



Water and Sewerage Services PC21 Mid-term Review Approach

The Utility Regulator's Approach to the
PC21 Mid-term Review

March 2023



About the Utility Regulator

Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs, Markets and Networks. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.



Our mission

To protect the short- and long-term interests of consumers of electricity, gas and water.



Our vision

To ensure value and sustainability in energy and water.



Our values

- Be a best practice regulator: transparent, consistent, proportionate, accountable and targeted.
- Be professional – listening, explaining and acting with integrity.
- Be a collaborative, co-operative and learning team.
- Be motivated and empowered to make a difference.



Abstract

We regulate the revenue NI Water receives through periodic price controls. Our proposals set an overall revenue requirement and identify the levels of capital and operational expenditure. NI Water is currently in its fourth regulatory price control period, PC21, which covers the period from April 2021 to March 2027. Our final determination for PC21 was published in May 2021. In addition to NI Water's revenue allowance, this set targets for improvements in service to consumers and the environment over the six-year period. It also provided a framework for sustainable service delivery by NI Water and supported the investment necessary to allow the planned development of housing and industry economic development that underpins the economy and wellbeing of our society.

In our final determination we outlined our intention to undertake a mid-term review during the PC21 period. This was so that the company's investment proposals could be reviewed and if necessary, amended as a consequence of any changes that might have occurred in the first half of the price control period. It was also to provide an opportunity for an interim assessment of the company's delivery against its commitments for the price control period and for the outcome of work completed in the early part of the price control period to be used to inform delivery proposals for the remainder of the period.

This document sets out our proposed approach for undertaking this review and has been informed by initial engagement with principal stakeholders.

Audience

Principal stakeholders (i.e. DfI, NI Water, NIEA, CCNI, DWI), consumers and their representatives.

Consumer impact

This document explains our proposed approach for the PC21 mid-term review. It explains how we will assess delivery against the requirements set out in the PC21 final determination and the impact that any changes experienced in the price control period might have on planned delivery. This includes the improvements that have been and could be delivered for consumers and the environment.



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Foreword

Northern Ireland Water (NI Water) is currently in its fourth regulatory price control period, PC21. This covers the six year period from April 2021 to March 2027. Our final determination for PC21 was published in May 2021. In addition to NI Water's revenue allowance, this set targets for improvements in service to consumers and the environment over the six-year period. It also provided a framework for sustainable service delivery by NI Water and supported the investment necessary to allow the planned development of housing and industry economic development that underpins the economy and wellbeing of our society.

PC21 is the second of our longer duration price controls and whilst this provides benefits in terms of providing extra time for efficient planning and delivery, it also introduces a degree of uncertainty associated with planning over the long term.

We therefore included the provision for a mid-term review in our final determination, explaining the rationale, the potential scope and the key milestones within the process. This was included so that the company's investment proposals could be reviewed and if necessary, amended as a consequence of any changes that might have occurred in the first half of the price control period. It was also required to allow us to undertake a determination for elements of the investment programme which were insufficiently developed for us to do so previously. In addition it provides an opportunity: for us to undertake an interim assessment of the company's delivery against its commitments for the price control period; for the outcome of work completed in the early part of the price control period to be used to inform delivery proposals for the remainder of the period; and, for us to review NI Water's progress in delivering the key development outputs required to support its investment planning for PC27.

This consultation document sets out our proposed approach for the mid-term review and the timescale to completion. It builds upon the outline proposals included in our PC21 final determination and explains the extent and scope of the work that we are planning to undertake through reference to specific elements of the price control. It provides an opportunity for consumers, stakeholders and NI Water to comment on our proposals and to inform the final approach adopted for the mid-term review.

1. Introduction

Regulatory Context

- 1.1 The Utility Regulator's (UR) primary role within the Northern Ireland water industry is to promote and protect the interests of the consumer, both today and in the future.
- 1.2 NI Water is a government-owned company which is responsible for providing water and sewerage services to consumers in Northern Ireland. Since it is the sole provider of these services, the UR regulates the amount of revenue the company receives.
- 1.3 Our determination of the company's revenue requirement is undertaken through periodic price controls, one of our principal regulatory processes. These:
 - Establish the funding required by NI Water to meet departmental priorities for the price control period contained within its Social and Environmental Guidance;
 - Require NI Water to deliver enhanced regulatory outputs, continued investment, improvements in service and efficiencies; and,
 - Aim to ensure value for money for consumers and determine how much the company is allowed to charge.
- 1.4 The domestic consumer charge and the domestic allowance for commercial consumers is met by Government subsidy through public expenditure (PE) mechanisms. The remainder of the charge for commercial consumers is recovered through bills. NI Water's reliance on government funding for the majority of its revenues, means it is also classified as a non-departmental public body for public expenditure (PE) purposes. As a result it is subject to the rules that govern PE and is required to operate within PE limits set by the NI Executive.
- 1.5 Our price controls are set in the context of the PE environment and specific regulatory processes have been established to allow spending constraints to be accommodated if required. In the event of PE reductions for the provision of water and sewerage services, or significant budgetary pressures, we will work with the company and other stakeholders to ensure that NI Water delivers the best possible package of outputs within the funding allocation. This includes agreeing changes to outputs and/or prices if appropriate.

