



Northern Ireland  
Assembly

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**COMMITTEE FOR  
REGIONAL DEVELOPMENT**

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**OFFICIAL REPORT  
(Hansard)**

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**Briefing by the Utility Regulator  
on Water and Sewerage  
Governance Issues**

16 February 2011

**NORTHERN IRELAND ASSEMBLY**

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REGIONAL DEVELOPMENT**

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**Briefing by the Utility Regulator on Water  
and Sewerage Governance Issues**

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**Members present for all or part of the proceedings:**

Mr Fred Cobain (Chairperson)  
Miss Michelle McIlveen (Deputy Chairperson)  
Mr Billy Armstrong  
Mr Cathal Boylan  
Ms Anna Lo  
Mr Fra McCann  
Mr Ian McCrea  
Mr Conall McDevitt

**Witnesses:**

Mr Shane Lynch            ) Utility Regulator  
Ms Jo Aston                )

**The Chairperson (Mr Cobain):**

Good morning, Shane.

**Mr Shane Lynch (Utility Regulator):**

Good morning. This is my colleague, Jo Aston, director of water at the Utility Regulator. My name is Shane Lynch; I am the new chief executive, and I have been in position since 4 January. I showed up in good time to deal with the events in Northern Ireland Water experienced earlier that month.

Thank you for inviting us to address the Committee today. We would like to talk about two related issues; one is the memorandum of understanding (MOU) between the Utility Regulator and the Department for Regional Development, and the second is the proposed Bill, which members have before them.

We only had sight of the draft Bill at the end of last week and would have preferred to have made a written submission in advance of the meeting, but, given the time frame, that was not possible. What should have been sent to members, and what you hopefully now have, is the presentation that I intend to talk to. What is in the presentation and what I will talk about is our preliminary analysis of the draft Bill, particularly the preliminary legal analysis of it. We have not yet had enough time to get into detail on it.

First, I will talk about the MOU, and its purpose, that we signed with the Department almost three months ago. Secondly, I will set out our high-level views on the proposed legislation. In our opinion, the proposed legislation is unnecessary. Also, we also do not believe that there is an emergency and we do not believe that there is need for accelerated passage. Finally, I will point out that some clauses in the draft Bill go well beyond the stated aim as set out in the explanatory and financial memorandum. I will wrap up by reiterating our views on the value of economic regulation, even in the context of public expenditure, and why we think it still adds value for water consumers.

One key point that I will make up front is that we feel that there has not been a lot of consultation with us; and that, more importantly, there has not been any consultation with consumers. We think that that is vitally important, particularly for paying consumers — and business consumers are paying consumers. We have had some correspondence and dialogue with officials on the policy objectives of the draft Bill. However, as yet, we have had no discussion on the draft Bill itself. The devil is in the detail of the draft Bill. Also, there has been no discussion at ministerial level on the draft Bill with me, my predecessor or my chairman.

I will now talk about the purpose of the MOU that we signed with the Department almost three months ago. We signed it in good faith after quite a bit of discussion and dialogue. That discussion and dialogue recognised that we were in a different place to that envisaged when the primary legislation was enacted in 2006. In other words, we were in a hybrid world in which 70% to 75% of the revenues of Northern Ireland Water coming from public expenditure and the

rest from paying business consumers. At that time, we were also doing what is known as PC10, which was the first price control that we, as Utility Regulator, were putting in place for the company. We all quickly recognised that we did not have a 100% Go-co and that we had to clearly recognise the fact 70% to 75% of the money was coming from public expenditure. We needed to do something about it.

I would not describe it as a conflict or a contradiction, but as a reality. It is something that is not unique to Northern Ireland Water. There are other examples in the UK and elsewhere of companies that are public-sector funded but also have economic regulation. So, these two things can work hand-in-hand and in harmony. I take the view that they are not in conflict and do not need to be in conflict.

The key thing is — and this is interesting — the MOU has formal legal status under article 11 of the Water and Sewerage Services Order (Northern Ireland) 2006. It was laid before Parliament on 8 December 2010. The MOU and the associated consequent written agreement are given effect through modifications to Northern Ireland Water's licence. The licence is a legally-binding document. It derives from primary legislation. We are currently in process of drafting and discussing those licence modifications with Northern Ireland Water.

