

# **The Utility Regulator**

## **Development of our 5 year Corporate Strategy**

### **Consultation on Key Issues**

**27<sup>th</sup> June 2008**

[This consultation closes for responses on 19<sup>th</sup> September 2008]

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# Chapter 1 Introduction

## Background

During 2008/9, the Utility Regulator is seeking to produce our first ever 5 year Corporate Strategy. The development of this Corporate Strategy will mark something of a watershed for the Utility Regulator. For the first time in our evolution we've set out to formally plan, consult on, agree and then undertake a set of strategically considered themes and priorities for the next five years.

The drafting of this Corporate Strategy consultation will involve effort not only in assessing our priorities for approaching the present energy and water regulatory challenges, but also in examining our opportunities and strategic priorities in a rapidly moving regulatory environment. Many issues are combining to set a strongly dynamic and multifaceted background for our 5 year planning horizon. To note just a few: the introduction of domestic water charging within a new regulated water and sewerage industry; high and volatile wholesale energy prices; achieving optimal benefits from the current drive towards all-island co-operation on key energy issues; the search for an environment more conducive to competition in energy retail markets; the "internationalisation" of regulation (e.g. in terms of EU<sup>1</sup> legislation, cross-border trading and international environmental commitments); and the increasing importance of social and environmental issues in both the water and energy arenas.

Developing our Corporate Strategy is an important exercise for us for a number of reasons.

Our office has been going through significant change and restructuring in recent times. From April 2007, we have become a multi-Utility Regulator: we are now economic and customer service regulator for the water and sewerage industry in Northern Ireland. This was added to our longer standing duties as economic regulator of the electricity and natural gas sectors in Northern Ireland. The scope of our work brings with it many challenges, for example bedding down the water regulation processes with other key stakeholders including DRD<sup>2</sup>, EHS<sup>3</sup>, NIW<sup>4</sup>. It also brings opportunities – for example to learn from best practice and incorporate these ideas across all our industry functions. We see the development of the Corporate Strategy as a way of thinking through and consulting with our stakeholders on these challenges and opportunities in a transparent and constructive way.

In addition to taking on water regulation, our office has been going through significant *internal* change and reorganisation. This has included the recruitment of a new team of Directors, and also an expansion in our staff resources to be able to properly fulfil our duties and responsibilities. In this light, the development of the Corporate Strategy is an important vehicle for identifying key work context and planning issues, and allowing us to consult with our industry, governmental and consumer stakeholders to better understand the issues that we are

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<sup>1</sup> European Union.

<sup>2</sup> Department for Regional Development.

<sup>3</sup> Environment and Heritage Service.

<sup>4</sup> Northern Ireland Water.

facing and to map out a strategic direction of travel that will meet our challenges in an optimal way.

We recognise that thinking strategically in conjunction with our wide spectrum of stakeholders is a necessary requirement for achieving our duties and protecting customers of the regulated companies. We hope that the development of our corporate Strategy will facilitate this thinking process and better overcome the intricate set of energy and water regulation issues facing us today. As well as our internal team of skilled, experienced and motivated staff, we will welcome alliances externally with government departments, organisations and other stakeholders, as we believe wholeheartedly in delivering our priorities through collaboration and co-operation.

The protection of utility customers in NI<sup>5</sup> is our key focus, but our work is not simple and the problems can be difficult to overcome. Our day to day work on regulation and customer protection incorporates legal, financial, economic and technical aspects; it also has a rich contextual environment which includes our statutory duties and governing legislation, relationships with industry and other regulators, local and national government, EU policy frameworks, etc.

Aspects to consider from a Utility Regulator perspective....



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<sup>5</sup> Northern Ireland.

This complexity drives us to keep working hard to offer an independent centre of expertise, focused on protecting present and future consumers' interests, and to ensure openness and transparency of our decision-making processes. Importantly also, in the context of the return of devolution, as a non-Ministerial Government Department we will seek to provide a professional, informed and objective resource to the Assembly and Committees on energy and water regulation and charging issues, and related issues such as sustainability.

## Purpose of this document

The purpose of this document is to engage early, directly and transparently with our stakeholders to consult on, and hopefully stimulate a constructive debate about, the issues that are relevant to the building up of our 5 year Corporate Strategy. This consultation will thus form a foundation stone to the development of our actual Corporate Strategy document later this year – we are hopeful that our stakeholders will take the opportunity to engage with us on the questions and issues raised in this document.

At various points in the document we have specifically asked consultation questions. We welcome views specifically on these questions, and indeed on any other issues raised by the consultation and on which respondents would like to comment. (Responses please by 19<sup>th</sup> September – see chapter 6 below for further consultation details).

This consultation represents the first step in the development of our Corporate Strategy. Our intended timeline to delivery of the Corporate Strategy is:

- July – Sep:** Consultation on the key issues raised in this document. Further ongoing internal work and discussions as necessary with interested parties.
- Oct – Dec:** Reflection on comments raised during the consultation and further discussions or consultation with key stakeholders as necessary.
- Jan - Mar 09:** Final drafting and publication of Corporate Strategy document.

The remaining chapters of this document are:

- Chapter 2:** Background to the Utility Regulator and our work in the regulated sectors.
- Chapter 3:** The regulatory environment and factors that will influence our strategic direction.
- Chapter 4:** Our first thoughts on likely strategic themes and priorities.
- Chapter 5:** How we would intend to deliver on our strategic priorities.
- Chapter 6:** Specific Questions and consultation details.

# Chapter 2 Background to the Utility Regulator and our work in each of the three regulated sectors

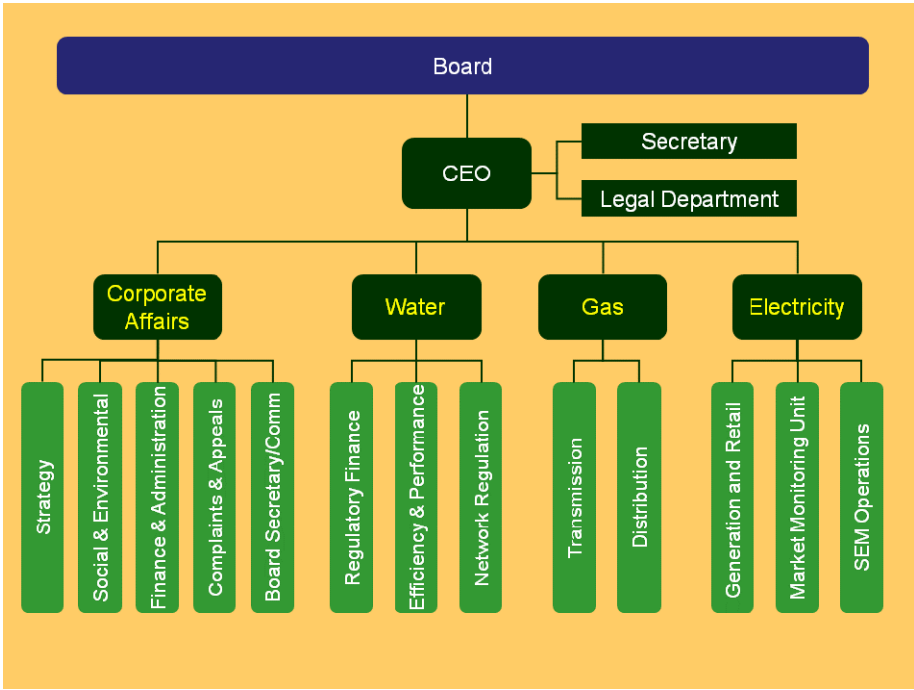
## 2.1 Who we are

What is now the NIAUR (Northern Ireland Authority for Utility Regulation) – called the Utility Regulator on a day to day basis – was first established in 1992, following privatisation of the Northern Ireland electricity industry. With the development of the natural gas industry in Northern Ireland, the Utility Regulator’s role was extended in 1996 to cover gas. From April 2007 we also became the economic and customer service regulator for Northern Ireland’s water and sewerage industries. **At the heart of our duties and functions is the protection of the interests of water, sewage, gas and electricity consumers in Northern Ireland.**

The Utility Regulator is a non-Ministerial Government Department. It is not a policy-making Department but its role is to ensure that the utility industries in Northern Ireland are regulated and developed within the strategic policy parameters set out by Ministers and in the relevant legislation.

Within the office, we currently have approximately 65 staff.

The Utility Regulator’s internal structure



The Utility Regulator exercises its broad range of functions in line with statutory duties set out mainly in the Energy (Northern Ireland) Order 2003 and the Water and Sewerage Services (Northern Ireland) Order 2006. The relevant parts of these are included at Annex 1 of this document for ease of reference.

Briefly, the Utility Regulator has a number of principal statutory objectives:

As regards the water and sewerage sector:

- a. to protect the interests of consumers in relation to the supply of water by water undertakers and the provision of sewerage services by sewerage undertakers, wherever appropriate by facilitating effective competition between persons engaged in, or in commercial activities connected with, the supply of water and the provision of sewerage services;
- b. to secure that the functions of a water undertaker and of a sewerage undertaker are properly carried out as respects every area of Northern Ireland; and
- c. to secure that companies holding appointments as relevant undertakers are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of the functions of such undertakers.

As regards the electricity industry:

to protect the interests of consumers of electricity supplied by authorised suppliers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission or supply of electricity.

As regards the gas industry:

to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland.

Our work is delivered in a fast moving and at times complex environment. Therefore robust analysis, transparency, good communication and co-operation with stakeholders are vital. We need to maintain close contact and positive collaboration with a number of companies acting in the energy and water sectors. Equally we need such collaborations with governmental organisations involved in the energy and water industry in Northern Ireland. This will include those organizations involved in the management of the environment and in the development of Northern Ireland's social and customer-facing policy and structures.

## 2.2 Our interaction with the regulated utilities

Our work involves the regulation of several key utility sectors in Northern Ireland – water and sewerage, natural gas and electricity, and is based on our statutory duties and functions as laid out in the relevant legislation. We are the first example of a multi-utility regulator in the UK<sup>6</sup>.

Our functions and duties are fairly wide-ranging, but at heart they relate to the protection of customer interests through effective regulation of the three regulated sectors. We achieve this by:



- Protecting the interests of Northern Ireland consumers of today and tomorrow by effective and transparent scrutiny and regulation of regulated companies.
- Issuing and maintaining licences for gas, electricity and water companies to operate in Northern Ireland.
- Protecting vulnerable customers of these companies in Northern Ireland.
- Ensuring that these companies comply with the relevant legislation and licence obligations.
- Encouraging regulated companies to be more efficient and responsive to customers.
- Controlling the prices these companies charge to customers in Northern Ireland.
- Working to encourage competition in the gas, electricity and water and sewerage services markets.
- Setting the standards of service which these companies provide to customers in Northern Ireland.
- Acting as an adjudicator on certain customer complaints, disputes and appeals.
- Carrying out our duties with the environment and sustainability in mind.

There are many similarities in the work issues that we deal with in relation to each of the three regulated sectors: e.g. the protection of customer interests from monopoly exploitation; the need to control prices and scrutinise service levels for customers. To some degree that allows us to adopt cross-sectoral thinking and approaches to problems – we see this as a valuable tool stemming from our multi-utility basis, and we return to this in the course of this document.

However there are also many work issues that arise that are specific to an individual regulated sector. This can be the case because simply of the individuality of the sectors with which we interact; but to a significant degree it is also a symptom of the fact that the maturity of the

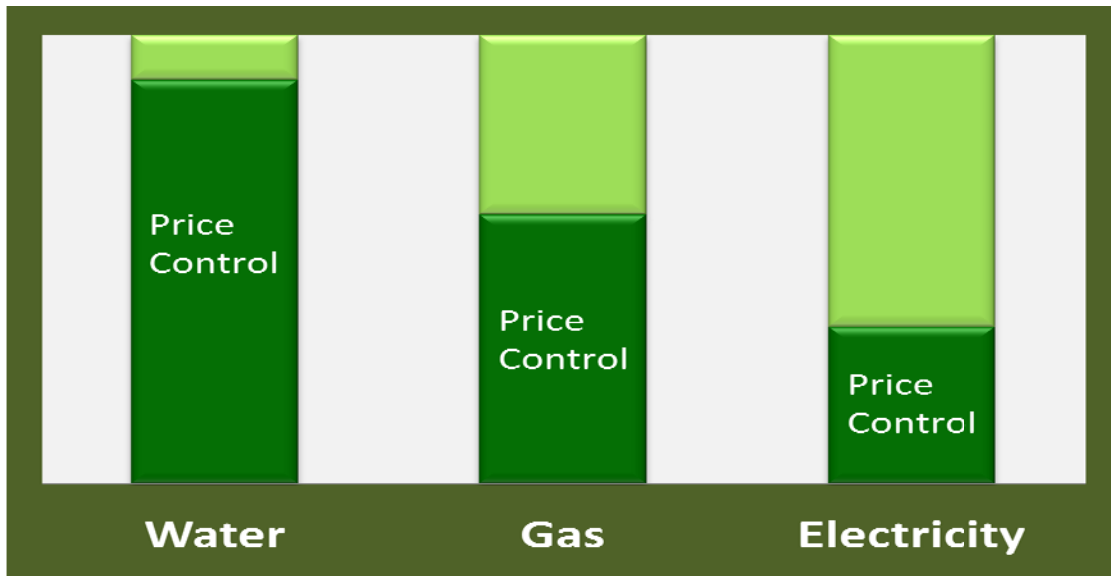
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<sup>6</sup> United Kingdom.



regulatory interface with each of the three sectors in the NI context is different (see diagram below). In electricity, our interaction with the industry is largely characterized by regulation of relatively more mature regulated markets, the development of all-island approaches to issues and problems, developing competition in various markets, and effective price controls where still considered necessary – though the latter makes up a relatively smaller part of our workload. The electricity industry is relatively large, mature and diverse and has a significant (and growing) all-island aspect to it already.

Price control in the three regulated sectors



In gas, the regulated markets and industry structure in NI are relatively immature compared to electricity and gas for example in the GB<sup>7</sup> marketplace. Much of our interaction with industry players remains in terms of price controlling the monopoly networks and establishing the necessary third-party access arrangements, as well as controlling final gas retail prices to consumers. We are at the initial steps of developing all-island thinking (we return to this in the paper below) and also the initial steps of developing fuller real competition in the gas retail markets.

In water and sewerage, the relationship between the NIAUR and the newly established water and sewerage undertaker is a new and evolving one which needs to be bedded down and worked through – particularly the new price control regime. Much of the effort in the early years will very much be focused on establishing the data systems and analyses aimed at delivering the first two year price setting (beginning April 2010), and the subsequent 5 year setting (April 2012-2017). Issues such as developing competition will be for the long term. We return to the current water and sewerage regulatory issues more fully below.