Overview of NI Water Price Controls

- 1.6 NI Water's first three price controls, known as PC10, PC13 and PC15, covered the three year period (2010-13), the two year period (2013-15) and the six year period (2015-21) respectively. NI Water is currently in its fourth regulatory price control period, known as PC21, which began on 1 April 2021 and runs for six years until 31 March 2027.
- 1.7 Longer timescales were introduced for PC15 and PC21 in recognition of the need to provide a more stable and predictable framework to support the long term water strategy and the benefits that longer price control periods can provide in terms of promoting planning and efficient delivery.
- 1.8 A period of six years was chosen to provide an appropriate balance between allowing sufficient time for efficient planning/delivery and the potential uncertainty of outcome associated with planning over the long term.
- 1.9 Our approach to PC21 was developed within the context of DfI's long-term water strategy for Northern Ireland. This covers a 24 year horizon and aims to deliver a more strategic, holistic and integrated approach to the management of all aspects of the water and sewerage industry.
- 1.10 This strategy helped inform the content of department's Social and Environmental Guidance for the PC21 period, which has subsequently been reflected in the company's business plan proposals and the outcome of our final determination.
- 1.11 The next price control period (referred to as PC27) will commence on 1st April 2027. The development of our approach to PC27 will commence at the start of 2024. This process will be informed by development work undertaken by NI Water in the PC21 period and the outcome of the assessments undertaken in the PC21 mid-term review, including the considerations of the various working groups involved in the process.

Provision for a PC21 mid-term review

- 1.12 As in PC15, our PC21 Approach recognised:
 - The uncertainty that might be associated with longer investment planning periods;
 - That changes in PE funding during the period had the potential to impact on budget availability; and,

- That work undertaken in the early part of the price control period might help inform delivery proposals for the remainder of the PC21 period.
- 1.13 We therefore included the provision for a planned mid-term review in order to:
- Allow for managed changes in funding;
 - Provide an opportunity to implement innovative and sustainable solutions that might develop from strategic studies and pilot projects undertaken early in PC21;
 - Provide the opportunity to deal with material changes which might accumulate over a 6 year price control period and result in a stepped change in prices at the start of the next price control; and,
 - Avoid the regulatory burden associated with continuous change by introducing a single opportunity for re-opening the financial determination for PC21.
- 1.14 In Section 6 of our [PC21 final determination](#), we explained the potential remit of the mid-term review. We also listed the elements of the price control that we were not minded to reopen as part of the process.
- 1.15 This approach document builds on the outline proposals included in our final determination and describes our proposed approach for the mid-term review through reference to key elements of the price control. It explains the rationale for the mid-term review, its aims, the potential scope, the limitations that are expected to be applied and sets out the proposed timetable to completion.
- 1.16 Its development has been informed by the funding provision and the performance delivered by NI Water during PC21 to date. The proposals and key areas of focus have also been informed by the outcome of initial engagement undertaken with our principal stakeholders:
- Department for Infrastructure (DfI);
 - Northern Ireland Water (NI Water);
 - Consumer Council for Northern Ireland (CCNI);
 - Drinking Water Inspectorate (DWI); and,
 - Northern Ireland Environment Agency (NIEA).

2. The Mid-term Review Process

A proportionate approach

- 2.1 When we introduced the concept of a mid-term review in PC15, it was our intention that it should be limited to those areas where it would provide benefit, or was necessary. This is to try to ensure the opportunities and incentives of a 6-year plan are maintained as far as possible.
- 2.2 Our approach has been developed in this context and in developing our proposals we have taken this into account.
- 2.3 It also recognises the fact that established processes already exist for managing changes that might typically occur in a price control period, including those associated with modest changes in PE funding, i.e.:
- The Memorandum of Understanding (MoU) and Consequent Written Agreement (CWA) between the Utility Regulator and the Department;
 - The stakeholder Change Control Protocol; and,
 - The logging up and down process applied in the next price control.
- 2.4 In addition we have considered opportunities for the mid-term review to feed off existing regulatory processes and sources of information, such as the annual information return and the planned PC21 scope certainty submissions.
- 2.5 We believe that this has resulted in a reasonable and proportionate approach which will help minimise the input required from those involved in the process.

