Report of Working Group on Future Funding Model for Irish Water

4 September 2017

An Roinn Tithíochta, Pleanála agus Rialtais Áitiúil
Department of Housing, Planning and Local Government

Contents

Introduction

1. Following on from the Confidence and Supply Arrangement, an Expert Commission was established to examine the future funding of domestic water services. The Report of the Expert Commission was published in November 2016 and has been considered by the Joint Oireachtas Committee on the Future Funding of Domestic Water Services (JOC) which published its report in April 2017 and which recommendations were accepted by the Oireachtas. Consideration is now being given to the amendments required to the funding model of Irish Water to reflect the recommendations of the JOC report. The recommendations which impact directly upon the funding model are:
    - The introduction of measures to provide funding certainty for Irish Water over a long-term multi-annual budgetary cycle;
    - The requirement that the funding of water services for normal domestic and personal use should be out of taxation; and
    - The excessive or wasteful use of water should be discouraged by requiring users to make a payment for such usage above a threshold, at rates determined by Commission for Energy Regulation (CER) based on volume used (threshold of 1.7 times average household use, recommended with the, the latter also being determined by the CER).

2. The Department of Housing, Planning and Local Government (DHPLG) established a working group comprising the Department of Finance, the Department of Public Expenditure and Reform, NewERA, the CER and Irish Water to examine the implications of the JOC recommendations for the funding and regulatory model. The membership of the group is set out in Appendix 1 and the work was progressed through bilateral and sub-group engagement as well as plenary meetings.

3. At an early stage the working group agreed on a set of guiding principles for the development of the new funding model, which were reflected in the Memorandum to Government on the General Scheme of the Water Services Bill 2017 in May 2017. It is agreed that the key components of the funding and regulatory model will remain in place, on the basis that:
    - Irish Water remains a regulated national water public utility, leveraging the utility experience within the Ervia Group and driving the transformation to a single way of working as a utility;
    - Within the context of the Water Services Strategic Plan (WSSP[1]), Irish Water remains responsible for decisions on the investment priorities, capital maintenance and operational efficiencies programmes;
    - The regime of Ministerial consent being required for capital commitments being made by Irish Water, with advice to the Ministers being provided by NewERA, will continue;
    - The CER will continue to examine and benchmark costs, setting the allowed revenue and efficiency targets for both capital and operational expenditure for a multi-annual revenue cycle; and

[1] *This is the 25 years strategic plan approved by the Minister in accordance with Section 33 of the Water Services No.2 Act, 2013.*

- The CER has set a performance framework for Irish Water, and this framework together with the WSSP/Strategic Funding Plan objectives will be used as part of the Departmental oversight arrangements.

4. Specifically in relation to changes to the funding/regulatory model, the work of the group was guided by the following key requirements:
    - Ensuring compliance with the Water Framework Directive (WFD);
    - Supporting the economic regulatory process;
    - Improving the transparency of funding arrangements and avoid unnecessary circular flows of funds;
    - Avoiding cross-subsidisation between sectors (a requirement of the WFD) and underpinning the aims of current water pricing policy for the non-domestic sector;
    - Driving operational and capital efficiencies in line with the regulatory regime; and
    - Providing the necessary clarity to facilitate the appropriate capital investment by Irish Water.

Background and Context

5. The legislative approach and funding model changes in the light of the JOC's recommendations have to be developed in the context of the EU Water Framework Directive requirements. Details of these requirements are set out in Appendix 2. A number of key points in this regard were made in the letter of Commissioner Vella to Minister Coveney of January 2017. While stating that the WFD is a flexible instrument allowing the public authorities of each Member State a margin of appreciation, the Commissioner stated that water pricing policy must comply with the principles of cost recovery and "polluter pays", which are also fundamental to the directive. The Commission encouraged the Irish Authorities therefore to give particular attention to the following key issues:
   - The recovery of costs must ensure that the Irish Water sector meets its serious needs in terms of both maintenance and investment in the water and waste water sector.
   - In order for the charge on excessive or wasteful use of water to attain its purpose, the consumption of water for normal use, should be set at a reasonable level, and the charge for excessive or wasteful use of water should be dissuasive. The completion of metering will be instrumental to this effect.

6. Similar points were re-iterated by Commission representatives before the Joint Oireachtas Committee, with an emphasis on the importance of policy ensuring the effectiveness of outcomes and compliance with public health and environmental standards, including securing the €13 billion investment required over the long-term to bring the water system in Ireland up to standard.