I also make the point that the MOU does what the explanatory and financial memorandum sets out as the aim of the draft Bill. Therefore having the MOU, and the licence modifications deriving from it, plus having the Bill enacted, and the licence modifications that will derive from that, in our view, could make the governance arrangements even more complicated, rather making them less so, which is what we are all striving to do.

The key thing about the arrangements that we now have in place is that they recognise the differences between the public expenditure world and the PC10 world. For example, in a constrained economy, the money that Northern Ireland Water has under public expenditure for the three years of the price control period is less than we allowed under the price control. Therefore what has to happen in those circumstances is that we cannot expect Northern Ireland Water to deliver the same output as envisaged under PC10, because it has less money.

We have to adjust the deliverables in an expert and professional way. For instance, Northern Ireland Water was expected to deliver X, Y and Z. We would now discuss the matter with the

company and perhaps decide that it would deliver X and Y and maybe forget about Z. That would be a discussion about priorities, given that we are in a constrained environment. We can also have a discussion about the fact that public expenditure works largely on a one-year basis, whereas price control is over three years. Again, it is relatively easy to have that discussion and make the necessary adjustments. In doing all this, we ensure that we continue to have transparency and accountability and that we are delivering value for money, given the money that we have. That becomes even more important when there is less money to go round.

We cannot see why the proposed legislation is necessary. There are two or three reasons for that. First, the MOU already ensures the predominance of public expenditure. Northern Ireland Water is already accountable, as an NDPB, for public expenditure purposes.

Of more concern is our view that the proposed legislation goes beyond the stated aim. The Department and the Minister will have powers to direct the Utility Regulator when, and more importantly perhaps, when not, to carry out investigations. In our view, the memorandum does not accurately reflect that; it describes only powers to direct us to carry out investigations. When one reads the draft Bill in its completeness, there is a lot more to suggest that, in effect, we could be directed not to carry out an investigation. That is a concern for us, because we can only do our job by enforcing the licence conditions. If something goes wrong, we need to be able to carry out investigations to examine what has gone wrong and what enforcement orders would be appropriate. If we cannot carry out the investigation, we cannot do our job.

The Committee has already heard the proposal to replace the Competition Commission, which determines disputes between the regulator and Northern Ireland Water if they arise. The key point that has not been made already is that whatever replaces the Competition Commission — and the proposal is that it should be the DRD — should be capable of doing the job, have the expertise to do it, be sufficiently independent and be free of conflicts. In our view, and with respect, the DRD does not tick any of those boxes.

Clause 2 is giving the Minister an open-ended power to veto a licence modification. Most importantly, most of the powers proposed in the draft Bill are not set in the context in which we or the Department normally operate, which is the purpose or objective under which our powers must be exercised. Our purpose is to protect consumers and ensure that Northern Ireland Water delivers for them. That context is not present in the draft Bill, which means that powers are open-

ended and could be used, for example, for short-term political reasons, which, we argue, is not in the long-term interests of consumers.

In our view, the regulatory model is well-proven in any utility, irrespective of ownership and how a company is funded, and whether it is in state or private ownership. That is a key consideration. The model works because it is independent and expert, and it provides a sufficient challenge on expenditure and performance. Even in the scenario that we are dealing with in Northern Ireland, with a hybrid in public expenditure, economic regulation continues to add value. However, it must be allowed to operate independently.

To conclude, our preliminary view is that the proposed legislation is not necessary. We cannot see the need for accelerated passage, and the reason is that the MOU and the other instruments in place have already recognised and taken care of the situation in which we find ourselves. Water consumers, particularly paying business consumers, deserve proper consultation. The proposed powers go well beyond the stated aim of the draft Bill and, in our view, are to the detriment of consumers. Economic regulation adds value, irrespective of where the money comes from or who owns the business. That concludes my presentation. I am happy to take questions.

**The Chairperson:**

I have two quick questions. What you are telling us is the complete opposite of what the Department has told us on some of this. Therefore, we need some clarification. You are saying that you believe that the MOU and the governance letter, which are already signed, cover most of what we are talking about.