Engagement and consultation

- 2.6 Our intention is that the mid-term review process should be as open, transparent and collaborative as possible. To ensure that this is the case we will engage regularly with principal stakeholders throughout the process.
- 2.7 This commenced in February 2023 and the timing and frequency of further engagement will be agreed as the process progresses. Where possible we will combine this engagement with established meetings to minimise any regulatory burden.

- 2.8 This approach document is being published for consultation to allow consumers, stakeholders and NI Water to comment on our proposals and to inform the final approach adopted for the mid-term review.
- 2.9 This differs from the PC15 mid-term review process, where the document was issued to principal stakeholders for comment rather than being subject to wider consultation. The decision to propose a different approach for the PC21 mid-term review has been taken on the basis that it aligns better with our values of transparency and accountability.
- 2.10 We also plan to consult on our draft report at the end of the process for the same reasons. This will allow consumers, stakeholders and NI Water to comment on the outcome of the process and for us to consider the feedback received prior to the publication of our final mid-term review report.

3. Our approach to Specific Areas

Background

3.1 The mid-term review was never intended to reopen the following elements of the financial determination, and this remains the case.

- Return on Capital.
- Operational Cost Efficiency.
- Capital Cost Efficiency.

3.2 Its scope was however always expected to cover the following:

- The impact of changes in funding, or significant budgetary pressures, on output delivery and the K-Factors previously established;
- Consideration of the outcome of the work completed on scope certainty and the associated impact on the prioritised list of outputs;
- Investment programme changes required due to emerging needs and pressures;
- Consideration of capital maintenance funding levels and serviceability to check whether assets are being maintained and the PC21 final determination assessments remain valid;
- A review of delivery against the development outputs included in the final determination to determine whether elements of funding for the second half of the period should be approved and whether NI Water's capability and techniques are being developed sufficiently to support more robust business planning for PC27;
- The review of existing consumer measures and consideration of the incorporation of new consumer measures and targets developed and agreed through the CM/SAT stakeholder group;
- A review of the target performance bands set for water quality and environmental compliance performance measures; and,
- Opportunities for implementing any innovative and sustainable solutions proven in the early part of PC21.

- 3.3 The following sections of this report explain the approach we intend to take on these issues and other areas of focus that have been identified through further consideration and stakeholder engagement in the process to date.

Budget uncertainty

- 3.4 NI Water has largely been funded to final determination levels for both Opex and Capex in the first two years of PC21. This includes adjustment for higher than anticipated levels of inflation.
- 3.5 Although it is not clear whether this position can be maintained moving forward, the lack of certainty in relation to budget projections makes it impractical to introduce specific alternative budget scenarios in the mid-term review process.
- 3.6 We therefore plan to proceed on the assumption that the full final determination allocation will be provided for the remainder of the period in line with experience in the price control to date.
- 3.7 We will however continue to liaise with DfI in relation to ongoing budgetary provision and remain open to introducing planning scenarios at a later date if this is required and if time permits. It is however recognised that this has the potential to impact the planned delivery programme and would need to be carefully considered and managed in conjunction with other stakeholders if it occurs.
- 3.8 In the meantime, our assessment of changes to output delivery will focus on the impact of specific Capex and Opex cost pressures and programme changes, as detailed below.

Capital Investment

- 3.9 NI Water invests capital expenditure to maintain its existing assets, meet more demanding quality obligations, provide extra capacity for growth and improve the service it currently provides to consumers.
- 3.10 Any cost pressures or budget reductions from the final determination allowance will therefore constrain NI Water's ability to deliver the PC21 outputs and the associated service improvements for consumers.
- 3.11 We do not propose re-opening our PC21 assessment of capex cost efficiencies or undertaking a wholesale review of the investment proposals outside the areas listed below.

Scope Uncertainty in the capital programme

- 3.12 In Section 4.29 of our PC21 final determination we noted the areas of the company's business plan that contained a level of scope development that was insufficient for a determination. These included:
- The scope of water treatment works improvements being reviewed by the Drinking Water Inspectorate;
 - The company's Drainage Area Plans and integrated environmental studies needed to identify efficient solutions to major drainage issues; and,
 - The future consents and catchment studies needed to identify appropriate least cost solutions for wastewater treatment and sewerage system upgrades.
- 3.13 For the PC21 final determination, NI Water provided a list of projects where further development work was necessary to confirm an efficient scope and cost for determination. The company also provided a programme of development work which would allow the cost of these schemes to be determined at the mid-term review.
- 3.14 In the interim, our final determination included a 'holding' allowance for this work based on the company's latest best estimates. This ensured that price limits and capital budgets made provision for the necessary work while efficient solutions were being finalised.
- 3.15 The resubmissions were originally to be made in four batches between September 2021 and March 2023. To date three have been received and the overall cost has increased significantly compared to the estimates included in the final determination.
- 3.16 A subset of the projects submitted in Batch 1 to 3 show a disproportionate increase in costs. This may also be the case with Batch 4. NI Water has therefore proposed deferring any projects where costs have increased disproportionately to PC27 to allow further modelling to be undertaken and alternative lower cost solutions to be investigated. In doing so it has requested that these schemes be replaced with 'substitutes'.
- 3.17 This 'substitution' process needs to be the subject to further discussion and agreement with NIEA and so it has been agreed that an additional (fifth) batch of schemes will be submitted at the end of June 2023. This will cover any outstanding elements of the revised PC21 programme agreed by NIEA and NI Water and include the supporting information needed to allow the entire scope/certainty submission to be assessed.