<sup>7</sup> Great Britain.

In all our work with the regulated sectors, we are required to take account of the five principles of best regulatory practice. These principles do now, and in the future will continue to, underpin how we work within the regulated sectors.

### **Proportionality**

Our actions should be appropriate for the perceived problem or risk.

### **Accountability**

We must be able to justify the decisions we make and expect to be open to public scrutiny.

### **Consistency**

Our actions and decisions must be “joined up” and implemented fairly and consistently.

### **Transparency**

Our work and decisions should be open, simple and user friendly. Policy objectives and decisions should be clearly defined and effectively communicated to all our stakeholders.

### **Targeting**

Our Regulatory action will be focused on the problem. We should aim to minimise side-effects and ensure that no unintended consequences will result from our actions.

By way of a fuller introduction to our work and background to the rest of this document, [Annex 2](#) gives a brief overview of the main areas of cross utility interaction within the organisation. We have not intended this to be all encompassing; rather we are seeking to give readers a brief overview of our current main work areas in each of the three regulated sectors. For completeness, we have also included a fourth section relating to our work on environmental and social issues that cut across the regulated sectors and do not fall solely into any one of the three.

# Chapter 3 The regulatory environment and the factors that will influence our strategic direction

## 3.1 Introduction to Chapter 3 – challenges and opportunities

The purpose of this third chapter of the consultation document is to discuss the key context issues/trends that will impact on our aims, strategic priorities and policy direction. By way of background, we begin with a brief discussion of some general challenges and opportunities that influence our work. The chapter then proceeds with a fuller discussion of an initial list of specific key issues/trends which we have identified for discussion in this consultation.

***We are keen to take views on whether there are other important factors that we should take cognisance of going forward.***



### Our challenges

There is an increasing awareness that **Sustainability and environmental challenges** are becoming one of the main threats to future generations and present customers. The effects of climate change will result in significant challenges including: how to price fossil fuels to reflect carbon content, problems in security of supply, increasingly aggressive targets for the share of renewables in electricity generation, the grid and technical implications of significantly enhanced renewable energy production, notably wind power. In terms of water and sewerage, the issue will impact prices through increasing imposition of higher standards of treatment for both water and sewerage whilst attempting to offset carbon emissions. The European Water Framework Directive is just one example of the type of legislation which will affect these services in the future. This will continue in the face of greater restrictions on abstractions and impoundments. We are currently consulting on our first ever “sustainability” strategy (we discuss this more below) and environmental issues will be a key area of discussion in the coming price control work with DRD, DOE<sup>8</sup> and NIW.

There are a number of **social challenges** in Northern Ireland, one of the most relevant being the high level of “fuel poverty” and the fear of the added impact on vulnerable customers with the onset of domestic water and sewerage charging. Latest indications, even prior to recent energy price rises, are that over one third of all households in NI are in fuel poverty. The main reasons for fuel poverty are found in poor thermal efficiency of the dwelling, low household

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<sup>8</sup> Department of Environment.

income and increasing fuel prices driven largely by wholesale fuel input prices determined outside NI. A similar social challenge exists for water. It is important for us to secure sufficient protection for the most vulnerable in our society with regard to the payment of water and sewerage charges and to work in a joined up way with wider Government to seek to protect vulnerable customers from the impact of rising charges.

The **new water regulatory regime** is a key part of our context in the coming period. New relationships (both informal and statutory-based) have to be forged with many key stakeholders – NIW, environmental regulators, DRD, CCNI<sup>9</sup>, Customers, Assembly Committees, Ministers, etc. Also there are many different factors that come into play; key policy goals that need to be worked on and bedded in – NIW organisational change, financing issues, customer charging, customer standards, metering, price control regimes, data systems and reporting, etc. During the five year horizon of this Corporate Strategy, the priorities will be preparation and implementation of the first 2 year Price Control cycle from 2010 and the development and application of the subsequent 5 year Price Control cycle from 2012.

In energy terms, Northern Ireland is at the end of long supply chains. These factors add extra challenges for **security of supply**, in terms of both supply distance and potentially technical barriers. Within our power generation mix, there are also security of supply issues in terms of our reliance on gas for power generation and how to allow in the future for much greater levels of renewable power. In water, security of supply challenges relates mainly to water quality and maintenance standards – key issues in the price control process.

The **small scale of the Northern Ireland market** creates challenges due to low-economies of scale and opportunities to gain value. As a result, theoretically, costs may be higher than otherwise and thus final prices for customers may potentially be higher than in a larger market scenario. The negative consequences of low economies of scale will be felt arguably across all three regulated sectors. One of the key areas which we will wish to explore in terms of future strategic themes and priorities, is the potential for a smallish jurisdiction like NI to help develop regulatory approaches or policy frameworks that tailor solutions specifically to our needs and helps us overcome any negative size consequences. In that vein, comparisons with GB regulatory structures may not be the most valid – we need to research and find optimum solutions and policy frameworks from those areas where common problems have been successfully overcome in ways that are clearly transferable to our own structures.

**Consultation Question 1:- We would welcome views as to whether there are other significant challenges which we ought to have reflected here.**

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<sup>9</sup> Consumer Council for Northern Ireland.

## Our opportunities

We can learn from **regulatory best practices** in the GB, RoI<sup>10</sup> and European context, but to shape the policy specifically for Northern Ireland circumstances and problems. Devolution offers a new opportunity to do this and to tailor solution specifically for our local problems and circumstances.

To learn and **operate on a cross-utility basis** (e.g. sustainability, competition issues, metering policies) driving synergy analysis and applying best-practice thinking where relevant across all the sectors we regulate. We have already put in place a number of internal cross-directorate working groups charged with looking at these sorts of issues on a joined-up basis.

To harness the growing **social pressure** to deal coherently and effectively with sustainability, fuel poverty and water affordability problems. This should make customers and our stakeholders more willing to participate in the resolution of these sorts of issues and offer a more conducive environment to problem solving.

In energy for the main part, the maximization of **all-island opportunities and wider European-market integration opportunities** raises a potentially significant opportunity for enhancing economies of scale, facilitating competition and being able to benchmark regulation in terms of industry efficiency and best practices. At the EU level, much work is underway in both the gas and electricity sectors on inter-member state initiatives. More locally, in 2004 the UK and Republic of Ireland governments set a policy framework for moving to an all-island energy market. A major element of this strategy was the creation of a Single Electricity Market (SEM) in November 2007. Work is now beginning on taking forward several varied work areas aimed at developing all island gas market arrangements.

To better understand the contribution that **technological developments** such as smart metering, “smart” appliances, cutting edge renewable technologies, etc. can make towards our policy goals and then maximize the impact of these developments through innovative thinking and solutions, and through strategic working with stakeholders.

To maximize **the strengths of our organisation**: we regulate some of the most key industries in NI; we have a strong and experienced board and a skilled and nimble workforce, which can be an informed, professional and useful resource for NI policy makers. Given the limited size and number of stakeholders involved, there is an opportunity for NI to move more quickly than some other regions/countries and to position ourselves as a centre for excellence, for example in renewables technologies or in developing energy services companies.

**Consultation Question 2:- We would welcome views as to whether there are other significant opportunities which we ought to have reflected here.**

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<sup>10</sup> Republic of Ireland.

The next chapter (chapter 4) sets out for consultation our initial thoughts on work themes and priorities for delivering our goals and duties over the next 5 years. However, as a precursor to that, it is important to reflect on those factors that will affect and change the environment and context in which we will work in that coming period. This is of course not easy and the future is difficult to predict. However it is an important part of our Strategy development, and the thinking and forward scanning can be updated as we update the Corporate Strategy in coming years. We scan forward in terms of context in the following sections:- 3.2 (for the coming 5 year horizon) and 3.3 (briefly for the longer term horizon scan).

These factors then begin to pinpoint and lead through to those work areas that we might deem to be priorities in the coming strategy planning horizon.

### 3.2 Context factors that will influence our work in the coming 5 year period

There are a number of key “context” factors that will influence our work and strategic direction in the coming period. We have tried to identify those factors that will influence our strategy over the coming 5 year planning horizon. In the following section (3.3) we have also attempted to look further ahead where appropriate to define longer-term issues that are of sufficient importance to our future work to merit discussion now. These contextual factors are then used (in chapter 4) to identify for consultation our first thoughts on priorities and themes for future work areas.

#### *(i) Rising prices to consumers and the need for concerted action*



Across NI society, there is a growing awareness of the negative impacts that higher utility prices are having on already-stretched household budgets. At the same time there is a need to maintain as much downward pressure on business utility costs also for economic development reasons.

Recent years have been characterized by high and volatile wholesale energy prices. NI’s relatively small size and its position at the end of long supply chains, as mentioned in the “challenges” above, exacerbate the potential problem.

A related issue is that of security of supply in terms of wholesale oil and gas availability and price, both as an end-use fuel, and also as a primary fuel source for power generation. Security of fuel supply concerns are particularly topical across Europe as North Sea oil and gas stocks dwindle and reliance on imports from Russia and the Middle-East increases. At the same time, oil prices remain historically high with little expectation of a downturn, as a result of surging worldwide demand, shortages of supply and uncertainty arising from war and terrorism.



In addition, there are several factors which would indicate that longer-term fuel price pressures are unlikely to weaken substantially – these include ongoing demand/supply tensions in the medium term, increasingly high targets for renewable generation, fuller pricing-in of the environmental costs of carbon to fossil fuels. With the upward trend in wholesale energy prices showing no sign of abating in the short term (and which can make up a substantial proportion of the final energy bill to customers); together with the arrival of domestic charging for water and sewerage services, it is not difficult to understand why the issues of fuel poverty and water affordability have come to the fore in public consciousness in recent times.

Our principal objective in electricity is to protect consumers' interests, and in gas it is to promote the development of an efficient, economic and co-ordinated gas industry, with consumer protection being given as a general duty. In water, electricity and gas we are required to have regard to the interests of vulnerable customer groups (including individuals with low incomes). We therefore have a clear basis for action to protect such groups, in balance with our duty to consumers in general; to date this has been evidenced by our track record of supporting action against fuel poverty. As we move forward in terms of developing strategic priorities for the coming 5 years, it will be important to agree with stakeholders how best we might urgently arrange concerted action to deal with these issues as effectively as we may. In both water and energy, the respective Departments have statutory powers to give us guidance as to social or environmental matters to which we should have particular regard. It would be important that the interface between the relevant government departments' policy decisions in these areas and our regulatory regime was transparent and "joined-up". As regards energy, our involvement in the NI Fuel Poverty Taskforce should help in this regard.

Linked to this issue, is the topic of social tariffs and tariff structures that address the needs of low income consumers. Although we feel that the Utility Regulator should not pro-actively lead initiatives on affordability tariffs – this should come from Government, we should be ready to respond constructively to others' initiatives. Northern Ireland has such high levels of fuel poverty that any initiative will need to be tightly targeted, which requires clear decisions about eligibility. Political leadership will therefore be essential. In energy, it would be important that DSD<sup>11</sup> and DETI<sup>12</sup> were in alignment. It will also be important to us as a cross-utility regulator that any such policy initiatives in energy be designed bearing in mind decisions on water affordability tariffs, and vice versa.

## *(ii) "All-island" energy developments*

As described in the previous chapter, in recent years the Utility Regulator has been working with the relevant Government departments in NI and the RoI, together also with the CER, the energy regulator in the RoI, and the industry stakeholders to progress work on all-island energy issues. The work programme in which we have been participating emanates out of the 2004 All-island Programme (AIP) Framework document agreed by the two Governments and has included the successful implementation of the Single Electricity Market in November 2007. Already there are plans that in the coming period, market synchronization and retail harmonisation in both electricity and gas markets North and South will be considered and where beneficial progressed by the Governments and Regulators. Also specifically in the gas

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<sup>11</sup> Department of Social Development.

<sup>12</sup> Department of Enterprise, Trade and Investment.

sector, the current work programme is aimed at developing arrangements whereby all stakeholders can buy, sell, ship, operate, develop and plan the natural gas market north and south on an all-island basis.

In terms of the development of this Corporate Strategy consultation, it is clear that the all-island energy work programme will continue to influence many of our decisions and our planned priorities over the coming work planning horizon. In particular, the future direction of travel of the all-island energy work programme will be heavily influenced by two factors being developed later this year.

The first is the intended review of the 2004 AIP Framework document which is scheduled for autumn of this year. The second is the development of the SEM Committee's workplan, which again is scheduled for autumn of this year.

These are likely to include more detailed consideration and clarity on the work programmes relating to the development of common regulatory and industry arrangements for gas, and also significantly updated thinking on the development of renewables and in particular wind opportunities on the island (we return to consider future work priorities and themes in the following chapter).

Clearly the development of this Corporate Strategy will need to align with and influence, and be influenced by, the development of these two factors later this year. We will be working directly with the two Governments and our fellow energy regulator in the RoI<sup>13</sup> to ensure this is the case. By the time we come to finalise our Corporate strategy document later this year, these factors will have been clarified and their implications for future work priorities better understood.

### *(iii) The new water and sewerage regulatory regime*

The Utility Regulator was appointed as economic and customer service regulator of the water and sewerage sectors in NI in April 2007 under the Water and Sewerage Services (NI) Order 2006. Our appointment to this role was part of a wider reform package of the water and sewerage industry in NI that established the setting up of NI Water as a Government-owned company acting as the sole water and sewerage service provider in NI. As the regulation of water and sewerage services and the related issue of customer charging is a relatively new issue within the Utility Regulator's remit we will need to be flexible to adapt our experience in utility regulation and price controls to this newly regulated sector. At the same time, learning from other regulators (such as Ofwat<sup>14</sup> and WICS<sup>15</sup>) and organisations in the water sector will be a key way of successfully delivering on our duties. We are already in the process of learning from experience elsewhere in similar water regulation issues, and adapting these experiences to our own particular NI circumstances.

We are working with our stakeholders to establish the new regulatory regime. Much of this will be aimed, during the coming period, at putting in place the first formal price control of NIW and

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<sup>13</sup> Republic of Ireland.

<sup>14</sup> The economic regulator for the water and sewerage industry in England and Wales.

<sup>15</sup> The Water Industry Commissioner in Scotland.



the many associated workstreams such as: establishing binding service standards, establishing proper information processes and reporting from NIW, agreeing investment requirements in terms of both replacement and new environmental-driven requirements and working towards a tough but deliverable price control to drive efficiency from 2010. Our aim in discharging these duties is to protect consumers, promote value and safeguard the future.