7. Article 9 of the WFD requires the recovery of costs of water services having regard to economic analysis conducted in accordance with Annex III of the WFD. This Annex specifies a number of elements to be taken into account in cost recovery calculations. These include:
   - Long term forecasts of supply and demand for water
   - Estimates of the volume, prices and costs associated with (the provision of) water services
   - Estimates of relevant investment including forecasts of such investments

8. These are all matters covered by existing legislation through:
   - Water services strategic plan (section 33 of the Water Services (No.2) Act, 2013)
   - Investment plans (section 34 of the Water Services (No.2) Act, 2013)
   - Requirement for the CER to have regard to demands for water both current and foreseeable (Section 39 (2)(f) of the Water Services (No.2) Act 2013)
   - Water Charges plan must set out the costs to be incurred in the relevant plan period by Irish Water in carrying out its functions (section 22(3)(b)) of the Water Services (No.2) Act 2013
   - The Irish Water Business Plan

9. The first Water Services Strategic Plan was approved by the Minister for Housing, Planning and Local Government (HPLG) in October 2015. The evolving plan and the first investment plan under section 34 of the Act, were key inputs into the Irish Water Business Plan to 2021 which was considered by Government in September 2015. The Government indicated its support for the

Business Plan to Irish Water, subject to budgetary and regulatory approval and the underlying figures were reflected in the Government budgetary forecasts. Subsequently, the Programme for Government commits to a capital investment programme, which includes the €5.5 billion in capital investment set out in the Irish Water Business Plan to 2021, to continue to upgrade the dilapidated national water infrastructure. Against the background of the level of State funding envisaged in that plan, the CER made a decision on the second regulatory period 2017-2018 in December 2016, setting allowed revenue for this period. The key elements of the regulatory model are set out in Appendix 3.

Current Funding Arrangements

10. The overall forecast Irish Water expenditure (in both accrual and cash flow terms) for 2017 and 2018 is set out in table 1 below, with the expenditure in cash flow terms being the amount which would impact on the General Government balance in a year (net of revenue from non-domestic customers and connection charges):

Table 1 – Expenditure

	Accruals		Cash	
€m	**2017**	**2018**	**2017**	**2018**
Capex	527	680	490	625
Opex	702	723	697	722
Financing costs	17	15	17	15
	1,246	**1,418**	**1,204**	**1,362**

11. The sources for funding (cash flow) under current arrangements is set out below:

Table 2 – Sources of Funding

€m	**2017**			**2018**		
	Irish Water	**LA**	**Total**	**Irish Water**	**LA**	**Total**
LGF						
• Operational subvention	475		475	474		474
• Working capital loan to be converted to subvention	39		39	29		29
• Additional subvention for suspension of charge	125		125	42		42
• Additional subvention for abolition of charges	114		114	175		175
• LA LGF payments	**0**	**68**	**68**	**0**	**68**	**68**
Total LGF	**753**	**68**	**821**	**720**	**68**	**788**
Non-Voted expenditure	**270**		**270**	**270**		**270**
Total State	**1,023**	**68**	**1,091**	**990**	**68**	**1,058**
Revenue from Customers						
• Non-domestic charges	171		171	186		186
• Connection charges	36		36	48		48
Total Revenue	**207**		**207**	**234**		**234**
Net Debt & Miscellaneous	**(26)**		**(26)**	**138**		**138**
Total	**1,204**	**68**	**1,272**	**1,362**	**68**	**1,430**

12. Under the present funding model, the amount of Irish Water debt at end 2018 is anticipated to reach over €1 billion (€975 million at the end of 2016).

13. While there are arrangements in place in relation to financial governance of Irish Water that monitor actual operating and capital spending, the current arrangements underpinning State funding are as follows:

- Payment of subvention based on invoicing by Irish Water to DHPLG for the purchase of water in respect of free child allowance, subsidised tariff rate and cost of capping of charges;
- Payment of capital contribution based on Government agreement and request for payment from Irish Water, with Ministerial consent required for Irish Water's annual programme of capital commitments and individual capital projects over €20m; and
- Ministerial consent required, following NewERA advice, for borrowing by Irish Water on a facility by facility basis within the statutory limit on borrowing.