- 3.18 Once received, this will provide a full revised list of prioritised and costed outputs which we will assess to establish what can be delivered in the PC21 price control period within the Capex funding allowance.
- 3.19 As part of the assessment process, we will ask the Reporter to review the proposed solutions and costs for a sample of the schemes to ensure that value engineering has been applied appropriately and that any scope risk applied is reflective of the improved 'scope certainty'.

Other PC21 Capital Programme changes

- 3.20 It is recognised that there can be a need to make changes to the planned delivery programme during a price control, for example as a result of changing regulatory standards, changes in funding or emerging pressures.
- 3.21 Our established regulatory processes already include a formal Change Control Protocol which allows these changes to be accommodated and managed. This sets out the procedures and steps that key stakeholders have to follow to control changes to outputs. It provides a structured framework for managing change and ensuring that: changes have been agreed by stakeholders; that the necessary funding is available; and, that changes are reflected in associated documentation and monitoring processes.
- 3.22 To date in PC21 there have been three change controls submitted by NI Water. These have been approved by the Output Review Group and we will assess them in the mid-term review. In addition, NI Water will be asked to identify any further emerging investment requirements so that these can be considered in conjunction with all other changes, including the revised list of schemes agreed through the scope certainty submission process. This will allow stakeholders to make informed decisions on investment priorities for the remainder of the period and allow outputs to be adjusted accordingly.
- 3.23 Any proposals brought forward by NI Water will need to be supported by business cases justifying the need and the extent of the investment so that this can be assessed.

Capital Cost Pressures above Inflation

- 3.24 NI Water has advised it is experiencing significant construction cost pressures above inflation and that it wishes the impact of this to be considered at the mid-term review.
- 3.25 NI Water will therefore be asked to submit evidence to allow us to determine the materiality of this issue and whether it needs to be accounted for within

the process. In doing so we will assess any impact on the outputs that can be delivered within the period.

Base maintenance investment

- 3.26 A major component of NI Water's capital programme is the investment needed to maintain its existing assets and the service they deliver. This equates to approximately 40% of the company's total capital budget and is referred to as base maintenance.
- 3.27 In line with consumer expectations and the requirements of the S&EG, the established policy is that base maintenance allowances should be maintained irrespective of any budgetary pressures.
- 3.28 This principle is intended to ensure that there is no overall deterioration in the asset base and the associated level of service provided to existing consumers and we plan to continue to apply it in the mid-term review.
- 3.29 The company has however advised that its base maintenance costs have increased in PC21 to date due to the impact of cost pressures above inflation. We will therefore ask NI Water to provide evidence to demonstrate this is the case and consider how this might be dealt with. For example, whether the allowed maintenance budget needs to be increased so that the principle of protecting existing services to existing customers is maintained.
- 3.30 If this is the case and overall funding is not increased accordingly, this could lead to additional pressures on the enhancement budget and impact the delivery of associated outputs. This will be assessed and taken account of in the process.
- 3.31 The PC21 final determination also included an 'incidental base' uplift to account for additional base maintenance required as a consequence of the step change in the scale of the enhancement programme compared to historic levels of expenditure.
- 3.32 Consideration will therefore be given to whether this allocation needs to be changed to account for any adjustments made to the enhancement programme as a result of budgetary pressures/cuts or the outcome of the scope certainty review process.

Enhancement investment

- 3.33 The remainder of NI Water's capital budget is spent on enhancing the company's assets to deliver improvements for consumers. This includes meeting enhanced quality obligations, providing extra capacity to

accommodate growth/development and improving the service provided to consumers (for example by reducing incidents of low pressure or flooding).