Other key water-related issues which will heavily influence our regulatory context in the coming period include: the position which will be adopted in relation to universal metering of water provision; the decisions in the future on the extent and depth of performance standards and customer service obligations; the position taken by stakeholders, including DRD and the Legislative Assembly in relation to the related issues of water charging, social tariffs and affordability.

In the longer term, we will need to reflect on if and how we might seek to introduce competition into various aspects of the water/sewerage regulated sectors. Whilst this is not on the short-term horizon in relation to NIW, two factors imply that there will be a medium terms impetus to reconsider the issue.



First, our main duty in relation to water regulation is to protect customer interests, *wherever appropriate by facilitating competition*. This provides a statutory imperative for us to consider the appropriateness on introducing competitive forces into the relevant regulated sectors.

Second, we are aware that the regulatory authorities in England/Wales and Scotland are in the process of actively considering the best way forward in terms of introducing competitive forces into the water and sewerage industries there. Ofwat has recommended that contestable water and sewerage markets are opened to competition where it will benefit consumers and to achieve an efficient and innovative sector which is able to respond to the challenges facing it, such as climate change, rising consumer expectations and growing population in water-scarce areas. Ofwat have argued that the current scope for competition in the water and sewerage sectors is severely limited by legislation, is confined to a small number of business customers and has not developed successfully. They are proposing that more of the market is opened progressively, starting with all business customers. In time households could be able to choose their water supplier, when the market is ready and safeguards are in place.

Ofwat pursuit of this is underpinned by the view that competition will drive benefits such as greater responsiveness to customers' needs, innovative approaches to adapting to climate change and downward pressure on costs. Competition can also help respond to the environmental challenge of water scarcity, which the Government highlighted in its water strategy. Markets could spur innovation in developing and making better use of water resources and more water efficient services, supporting sustainable water abstraction. Ofwat have recommended a step-by-step approach to developing markets, allowing competition to prove itself. Early priorities are the development of competitive retail services markets and tackling barriers to new entry to upstream water resources markets. Progressive vertical

separation of companies, including separated accounts and price controls, will be important in enabling competition to develop.

We will be able to keep a watching brief on the issues as they play out there and determine the implications for future policy/strategy here in this regard.

It is important to note here that at the time of drafting, there is a significant degree of uncertainty around some of the key policy background to water and sewerage regulation, as we are awaiting the full outcome of the Independent Water Review Panel and subsequent NI Executive policy decisions on key factors such as tariffs and regulatory approaches. We anticipate that the outcomes of this work should be available by the time we are working on our final Corporate Strategy document later this year and we will ensure that our final strategy aligns with these outcomes.

#### *(iv) The growing importance of EU-level factors to our work*

This is a reality that will affect our work context in many ways.

Cross-border trading and regulation is one of the new developments in regulation across a number of sectors. It sets a key growing context for our work. For example, there is the strong EU element in how communications services are now regulated and postal competition is being driven largely by EU directives. Of even more relevance, energy prices in the UK have probably been affected over the last few years as much by developments in Continental Europe as by other factors. In relation to our water and sewerage sector, our context is influenced by the Water Framework Directive, Urban Waste Water Treatment Directive, Drinking Water Quality Directive and EU driven targets for improving water and wastewater quality and treatment.

On another front, we know that EU legislation is going to be a main factor in setting the UK's targets for renewable generation. Also, it seems likely that forthcoming EU legislation will strongly reinforce the cross-border nature of energy regulation, requiring the single European market to become an objective of national regulators and giving the EU level some influence over the national level regulatory agenda.

Moving to another policy area, liberalising energy markets has been a key goal for European regulation policy; however it has proven difficult to deliver first rate competition in NI and RoI energy markets – particularly at the domestic customer level. This is not an unusual difficulty in the wider European energy market context, and dissatisfaction with the progress towards energy market liberalisation across the EU has recently led the EU to issue the so-called “third package” proposals of further energy market and associated regulatory reform – see box below for detailed background to this.

- The European Commission issued in September 2007 a set of legislative proposals, called the *Third Energy Package*, with the objective of ensuring a real and effective choice of supplier to European customers. The package of measures tries to define a new Energy Policy for Europe. It is composed by a Regulation establishing the EU Agency for the cooperation of National Energy Regulators, an Electricity Directive amending and completing the existing Electricity Directive 2003/54, a Gas Directive amending and completing the existing Gas Directive 2003/55, an Electricity Regulation amending and completing the existing Electricity Regulation 1228/03 and a Gas Regulation amending and completing the existing Gas Regulation 1775/05.

The Commission's proposals put consumer choice, fairer prices, cleaner energy and security of supply at the centre of its approach through proposals in:

- **Effective separation of supply and production activities from network operations.** It is considered that existing unbundling provisions are not sufficient to ensure a well-functioning market. The preferred option of the Commission remains ownership unbundling, meaning that the same person or persons cannot exercise control over a supply undertaking and, at the same time, hold any interest in a transmission system operator or transmission system. This rule would not only apply at national level but throughout the EU; no supply or production company active anywhere in the EU can own or operate a transmission system in any Member State.
- **Enhanced powers and independence of national regulators.** The existing Regulatory authorities do not have the same powers and independence in all Member States; some of them are not strong enough for a properly functioning market, in particular as regards the use of network infrastructures. For these reasons, the strengthened of regulatory authorities powers is one of the aims of the third energy package, through the cooperation with the Agency for the Cooperation of Energy Regulators and the Commission, the enhancement of their market regulation powers, obliging companies to keep record of the data related to their operational decision for five years at the disposal of national regulatory authorities. It is also an aim of this set of measures to strengthen national energy regulators' independence, for that, it is proposed that regulatory authorities have legal personality, budgetary autonomy, appropriate human and financial resources and independent management.
- **An independent mechanism for national regulators to cooperate and take decisions: the Agency for the Cooperation of Energy Regulators.** It is established the creation of an independent body which can tackle cross-border issues. This body could make proposals to the Commission regarding decisions that involve substantive decisions and take individual regulatory decisions which are binding on third parties concerning detailed technical issues that are delegated to them. The main proposed tasks would complement at European level the regulatory tasks performed by the national regulators. The structure should provide a framework for national regulators to cooperate, a regulatory review of the cooperation between transmission operators and scope for taking individual decisions concerning infrastructure in the territory of more than one Member State.
- **Efficient cooperation between transmission system operators.** There exists a voluntary cooperation among transmission system operators (TSOs) but it has shown to have some limits. Therefore stronger cooperation between transmission system operators and a clear and stable regulatory framework, including regulatory coordination are necessary for electricity and gas market better integration. In this sense, network access rules and operational rules need to be compatible, there has to be effective exchange of information between transmission system operators and a good coordination of new investment to increase interconnection capacities. It is therefore proposed to task the transmission operators with strengthening their cooperation in a number of key areas, such as coordination of grid operation, investment planning, development of technical and market codes, etc. To develop the proposed tasks, the Commission will formally designate the European Networks of (gas and electricity) transmission system operators in charge of them. The Agency for the Cooperation of Energy Regulators will monitor how the European Network of transmission system operators carries out those tasks.
- **Improving the functioning of the market.** The proposal aims at improving the legislative framework to facilitate third party access to key infrastructures (access to storage, to LNG terminals), to increase transparency on the market, to enhance market integration and to improve access to retail customers.
- **Cooperation to reinforce security of supply.** It is important to ensure that the electricity and gas systems can meet demand even in peak times, so the proposed measures give the task of making system adequacy forecasts for every summer and winter as well for the long term to the Network of European Transmission System Operators. The package highlights two issues in this sense: increase transparency from storage operators and promotion of regional and bilateral solidarity. A European outlook is necessary to take into account the possibilities to export and import electricity and gas in peak demand conditions. Due to the cross-border electricity and gas flows within the internal market, the outlook needs to be carried out at the European level.

Although the third package proposals are unlikely to be implemented formally before 2012, voluntary developments can be expected well before then. For example, Gas Platform has been created as a regional gas forum for Germany, France and the Benelux countries, and Regulators have already established Regional Coordination Committees (RCCs) as a means of co-ordinating Regulatory efforts on a regional basis as part of the ERGEG<sup>16</sup> Regional Initiative.

As driven by EU obligations, pursuing higher levels of competition in energy markets and greater opportunities for customers to choose their suppliers will be a significant issue and challenge going forward, and will only be achieved through co-operation and joined up thinking with other stakeholders. We are currently consulting on an energy retail competition (<http://ofreg.nics.gov.uk/23%20April%202008.htm>) strategy paper that sets out our views on the existing levels of competition, ways to extract further long-term benefits from increased competition, and barriers and policy options to enhance energy retail competition. We discuss this further in the next chapter.

### *(v) Environmental Sustainability*

As noted elsewhere, environmental issues will set a key contextual challenge going forward. It has been commonly accepted that our current model of development, based on the erosion of natural resources and ecosystems, is unsustainable. The need for sustainability is even more pressing in the context of activities related to the emission of greenhouse gases, mainly CO<sub>2</sub>.

The Utility Regulator has as its main duty the protection of customers and our approach to that role is wide, considering that protection should be given to all customers, both present and future. From this perspective, pushing our green agenda becomes a priority. To this end, we are currently consulting on our first ever “sustainability” strategy and many of the issues covered therein will form part of our Corporate Strategy thinking in this area (<http://ofreg.nics.gov.uk/31%20March%202008S.htm>).



### *(vi) Technological and information advances*

The technological background to our work and the industries we regulate moves quickly. In areas such renewables technologies and smart metering we are seeing fast progress in development and an emerging need to better grasp the implications for policy. This pattern will continue, if not accelerate in the years to come, and may well be accelerated by the growing move on the island towards competitive energy markets and the competitive pressures for development and innovation that go with that. Some of the attendant issues to fast-paced-change can be complex. For example, in relation to smart metering, issues such

<sup>16</sup> European Regulators' Group for Electricity and Gas.

as the needs of demand side management, environmental concerns, desire for enhanced tariff options, enhanced customer information, etc, all come together in one technological issue – hence the complexity, but also an opportunity which we are keen to avail of.

### *(vii) Where does “gas” go from here in N.I?*

The expansion of the natural gas industry within Northern Ireland is still a relatively new development. The reasons to promote it are well known and mainly focused on environmental benefits, since gas is less environmentally damaging compared with coal and oil. There are also economic reasons to promote gas, such as increased choice for customers and diversification of energy sources. Finally, there is of course our statutory duty to promote the development of natural gas as set up in the Energy Order 2003.

However there is a real danger that the further development of the natural gas sector in NI may not happen as quickly as we may wish. Further extending the gas network beyond those areas already served will be costly, even if it can be proved of overall benefit to do so. Deepening connection rates in those areas already linked to the gas network may also be problematic in a world of high and volatile wholesale prices – though this may be helped by the relatively low carbon emissions from gas and in a world where fuel prices will probably increasingly “price-in” carbon emissions. There is also the need for the private sector owners of the gas companies to work closely and co-operatively with the range of public and consumer/environmental bodies who can help create the environment where gas roll-out can be re-invigorated. We return to some of these gas issues in the next chapter in terms of potential policy priorities.

### *(viii) Our own Organizational development*

The Utility Regulator has been undergoing a significant restructuring over the last year. It is intended that the internal reforms will continue over 2008 and 2009, and result in an improvement of quality and accountability in financial processes, the revision of human resources policy and communications approach and the devising and operating of our processes to demonstrate value for money.

## **3.3 Some initial thoughts on other long-term influences**

Although our Corporate Strategy development will be designed for a 5 year period, we recognize that energy and water issues have to be considered in short, medium and longer term. With that in mind, we have started a process of starting to scan “over” the horizon even further ahead and begin a discussion on the sorts of issues that will influence our work in the longer term – a so-called “2020” scan. We report on some first thoughts in the table below (both in a cross utility and also sector-specific way). These are very much preliminary, non-exhaustive, and intended to stimulate a future debate and discussion – ***we would welcome views from others to help us build up this thinking.***



## 2020 ISSUES

### CROSS UTILITY ISSUES

- The implications of future ownership models of utility assets will need to be considered. This will have implications for how regulated assets are ring-fenced, the implications of associated financing models for incentives, risks to consumers, allowed rates of return, etc.
- Sustainability will remain with us as a long term issue. In a scenario where supply/demand balances and external risk factors maintain high and volatile wholesale fossil fuel prices, the implications for investments in renewable technology and the associated implications for existing “pipes” and “wire” networks (and their operational management) will need to be understood. Both as regards the sustainable aspects of the water and sewerage sectors in themselves, and also as major consumers of energy, these issues will cut across all the utility sectors we regulate.
- Security of Supply issues will likely remain an issue that impacts on future work and decisions.

#### ELECTRICITY

- More renewables – notably wind; grid and network management implications; backup of traditional generation (but cleaner and least cost).
- Electricity market: much more “connected” to GB, to Europe?
- UK Energy policy outcome by 2020 at present unclear. Much more nuclear energy? – would mean we will likely be imported more of this source through the interconnector(s).
- There will be different models of electricity supply retail: dual fuel, bundled products and diversification into related and non-related services to make use of customer base and retail loyalty.

#### GAS

- Security of supply issues will have been worked through: gas storage should be in place; picture on price and long term supply contracts will be clearer.
- European Single Gas Market: changes will be required;
- Increased indigenous West Coast gas finds? Would the island ever become a net exporter of gas?
- Decision about where the gas should be burnt: domestic boils, CHP, central heating. Legislative and regulatory framework to allow this is needed.

#### WATER

- Water Framework Directive fully worked through
- Regulatory and charging regimes will have bedded in and become “normalised”.
- Challenges in: metering, changing tariffs, etc will have been decided and worked through.
- Competition: GB picture will have clarified. Lessons learnt will have been concluded and NI able to draw from this experience and set its own policy.
- Adaptation needs to changing climate patterns will be understood and progressed.

**Consultation Question 3:- We would welcome views as to whether there are additional significant “context” issues which we ought to have reflected in this chapter but have omitted.**

**Consultation Question 4:- We would welcome views as to whether there are significant issues within the context issues already identified which we should have noted.**

# Chapter 4 Our first thoughts on potential strategic themes and priorities.

## 4.1 Introduction to Themes and Priorities

The purpose of this chapter of the consultation document is to take the context themes and issues identified above and start to develop thinking on the sort of goals and actions we should seek to pursue during the 5 year strategic planning horizon. To help structure this part of the consultation paper and frame some thoughts we've used a framework below in the rest of this chapter related to the "product chain" associated with our regulated utility sectors - fundamentally the core of our Utility Regulatory functions relates largely to three areas of the product/value chain:

The Utility Regulator's work within the regulated sectors....

### (1) Wholesale markets

Regulation of the wholesale end of the utility markets, notably in energy (and especially electricity) at this time, including generation issues and licenses, SEM, economic purchasing obligations, hedging and wholesale energy purchasing strategies.