New Funding Arrangements

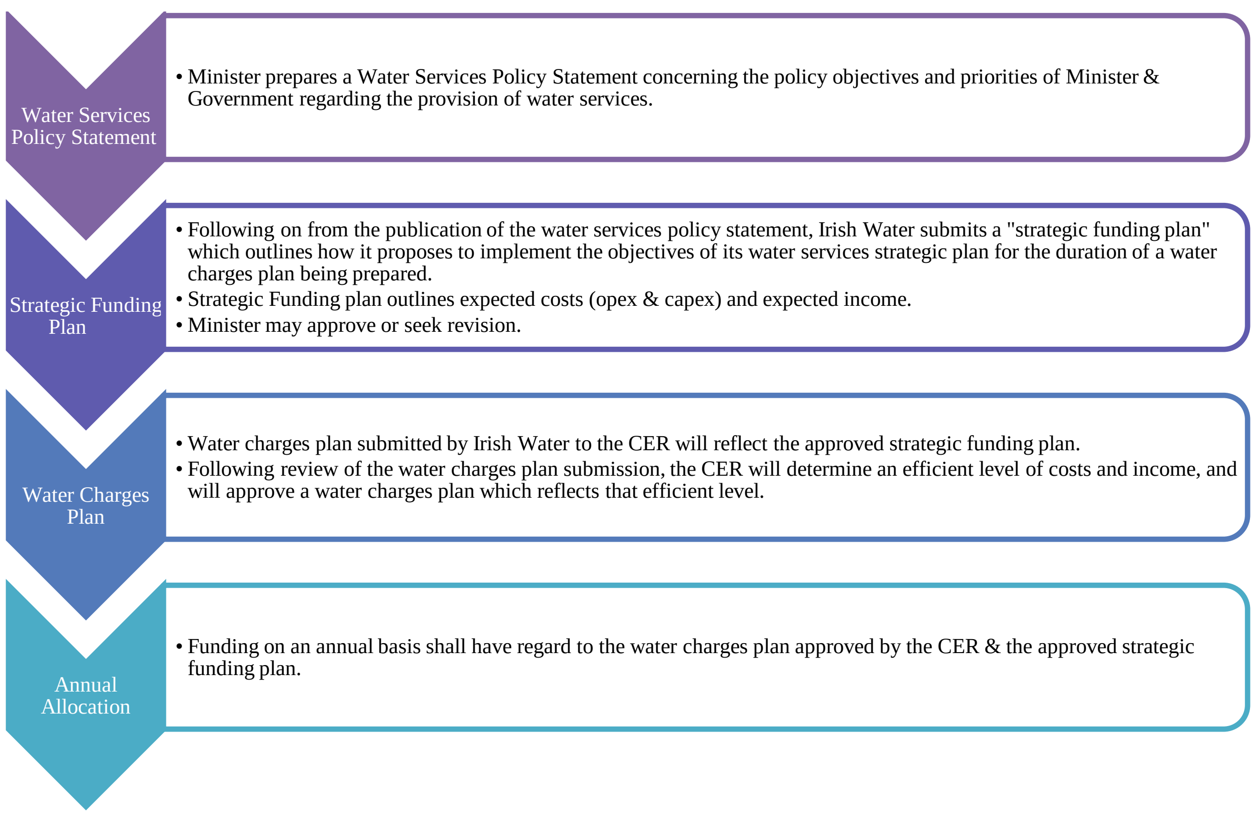
14. The working group has considered the recommendations of the JOC regarding the provision of funding certainty to Irish Water on a multi-annual basis, having regard to the requirements of the Water Framework Directive (WFD) and government budgetary processes. The proposed new funding arrangements build from the experience of the first two regulatory cycles and take account of recommendations of the JOC and the requirements of the WFD. In line with the principles agreed for the working group, and already outlined to Government, it is proposed that the regulatory model would remain intact. This has the benefits of providing independent scrutiny of the efficiency of operational and capital spending by Irish Water, driving efficiency and innovation and benchmarking costs against other water utilities.

15. The proposed model, in terms of the setting of the overall multi-annual financial parameters and managing the budgets on an annual basis, is set out below.

Setting the overall multi-annual financial parameters

16. The Water Services Bill 2017, will underpin, as necessary, the process set out in figure 1 below, which seeks to provide as much certainty as possible for the utility and the CER at an early stage in the evolution of plans as well as providing a clear outline to the Government on the funding requirements on a multi-annual basis to inform the budgetary process (while recognising that there will be annual allocations of funds).