- 3.34 As a result of the established principle of maintaining levels of base maintenance expenditure, any budgetary constraints will therefore primarily impact the enhancement element of the budget and the improvements that this is intended to deliver for consumers.
- 3.35 In addition, in line with previously established principles, it is anticipated that drinking water investment will be prioritised within the process. Any output reductions due to cost pressures are therefore expected to mainly affect wastewater investment and more specifically the Unsatisfactory Intermittent Discharge (UID) programme.
- 3.36 In the mid-term review we will evaluate the impact of:
- The work undertaken to review and revise the prioritised list of wastewater outputs as a result of the scope certainty submissions;
 - Any change controls that have been submitted/approved;
 - The impact of cost pressures above inflation;
 - Additional outputs that can be delivered as a consequence of any cost challenges applied; and,
 - The outcome of our assessment of the business cases submitted by NI Water for expenditure areas where approval for continued investment for the remainder of period is dependent on proof of benefit.
- 3.37 In doing so we will comment on the potential impact that any changes could have for consumers through reference to specific schemes and the benefits they are intended to deliver.

Management and General

- 3.38 The Management and General sub-programme covers investment which delivers the capital assets required to support the general delivery of services which are not directly related to the operational water and sewerage service assets.
- 3.39 It includes the provision and maintenance of general facilities and accommodation, vehicles, information technology (including hardware and software) and the updating of network records. In overall terms it represents a significant element of the capital programme.

- 3.40 In our initial engagement with a stakeholders, a number asked whether there would be scope to reallocate any funding from this sub programme to mitigate the impact of cost pressures on the wastewater programme, and more specifically, the release of development constraints.
- 3.41 We plan to review whether there are any opportunities to do so, by engaging with NI Water to establish if there have been any material changes in costs and/or the company's investment proposals for Management and General.

Delivering sustainable outcomes

- 3.42 When outlining the potential approach to the mid-term review in the PC21 final determination, we noted that it would consider opportunities for implementing any innovative and sustainable solutions proven through the strategic studies and pilots undertaken by NI Water in the early part of PC21.
- 3.43 We will consider these opportunities through our review of the outputs delivered to date by NI Water and through ongoing engagement with the company during the mid-term review.
- 3.44 We therefore expect NI Water to highlight any emerging opportunities identified through work completed to date as part of the process.

Provision of investment planning information by NI Water for the MTR

- 3.45 To allow us to complete our assessment of the investment programme at the mid-term review, we will ask NI Water to provide a list of projects. This list should include the original PC21 schemes, any that have been brought in as 'substitutes' and any that might be brought in if extra funding was provided.
- 3.46 NI Water will be asked to submit a range of costs for the schemes. This will include the original baseline cost where it exists and the company's current estimate, taking account of any costs changes experienced. The key reasons for any changes should be categorised (for example as a consequence of cost pressures above inflation or scope certainty updates) and the cost for each reason should be listed separately in the submission.
- 3.47 NI Water will also be asked to identify the priority schemes that it now plans to deliver for the PC21 funding allowance. The original list of PC21 projects should also be easily identifiable
- 3.48 We will agree the exact format and extent of the information to be submitted through engagement with NI Water during the process. But we are also likely to request some supplementary information such as the benefits that the scheme is expected to deliver (for example in improving quality in a

particular water body or removing development constraints in a particular town or area).

- 3.49 In the absence of budget confirmation for the remainder of PC21, this will provide the Utility Regulator and other stakeholders with visibility of the potential impact and loss of benefit over the entire period if cost pressures are not met by additional funding. It will also show the extent to which each contributing factor is impacting delivery in each area of planned improvement.
- 3.50 It is recognised that further submissions on adjusted outputs may be necessary after the mid-term review when future budget provisions are confirmed. These will continue to be subject to separate assessment and challenge to ensure that NI Water delivers the best possible package of outputs within the allocation provided.

Operating Expenditure

- 3.51 NI Water will not be asked to undertake detailed assessments of the specific impacts of any opex planning assumptions as part of the mid-term review process. This would be a complex task which we believe would best be undertaken subsequently when clarity on the actual level of resource funding provision becomes available.
- 3.52 In addition, we do not propose re-opening our PC21 assessment of opex cost efficiencies or undertaking a wholesale review of the investment proposals outside the specific areas detailed below.

General

- 3.53 We will comment on NI Water's outturn performance against its final determination opex allowances in the first two years of PC21 and also consider whether any adjustments are required as a consequence of changes made to the capital investment programme (i.e. Opex from Capex).

Power costs

- 3.54 We are aware that the company's power costs have increased significantly since the PC21 final determination and have been advised that they are expected to be over three times higher in 2023-24.
- 3.55 Any additional power costs that NI Water has experienced in PC21 to date have been met by additional subsidy from DfI through Department monitoring rounds and have therefore not impacted tariffs.