### (2) Networks

Much of our upcoming work in the 5 year planning horizon on water and sewerage regulation falls into this category. Effectively regulating natural monopolies and incentivising efficient behaviour, guarding against market abuse by dominants, establishing level playing fields and third party access to monopoly networks, price controls (including control of those energy retail sectors where monopolistic attributes remain and competition is insufficient to fully protect customers), protection of customers (network tariffs and service quality), safety and environmental issues. Agreements we reach and decisions we take in relation to price controls, especially in relation to water and sewerage, will be a key aspect of our work here.

### (3) Retail sector

Developing effective competition, customer protection (price and service quality), effectively contributing to the delivery of safety, environmental and social issues, including fuel-poverty.



We think it is useful to use these three segments to structure thinking about our core regulatory activities and actions over the coming 5 year horizon. In addition we need to consider what we will actually undertake - delivery of these core regulatory activities requires us to work in six areas common across all the three industries:

The Utility Regulator's work across the regulated sectors....

**1) Statutory enforcement.**

Licence regulation, enforcement orders, standards of performance, regulatory directions, price controls, etc.

**2) Regional cooperation.**

Working *within* NI with other key stakeholders and regulatory agencies through co-operation and MoUs; *external* co-operation with other UK regulators, notably Ofgem, Ofwat and WICS; external work and links with other bodies, notably CER and the EU.

**3) Delivery of the sustainability and social policy agendas.**

Several themes cut across many of our work areas and influence our policies, actions and priorities. Issues such as climate change, the need for environmental sustainability, tackling fuel poverty arise within and are impacted by many of our policies and actions.

**4) Pursuing security of supply in terms of price, diversity and infrastructures investment.**

This is a key requirement in both energy and water and drives a lot of our analysis and debates with the regulated industries, particularly in terms of efficiency of operations, investment requirements and business planning, etc.

**5) Industry development. Developing our utilities and regulated companies.**

We recognize that, as well as controlling monopoly aspects of utilities and ensuring customers are protected in terms of price and quality of service, a key task is to look into the medium term and work with industry to identify optimal investments, technologies and strategies that will work in the medium/longer term to the benefit of customers as well as the industry. Encouraging the regulated utilities to take these considerations into account, either through persuasion or through more direct routes, such as price control investment allowances, is a key element in our armoury for pursuing our duties and objectives.

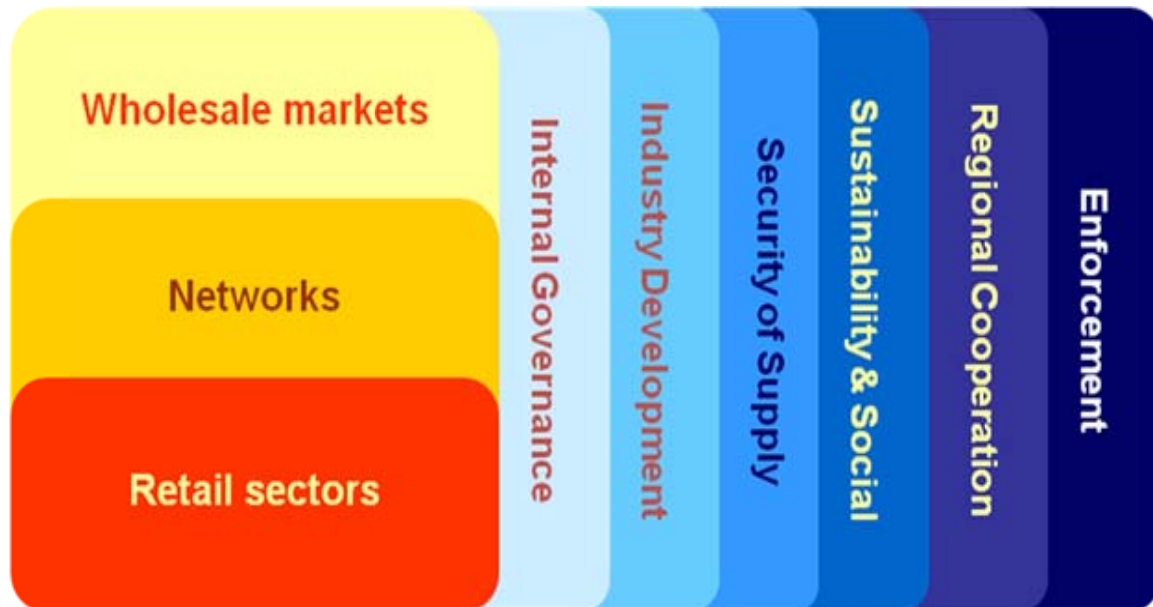
**6) Internal governance, risk assessment and management, effective regulation and accountability.**

In all we do, our impact is maximized and best results obtained when we make good decisions based on sound analysis, when we have scoped for industry and customer risks and devised best-available means of minimizing these risks and managing residual risks, where we act transparently and in co-operation with others, and when

Delivery of our core regulatory functions in each sector can only be achieved through effective performance in these six areas – they cross over all the work we do in each step of the value chain and in each regulated utility. Bringing the two concepts of a three way segmentation of

our regulatory interface, and the 6 main methods of action in these three areas, leads to the next diagram – we use this as the basic structure for the remaining part of this chapter.

### Regulatory approach to the Value Chain



## 4.2 First thoughts on priorities for the next 5 years

The purpose of this second section of this chapter is to seek consultation responses in relation to potential goals and priorities in the coming 5 year work and planning horizon. We will consider these responses, and alongside ongoing internal work in relation to goals and target setting, will develop our actual Corporate Strategy later this year.

We have structured this chapter in relation to the **(1) Wholesale**, **(2) Network**, and **(3) Retail** segments described above. It becomes immediately clear that the issues and problems to be dealt with are significant. Indeed some of the issues discussed below will prove intractable, will have roots and ramifications that spread beyond NI, the island of Ireland, and indeed the UK, and may involve the need for co-working and interaction with a wide variety of stakeholders. **That is our challenge!**

# (1) Wholesale Markets

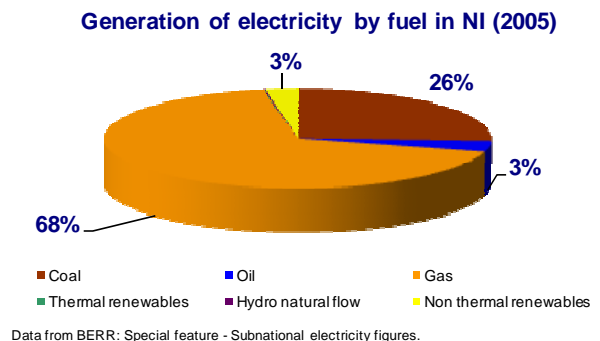
## 1(a) Security of Supply.

In **energy**, we noted earlier security of supply issues and the rise in wholesale fuel prices – these will be to the fore and will require consideration during the 5 year horizon.

Over a short number of years from now we can expect a wave of new electricity generation build on the island. We understand that a number of players are interested in the opportunities for increasing their generation capability and taking advantage of the SEM arrangements. A reconsideration of the generation security of supply issue would present an avenue for these players to offer potential options for new generation capacity that could widen the fuel source mix.

These challenges were noted in chapter 3 above and will arise in a number of contexts:

- (i) the implications for fuel mix of our power generation where we already have a significant dependence on gas fired power in the NI context (in 2005, electricity generation with gas was 68% of the total);
- (ii) within the foreseeable future the potential need for new and additional generation capability for NI and how this requirement links to generation capacity and use for the island as a whole;
- (iii) the need to define the capability, optimum grid investment requirements and best practical way forward for enhanced connection of renewable generation, notably wind power, onto the grid and;
- (iv) also in the context of investigating options for additional gas storage capabilities for NI and for the island as a whole. The energy security of supply issues are all the more complex given the long-term nature of the decisions and investments required, the fact that such investments are largely under the control of private companies and the increasing need to consider these issues on an all-island basis.



In **water**, security of supply, both in infrastructural and “quality” terms, are fundamentally important and drive a significant proportion of all required regulated expenditure. The main arena for the outworking of these issues in the water context will be the first price control of NIW – and the investment and asset investigation and requirements coming out of that. We return to the issues around water price controls in more detail in the “networks” section below.

### *1(b) High and volatile wholesale fuel costs.*

In energy, as discussed above, this has been part of the key background context to many of our issues over the last few years – it has contributed directly to large increases in gas prices to customers, and has also fed through into increased electricity prices through higher fuel input costs to generation. The question we need to ask is whether there is any way in which we in NI can reduce our exposure to high wholesale market costs – do we have a policy response that might deliver this? This will be difficult and the problem is in no way unique to NI or indeed the UK. However, potential options we could analyse and decide upon in the coming period include actions on three inter-related fronts:

*Reducing our overall exposure to high and volatile costs* – policy direction here may include extending our use of renewable energy technology (at least to the extent that this can be shown to contribute to cost reduction) and driving down hard on progressing energy efficiency. We are currently in the process for example of fully reviewing the operation and future direction of the Energy Efficiency Levy. Also planned, is a review of our role and powers in scrutinizing the purchasing and hedging strategies of regulated companies to ensure that value for money is being achieved for customers and energy efficiently purchased. Clearly, increasing future competitive pressures in the energy markets should also drive efficiency and downward cost pressures.

*Reducing our sectoral exposure to the high cost peaks* – policy direction here points to initiatives such as examination of gas storage options and the best way forward with Government, CER and the relevant companies. There is also work planned on demand-side management within electricity which should lead to some future gains here.

*Reviewing our fuel generation mix and efficiency of purchasing* – policy direction could relate to review of power station back-up capabilities and fuel input options to ensure efficiency in purchasing options and cost implications for customers; review the longer term likely trends in wholesale fuel prices to try to ascertain possible options for optimum fuel use for power generation and customer heating requirements.

### *1(c) Liquidity of contracts under the Single Energy Market.*

This is an energy wholesale-related issue. It would appear that a liquid market for wholesale electricity products under the new SEM arrangements is proving slow to emerge and a fully functioning hedging market is in its infancy at the moment. Not only is this an issue for the more efficient operation of the wholesale market per se, but it also has ramifications for the rest of the value chain. Wholesale costs of electricity purchases can account for well over half of the total cost base for a supply business and therefore represent a key determinant of the competitiveness of new entrants. Arguably, a more liquid contract market would enable suppliers to have access to a wider set of physical purchasing options and financial hedging instruments, thereby enabling suppliers to effectively hedge their contract commitments in the supply market and reduce their exposure to peak prices.

Having been introduced relatively recently (November 2007), a full set of hedging instruments has yet to be developed to enable suppliers to limit their exposure to pool prices and exploit more efficient or innovative contract strategies.

Potential policy options include, with CER, to re-examine and consult on the liquidity issues arising under SEM with a view to developing within the next year a set of responses that will deliver enhance levels of liquidity, contract and hedging options into the market.

### 1(d) Future of the Belfast West site.

We will need to consider and set out the best way forward for the use of the former Belfast West Powerstation site, now that clearance is complete. Options to be considered include releasing the site from the Landbank, and possible use for another powerstation should a suitable project proposal be forthcoming – this may potentially tie in with other strategic themes in terms of security of supply/diversifying power generation mix. We may seek to consult and decide on the way forward during the planning horizon.

**Consultation Question 5:- We would welcome views as to whether there are other significant “wholesale” issues which we ought to have reflected here.**

## (2) Networks

Regulating Utility networks effectively will be a key goal in the coming period. As noted in the introduction, effectively regulating natural monopolies and incentivising efficient behaviour, guarding against market abuse, establishing level playing fields and third party access to monopoly networks, all will be key parts of our work in the coming 5 year planning horizon. Agreements we reach and decisions we take in relation to **price controls** investment requirements and outputs, both in relation to the regulated companies themselves, but also in tandem with other stakeholders, notably the sponsoring Government Departments, environmental and consumer bodies, will be a key aspect of our work here. As regards the main issues that will come to the fore in the upcoming price control/network regulation context, particular issues to mention include:



## 2(a) How to build the “green agenda” into network policy making and decisions.

Over the coming work and planning horizon, environmental issues will play a key role in framing decisions. We have discussed above in terms of challenges and thematic context, the importance of sustainability-related issues in our strategic vision going forward. In recognition of this, the Utility Regulator is currently undertaking an important consultation on its future role on sustainability (<http://ofreg.nics.gov.uk/31%20March%202008S.htm>). This consultation is a result of significant work and pre-consultation by us, and explicitly recognizes the importance of building the sustainability agenda into our future plans even more than heretofore. The sustainability consultation includes proposals for action and is consulting on these proposals in advance of producing a formal action plan – during the early part of the planning horizon it is likely to be a priority to follow through and deliver on the sustainability consultation findings.

### **Proposals from current Sustainability Consultation (see current sustainability consultation paper for more details):**

- (a). Cross utility licence condition requiring licensees to have in place environmental policies.
- (b). Cross utility requirement to report annually of sustainability activities and initiatives.
- (c). Requirements on licence holders to provide customers with environmental information in relation to fuel mix in a uniform and easy to understand format, on all bills and promotional literature.
- (d). Strategic investigation into use of “Smart Meters” as a mechanism for delivering better quality and timely information to customers.
- (e). Work with energy licence holders to assess current tariff structures.
- (f). Continue to work with partners and stakeholders to ensure renewable generation can be equitably accommodated on the electricity network.
- (g). Ensure price control processes take into consideration the effect of climate change on electricity and gas networks.
- (h). Carry out a full strategic review of energy efficiency delivery mechanisms
- (i). Develop a strategy in relation to gas promotion, which considers the potential benefits of common arrangements for the transmission and distribution of gas on the island of Ireland.
- (j). Developing sustainability within the NIW price control
- (k). Improving our own practices and procedures.

In relation to **energy** there are a number of relevant important issues to which we need to frame our policy thinking.



In the context of the ongoing drive **to increase the share of renewable generation**, there is a common acceptance of **the potential for wind power** to contribute substantial new generation capability in the future. The policy dilemma is how best to effectively and efficiently deal with the situation where the large bulk of demand lies on the eastern seaboard of the island, but most of the wind generation capability and planned investment lies in remote areas towards the west. The Grid implications are significant and future investment strategies agreed under price control discussions will need to explicitly recognize and deal with that policy “knot”. A closely aligned issue is the increasing push for more **micro-generation** - the micro-generation “agenda” is of interest across a number of regulatory and policy development fields (e.g. environmental, rural, social). However increasing micro-generation brings with it issues of the tariffs payable for such generation, and how best to maintain stability, co-ordination and cost effectiveness of electricity networks. The debate on resolving this policy-knot is usefully framed within three sets of inter-related questions.