Figure 1



17. The water charges plan submitted in future by Irish Water to the CER for review and approval will reflect prior engagement with DHPLG on objectives and funding requirements (through the approval of the 25 year Water Services Strategic Plan, the Water Services Policy Statement and the Strategic Funding Plan). The Strategic Funding Plan will set out costs of domestic and non-domestic water services, distinguish between operating and capital costs, and provide projections of income over the multi-annual period of the next water charges plan. It is envisaged that the Minister for HPLG will seek prior Government approval before approving the Strategic Funding Plan as the basis for the Irish Water submission of the water charges plan to the CER. This will allow the expected costs and State funding to be factored into the Government budgetary forecasts, including multi-annual capital plans.

18. It is proposed under the legislation that the Strategic Funding Plan will be laid before the Houses of the Oireachtas. This will be an important step in providing the funding certainty and long-term stability for the water utility recommended by the JOC, so that it can plan and deliver the requisite level of operational and infrastructure projects.

19. The multi-annual Strategic Funding Plan will translate into annual funding requirements. Following determination of the allowed revenue for the plan by the CER, DHPLG will receive the bill for the costs of water services used by domestic customers within the normal spectrum of usage, allowing for excessive/wasteful usage payments received by Irish Water (net of waivers for medical reasons and larger households). The CER will review the consumption data that underpins these bills. Funding commitment letters will set out the steps to be followed in the event that the costs decided upon by the CER cannot be met fully from State sources on an annual basis, outlining the justification for this decision in the context of the provisions of the WFD and the mechanism for change control involving the CER.

Annual funding

20. Two issues emerged in the context of consideration of annual funding provision – the source of funds and the nature of funds. For reasons of improved transparency of funding and accountability the Departments of Public Expenditure and Reform and Finance favoured the channelling of all State funding to Irish Water through the Vote of DHPLG. Subject to ensuring that the manner of disbursal of the funds was compliant with the WFD and supported the economic regulatory model, the DHPLG is agreeable to this approach. From a consistency perspective, other water related expenditure provided to local authorities currently channelled through the Local Government Fund (LGF) would also move to Exchequer funding.

21. A further matter for consideration is the type of funding, most particularly capital funding. At present, following a typical regulatory utility model, the capital programme is funded through a mix of debt, equity (capital contribution) and cash from operations.

22. NewERA was asked to consider the options in relation to the form of capital funding for Irish Water and they prepared a discussion paper for the working group following consultation with Irish Water and the CER. NewERA examined options relating to funding Irish Water's capital expenditure through either equity and debt or capital grants (in each case the funding would be provided by DHPLG). NewERA concluded that there would be significant benefits to maintaining an equity and

debt funding approach (where both the equity and debt would be provided by the Minister for HPLG, as opposed to being raised from external sources) compared to the use of capital grants, in particular as this approach would be best placed to help facilitate:

- Delivery of Irish Water's business plan
- Maintenance of the regulatory model
- The requirements of the WFD by providing for the full economic cost of water/wastewater services to be reflected and avoid any suggestion of cross – subsidisation between the domestic and non-domestic sector.

23. Irish Water has a strong preference for State funding to remain in the form of subvention, equity and debt (replacing the commercial debt), as this most closely aligns with the regulatory model and allows the utility to balance and time spending appropriately across operations, capital maintenance, network rehabilitation and expansion including in respect of the funding of major infrastructural projects.

24. The CER has expressed particular concerns that a move to capital grants, compared to the current funding approach, would present very significant challenges. The key purpose of the regulatory model is to drive efficiency and improve customer service. The further the funding moves along the spectrum of normal debt/equity funding to capital grants, the more it impacts on the degree to which the regulatory model drives efficiency and appropriate asset management choices. Furthermore, a pure capital grants approach would make it difficult to develop cost reflective charges required from a WFD perspective for the non-domestic sector and domestic excessive/wasteful use payments, raising a potential risk of legal challenge to tariffs.

25. The Departments of Public Expenditure and Reform and Finance were not agreeable to Irish Water continuing to raise debt for capital funding (even via the Minister for HPLG) on the basis that all net expenditure (i.e. net of non-domestic revenue) of Irish Water is reflected in the General Government Balance and it would be more transparent for the funding to be provided through voted expenditure via capital grants. Furthermore, it is not possible for Ministers other than the Minister for Finance to issue debt. The Departments did accept that to help ensure cost recovery and avoid a suggestion of cross-subsidisation or State aid, Irish Water should be allowed to fund capital expenditure related to the non-domestic sector partially through debt (within limits set from a General Government debt management perspective).