**Mr Lynch:**

Yes. They cover the issues between the regulator and the company. The Bill addresses other issues that are between the Department and the company, particularly on financial control. However, we believe that that issue is also covered, because an accounting officer has been appointed who reports to the senior accounting officer in the DRD.

**The Chairperson:**

My other question is about clause 2 and the modifications that can be vetoed on a licence.

**Mr Lynch:**

The potential is there, but that is not to say that that would happen. However, the power will be there to veto a licence modification or an investigation.

**The Chairperson:**

So, the regulator could propose variations to the licence which the Department could override.

**Mr Lynch:**

Yes.

**Mr Boylan:**

Thank you for your presentation. This is the fourth year that I have been on this Committee. From day one, there has been a series of complaints around how this model has run, be it about billing or anything else. However, I want to talk about what you have said today. You said that there is no need for the draft Bill. Do you believe that the model is working all right as it is? Clearly, there are problems with the model that was set up originally, and those need to be addressed. You say that there are checks and balances, but the things that have happened in the NIW over the past four years should not have happened.

You talked about the level of expenditure. In the past three years, £1 billion or more have been spent. That is a serious investment. We are looking at legislation that is eight clauses long and have an opportunity to amend it. You mentioned clauses 2, 3 and 4: are you saying that there is no way in which those clauses could be amended that you would be content with?

You began your presentation by talking about the purpose of the memorandum of understanding and went on to say that the proposed legislation is not necessary. You laid your cards on the table at the outset, which is fair enough. I have a few other questions, because I want to tease this out, but perhaps you could answer my questions about the clauses.

**The Chairperson:**

Shane, before you answer; we have to be careful that we do not become inquorate. Therefore, members should get in as many questions as possible.

**Mr Lynch:**

I will say a few general things and then pass over to my colleague Jo to pick up on the detail if that becomes necessary. Over the past few years, a number of incidents in Northern Ireland Water have grabbed the headlines: the recent freeze/thaw; procurement issues; and the billing issue a couple of years ago. On the positive side, the performance of Northern Ireland Water has improved significantly over the past two or three years, and we picked up on that in our recent cost and performance report. Having said that, it still has a long way to go, and we recognise that there is a 40% efficiency gap between it and the best in its peer group. There have been issues, and they have been addressed.

The question is this: does the draft Bill fix the things in the model that are broken? In our view, it does not. Let us take billing as an example. The billing issue required an investigation by the Utility Regulator, which was carried out. Corrective actions are now in place and, thankfully, everything has worked OK with billing since then.

We are currently investigating the freeze/thaw incident. I would also say that —

**Mr Boylan:**

I will stop you at that point. I am sorry; I know that you are answering my questions. However, what you are saying, in effect, is that — and you are clearly saying it — the draft Bill does not fix the problems and we should continue with what is there. That is fine, and you can respond to the clauses and say whether we need to amend them. You are saying that the draft Bill will not work, so you want a continuance. When I asked about checks and balances in the system, the former chief executive said that there was a contingency plan to deal with the issue over the Christmas period; but, in effect, there was not, and that was clear to see. I am asking you to make those things your starting point. I have seen the problems, because I have been dealing with this issue for four years.

**Mr Lynch:**

I have almost 30 years' experience working in the utility sector, and I have seen utility companies up their game in the framework of economic regulation over time, and I have seen that happen in Northern Ireland. Fifteen years ago, Northern Ireland Electricity experienced similar problems and behaviours as those that Northern Ireland Water has experienced in recent times. With good economic regulation and a few other things, it has upped its game, and I am glad to say that it is



one of the top performing utilities in the world.

**Mr Boylan:**

A billion pounds has been spent, Shane. I would not be happy if I asked a private contractor to come in and do a job for me and he behaved in that way. That is all that I am saying to you. We, in the Committee and as public representatives, are talking about a billion pounds. You are saying that it has upped its game, and that is fine. However, all that I am saying to you is —

**Mr Lynch:**

I said —

**Mr Boylan:**

That is fine. It is 100%. I respect that.