*First*, will the need and ability of the electricity grid to take significant extra wind generation in the future change significantly? The NI Grid is not capable of handling all the future planned wind projects, let alone a substantial increase in wind project development. We need to debate and understand better the system and cost implications of enhanced renewable generation and establish clear investment approaches that align with a thought-through agreement of where we want to get to, and that align also with other relevant factors – particularly planning consents and policy.

*Second*, will the future electricity grid look significantly different? We know that renewable generation tends to be small scale, variable in output (wind, solar) and geographically scattered. Significant enhanced renewable generation in the future may require the Grid to operate differently to present, with perhaps sub-elements of the grid needing to be isolated and separately balanced and that can deal with more scattered and variable generation with different reserve characteristics

*Third*, do we understand enough about the cost implications of an enhanced renewable generation fleet, as against the current level of conventional generation? Once we understand better the answers to the above, cost implications can be better informed policy option understood.

The above may point to the need during the early part of the planning horizon to initiate an exercise to consult and agree on policy actions that allow the Utility Regulator to maximize our input and influence on ensuring progress in resolving these questions.

Given the direction of travel of policy making at the local and EU levels, it is likely that during the planning horizon we will have to review the implications of **the new “carbon economy”** for energy policy making in NI. Increasingly there will likely to be pressure to “price-in” the full costs of carbon emissions, not just for coal products use, but also for gas and heating oil products use also. This has obvious potential implications for pricing and tariffs, and may lead us to consider the concept of “shadow pricing” carbon into investment decisions. It also has implications for the balance of fuel use, and also have network implications – for example, increasing costs of environmental considerations of coal and oil, may offer an opportunity for improving the economics of gas network extension and roll-out.

It would appear from the above, that many of the issues around the sustainability agenda in energy relate to how we might best work to prevent further climate change.

By contrast, in relation to **water and sewage network decisions, environmental issues** are also a key policy driver – but largely in the context of *working to adapt* to climate change, and increasing instances for example of heavy storms, flash flooding, drier summers. The relationships between the regulated water and sewerage company, the Utility Regulator, other relevant regulatory agencies (DOE, EHS) and consumer bodies are still being bottomed out and understandings reached as we all come to terms with the new water company structure, legislation, licencing regimes, etc. There remains much work to do in this regard in the coming 5 years. What is already clear however is that environmental concerns are a significant contributor to investment requirements of the new water company. To that extent, there is a requirement for all the relevant stakeholders to understand the environmental issues and their relevance to investment needs, and to find optimum cost efficient and effective strategies for meeting network requirements without undue cost burden on today’s or future customers. We see the future price control(s) on NIW as the key forum on which these debates can be centred and consensus reached – this is likely to be the key aspect of our water work in the planning horizon.



## **2(b) Metering**

Also in relation to utility “network” issues, it is important to note the “metering” issue as one to which we will continue to dedicate resource and policy analysis in the planning horizon. It goes without saying that the issue of water/sewage metering is an important one and generates much debate – the debate has environmental, social, efficiency of use, tariff, cost, etc, aspects to it.

In relation to water, metering would enable more innovative tariffs that could protect vulnerable customers while giving clearer signals of the economic value of water. We have undertaken a review of metering using independent consultants and have forwarded the outcome of this to the Independent Water Review panel and the appropriate Assembly Committee. We are awaiting further developments on this pending the decisions on water from the Executive – probably later this year. We anticipate that the issues and way forward will be clearer in time for the finalisation of our actual corporate Strategy document later this year.

In terms of energy, an important issue we wish to note here is that of the way forward on **metering issues**, especially the future role of “smart” metering technology for us. We note this issue here as a network issue, but return to it more fully in the third section [“(3) retail”] below.



## *2(c) The future direction of “all-island” energy work (network issues).*

Both our electricity and gas Operational teams are currently devoting significant time to **energy issues in an all-island context**. During the planning horizon, we will continue to move forward with this work programme where it can be shown that the cost/benefit balance justifies it. The successful implementation of SEM last year was a key milestone, and work is now ongoing on various other workstreams. Future Electricity all-island work is already planned and will be actioned under the SEM Committee umbrella. In relation to gas, the “Common Arrangements for Gas” (CAG) programme intends to develop a set of arrangements whereby all stakeholders can buy, sell, ship, operate, develop and plan the natural gas market north and south of the border effectively on an all-island basis. At present harmonisation of the transmission tariff methodologies in the Republic of Ireland and Northern Ireland and moving towards a single operational regime (including harmonised rules for gas quality and emergencies) is taking policy priority. It is expected that further changes will need to be brought about before full market harmonisation; these include:

- a single transmission planning regime;
- harmonised connection policies (including any gas users located in the Republic drawing gas from the S-N line); and/or
- single approach to security of supply

Although current priorities relate to the harmonisation of the wholesale and some operational aspects of the energy markets, it is these changes that will allow the development of harmonised retail markets in coming years. Thus, during the 5 year planning horizon ongoing progress will be made on all-island energy issues. However, there is also a need to begin to consider the next steps that might be taken after the current workstreams are completed - we would therefore intend to review next steps with DETI during the work planning horizon.

## *2(d) Energy network extension issues.*

Given the benefits that may be obtained from a further roll-out of natural gas in NI, we consider that a priority may be a new re-assessment of the benefits and options to accelerate further development of the Northern Ireland gas industry.

There are a number of reasons why this might be a high-priority action:

- Replacing heating oil with gas as the fuel of choice for the domestic sector would be a significant policy action to reduce Northern Ireland’s carbon footprint - the effect may well be larger, for instance, than installation of micro-renewables in homes;
- Although it is extremely difficult to predict future fuel prices, there are some reasons to speculate that, over the long-term, gas prices may be lower than oil prices. (These relate to there being larger gas reserves around the world than oil reserves; gas being less concentrated in areas of political instability; the future likelihood that competing fuels will have to “price-in” their higher carbon content; and Europe’s relative proximity to gas reserves.)
- Installing gas central heating continues to be a main method of combating fuel poverty.

- Promoting the development of the gas industry is one of our key statutory duties. An enhanced gas sector also has the potential to help deliver on other policy priorities – notably in relation to sustainability and lessening of fuel poverty. In addition, extending the natural gas network in NI is also identified in the Utility Regulator’s current retail strategy consultation document as a key policy area helping to deliver the framework under which further retail competition might better flourish.
- It should also be remembered that one reason why gas is relatively expensive in NI, compared to GB, is that our infrastructure has been built with the capacity to allow for future growth. The faster we see new connections, the faster the infrastructure cost-per-home will fall. Promoting take-up is therefore good for the competitiveness of existing industrial gas users, and will also help to reduce energy costs relative to elsewhere.

It may be a policy priority that we actively engage with Government and stakeholders to examine the feasibility and options to accelerate the roll-out of gas to the domestic sector, for example in the ten towns served by the Firmus networks. Equally, consideration should be given to further extension of the gas transmission network that could bring gas to new parts of Northern Ireland.

Whilst progress on developing the gas industry in NI has been steady since 1996 (Phoenix now has over 110, 000 customers, and firmus are in the process of taking gas networks into the large towns outside of the Greater Belfast area), there is a set of questions that need further consideration during the 5 year planning horizon. Can the gas sector roll-out be accelerated and deepened in the gas distribution areas already licenced to Phoenix and firmus? How can this be achieved most effectively and efficiently, and where does the balance of responsibility for driving this lie between government, the regulator and the companies themselves? How should we best work with the companies through their price controls to organize the marketing and incentivisation of gas connections to maximize the potential customer base switching to gas where that is the best choice for customers? Is there a way of developing economic proposals for the extension of the gas network beyond the current areas served to offer the fuel choice benefits to a wider customer base? These questions will require careful consideration and co-operation with other stakeholders to successfully manage. We would welcome views on the priority we should give to initiating a debate and formal consultation on these issues in the early part of the planning horizon.

A related issue which we wish to note at this point is that of the potential for **the development of district “heat” networks**.

This development would have the potential to hit several policy goals with one stroke if it could be effectively and efficiently delivered: aid the economic roll-out and extension of the natural gas network; contribute to sustainability and carbon reduction targets; and contribute to alleviating fuel poverty. At present the policy framework for delivering higher levels of district heat networks, combined with substantially increased use of CHP<sup>17</sup> plant technology, is simply not sufficient – there is for example the lack of a legal and licencing framework; nor has the concept filtered sufficiently into the policy making thoughts of the wider public sector in NI. We potentially could seek to initiate formal analysis and consultation in the early part of the

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<sup>17</sup> Combined Heat and Power.

planning horizon to scope the potential for such developments and the gaps that require to be filled to make such developments happen on the ground.

### 2(e) Utility Network financing issues.

Current **ownership and financing structures** of our main regulated utility assets are diverse. They include private equity ownership of Viridian and Phoenix, “mutualised” ownership through NIEH<sup>18</sup> of some key gas and electricity transmission infrastructure, semi-state ownership of firmus (through BGE<sup>19</sup>), and “government-as-shareholder” ownership of NIW Limited. Whilst ownership per se is not the main concern of regulation, some of the accompanying implications of ownership models, and the associated financing aspects, are of real interest. For example, in the various models, how and to what degree can we effectively incentivise, benchmark and regulate management and operational efficiency? How can we ensure that we are setting the correct cost of capital and avoiding excess returns to equity investors? Also, in the private equity ownership model, do we need to direct policy thought towards the already high levels of debt finance that underpins much of our strategic utility infrastructure? To date, much of our regulatory intervention has been aimed at ensuring that appropriate licence provisions are in place to protect customers – for example financial ring-fencing provisions to protect the regulated businesses from wider company financing issues. In the coming planning horizon we may consider it important to review and consult on whether there is the need for any further issues to be addressed or assurances to be sought to effectively protect customers in light of different financing models.

In relation specifically to **mutualisation**, we are already in the process of formally reviewing the corporate governance arrangements of NIEH. During the planning period, we are likely also to consider in-depth the performance of the mutualised companies, benchmarked where possible, and take a view as to the overall benefits or otherwise of the mutualised financing model. Should it prove to be working well and delivering real gains for customers, there is the wider issue of the applicability of such a financing model to other utility assets, both energy and indeed water. We therefore will consider the need to undertake a review of the mutualisation model to date and its applicability to other investments/assets.

### 2(f) Other water-specific network issues.

Given that water regulation is bedding down in NI and all the parties are getting to grips with new legislation, licencing and price control plans, there are a number of **water network-related issues** which should be noted as arising during the 5 year planning horizon. These include a number of key network-related tasks that emerge during the planning horizon: the informational and data requirements necessary for effective regulation and informed price controls, including developments of sufficiently robust reporting frameworks and asset plans; enhanced regulatory scrutiny regimes will need to be bedded down with NIW and detailed

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<sup>18</sup> Northern Ireland Energy Holdings.

<sup>19</sup> Bord Gáis Eirean.

reporting regimes implemented; the use of the “reporter” will continue to be bedded down with NIW; the implications for price controls and network investments of political decisions on environmental, metering and sustainability agendas will need to be understood and dealt with. These are all significant issues which will play out over the coming years, mostly in the context of regulated business plans and the various steps and consultation stages of the price control process.

**Consultation Question 6:- We would welcome views as to whether there are other significant “network” issues which we ought to have reflected here.**

### **(3) Retail**

The final section of the value/product chain that we will use to structure the discussion in this chapter relates to our role in the regulated utility retail markets during the 5 year planning horizon. (Retail issues below largely relate to the energy sectors in the coming 5 year planning horizon. Although water regulation in the GB markets has recently been moving to build in the concept of water supply as a separate licenced and regulatory function, we do not envisage that this will be a significant factor in the NI scenario in the coming planning horizon – we will of course keep this under review and respond as necessary should circumstances or priorities change).

#### ***3(a) Role of regulation at the retail level – move towards de-regulation.***

During the planning horizon we will likely seek to better define and review our role in providing “customer choice”, and the extent to which we can seek to move away from regulation at the retail level and allow the competitive functioning of markets to protect customers and deliver innovation, quality and downward price pressures. Our overall aim is to regulate effectively and efficiently where we have to, but step back and let the market and competition perform their roles unhindered where we are assured that markets are indeed working effectively. In this vein, our recent consultation and proposals for delivering more and effective competition into our energy retail markets will be a key first step along this path – we return to this below. At a strategic level, clearly our preferred policy direction in this may not take us towards a model that mirrors the utility retail markets in GB (for example in terms of very high churn rates); rather our desire would be to move towards retail market structures that are tailored and best for our particular circumstances.

In relation to the potential for **retail competition in the water sector**, it is something that we are aware of in the English and Scottish contexts. During the planning horizon however, there are many other water issues that will take up the available policy bandwidth and we have no early plans to press for water retail competition – the intervening period can be used as a useful period to assess how the retail issues are developing in GB and what lessons we might learn for future policies in this area in NI.

### **3(b) Customer interfaces in an increasingly competitive market.**

As we increasingly move towards fuller levels of energy competition during the planning horizon, issues around **the interface between customers and the competitive market** will come more to the fore. This set of issues include the following aspects: how best to enshrine and protect good customer service in increasingly competitive energy markets; how to ensure stability in market functioning and where appropriate avoid unnecessary and costly levels of customer dissatisfaction, and potentially costly “churn” of customers between competing suppliers; how best to provide customers with the necessary information on tariffs and pricing to allow them to make appropriately informed decisions on suppliers and terms of use; defining exactly what we mean by customer “choice” and what that means for retail market policies pursued. There are related issues in terms of customer protection and rights which may form part of the EU third energy market liberalisation programme (mentioned above) and which again form part of the context for which we need to do some future work and thinking. We can deal with these issues singly and as they arise in future circumstances – or we can recognize them as an inter-related “package” and initiate a deliberate consultation and debate on them. Our tendency is towards the latter option and we could potentially seek to begin this consultation/debate in the coming planning horizon.

### **3(c) Metering issues.**

We are very aware that during the 5 year planning horizon a set of **metering issues** will come to the fore, including in relation to “smart” metering:- for example in relation to the appropriate energy metering technology and its role within future retail markets; its role in terms of providing information and flexibility to customers themselves; its role in helping to deliver environmental goals and tariff structure flexibility; etc. The Utility Regulator has set up an internal working group under Director control and with representatives from each of the three internal utility teams to examine metering issues in the round and share ideas and thinking across the 3 directorates. During the early part of the planning horizon we intend to develop our policy approach to metering in both energy and water sectors.

In relation to water metering specifically, we’ve already noted that metering would enable more innovative tariffs that could protect vulnerable customers while giving clearer signals of the economic value of water. We have undertaken a review of metering using independent consultants and have forwarded the outcome of this to the Independent Water Review Panel and the appropriate Assembly Committee. We are awaiting further developments on this pending the decisions on water from the Executive – probably later this year. We anticipate that the issues and way forward will be clearer in time for the finalisation of our actual corporate Strategy document later this year.