26. A model based on Irish Water billing DHPLG for domestic water charges based on an economic tariff set through the normal regulatory process, with additional capital funding based on capital contributions (equity) from DHPLG and debt raised for capital expenditure associated with the non-domestic sector, together with revenues from tariffs (non–domestic & excessive/wasteful use payments) can be supportive of the regulatory model. The CER and Irish Water can work within that framework to deliver the required investment and efficiencies over the multi-annual period of the relevant business plan and revenue control period. This is subject to sufficient flexibility of funding between years over the period of each revenue control. In this regard, it is noted that the CER set an efficiency challenge of 20% over the four years of regulation to end 2018 and the Irish Water business plan targets €1.1 billion in operational efficiencies and €0.5 billion in capital efficiencies over the period to 2021.

27. In the light of the varying views, the working group agreed that:
    (a) All State funds to Irish Water in respect of domestic water services should be channelled through the DHPLG Vote;
    (b) Debt (within parameters to be agreed) should only be raised by Irish Water in the context of the financing of the non-domestic portion of capital expenditure, with further consideration to be given to whether this debt can be provided to Irish Water by the State and/or commercial lenders;
    (c) Subvention payments by DHPLG to Irish Water would be based on the purchase of water as heretofore, albeit that it is now covering the entirety of domestic water consumption other than the excessive/wasteful use payments;
    (d) Capital contributions to Irish Water will be increased (offset by a reduction in borrowing) to encompass capital funding for the domestic water services and will be paid on broadly similar terms to Irish Water as to date, but channelled through the DHPLG vote rather than from non-voted sources.

28. The capital contribution from DHPLG would be treated as equity by Irish Water, subject to similar conditions as applying when such contributions have been provided by the Minister for Finance to date (i.e. unconditional, irrevocable and non-refundable capital contribution to the company). A separate sanction reflecting the nature of the capital spending and the regulatory process will be required from the Minister for Public Expenditure and Reform, rather than the general delegated sanction provided to the DHPLG in respect of the overall capital expenditure provided for in the DHPLG's Vote.

29. Under these arrangements, the subvention currently paid through the LGF would be provided through the DHPLG Vote. At present the subvention which is calculated based on the portion of the allowed revenue approved by the CER in the respect of the domestic sector, includes opex, depreciation and return on capital. Under the new arrangements, this subvention and the underlying tariff will be split between current and capital elements, so that the funding lines in the government accounting is aligned with normal capital classification within the Vote. In the case of Irish Water's financial statements, it is anticipated that this will continue to be treated as revenue.

30. Subject to finalisation of the estimates process and alignment of the subhead provisions with regulatory figures, the proposed subhead presentation for 2018 would be as follows:-

Table 3 – Proposed New Subheads

2018 €m	Current	Capital	**Total**
Subhead B.X Payment to Irish Water in respect of domestic water services	600	120	720
Subhead B.Y Capital contribution to Irish Water	-	380	380
	600	**500**	**1,100**[2]

[2] *Balance of funding met by €28m in debt and €234m in non-domestic revenue to give total funding requirement of €1,362m*

31. The changes in funding sources, save for the additional revenue required in the light of the discontinuance of the domestic charging under the 2014 Water Services Act, will be neutral in an overall Government budgetary context. Allowing for the adjustment for the replacement revenue, the overall funding requirement in 2018 for domestic water services under the previous funding regime would have been

- €720m subvention from the LGF
- €270m in equity from Minister for Finance; and
- €110m in debt[3]

totalling €1,100m.

32. Total capital spending forecast for 2018 is €625m of which €500m (80%) relates to the domestic sector. Under previous arrangements, €380m of this funding would have been financed by equity (€270m) and debt (€110m) with the balance (€120m) financed from the subvention (the cash equivalent of the allowed revenue set by the CER). Under the new arrangements the subvention will be related to the allowed revenue, but split between capital €600m and current spending (€120m) but the total remains equal to that which would have been paid from the LGF. The capital under Subhead B6 will be the equivalent of the capital contribution (equity) and the domestic related debt. These figures will be finalised in the context of the Estimates process, having regard to the regulatory decision in respect of 2017/2018.