- 3.56 We however understand that this approach may not be sustainable moving forward. We therefore intend to engage with Dfl and NI Water during the mid-term review to establish how these additional costs should be dealt with for the remainder of the PC21 period, considering affordability as part of the process. This may result in some, or all, of these additional costs impacting tariffs.
- 3.57 In recognition of the potential for power costs to reduce again in the second half of PC21 we will consider whether a mechanism should be introduced in PC21 or PC27 to apply any necessary corrections.

Other Opex Pressures/Easements

- 3.58 Other material cost pressures, such as increased chemical costs, will be considered on the basis of any evidence submitted by the company.
- 3.59 We will also investigate whether any Opex cost items are increasing at a lower rate than the inflationary uplift allowed for in the tariff process to determine whether any justifiable cost increases are balanced to some degree.

PC21 Outputs

Background

- 3.60 During a price control period water and sewerage companies deliver a series of outputs which aim to secure the outcomes consumers want.
- 3.61 For PC21 we assessed NI Water's proposed outputs in line with the anticipated level of investment and the priorities set out in the departments Social and Environmental Guidance. The outputs included in the final determination formed part of an overall package which the company is expected to deliver.
- 3.62 The sections below identify the types of output included in the PC21 final determination and how we intend to treat them in the mid-term review.
- 3.63 Where possible we will use the data which NI Water provides in its annual return submission to undertake our assessments to help to minimise the burden of the process on the company.

Service level outputs

- 3.64 Service level outputs measure the impact of investment on the level of service experienced by consumers. For example, the number of properties at risk of low pressure or flooding, the level of quality compliance or the number of customers experiencing interruptions to supply.

3.65 For the mid-term review we will:

- Review performance to date against final determination targets to assess NI Water's success in delivering against the improvements originally planned;
- Review the performance bands set for the water quality and environmental compliance measures, using actual and projected performance, to determine whether they remain valid. In doing so we will take account of the impact that COVID had on sampling activities and will adjust our approach accordingly if this affects our ability to update this analysis;
- Review the leakage targets set in the final determination against the company's latest sustainable level of leakage assessment and performance to date to determine whether they need to be adjusted; and,
- Consider the impact of the outcome of work undertaken by NI Water to 'refresh' the low pressure Register on the targets set for the two low pressure measures included in the final determination. This is necessary because this work has resulted in a 'step change' increase in the number of low pressure properties and so the PC21 targets would have been different if this information had been available at the time of the determination. We will ask the Reporter to review the approach and the outcome of the work undertaken by the company to determine whether it aligns with best practice and whether the revised number of DG2 properties represents a reasonable estimate. This work will be undertaken as part of the audit of the 2022-23 annual information return.

General Activities

3.66 We include general activities, such as the rate of replacement of water mains or the replacement of sewerage, as outputs where it is not possible to establish a clear link between activity and service level outputs in the short term. This ensures that NI Water puts forward robust plans for each price control period against which delivery can be monitored.

3.67 For the mid-term review we will:

- Review performance to date against final determination targets to assess NI Water's success in delivering against the level of activity originally planned; and,

- Consider whether any adjustments are necessary as a consequence of cost pressures above inflation impacting the base maintenance allocation which funds the majority of this work.

Nominated Outputs

- 3.68 Nominated outputs are specific items, often identified by the quality regulators, such as improvements to treatment works so that discharge standards meet mandatory legislative requirements. They also include a number of specific improvements that NI Water has identified as nominated outputs in its business plan, such as trunk main schemes and the provision of additional water storage capacity.
- 3.69 The PC21 final determination included a list of named priority outputs which NI Water is expected to deliver through its capital investment programme.
- 3.70 For the mid-term review we will:
- Review performance to date against final determination targets to assess NI Water's success in delivering against the original plan.
- 3.71 We will also adjust the list of nominated outputs to reflect the outcome of our consideration of the following:
- The work undertaken to review and revise the prioritised list of wastewater outputs as a result of the scope certainty submissions;
 - Any change controls that have been submitted/approved;
 - The impact of cost pressures above inflation; and,
 - Additional outputs that can be delivered as a consequence of any cost challenges applied.

Development outputs

- 3.72 The final determination for PC21 included 25 key development objectives which cover areas of improvement that cannot necessarily be monitored using numerical targets. They are intended to help ensure NI Water develops its planning capability and introduces new techniques to improve this and the service delivered to consumers over the longer term.
- 3.73 These objectives include areas where we consider development to be necessary to justify the need for investment in the second half of the price control period and to support NI Water's preparation of its PC27 business plan submission.

3.74 For the mid-term review we will:

- Assess business cases submitted by NI Water for those objectives where approval for continued investment for the remainder of period is dependent on proof of benefit; and,
- Assess NI Water's progress in delivering all the development outputs included in the PC21 final determination. This will include whether any specific milestones set out in the final determination have been met and whether we consider sufficient progress is being made to support the company's PC27 submission. We will ask NI Water to share its internal progress updates to help inform our assessments.