**Ms Jo Aston (Utility Regulator):**

I wish to speak about the history of events at Northern Ireland Water, with which we are all very familiar. Those events have been very negative and have undermined the confidence of consumers. What caused those failures? Was it the model, which is what we are talking about here today, or was it something else? Let us consider the issues. The first one was about billing and the apportionment issue. That was all about data, which Northern Ireland Water inherited from the Water Service. That is not unusual: all water companies that have come from local authorities into the regulatory regime were required to start getting the data that they needed to make the decisions that they had to make about investment in the longer term rather than annually. So, there was a data issue.

Then there was the procurement issue. If we look at the analysis of that, we will see that not an insignificant percentage of those procurement issues arose during the time of the Water Service. So, I think that you have to look at the reasons for those issues.

We are now looking at the current freeze/thaw issue. We are in the middle of an investigation, which I cannot talk about for that reason, and I, therefore, ask that members pause for a moment until the findings of that investigation come out. In saying that, what the Committee has here, and what the structure has delivered, is a Utility Regulator that has enforced changes on the company on those data issues that caused previous problems, and the company has offered us

undertakings. We are still doggedly following those undertakings and are having regular meetings with the company. Data issues are not turned around overnight, and we have spoken to the Committee about that. We need to be very clear about the causes of those problems.

**Mr Boylan:**

Jo, can I stop you there?

**The Chairperson:**

I have to say that we are wandering off the subject.

**Mr Boylan:**

I totally agree, but I want to say this, Chairperson, and you know this for a fact. On this business of the billing issue, we talked about a business plan. I want to refer this to public and private sector. That should have been all dealt with. The issue of a lack of data has been beaten to death in this Committee. That should have been foreseen. It is all right saying that a business plan was brought forward to support it, but six months later the company finds out that it has not the data and that is the excuse. An investigation is ongoing: fine. However, when the former chief executive stood up and said that the company had a contingency plan to deal with that, it did not.

To be fair to the company, there have been major changes in infrastructure. You know that, Shane. You have been in the business. There have been changes in sewerage and waste water treatment. That is fantastic and those percentages are fine. However, I asked the question earlier about the water mains issue. Had it been addressed next, we might not have had half the problems that we had at Christmas. However, that is another matter.

I want to deal with the Bill. Jo has not answered how we would better those clauses. That is my first question about the proposed legislation.

**Ms Aston:**

Which specific clauses?

**Mr Boylan:**

You said:

“Clause 2 is giving the Minister an open-ended power to veto a licence modification.”

Is there an opportunity to amend this legislation at Consideration Stage?

**The Chairperson:**

There is no Consideration Stage.

**Mr I McCrea:**

There is no Consideration Stage with accelerated passage.

**Mr Boylan:**

But if it goes past the Committee Stage, is there not an opportunity to amend the Bill?

**The Chairperson:**

There is no Committee Stage.

**Mr Boylan:**

No, I know that there is no Committee Stage —

**The Chairperson:**

There is nothing. There is no chance to amend the Bill. Take it as it is.

**Ms Aston:**

With licence changes, what we are required to do and what we are currently doing reflects the MOU. In the MOU, we have agreed that we will make licence changes to reflect that agreement. We have also agreed in the MOU that we will talk to the Department about those licence changes to make sure that it agrees that they reflect the essence of the agreement. We have drafted those licence changes. They are now with the Department and the company. We are statutorily required to consult for 28 days on those amendments to the licence, which we will do. We are lined up to do that and will do it in the month of March. There is a process there, and there is engagement with the Department in making those licence changes.

**Mr McDevitt:**

On the issue of direction, it is framed in the legislation as a positive that the Department will take on the power to direct. However, with that power comes the negative: it is the power to direct you not to do something. It is an all-encompassing clause. What are the risks, to yourselves and to the regulated framework or regime, of that power making it onto the statute book?

**Mr Lynch:**

A regulator does his job through the licence. That is the contract that a regulator has with the company. It is a sacrosanct rule everywhere else that licence modifications are made by the regulator. In the event of a dispute, which can happen, the regulator is not always right. The dispute should go to an independent body capable of resolving it.

However, if there is a situation where the independent body is the shareholder and policymaker, and where that body can simply issue directions for licence modifications that are not even in the context of what we are trying to do for the company, that is a blank cheque and, in our view, it is not in consumers' interest. As stated in primary legislation, the primary objective is to protect consumers.