33. The payment in respect of domestic water services would be based on invoices outlining the consumption by domestic customers at the tariff rate set through the regulatory process, split on an agreed formula between capital and current elements. DHPLG would be billed on a monthly basis as set out below:-

Bill for normal domestic water usage (indicative format)

The Commission for Energy Regulation (CER) would set the allowed revenue for Irish Water, taking account of operational costs, planned investment and required efficiencies in the normal manner. This is disaggregated between revenue due to be collected from non-domestic and domestic users. The latter, less revenue from the payments for excessive/wasteful usage, would fall to be paid by the State which will be a customer of Irish Water in relation to normal domestic use. Thus the Bill to DHPLG would comprise:

(No. of customers for water supplied) x (water supplied) x (unit charge – current portion)	A
(No. of customer for waste water removed) x (wastewater removed) x (unit charge – current portion)	B
(No. of customers for water supplied) x (water supplied) x (unit charge – capital portion)	C
(No. of customer for waste water removed) x (wastewater removed) x (unit charge – capital portion)	D
Less: revenue arising from Excessive/Wasteful usage payments (net of waivers for medical reasons & larger households)	E
Total Bill	A+ B+C+D-E

34. The advantage of this approach is that the funding would clearly align with the regulatory settlement, allowing for benchmarking of Irish Water costs against other water utilities which is an important driver in setting their efficiency challenge from the CER's perspective. From a WFD perspective, the approach allows Ireland to demonstrate cost recovery required under the directive to the European Commission. This approach is also aligned with the recommendations of the Expert Commission and

[3] *80% of costs relate to domestic sector, so forecast debt in respect of the domestic sector for 2018 would have been 80% of the €138m total debt forecast set out in Table 2, page 7.*

was the basis of DHPLG's engagement with the Office of the Attorney General when considering the issues around the potential charging regimes and compatibility with the WFD.

35. In addition, the approach is compatible with the essence of the recommendations of the JOC in that
    - Funding of Irish Water is clearly identifiable within taxation[4] to meet the cost of domestic water services
    - There is an identifiable link between the revenue provided to the utility by the Exchequer and the services the revenue pays for, as the bill for normal domestic water usage is determined through the independent regulatory model.
    - The funding model incorporates the principle of the recovery of costs of water services as set out in Article 9.

36. Irish Water is required to plan major infrastructural projects that are a key element of Irish Water's overall nationwide remit to meet the bulk of domestic, commercial and industrial water services needs into the medium to long-term future (to 2050 and beyond). Such major projects will have substantial funding requirements for construction phases beyond 2021 and there will be a requirement to consider financing arrangements for these major infrastructure projects within the above structure (e.g. unitary project based payments versus up-front capital).

Irish Water debt

37. The Government has already decided that Irish Water commercial debt should be replaced with State debt and the approach to implementing this decision is under discussion by a separate working group. Under the new model, it is proposed that the only debt to be raised by Irish Water would be against the revenue stream from the non-domestic sector. Within this framework, given that the debt raised would impact on the level of General Government debt, a limit would be set for drawdown on an annual basis within the budgetary framework and the requirement for Ministerial consent for individual borrowing facilities would continue to apply.

38. It is proposed that the working group, which was already established by the Department of Finance to look at the implementation of the Government decision, should now focus on considering the appropriate nature and level of facilities for the non-domestic debt and consider the approach to replacing the existing commercial debt. At the end of 2016 there was €975 million of such debt on the Irish Water balance sheet, and pending alternative arrangements, the existing debt facilities will continue to be maintained by Irish Water.

[4] *In that all funding is through the Vote and therefore funded from general taxation*

Overall Financial Governance

39. The DHPLG will update its financial governance arrangements with Irish Water in the light of the foregoing. An oversight agreement, as required under the new code of practice for the governance of state bodies, is currently being prepared and a revised shareholder expectation letter is being drafted.

40. These documents will reflect an overall financial governance arrangement involving:-

- Provision by Irish Water of capital and operational budgets and cash flow forecasts at outset of year, reflecting the CER's allowed revenue decisions;
- Quarterly meetings with DHPLG, NewERA and IW on financial performance;
- Subvention invoices to DHPLG accompanied by expenditure to date and consumption details (in line with reports to the CER);
- Capital consents in line with agreed processes with NewERA;
- Monthly meetings on capital programme between DHPLG and IW regarding capital programme implementation;
- Monitoring meetings on capital funding involving CER and the Environmental Protection Agency, chaired by DHPLG, which will address any changes in investment plans; and
- Borrowing limit set on an annual basis, and consents required for individual facilities.

41. A separate sanction will be provided by the Minister for Public Expenditure and Reform relating to spending under the new capital contribution subhead within the Department's Vote.