In relation to metering across all the sectors, there are a number of metering issues that we might seek to establish clear policy goals on in the coming planning horizon; these include:

- ⇒ the best way to factor in the benefits of smart metering in the provision of tariff and usage information to customers, and also back to suppliers/network operators. How can this best be organized; what can we learn from pilots and experience elsewhere?
- ⇒ how should metering developments best tie into our future work on other policy goals such as retail strategy, affordability and sustainability? We also need to examine the charging implications of metered versus non-metered customers.
- ⇒ what are the opportunities for meter “sharing” between utility customers in the future – are there cost gains to be achieved in the future scenarios?;
- ⇒ what are the implications for our approach to metering coming out of our all-island electricity and gas work?

### *3(d) Energy Retail Competition Strategy – Preliminary Thoughts*

As flagged earlier, the Utility Regulator published in April this year a consultation paper on the future of energy retail competition in NI (<http://ofreg.nics.gov.uk/23%20April%202008.htm>). The paper goes into many issues in depth and seeks responses by the 16<sup>th</sup> of July. Briefly, it notes that although the Northern Ireland electricity and Greater Belfast gas markets are fully liberalised, with all customers able, in theory, to choose their gas and electricity supplier, there is more that can be done to further promote competition, particularly outside the market for industrial electricity customers. In particular, there are no active competitors to the incumbent suppliers – NIEE Supply<sup>20</sup> and Phoenix Supply – in the domestic energy markets and begins by trying to identify barriers to competition and reviewing potential policy options and solutions to address these. In the context of the 5 year planning horizon and this Corporate Strategy, our overall policy stance remains to aim to achieve our principal objectives in the sectors we regulate, encouraging increased competition that delivers overall consumer benefit, within the clear ambit of our statutory duties.

The retail consultation paper includes a list of suggested potential actions in the gas and electricity sectors that are currently being consulted upon. For completeness, and as an outline of our first thought in terms of associated priorities for action, we repeat them here (much more detail and background can be found in the Consultation document referenced above):

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<sup>20</sup> NIE Energy Supply.

In the short-term	In the medium-term
<ul style="list-style-type: none"> <li>Actively seek to address concerns regarding data availability or transparency.</li> </ul>	<ul style="list-style-type: none"> <li>Develop criteria for assessing whether the scope of the NIEE<sup>21</sup> price-control can be reduced.</li> </ul>
<ul style="list-style-type: none"> <li>First re-consider, and then where appropriate support, activities under the SEM arrangements to further develop wholesale market liquidity.</li> </ul>	<ul style="list-style-type: none"> <li>Review inclusion of the K-factor in NIEE supply price-control.</li> </ul>
<ul style="list-style-type: none"> <li>Progress our work in conjunction with the CER/SEM to agree and implement a programme of retail market synchronisation.</li> </ul>	<ul style="list-style-type: none"> <li>Review price control transparency issues and future work requirements in terms of the level of allowed regulated margins. Both areas are already recognised within the Utility Regulator and their assessments will be built into future price control work and methodologies.</li> </ul>
<ul style="list-style-type: none"> <li>Examine options, alongside DETI and Government as necessary, to re-invigorate economic and co-ordinated gas roll-out, both to new areas and within existing distribution/supply areas.</li> </ul>	<ul style="list-style-type: none"> <li>Consider potential for shallow supply model.</li> </ul>
<ul style="list-style-type: none"> <li>Review through GMOG the key operational and technical issues raised.</li> </ul>	<ul style="list-style-type: none"> <li>Consider the need if any to impose more structure or transparency on the Phoenix tariffs through the price-controls.</li> </ul>

### ***3(e) Fuel poverty & social action.***

Whilst there has been a lot of debate around the issue of **fuel poverty**, the policy levers to deal effectively with the problem lie as much in the wider tax and social security systems as they do in the realm of energy efficiency and curbing excessive fuel use by customers. To that extent, dealing with the problem will require co-ordinated action across several fronts – and we are aware of (and indeed contribute to) many of the initiatives already underway on fuel poverty action. That said, during the planning horizon we may seek to review, consider and consult on our role in relation to fuel poverty issues to ensure that it is being effectively targeted and addressed where we can positively influence it; and to establish if there are other

<sup>21</sup> NIE Energy.



actions that we should pursue. This re-consideration and consultation will take place in the context of an already-planned a review of our **social action plans** and the review that is already underway into the operation of the energy Efficiency Levy. In addition, we are aware of the wider external debate on fuel poverty, social tariffs, sustainability and related issues. In this area, the Utility Regulator is working with the Northern Ireland Fuel Poverty Advisory Group – which advises the Minister and her Department on addressing fuel poverty – and has commenced work in the recently created Fuel Poverty Task Force. We will respond positively and constructively to developments in these areas as they connect into our future workplans.



**Consultation Question 7:- We would welcome views as to whether there are other significant “retail” issues which we ought to have reflected here.**

**Consultation Question 8:- The Utility Regulator has limited resources, both as a whole and also within each operational Directorate, to deliver priorities in the coming 5 year period. We would welcome early views from respondents on the urgency, importance and thus prioritisation of strategic goals and work priorities.**



## Chapter 5 How we will deliver

As set out in the Introductory chapter, once we have consulted on and developed the thinking around our 5 year Corporate Strategy, we will move to produce the actual strategy document later this year. A key aspect at that stage will be ensuring deliverability of our strategic priorities. At this early stage we wish to note our intentions to deliver on our strategy via:-

***FWPs<sup>22</sup>***: This is our first 5 year Corporate Strategy; we will put this into practice and deliver our aims through annual FWPs. Whilst publication of our FWP is mandatory, this Corporate Strategy is voluntarily - we do it because we want to make sure all our actions have a sound strategic foundation. However, the Corporate Strategy is a living baseline for the organization, and it will be reviewed every 2/3 years to ensure it remains relevant to the industries and appropriate for what we want to achieve.

***Resources***: It is important that the Utility Regulator delivers “value for money” to customers. Our running costs are met by licence fees which in turn are paid for by the utility customers. It is essential therefore that we protect customers and perform our duties as economically and effective as possible. We will deliver through having skilled staff operating in a team-based and knowledge driven environment, working on well-planned and quality-driven project teams.

***Delivery through partnership*** (e.g. other regulators alliances, local and national government Departments, other statutory bodies, companies, consumer groups): The regulatory environment in which we operate can be a complex one. This means that we can maximize our contribution only through good working partnerships with our stakeholders. We will deliver by working transparently and constructively with the relevant EU, National and Local Authorities, as well as the licensees and other consumer and interest groups.

***Delivery through consultation***: We recognize the importance of consulting widely on our projects, plans and decisions. Some of our stakeholders may not always agree with what we do but at least they should know clearly why we propose certain courses of action at an early a stage as possible. We will deliver our policies using the best available evidence and taking into account evidence from all our stakeholders. We will deliver by being an effective and proportionate regulator, intervening to protect consumers and their interests where the market is not effective, and where the benefits justify action.

***Delivery overseen by our Board***: We have a Board and an executive staff that we are confident can deliver on our duties and maximize our contribution. The Utility Regulator’s board currently consists of a chairman (Prof. Peter Matthews) and seven other members that have significant experience in regulation, energy, water and corporate governance.



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<sup>22</sup> Forward Work Plans.

# Chapter 6 Questions and consultation details

## Specific questions

At various points in the document we have specifically asked consultation questions. We repeat them below for completeness. We welcome views and responses on these questions, and indeed on other issues raised by the consultation and on which respondents would like to comment.

**Consultation Question 1:- We would welcome views as to whether there are other significant challenges which we ought to have reflected here.**

**Consultation Question 2:- We would welcome views as to whether there are other significant opportunities which we ought to have reflected here.**

**Consultation Question 3:- We would welcome views as to whether there are additional significant “context” issues which we ought to have reflected in this chapter but have omitted.**

**Consultation Question 4:- We would welcome views as to whether there are significant issues within the context issues already identified which we should have noted.**

**Consultation Question 5:- We would welcome views as to whether there are other significant “wholesale” issues which we ought to have reflected here.**

**Consultation Question 6:- We would welcome views as to whether there are other significant “network” issues which we ought to have reflected here.**

**Consultation Question 7:- We would welcome views as to whether there are other significant “retail” issues which we ought to have reflected here.**

**Consultation Question 8:- The Utility Regulator has limited resources, both as a whole and also within each operational Directorate, to deliver priorities in the coming 5 year period. We would welcome early views from respondents on the urgency, importance and thus prioritisation of strategic goals and work priorities.**

## **Section 75 – Equality considerations**

Section 75 of the Northern Ireland Act places a duty on public authorities to have due regard to the need to promote equality of opportunity and regard to the desirability of promoting good relations between different categories.

Whilst every care has been taken in the drafting of this document to adhere to best practice in relation to Section 75, the Utility Regulator would very much value the input of its stakeholders and the communities with whom it endeavours to participate.

We aim to promote equality of opportunity between nine categories of persons, namely between persons of different religious belief, political opinion, racial group, age, marital status or sexual orientation; between men and women generally; between persons with a disability and persons without; and between persons with dependents and persons without.

As part of this consultation exercise we would like to determine whether any of the nine groups defined above are likely to be significantly affected, either positively or negatively, or could the key issues under consideration create differential impacts between groups within each Section 75 category? Is this impact adverse or beneficial?

The Utility Regulator is keen to incorporate any recommendations received in this regard into its strategy proposals and will respond to contributors indicating what decisions it has made in respect of the consultation.

### **Consultation details:**

Responses to the questions and issues raised in this paper should be sent, ideally in electronic format, to the Utility Regulator by **Friday 19<sup>th</sup> September**.

Responses should be sent to:

**Elena Ardines**

**Strategy branch**

**The Utility Regulator**  
**Queens House**  
**14 Queen Street**  
**Belfast – BT1 6ER**  
**e-mail: [elena.ardines@niaur.gov.uk](mailto:elena.ardines@niaur.gov.uk)**

Your response may be made public by the Utility Regulator. If you do not want all or part of your response or name made public, please state this clearly in the response by marking your response as '**CONFIDENTIAL**'. Any confidentiality disclaimer that may be generated by your organisation's IT system will be taken to apply only to information in your response for which confidentiality has been specifically requested.

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA) and the Data Protection Act 1998 (DPA)). If you want other information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Utility Regulator.

# Annex 1: Our Statutory Duties

## Relevant excerpt from Energy Order 2003

### OBJECTIVES OF REGULATION OF ELECTRICITY AND GAS

#### *Electricity*

#### **The principal objective and general duties of the Department and the Authority in relation to electricity**

**12.** - (1) The principal objective of the Department and the Authority in carrying out their respective electricity functions is to protect the interests of consumers of electricity supplied by authorised suppliers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission or supply of electricity.

(2) The Department and the Authority shall carry out those functions in the manner which it considers is best calculated to further the principal objective, having regard to -

(a) the need to secure that all reasonable demands for electricity are met; and

(b) the need to secure that licence holders are able to finance the activities which are the subject of obligations imposed by or under Part II of the Electricity Order or this Order; and

(c) the need to secure -

(i) that the prices charged to tariff customers by public electricity suppliers for electricity supplied under Article 19(1) of the Electricity Order to premises in any area specified in an order made by the Department are in accordance with tariffs which do not distinguish (whether directly or indirectly) between different parts of that area; and

(ii) that public electricity suppliers are not thereby disadvantaged in competing with other persons authorised by a licence or exemption to supply electricity to such premises.

(3) In performing that duty, the Department or the Authority shall have regard to the interests of -

(a) individuals who are disabled or chronically sick;

(b) individuals of pensionable age;

(c) individuals with low incomes; and

(d) individuals residing in rural areas;

but that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer.

(4) The Department and the Authority may, in carrying out any electricity functions, have regard to the interests of consumers in relation to gas.

(5) Subject to paragraph (2), the Department and the Authority shall carry out their respective electricity functions in the manner which it considers is best calculated -

(a) to promote the efficient use of electricity and efficiency and economy on the part of persons authorised by licences or exemptions to supply or participate in the transmission of electricity;

(b) to protect the public from dangers arising from the generation, transmission or supply of electricity;

(c) to secure a diverse and viable long-term energy supply;

(d) to promote research into, and the development and use of, new techniques by or on behalf of persons authorised by a licence to generate, supply or participate in the transmission of electricity; and

(e) to secure the establishment and maintenance of machinery for promoting the health and safety of persons employed in the generation, transmission or supply of electricity;

and shall have regard, in carrying out those functions, to the effect on the environment of activities connected with the generation, transmission or supply of electricity.

(6) In this Article "electricity functions" means -

(a) functions under Part II of the Electricity Order; and

(b) functions under this Order relating to electricity.

### **Exceptions from the general duties**

**13.** - (1) Article 12 does not apply in relation to functions of the Department under -

(a) Article 39, 40, 58, 59 or 60 of the Electricity Order; or

(b) Article 61.

(2) Article 12 does not apply in relation to anything done by the Authority -

(a) in the exercise of functions relating to the determination of disputes; or

(b) in the exercise of functions under -

(i) Article 46(3) of the Electricity Order; or

(ii) Article 8.



(3) The Authority may nevertheless, when exercising any function under Article 46 (3) of the Electricity Order, have regard to any matter in respect of which a duty is imposed by Article 12 if it is a matter to which the Office of Fair Trading could have regard when exercising that function.

(4) The duties imposed by Article 12 do not affect the obligation of the Authority or the Department to perform or comply with any other duty or requirement (whether arising under this Order or another statutory provision, by virtue of any Community obligation or otherwise).

## **Gas**

### **The principal objective and general duties of the Department and the Authority in relation to gas**

**14.** - (1) The principal objective of the Department and the Authority in carrying out their respective gas functions is to promote the development and maintenance of an efficient, economic and co-ordinated gas industry in Northern Ireland.

(2) The Department and the Authority shall carry out those functions in the manner which it considers is best calculated to further the principal objective, having regard to -

(a) the need to protect the interests of consumers of gas;

(b) the need to secure that licence holders are able to finance the activities which are the subject of obligations imposed by or under Part II of the Gas Order or this Order;

(c) the need to secure that the prices charged in connection with the conveyance of gas through designated pipe-lines (within the meaning of Article 59) are in accordance with a common tariff which does not distinguish (whether directly or indirectly) between different parts of Northern Ireland or the extent of use of any pipe-line; and

(d) the need to protect the interests of gas licence holders in respect of the prices at which, and the other terms on which, any services are provided by one gas licence holder to another.