Consumer measures

3.75 Section 3 of our PC21 final determination explained the work that had been undertaken by the CM/SAT Working Group on the development of alternative and more meaningful consumer measures and satisfaction survey. This resulted in a longer list of measures/targets as well as milestones for setting new targets moving forward.

3.76 Proposals for the continued review of existing measures and the development of new measures were explained and expectations around progress to be made by the mid-term review was outlined.

3.77 The final determination noted the potential for:

- Refining and/or setting different targets for the newly implemented PC21 measures;
- Introducing new consumer metrics during the early years of PC21 as well as at mid-term review;
- Introducing new KPIs/targets where time series data allowed, or if not, gathering data in PC21 to allow targets to be set for PC27; and,
- Fully retiring semi-retired targets.

3.78 It also reinforced the role of CM/SAT in monitoring and reviewing consumer service activities and making decisions on the items listed above.

3.79 This working group continues to meet to discuss consumer measures and will consider and advise on any changes that need to be implemented at the mid-term review.

Consumer Protection and Best Practice Framework

- 3.80 Section 3 of our PC21 final determination also explained the work being undertaken by the Utility Regulator on consumer protection and the Best Practice Framework.
- 3.81 The best practice framework will set out a range of mandatory consumer protection interventions for all network companies and suppliers to comply with, across electricity, gas, and water. In 2022 we consulted on proposals around principles and measures around a new mandatory Code of Practice which would replace and update the existing licence/code requirements which are no longer fit for purpose.
- 3.82 We are currently developing final proposals for the Code and anticipate consulting on licence modifications in the latter half of 2023. This will mean that the implementation work for Best Practice will be focused in the second half of the PC21 period after the completion of the mid-term review.
- 3.83 We are therefore not anticipating setting new targets at the mid-term review relating to vulnerable consumers and the delivery of enhanced customer service to those on the Customer Care Register.

Serviceability

- 3.84 Our primary mechanism for assessing the sufficiency of the company's base maintenance allocation, and whether it is maintaining its assets effectively, is our serviceability assessment. This uses trends for a range of primary and secondary performance indicators.
- 3.85 Annex F of our PC21 final determination explained the assessment process, the outcome of our assessment and the performance bands chosen for monitoring performance during the price control period.
- 3.86 We assess actual performance against the serviceability performance bands each year for our annual cost and performance report. This assessment considers whether the performance for individual indicators is stable, improving, deteriorating or marginal across four different service areas and allows us to conclude whether serviceability is being maintained overall.
- 3.87 We plan to update our serviceability assessment for the mid-term review using the updated information and longer data trends received in the 2022-23 annual information return. This assessment will allow us to consider and comment on whether:

- Performance to date supports the capital maintenance allowance included in the PC21 final determination, or provides any indication that this needs to be adjusted; and,
- The reference levels and control limits set in the final PC21 final determination remain valid or need to be adjusted.

3.88 In the initial bilateral stakeholder meetings it was noted that normal quality compliance sampling practices had been impacted by COVID. We will therefore consider the extent to which this impacts our ability to update our serviceability assessments at the mid-term review and adjust our approach accordingly.

Delivery of Social and Environmental Priorities

3.89 As noted previously in Section 1.1 of the approach, our price control determination establishes the funding required by NI Water to meet the priorities contained within the department's Social and Environmental Guidance (S&EG). A number of these priorities are not directly covered by the outputs listed in tables 3.1 and 3.2 of our determination.

3.90 During PC15, the department expressed a desire for an overview of progress against the S&EG priorities. As a result, reporting of progress on delivery of the S&EG priorities was incorporated into NI Water's annual information return.

3.91 This will allow an interim assessment of the progress being reported by the company to be included in the PC21 mid-term review if DfI considers this appropriate.

Tariff adjustment

3.92 The mid-term review proposals and timetable allow for a review of tariffs if this is deemed necessary. This is to avoid material changes in revenue accumulating over a 6 year price control and causing a stepped change in prices at the start of the next price control.

3.93 The intention is that the mid-term review should provide a single opportunity to re-open the financial determination to take account of:

- Any relevant items bids already determined as part of the regular monitoring of the company to the extent that they impact on regulatory funding;

- Any material change to capital funding determined through the change control protocol including any material increase or decrease in capital maintenance investment;
- Any material change in customer numbers and demand; and,
- Any material change in costs which cannot be defined with any certainty in the business plan. For example, the cash tax position of the company.

3.94 It was however not intended to reopen the following elements of the financial determination and we intend to follow this principle.