Summary of Recommendations

42. The revised funding model proposed for Irish Water seeks to ensure that:
    a) the maximum level of funding certainty on a multi-annual basis is provided within the constraints of government budgetary planning;
    b) the regulatory model is kept intact in order to drive efficiency and improved customer services;
    c) the requirements of cost recovery under the WFD are met; and
    d) transparency and accountability for funding to the Oireachtas is improved.

43. As a first step, the proposed Water Services Bill 2017 will provide for Irish Water to develop a multi-annual **Strategic Funding Plan** which outlines the costs and revenue requirements associated with the implementation of the Water Services Strategic Plan covering the period of the relevant regulatory cycle (five/six years), having regard to a Water Services Policy Statement by the Minister. This plan will be approved by the Minister as the basis for the Irish Water submission to the CER for the forthcoming regulatory cycle. This will provide ensure a common understanding between Government and Irish Water of the broad financial parameters and investment priorities. While Irish Water will receive annual budgets, they will be framed against the backdrop of this plan, and where funding reductions are required, change control mechanisms will ensure that the CER is involved in the associated decision making process.

44. All State funding to Irish Water in respect of domestic water services will be channelled through the DHPLG Vote and will be in the form of a payment for domestic water services as determined through the regulatory process and a capital contribution.

Table 4 – Proposed New Subheads

2018 €m	Current	Capital	**Total**
Subhead B.X Payment to Irish Water in respect of domestic water services	600	120	720
Subhead B.Y Capital contribution to Irish Water	-	380	380
	600	**500**	**1,100**

45. The payment in respect of domestic water services will be based on the purchase of water as heretofore, albeit that it is now covering the entirety of domestic water consumption other than excessive usage revenue. The capital contribution will be increased to encompass funding for domestic water services and will be paid, on broadly similar terms to Irish Water, as when issued by the Minister for Finance in the past.

46. Irish Water will raise debt (within limits) only for non-domestic sector capital expenditure in order to ensure that full cost recovery can be demonstrated for that sector and to avoid cross-subsidisation or state aid concerns. The D/Finance working group on debt will consider the best approach to facilitate this and the replacement of the existing commercial debt.

47. Irish Water are required to plan major infrastructural projects that are a key element of Irish Water's overall nationwide remit to meet the bulk of domestic, commercial and industrial water services needs into the medium to long-term future (to 2050 and beyond). Such major projects will have substantial funding requirements, therefore, there will be a requirement to consider funding arrangements for these major infrastructure projects within this structure (e.g. unitary payments versus up-front capital).

Appendix 1 – Membership of Working Group

DHPLG	Maria Graham (Chair) Patrick O'Sullivan Barry Ryan Eoin Fahey Ken Jordan
DPER	Tom Heffernan
D/Finance	John Palmer Brendan Coogan
NewERA	John Dillon David Stokes Cian Lucas
CER	Paul McGowan Sheenagh Rooney John Orme Aoife Crowe
Ervia/Irish Water	Jerry Grant Brendan Murphy Cathal Marley Chris McCarthy

Appendix 2 - Water Framework Directive

The Water Framework Directive (WFD) is the overarching Directive in relation to water policy in the EU. The aim of the WFD, which entered into force in 2000, is to achieve at least good status for all water bodies. It aims to do so by ensuring effective water management based on river basins and catchments, and by ensuring the sustainable use of water. Key elements of the WFD include:

- expanding the scope of water protection to address all waters (i.e. all rivers, lakes, groundwaters, transitional and coastal waters)
- achieving "good status" for all waters by a set deadline
- adopting a water management approach based on river basin management planning
- using economic instruments to support the achievement of water quality objectives and the efficient use of water resources
- getting the citizen more directly engaged with water management
- streamlining legislation.

The WFD sets out clear deadlines for meeting the objectives of the Directive. Member States are required to produce River Basin Management Plans which outline the proposed “Programme of Measures” to be implemented to meet the objectives within the specified timelines. The “first cycle” River Basin Management Plans covered the period 2009-2015. Having assessed the achievements of the first cycle, Member States were required to produce second cycle plans for 2016-2021. Third cycle plans are required for 2021-2027. 2027 is the final deadline for meeting the objectives of the WFD.

Article 9 of the Directive, deals with the recovery of costs for water services and provides as follows:-

“1. Member States shall take account of the principle of recovery of the costs of water services, including environmental and resource costs, having regard to the economic analysis conducted according to Annex III, and in accordance in particular with the polluter pays principle.