**Ms Aston:**

Can I give an example? We know from the hearing at the Public Accounts Committee that the Department is not in favour of our overall performance assessment of the company. That might be one that we are instructed not to use. That is a monitoring process that I have good faith in and which is a reflection of the level of investment that the company gets. It is a challenge, a push to make the company perform against itself. That is an example of where I would be concerned.

**Mr McDevitt:**

I have just one more question. Your briefing paper refers to what you describe as the evolving EU legislative framework for economic regulators. The briefing also references the 3rd EU energy package explicitly prohibiting regulatory authorities from seeking or taking direct instructions from government. Will you elaborate on that? Where is it? What is it? Do you believe that if we were to take on this power at a regional level, there would be a genuine risk that we would find ourselves in contravention of that?

**Mr Lynch:**

We look to the EU for policy direction on regulation. Probably, of all utilities, energy is the most advanced, or, certainly, well advanced. The current directive from Europe states that regulators must be totally independent to the extent that they cannot take or seek directions from a Minister. The underlying rationale for that is to prevent short-term political interference. Conventional wisdom in Europe at policy level is that that is detrimental to consumers, investors and all stakeholders in the long run. We do not have that in water, but energy tends to be the trendsetter

for policy.

**Mr McDevitt:**

Just one last question. In the regulator's opinion, is the proposed Bill in the consumer interest?

**Mr Lynch:**

In our preliminary analysis, the answer is a definite no. Our biggest concern is to have consultation. Consumers should be allowed to have their say, because we think that the Bill would have quite a material effect on them.

**Ms Lo:**

Many questions have been asked, but I am particularly concerned about the point that, with the Bill, the Minister for Regional Development will be able to replace the Competition Commissioner in determining disputes between NIW and the regulator. As the Department is also the policymaker, funder and the sole shareholder, there would be a conflict of interest in adjudicating disputes about billing, prices or whatever. Conall raised this question earlier; in your view, would the Department be subject to a legal challenge on this?

**Mr Lynch:**

That is a very interesting question. Our preliminary legal opinion is that there is a serious risk that it could be viewed as unlawful, simply because of the conflict of interest.

**Ms Lo:**

Would that also be because of having the sole shareholder and funder within one board?

**Ms Aston:**

The Minister's concern is that there might not be enough public expenditure to meet our determination. We totally accept that. The Minister cannot control that, particularly because of financial constraints at the moment, but we have the process there to deal with it. One of my greater concerns is that we set the efficiency challenges, which involves going through quite detailed econometric analysis and benchmarking. Our decisions on that being referred to the Department leaves one very concerned.

**Mr Boylan:**

Is there concern about the dilution of your role if the proposed Bill is passed, compared with what the model is now?

**Mr Lynch:**

Yes. We like to add value. I have been in the business a long time, and I do not like to do a job if I do not think that I am adding value. We add value largely because we are experts in the field and we are independent. That is what we bring to the table. Our ability to be independent and to bring to bear our expertise and our opinion would be diminished if the Bill is enacted.

**Mr Boylan:**

Finally, Shane, you mentioned the power in clause 2 to veto a licence. You went on to say that that might not be enacted.

**Mr Lynch:**

It is an option. The proposal is for the provision to be enacted. So, in legislation, the Department and the Minister will have the right to veto any licence modifications that we propose. They may or may not do that, but the bottom line is that they have that option. That changes things. More importantly, the context in which they can exercise that option is unbounded, so the veto could be for any reason.

**Mr Boylan:**

A lot of legislation passed by the Assembly contains clauses that may never be enacted. I was just clarifying that point.

**Miss McIlveen:**

Essentially, the Minister is being offered a blank cheque. You do not have to agree with me, but that is what appears to be happening. I do not have any concept of the rush and why it is necessary, other than the fact that we are five weeks away from the end of this mandate. Again, you do not have to comment, but it looks like it is being proposed for political reasons.

**Mr Lynch:**

I am quite hopeful that Northern Ireland Water will get its act together over time. The company is on a journey and will be helped by economic regulation. I caution against taking rushed

decisions. We will report on the freeze/thaw incident at the end of the month. It is much better to have an informed debate on the best place to go with the company in the cold light of day and with time on our hands. I strongly recommend not rushing into anything.

**The Chairperson:**

Thank you.