(3) In performing that duty, the Department or the Authority shall have regard to the interests of -

(a) individuals who are disabled or chronically sick;

(b) individuals of pensionable age; and

(c) individuals with low incomes;

but that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer.

(4) The Department and the Authority may, in carrying out any gas functions, have regard to the interests of consumers in relation to electricity.

(5) Subject to paragraph (2), the Department and the Authority shall carry out their respective gas functions in the manner which it considers is best calculated -

(a) to promote the efficient use of gas;

(b) to protect the public from dangers arising from the conveyance, storage, supply or use of gas;

(c) to secure a diverse and viable long-term energy supply; and

(d) to facilitate competition between persons whose activities consist of or include storing, supplying or participating in the conveyance of gas;

and shall have regard, in carrying out those functions, to the effect on the environment of activities connected with the conveyance, storage or supply of gas.

### **Edited statutory duties wording from Water and sewerage services Order 2006**

The Authority shall carry out the functions in the manner that it considers is best calculated—

(a) to protect the interests of consumers in relation to the supply of water by water undertakers and the provision of sewerage services by sewerage undertakers, wherever appropriate by facilitating effective competition between persons engaged in, or in commercial activities connected with, the supply of water and the provision of sewerage services;

(b) to secure that the functions of a water undertaker and of a sewerage undertaker are properly carried out as respects every area of Northern Ireland; and

(c) to secure that companies holding appointments as relevant undertakers are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of the functions of such undertakers.

The Authority shall have regard to the interests of—

(a) individuals who are disabled or chronically sick;

(b) individuals of pensionable age;

(c) individuals with low incomes; and

(d) individuals residing in rural areas,

but that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer.

The Authority may have regard to—

(a) any interests of consumers in relation to electricity supplied by authorised suppliers (within the meaning of the Energy Order);

(b) any interests of consumers in relation to gas supplied by authorised suppliers (within the meaning of that Order);

(c) any interests of consumers in relation to communications services and electronic communications apparatus (within the meaning of the Communications Act 2003 (c.21),

which are affected by the carrying out of that function.

The Authority shall carry out the functions mentioned in the manner that it considers is best calculated—

(a) to promote economy and efficiency on the part of companies holding an appointment under Chapter I of Part III in the carrying out of the functions of a relevant undertaker;

(b) to secure that no undue preference is shown, and that there is no undue discrimination, in the fixing by such companies of water and sewerage charges;

(c) to secure that consumers are protected as respects benefits that could be secured for them by the application in a particular manner of any of the proceeds of any disposal (whenever made) of any of such a company's protected land;

(d) to ensure that consumers are also protected as respects any activities of such a company which are not attributable to the exercise of functions of a relevant undertaker, or as respects any activities of any person appearing to the Department or, as the case may be, the Authority to be connected with the company, and in particular by ensuring—

(i) that any transactions are carried out at arm's length;

(ii) that the company, in relation to the exercise of its functions as a relevant undertaker, maintains and presents accounts in a suitable form and manner;

(e) to contribute to the achievement of sustainable development.

The Authority shall have regard to the principles of best regulatory practice (including the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed.

# Annex 2: Current work areas with the three regulated sectors

## (1) Water and Sewerage

The Utility Regulator was appointed as economic and customer service regulator of the water and sewerage sectors in NI in April 2007 under the Water and Sewerage Services (NI) Order 2006. Our appointment to this role was part of a wider reform package of the water and sewerage industry in NI that established the setting up of NI Water as a Government-owned company acting as the sole water and sewerage service provider in NI.

We exist for the benefit of consumers, over the short- and long-term. We therefore have three main statutory duties:

- a. To protect customer interests, wherever appropriate by facilitating competition;
- b. To ensure Northern Ireland Water (NIW) carries out its statutory and licence responsibilities, notably provision of service in every area of Northern Ireland; and
- c. To ensure NIW is financially sustainable. We see this as being in the long-term interests of customers, as it is necessary to secure the large on-going investments required for customer service.

In our work we have also been authorised by the DRD to carry out some functions on its behalf. To fulfil these duties we are also required to have regard to: the interests of vulnerable customers; efficiency and economy; protecting the interests of consumers as regards non-regulated activities and disposals of surplus land; and sustainable development.

Independent regulation is vital to protect customers. Experience suggests that steady pressure for efficiencies from an independent regulator can achieve substantial cost-savings (for instance, the state-owned Scottish Water saw a 40% reduction in operating costs along with a 24% improvement in quality scores, during the first charge cap period 2002-2006).

To deliver our duties we are now working to establish firmly the new regulatory regime, establishing binding service standards, establishing proper information processes and reporting from NIW, clarifying investment requirements in terms of both renewal and environmental-driven requirements and working towards a tough but deliverable price control to drive efficiency from 2010. Our aim in discharging these duties is to protect consumers, promote value and safeguard the future. We aim to take a long-term approach so that the company can be held accountable for the outcomes of substantial investment programmes. We will do this through benchmarking; setting efficiency targets with incentives and penalties; and rigorous analysis of management plans including trade-offs between capital and operational spend.

**At the time of drafting, there is a significant degree of uncertainty around some of the key policy background to water and sewerage regulation, as we are awaiting the full outcome of the Independent Water Review Panel and subsequent NI Executive policy decisions on key factors such as tariffs and regulatory approaches. We anticipate that the outcomes of this work should be available by the time we are working on our final Corporate Strategy document later this year. In the meantime however, the main tasks in our current Forward Work Plan associated with our water and sewerage regulatory objectives are set out below**

### ***A review of the Strategic Business Plan (SBP) 2007 – 2010***

NIW's SBP is an essentially technical document which should lay out what outcomes the company is aiming to achieve, what work will be required to enable these outcomes, and the operating and capital spend involved to deliver that work. It also includes the financial plans behind these costings.

The current SBP was determined prior to the establishment of the NIAUR's formal role in water & sewerage regulation. We therefore are carrying out a review to establish an acceptable baseline and we will then put in place a monitoring plan to track delivery of the outputs. The main objectives of our work are:

- a. to satisfy ourselves as to the acceptability of the outcomes specified in the plan;
- b. that the work-streams and associated investment described in the plan clearly defines necessary outcomes; and
- c. that efficiency targets set are appropriately demanding.

### ***Benchmarking service standards***

A key role of the Utility Regulator is to monitor the service being provided to the Customer and to benchmark with other companies in the sector e.g English and Welsh water companies. The company has for some years now supplied annual data streams for this comparative process, however the confidence level and completeness of this data need to be strengthened.

We have therefore laid out a new framework with NIW, and specified timeframes for delivery of such information where it cannot currently be provided. We aim to achieve a fuller range of data during the subsequent years. Our requirements and benchmarking work are both under development and will be focused on the company's performance, in terms of both the service provided to the customer and the associated costs.

### ***Price review 2010***

Despite the current uncertainties, we are continuing to prepare to put in place a price control from 2010. This work area spans a 2 to 3 year period, the programme for which is now underway.

In preparing this control we will require the company to define and justify its investment needs – specifying work streams and associated outputs – initially over a 2 year period, but set in a longer term context to ensure environmental and economic sustainability. A current focus of the Water Directorate Team is to establish a sound baseline for both OPEX<sup>23</sup> and CAPEX<sup>24</sup>. In the development of templates, consideration will be given to the requirements for the price control process. We have commenced consultation and the process of receiving and giving guidance on key price control factors and frameworks for planning (e.g. environmental and social objectives). This aspect of the process will depend heavily upon social and environmental guidance from the Minister for Regional Development. The price control timescale accommodates a robust process but will require setting prices initially for two years 2010/2011 and 2011/12; and then for a further 5 year period commencing April 2012.

### ***Metering review***

We recognise widespread public concern about capital-value based charges. Water metering would enable more innovative tariffs that could protect vulnerable customers while giving clearer signals of the economic value of water. We have undertaken a review of metering using independent consultants and have forwarded the outcome of this to the Independent Water Review Panel and the appropriate Assembly Committee. We are awaiting further developments on this, pending decisions from the Executive (probably later this year) on water and sewerage services.

### ***Implementation of legal and regulatory framework***

Significant work remains to set in place the full legal framework of regulation as set out in the Water and Sewerage Services (Northern Ireland) Order 2006 together with the NIW Licence. Over the next six months we will seek to engage with all stakeholders to clarify roles, responsibilities and interfaces. Inter alia, we expect to agree Memoranda of Understanding with the Department for Regional Development; the Consumer Council; and the Environment and Heritage Service and the Drinking Water Inspectorate.

The Water and Sewerage Services (Northern Ireland) Order 2006 together with the NIW Licence include some specific deadlines for submissions which, taken together with associated off-Licence activities have given rise to a number of key submissions & dates within the evolving regulatory cycle:-

**Codes of Practice** – We have approved several codes of practice from NIW (e.g. in relation to domestic sewerage and water services). Several others await the introduction of domestic charging (currently proposed for April 2009).

**Guaranteed Standards Scheme** – A considerable amount of work was progressed in defining the standards early in the regulatory process. Currently a cross utility team is looking at

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<sup>23</sup> Operational expenditure.

<sup>24</sup> Capital expenditure.



Electricity, Gas and Water Directorate approaches to ensure consistency and understanding of differences alongside the carrying out of joint related consumer consultation.

### **Determination of consumer complaints**

We have a legal role to make determinations on serious consumer complaints and to be the final point of determination on consumer complaints which cannot be resolved through the normal complaint process with the Consumer Council. We also have a legal duty to determine various consumer complaints and approve NIW's Codes of Practice for dealing with customers. These powers are set out in the Water and Sewerage Services (Northern Ireland) Order 2006. We are therefore in close liaison on these issues with the Consumer Council and with NIW as appropriate.

## **(2) Electricity**

Electricity was the only sector regulated by the NIAUR when first established in 1992, after the privatisation of the NI electricity industry. Since then the main purposes of the Utility Regulator related to electricity sector have been to secure that all reasonable demands for electricity are satisfied, to secure that licence holders are able to finance the carrying on of the activities which they are authorised by their licences to carry on; and to promote competition in the generation and supply of electricity. The Utility Regulator should secure as well that the prices charged to tariff customers are in accordance with tariffs which do not distinguish between different parts of the area and that public electricity suppliers are not thereby disadvantaged. Above all, the main objective of the Utility Regulator is to protect the interests of consumers of electricity supplied by persons authorised by licences.

Current main work areas include:

### **A new approach to trading energy across borders – the Single Electricity Market**

The Single Electricity Market (SEM) started, as planned, on the 1 November 2007. The SEM created a single market for the trading of wholesale electricity on the island of Ireland. The creation of a SEM is the biggest change in the electricity industry in Northern Ireland in the 15 years since privatisation. It is also seen as having European significance, setting up a new way in which EU member states can co-operate to create effective energy trading arrangements.

An important feature in making the SEM happen was our close working relationship with key partners. We led a three year project to deliver the SEM with the Commission for Energy Regulation (CER), our equivalent organisation in the Republic of Ireland. Our work on the SEM also involved close co-operation with the transmission system operators - SONI<sup>25</sup> and EirGrid in the Republic of Ireland. The wider electricity industry throughout the island of Ireland also played an important role in delivering a SEM. Finally, the support of the two government departments north and south (DETI and the Department of Communications, Energy and

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<sup>25</sup> System Operator of Northern Ireland.

Natural Resources - DCENR) that are responsible for energy policy, was important in delivering the SEM.

Before the SEM could start in November last year, we worked closely with our partners to make the necessary preparations. This included finalising a Trading and Settlement Code (TSC - the rules of the market), and the completion of the licensing and contract arrangements for the new market. We also spent some time planning quite technical elements of the SEM, such as the implementation of market power arrangements - including directed contract process and the setting up of Market Monitoring Unit (MMU). The MMU is a multi-disciplinary team who use their knowledge of energy and markets to understand how prices are being set in the SEM. It also assesses whether those prices are at a level expected in a competitive market. Information from the SEMO and international energy markets is obtained to help us analyse individual events in the SEM. This may include working out why spikes in prices occur, the operation of market rules and participant bidding – for example for evidence of manipulation or to understand the strategies behind bidding. Overall, the MMU provides an assurance that a specialist team is constantly monitoring the SEM to make sure that there is no market dominance and to provide an objective basis for acting to prevent unfair market behaviour.

Information Communication and Technology (ICT) plays an important role in the SEM project, both for external and internal interactions. The cross-jurisdictional nature of regulation of the market has brought to the fore the need to be able to share data with our CER colleagues. We are currently in the final stages of developing secure remote network access between the Belfast and Dublin offices. In doing so we have had to harmonise our filing structure so that both organisations access and record information in the same way. As part of the implementation of SEM a separate ICT solution was developed for market monitoring for the purposes of: data management – including automated downloading and storage of all market data, fuel price data and filing for the sharing information between the Belfast and Dublin – and data analysis tools, for statistical analysis. Our preparations also included work to complete transmission harmonisation arrangements and the capacity payment mechanism. Work also took place to set up the Single Market Operator (SEMO).

Although there is no doubt that aspects of the operation of the SEM are difficult, the changes have the potential to bring benefits to energy consumers on the island of Ireland. This includes combining two smaller markets to provide greater competition and investment opportunities, and security of supply and efficiency benefits. It is estimated that the SEM will lead net benefits equal to £100 million<sup>26</sup>.

Since 1 November, we have worked with our partners to set up a SEM Committee – established by legislation in both parts of Ireland – to take decisions in relation to any functions relating to SEM matters. The SEM Committee is made up of three representatives from the Utility Regulator, two from CER and two independent members. The first meeting of the SEM Committee took place on 13 November, and four further meetings have taken place during 2007-08. A key focus of its work to date has been the monitoring of the new market including its first MMU Inquiry.

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<sup>26</sup> A Cost Benefit Study of the Single Electricity Market – A Final Report for NIAER and CER, by NERA Economic Consulting, 2006.

Ongoing developments in the SEM are aimed at maximising the benefits gained from the all island arrangements. These include the further development of market systems and the development of arrangements for the SEMO.

## **Promoting retail competition:**

### **(a) Cross Border developments**

One important outcome of SEM was the development by the Utility Regulator and CER (the Regulatory Authorities – RAs) of greater harmonisation of the retail markets.

In April 2007 the RAs announced the alignment north and south of the Public Electricity Supply (PES) retail tariff years. This was followed up in June by a number of decisions outlining the transitional arrangements for the regulation of Northern Ireland Electricity (NIE) and the Electricity Supply Board (ESB) in the new wholesale market. In conjunction with CER we also agreed to place a number of controls on ESB and NIE in order to facilitate competition in generation and supply, to protect the interests of final customers and to provide clear, transparent and non-discriminatory mechanisms for the determination of PES tariffs.