Member States shall ensure by 2010
— that water-pricing policies provide adequate incentives for users to use water resources efficiently, and thereby contribute to the environmental objectives of this Directive,
— an adequate contribution of the different water uses, having regard to the economic analysis conducted according to Annex III, and in accordance in particular with the polluter pays principle.

Member States may in so doing have regard to the social, environmental and economic effects of the recovery as well as the geographic and climatic conditions of the region or regions affected.

2. Member States shall report in the river basin management plans on the planned steps towards implementing paragraph 1 which will contribute to achieving the environmental objectives of this Directive and on the contribution made by the various water uses to the recovery of the costs of water services.

3. Nothing in this Article shall prevent the funding of particular preventive or remedial measures in order to achieve the objectives of this Directive.

4. Member States shall not be in breach of this Directive if they decide in accordance with established *practices not to apply the provisions of paragraph 1, second sentence, and for that purpose the relevant provisions of paragraph 2, for a given water-use activity, where this does not compromise the purposes and the achievement of the objectives of this Directive. Member States shall report the reasons for not fully applying paragraph 1, second sentence, in the river basin management plans."*

The first cycle of river basin management plans was completed in 2010. Ireland signaled an intention to introduce water charges and did not avail of the exemption outlined in article 9(4) of the WFD. In line with article 9(2) of the WFD, we will be required in the final river basin management plan for 2018-2021 to set out our approach for the cost recovery of water services based on the economic analysis conducted according to Annex III, the contribution of the different water users to cost recovery and how this will contribute to achieving the environmental objectives of the Directive.

Appendix 3 – Regulatory Model

The Commission for Energy Regulation (CER) is the independent economic regulator of Irish Water. Section 39(2) of the Water Services (No.2) Act, 2013 sets out the matters to which the Commission shall have regard in carrying out its functions, including

- that water services are provided by Irish Water in an economical and efficient matter;
- the conservation of water resources;
- the continuity, safety, security and sustainability of water services;
- that Irish Water can meet all reasonable demand for water both current and foreseeable;
- the recovery of costs of water services in accordance with article 9 of the EU Water Framework Directive; and
- that Irish Water performs its functions in a manner that will enable the achievement by the State of the environmental objectives of that Directive.

In simple terms, CER regulates Irish Water by deciding on the appropriate levels of operational (current) expenditure and capital investment required to cover efficiently incurred costs for the provision of effective water and waste water services. Furthermore CER takes account of inflation, depreciation and an appropriate return on investment. In regulating Irish Water, the CER also provides efficiency challenges and incentives for efficiency gains to be made. Irish Water is allowed to recover revenue at a level that is consistent with what CER deem to be an appropriate level of efficiently incurred costs, taking account of those other factors such as inflation, efficiency gains, new activities, i.e. the allowed revenue.

Once the allowed revenue is determined (i.e. the price determination for water), the question of the sources of funding can then be determined, including the split between domestic and non-domestic charges and Government subvention. This regulatory process therefore delivers the price determination for public water and wastewater services. In carrying out this role the CER seeks to ensure that Irish Water is run as efficiently as possible by setting it an efficiency target (e.g. efficiencies of circa 20% within its controllable operating expenditure over the period from the start of 2015 to the end of 2018) while providing the requisite water and waste water services to the public. The regulatory model also provides for long-term planning of investment and operational efficiencies as the revenue control periods typically cover a multi-annual period.

The CER monitors Irish Water's performance to ensure that the revenue approved by the CER is used to deliver efficiencies and improved services for customers. The CER completes this in a number of ways, by monitoring the activity of the utility during the revenue control period and also completing an ex-post review of its performance.

The Water Services Act provides for two mechanisms for interface between the regulatory sphere and the policy formulation sphere:

Section 27 of the Water Services Act, 2013	"Commission may advise the Minister in relation to the development of policy regarding the regulation of the provision of water services"	The CER were asked by the Minister in line with the provisions of this section to advise him on the approach to water regulation, and the response forms the current framework for economic regulation.
Section 42 of the Water Services No.2 Act, 2013	Directions to the Commission Power for the Minister to give to the Commission such direction of a general policy nature as he or she considers appropriate Draft direction subject to 30 days consultation • Sent to JOC, CER • Published in Irish Oifiguil • Relevant Minister	This was used in 2014 to set out the parameters of the first charging regime, e.g. • Free allowance for domestic customers • Child allowance • Approach to regulation and regulatory asset base • Metered v assessed charges • Special arrangements for those with medical needs • Quality of water issues • Conditions associated with State funding.

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