allowing years 1 -3 variances could have on price limits in the remaining two years of PC21. We would therefore propose spreading this adjustment over a longer period with any amount not allocated to the remainder of PC21 in the next price control.

6.3 Revenue ‘true-up’.

6.3.1 In our Mid-Term Review submission we had proposed that a ‘True-up’ calculation at end of this price control is expanded to include any adjustments made as part of the MTR process. Given the significant uncertainty and the potentially material impact of this we felt it was the fairest way of ensuring customers do not overpay in the event that costs are lower than forecasts and that NI Water has a mechanism to address under recovery.

6.3.2 In their Draft Determination the Utility Regulator indicated that this had not been accepted as they felt introducing a new mechanism at this point would not be proportionate. While the Utility Regulator have stated they will review how they treat power as part of the next price control this does not deal with the issue in the current one.

6.3.3 The concept of a post period ‘true up’ is not new. In the past we have adjusted revenues retrospectively to reflect variances in revenue recovery and business transformation costs for example. Our proposal was merely to expand this to

include the adjustments agreed at the Mid-Term. We believe this is a sensible approach and we would ask the Utility Regulator to reconsider their position.

6.4 PUBLIC EXPENDITURE FORECASTS

6.4.1 The DD set outs adjusted RDEL and CDEL forecasts which reflect the revised opex, capex and non-domestic revenue allowances outlined above. These are shown in Table 6.3.

Table 6.3: MTR DD RDEL and CDEL forecasts

	2024/25	2025/26	2026/27
RDEL	£178.3m	£168.8m	£164.0m
CDEL	£464.7m	£556.8m	£459.8m

6.4.2 RDEL and CDEL forecasts were prepared using OBR's November 2023 RPI forecasts. We note that the MTR Final Determination will use OBR's March 2024 inflation forecasts. All other things being equal, this would result in a small reduction to both.

7 NEXT STEPS.

7.1.1 NI Water has submitted this response on 27 June 2024 in accordance with the Draft Determination timescales.

7.1.2 In our response, we have raised a number of concerns in respect of the Draft Determination. We appreciate that in considering our response, the Utility Regulator may wish to seek further clarification. NI Water would wish to assure the Utility Regulator that we will be happy to engage further to provide all clarification needed.