- Return on Capital.
- Operational Cost Efficiency.
- Capital Cost Efficiency.

3.95 Feedback from our initial stakeholder meeting indicates that NI Water is likely to seek a review of K-Factors as a consequence of financial pressures currently being faced, such as the significant increase in power costs.

3.96 If this the case, NI Water will need to:

- Inform us of the scope of any proposed changes before the start of June 2023; and,
- Complete its submission by 15 September 2023, so that the UR can complete its determination of K factors by 15 December 2023 in order for them to be incorporated into the 2024-25 scheme of charges.

3.97 In the event of a review being requested, we will work with the company to revise the existing financial model so that it can accommodate remodelling of K-Factors using the updated Opex and Capex figures generated by the mid-term review. Consideration of movements in volumes and connections will also be considered as part of this process.

3.98 It should be noted that a redetermination of K-Factors would require Utility Regulator Board approval and will be appealable to the CMA.

4. Mid-term Review Timeline

4.1 The proposed timetable for the mid-term review is detailed below. It has been developed in recognition of the need to inform the tariff setting process for 2024-25. It incorporates the dates of agreed regulatory submissions and the mid-term review milestones stated in the PC21 final determination.

Phase 1: Initial consultation and approach development	Date
Commence planning for the mid-term review	Jan 2023
Principal stakeholder engagement on approach	Feb 2023
UR publishes consultation version of draft approach document	27 Mar 2023
Consultation on draft approach closes	26 April 2023
UR publishes final approach document	w/c 1 May 2023
Phase 2: Information return and assessment	Date
NI Water submits calendar year compliance data	May 2023
NI Water submits its final scope/certainty submission	End June 2023
NI Water submits AIR23 data	14 July 2023
NI Water provides its consolidated mid-term review submission	15 Sept 2023
UR assesses and engages on NI Water submissions	May-Nov 2023
Phase 3: Completion - publication of mid-term review report and Tariff Approval	Date
UR publishes consultation version of draft report	18 Dec 2023
Consultation on draft report closes	19 Jan 2024
UR publishes final report taking account of feedback	w/c 19 Feb 2024
NI Water submits final tariff submission for 2024-25	End Jan 2024
UR review and approval of Scheme of Charges for 2024-25	Mid Feb 2024

Table 4.1: Mid-term review timeline.

5. Next Steps

Consultation process

- 5.1 This PC21 Mid-term Review Approach paper is published as an open document for consultation. We have not posed any specific questions and instead invite consumers and stakeholders to express views on any particular aspect of the proposed approach that they wish to.
- 5.2 Written responses should be received no later than noon on 26 April 2023 and should be addressed to:
- Paul Stewart
Price Control Manager (NI Water Lead)
Utility Regulator
Queen's House
14 Queen Street
BELFAST
BT1 6ER
- Tel: 028 9031 1575
- Email: Paul.Stewart@uregni.gov.uk and
[UREGNI Water Responses@uregni.gov.uk](mailto:UREGNI_Water_Responses@uregni.gov.uk)
- 5.3 Our preference is for responses to be submitted by e-mail.
- 5.4 We will publish submissions received in response to the consultation and to provide a public summary of the responses received. If respondents do not wish their response or name made public, this should be stated clearly by marking the response as confidential. Any confidentiality disclaimer that is automatically produced by an organisation's IT system or is included as a general statement in its fax or coversheet will be taken to apply only to information in the response for which confidentiality has been specifically requested. Individual respondents may ask for their responses not to be published in whole or in part, or that their identity should be withheld from public disclosure. Where either of these is the case, we will ask respondents to also supply us with the redacted version of the response that can be published.
- 5.5 As a public body and non-ministerial Government department, we are bound by the Freedom of Information Act (FOIA) which came into full force and effect on 1 January 2005. According to the remit of FOIA, it is possible that certain recorded information contained in responses can be put into the public domain. Hence, it is now possible that all responses made will be discoverable under FOIA – even if respondents ask the Utility Regulator to

treat responses as confidential. It is therefore important that respondents note these developments and in particular, when marking responses as confidential or asking the Utility Regulator to treat responses as confidential, should specify why they consider the information in question to be confidential.

- 5.6 In view of this, it would be helpful if respondents could explain to us why they regard the information they have provided as confidential in relation to the Freedom of Information Act. If we receive a request for disclosure of the information we will take full account of the explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances.

Approach document consultation timeline

Phase 1: Initial consultation and approach development	Date
UR publishes consultation version of draft approach document	27 Mar 2023
Consultation on draft approach closes	26 April 2023
UR publishes final approach document following internal sign-off	w/c 1 May 2023

Table 5.1: Mid-term review Initial consultation and approach development