A key control was the introduction of an Economic Purchasing Obligation (EPO) requiring NIE and ESB to purchasing hedging contracts in a manner that is fair, transparent and non-discriminatory while at the same time not overpaying for their contracts which would result in customers overpaying for their electricity. Both suppliers were required to produce hedging policy statements for approval by the RAs. Both suppliers were also required to submit for regulatory approval tariff methodology statements.

### **(b) Extending choice in the Northern Ireland market**

We want to extend real choice to customers in Northern Ireland through competition. Following the completion of non-domestic market opening in 2005, the market was opened to domestic customers and un-metered supplies on 1 November 2007 in line with an EU Directive concerning common rules for the internal market in electricity. Although no suppliers other than NIE Energy are currently supplying the domestic market, we are working to promote competition in this area.

Internally we set up a cross-directorate project team to look at retail competition. A key part of the project has been to work out what the key barriers are to retail competition and how they may be addressed. In this sense, a public consultation was launched on April 2008, with the objective of seeking views on the Utility Regulator's short-term and medium-term proposals for stimulating competition in the gas and electricity markets in Northern Ireland – we return to this more fully in later chapters.

## **Protecting consumers by regulating monopolies – price controls**

We use price controls to ensure that monopolies do not abuse their position, providing them with a future level of revenue to meet their statutory and licence obligations, and putting in

place incentives so that the companies can, for instance, offer a good quality of service to customers. During 2007-08, NIE Energy, SONI, and PPB<sup>27</sup> were subject to price controls.

Our work on the NIE Energy price control led to an outcome where business expenditure will decrease by 16 per cent in the current year and increase by 1.5 per cent next year - much of the decrease is due to the transfer of metering to the Transmission and Distribution business as part of the preparation for a competitive retail electricity market.

Our initial proposals on the SONI price control were published in December for consultation and we continued to negotiate with SONI on particular areas including the regulatory asset base (RAB) of the business, the weighted average cost of capital (WACC) and ownership of Castlereagh House Control Centre.

The new PPB price control is a major change from the previous arrangement which was based around an incentive on sales volume - which is no longer appropriate in the new wholesale pool arrangements. The new control is based on a basket of incentives which measure the efficiency of the operation of the PPB contracts and PPB interaction with the SEM and is for the period November 07 to March 09. The overall incentive amount will be based on PPB's operating performance and also partially on savings to customers.

Our work on the PPB price control is projected to save customers around £2 million in the period Nov 07 – March 08 through a reduction in regulated entitlement (when compared to the equivalent period in financial year 06/07). Also, going forward this price control will lead to a reduction of around £4 million in PPB's regulated entitlement for financial year 08/09 when compared to either of the two years price control outturn entitlements in financial years 05/06 and 06/07. This is in spite of PPB operating costs rising by around £1 million a year (post SEM) due to increased staff numbers. PPB has also established arrangements with the contracted generators that will provide additional benefits to customers for the duration of this new price control.

## Innovating on metering

Northern Ireland has been at the forefront of introducing modern metering technology, At present there are some 200,000 keypad meters installed in domestic premises representing approximately 27% of all domestic customers. We have also started to consider the issue of smart metering. Smart meters are a modern system of metering which allows two-way communication between customer and suppliers. Introducing smarter forms of metering for domestic customers have the potential to: improve customer service; increase domestic energy efficiency (helping to reduce greenhouse gas emissions); reduce fuel poverty and increase security of supply. The unique nature of the Utility Regulator also provides us with an opportunity to address the issue on a cross utility basis.

The Utility Regulator is also specifically planning smart meter pilots. This will involve 6 pilots to 200 customers each and discussions with NIE have begun on delivering this initiative. These pilots could explore the technical options available and look at supplier issues of interoperability and commonality between NI and ROI systems. A joined up approach is essential if smart metering solutions are to fit with the whole area of retail market opening – suppliers will want interoperability between their systems and NI and ROI meters so they will

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<sup>27</sup> Power Procurement Business.

want the same harmonization with respect to signing new domestic customers in NI and ROI. A steering group (chaired by the Utility Regulator) is being set up and it will drive policy for the working/project management group who will control and give directions to two further working groups, one dealing with customer behaviour and the other with technical issues. The results of these pilots will help inform the decisions as to the best way forward for smart metering in Northern Ireland. Any future decisions on smart metering implementation will also take into account the results of smart metering pilots in the Republic of Ireland and Great Britain

## Working in European markets

The Utility Regulator continues to work with the French, British and Irish regulators in removing barriers to a Regional Electricity Market as a stepping stone to a fully integrated European Internal Market for Electricity. The Single Electricity Market is a significant step towards regional integration of electricity markets, spanning two jurisdictions and removing barriers to cross-border trading.

## (3) Gas

Natural Gas first arrived from Scotland to NI in 1996. In the same year the functions of the Utility Regulator were extended to cover gas.

Current main work areas include:

### Working for customers on gas prices

The Utility Regulator continued to regulate gas companies through price controls. In 2007-08 we initiated or completed price controls on Phoenix Natural Gas (PNG) Distribution, firmus energy Distribution and Phoenix Supply Ltd (PSL).

Our work on the third PNG distribution price control took most of 2007 to complete. To complete the task, we brought together an expert team - consisting of Utility Regulator staff and specially commissioned engineers - to review the company's operations and regulatory submission documentation. The focus of our work was on making sure that PNG could run an effective network as efficiently as possible.

As a result of our work, the distribution charge being applied to gas supply companies fell from 40 pence per therm to around 33 pence per therm (based on 2006 prices). This led to an overall reduction in the costs of the network of around £6 million per year.

Work began in early 2008 on the second firmus energy price control. As with the work on the PNG distribution price control, we have brought together an expert team. This team will analyse firmus energy's cost projections to make sure that the company has sound plans for efficiently investing in the network. Having sound investment plans will allow firmus energy to continue making new network connections, so making natural gas a viable alternative fuel for customers in each of the ten towns that are served by the network. We have completed our

information request to firmus and have set out a clear template for dealing with the strict and diverse information requirements. This should allow a transparent flow of information and the achievement of the price control timetable in 2008.

Overall, the price control will make sure that distribution charges are set to a level that will protect customers and support the continuing development of the natural gas network in each of the towns along the North-West and South-North transmission pipelines.

In carrying out our work on the PSL price control, we were aware that even though the market for the supply of gas to domestic customers in the greater Belfast area has been open since January 2007, no new suppliers have as yet entered the market. Our extensive analysis for the PSL price control was completed at the end of 2007. We then sent out a paper in February 2008 for public consultation. The price control will provide customers with comfort that the prices they are paying are regulated. The price control covers customers consuming less than 25,000 therms as competition from alternative fuels is not enough to protect the interests of this part of the gas market. In addition, new suppliers have not entered the domestic gas supply market in the greater Belfast area even though the market has been open since January 2007.

## **Supporting new ways of delivering benefits to gas consumers**

During 2007-08 we were faced with making a judgement on the granting of a licence to a not-for-profit company limited by guarantee, NIEH in relation to the Phoenix transmission assets. The licence grant was in order to facilitate the sale of the assets. Our primary consideration was whether or not this licence grant would be in the interests of gas consumers in Northern Ireland. The transfer of ownership in Phoenix Natural Gas Transmission case was from a private sector company to a not for profit company which has no shareholders and instead has a group of members whose job it will be to monitor the company's obligations to gas customers. This process is referred to as mutualisation, and the key benefit is that profits will not be distributed to shareholders but will either be reinvested into the company or used to reduce tariffs for customers. Although we had previous experience of the 'mutualised model' in 2005, we decided to carry out a new assessment while making reference to our analysis conducted two years ago. A decision paper covering all the analysis and providing feedback on consultation responses was published in October 2007.

Overall, it is clear that the sale will lead to significant financial benefits. The immediate benefit has been a reduction of £4.7m in transmission tariffs in 2007/08. In addition to the one-off benefits the deal will deliver financial benefits to the Northern Ireland gas customers in the region of £25 million over 40 years.

## **Exploring the potential for an all-island approach to gas**

In late 2007, the Utility Regulator and the Commission for Energy Regulation (CER) came together to discuss the potential for an all-island approach to gas, in terms of Common Arrangements for Gas (CAG).

To start the project, a Memorandum of Understanding (MoU) between the Utility Regulator and CER on CAG was agreed. This MoU sets out the Utility Regulator's and CER's commitment and shared vision "whereby all stakeholders can buy, sell, transport, operate, develop and plan



the natural gas market both north and south of the border effectively on an all-island basis". An important element of the joint vision is to ensure that customers will receive benefits from the common arrangements. The MoU identified main areas of work, and both organisations have drafted a workplan for the project to set out how these areas will be addressed. It is estimated that project will be developed in the next months and significant parts of it will be completed by October 2009.

Since December 2007, the Utility Regulator and CER have been working on several workstreams associated with CAG. Dedicated teams have been established in both organisations to work together on the workstreams. These teams report to a 'CAG Steering Group' comprising senior management from both organisations which meets monthly to discuss current work plans and progress. Both organisations have also discussed the relevant issues with the government departments in each jurisdiction and have established a joint working group between the departments and regulators to ensure the project progresses effectively.

Extensive resources and time has gone into devising a high level Cost Benefit Analysis (CBA) and the structural design has been completed. The Single Transmission Tariff Methodology which focuses on the best approach to harmonise the structure of the tariffs charged to network users across Northern Ireland and the Republic of Ireland is currently underway. Expert assistance is in place to assist in this workstream and a lot of background work has been done in this area which is on track to be completed in late 2008. The Gas Industry Operation workstream which concentrates on an integrated transmission system that physically transports gas around the island is also in progress. Again, both organisations have been involved in intensive discussions to prepare a consultation paper on the issues involved in moving to a single operational regime on the island which will allow robust progress on the workstream in 2008.

The Utility Regulator and CER are committed to the implementation of the common arrangements for gas and are aware that the participation of the industry's stakeholders is important. Therefore in February 2008, both organisations held a joint Industry workshop to brief key stakeholders about the introduction, and predicted implementation, of the CAG Project. It is planned that all related papers will be sent for consultation and, where necessary, dedicated consultation workshops will be organised.

## **Achieving market harmonisation – working with European partners**

We have been heavily involved in the North West (NW) region of the Gas Regional Initiative (GRI) which is a European-wide effort to achieve market harmonisation on a regional level, in advance of full European-wide harmonisation. The Utility Regulator in conjunction with CER led the development of a MoU between the national regulators in the NW region. The purpose of this MoU was to help facilitate better regulatory co-ordination on cross border issues for example on interconnectors and market design. The signing of the MoU took place in October 2007 and should lead to regulatory decisions and processes that are more effective, consistent and coordinated. For example, it now places clear guidelines on Ofgem in Great Britain to consider the impact of any of its proposals on Northern Ireland and to engage with us in order to address any concerns.

Gas Transparency remains as one of the key priorities to help facilitate greater market integration. The transmission companies in the NW region set out detailed plans in December 2007 to improve transparency for some key areas identified by stakeholders. The Utility Regulator has worked with the transmission companies in Northern Ireland to set out common information matrices to provide transparent and consistent information to suppliers. After a period of consultation these matrices have now been approved and appear on the various transmission companies' websites for the benefit of all suppliers.

## **(4) Sustainability, Alleviating Fuel Poverty, and Social Action**

In addition to our work directly with the three regulated sectors, we also undertake a range of activities broadly speaking in the environmental and social arenas. We report on these briefly below for completeness.

### **Supporting energy efficiency – the Energy Efficiency Levy Programme**

We are responsible for administering the Energy Efficiency Levy Programme (EEL), which was introduced in 1997-98. The EEL was introduced to implement energy efficiency schemes for domestic consumers with the aim of reducing carbon emissions. However with increasing concerns over the level of fuel poverty the focus of the EEL evolved. Most of the EEL funding (80 per cent) is aimed at helping to lessen the impact of fuel poverty by improving poorly heated and insulated homes. The remaining 20 per cent is available for energy efficiency and emission reducing projects in the domestic and business sectors.

The EEL was last reviewed in March 2006. At that time, and following consultation, we said that the EEL would continue for a further 3 years. In February 2008 we published a terms of reference for the next review of the EEL. As part of the review, we are seeking the views of stakeholder groups in all sectors including environmental and fuel poverty groups.

### **Contributing to sustainable development – the Regulator's Role**

We have a vital role to play in promoting sustainability as we are the main gate keepers to infrastructure investment in three sectors with high environmental impact: water, gas and electricity. In recognition of our role, we developed a major strategy paper, Sustainability – the Regulator's Role, which we launched for public consultation in March 2008. We discuss this further in subsequent chapters

### **The Northern Ireland Renewable Obligation**

The Utility Regulator has statutory responsibility for the Northern Ireland Renewable Obligation (NIRO), which is a statutory requirement on electricity suppliers to source an increasing amount of their electricity from renewable sources.

We introduced changes to achieve the smooth running of the NIRO after the introduction of the SEM from November 2007.

There has been an increase in interest in renewable generation in the last year, both large scale and small with many projects coming on line. At the start of NIRO in 2005-06, suppliers had to source 2.5 per cent of their power from renewable generation. In 2007-08 this now stands at 2.8 per cent. The Obligation continues until 2027, when electricity suppliers in Northern Ireland will have to ensure 6.3 per cent of their electricity is from renewables.

## **The Climate Change Levy Exemption Scheme**

Throughout the year the Utility Regulator has also managed and administered the Climate Change Levy scheme (CCL), issuing Levy Exemption Certificates (LEC) to accredited generators in NI and RoI. The CCL is a tax on energy used by businesses. In relation to electricity, the CCL requires that suppliers charge commercial customers (i.e. business not domestic, governmental or charitable customers) an extra 0.44p per kWh (i.e. £4.41 per MWh), and these monies are then remitted to the government, where they are used to fund a national insurance contribution break and energy saving programs. Electricity produced from designated renewable and good quality CHP sources is exempt from CCL, and is issued with exemption certificates which can be bundled with the power when sold to a supplier

## **Social action**

Our remit represents a unique opportunity for a single organisation to bring forward a coordinated strategy for the protection of vulnerable customers in the provision of electricity, gas, water and sewerage services.

We are in the process of developing a social action plan. In order to inform the plan, and in partnership with the Consumer Council for Northern Ireland (CCNI), we have carried out consumer research to inform the Social Action Plan. This consisted of setting up focus groups of disadvantaged customers and asking their opinion on the various schemes provided by the energy suppliers and an omnibus report asking views on energy prices, supplier schemes and other issues. Energy and water suppliers were also asked to complete a questionnaire on the effectiveness of their schemes as were bodies that represent disadvantaged or vulnerable customers.