



ANNUAL REPORT 2008-09

ANNUAL REPORT 2008-09

Combined report of the Northern Ireland Authority for Utility Regulation (the Utility Regulator).

The Utility Regulator has decided to produce a combined energy and water and sewerage report in accordance with Article 5 (5) of the Water and Sewerage Services (Northern Ireland) Order 2006.

Laid before the Northern Ireland Assembly in accordance with Article 6 (5) (a) of the Energy (Northern Ireland) Order 2003 by the Department of Enterprise, Trade and Investment.

Our mission

**Value and sustainability
in energy and water.**

Our vision

**We will make a
difference for
customers by listening,
innovating and leading.**

Our values

**Be a best practice regulator: Transparent,
Consistent, Proportional, Accountable and Targeted.**

Be a united team – One Team One Mission.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

Contents

	Page
1 Chairman's Foreword	5
2 Chief Executive's Report	6
3 Electricity	9
4 Gas	15
5 Water	21
6 Energy efficiency, alleviating fuel poverty, sustainability and social action	27
7 Effective and efficient regulator	33
Appendix 1: Progress against Forward Work Plan targets 2008-09	41
Appendix 2: Financial report	50

1

Chairman's Foreword



The Utility Regulator exists to protect energy and water customers in households and businesses. We live in difficult times for consumers. Household budgets are stretched, and businesses need to keep their costs down so as to save jobs and maintain wealth-creation. Northern Ireland's utility consumers will continue to benefit because we have a dedicated local energy and water regulator devising tailored, innovative solutions to local problems.

It is more important than ever that we do our job well. This report shows that in 2008-09 we have risen to that challenge. Our work pays for itself many times over: bills for consumers would have been higher in 2008-09 in the absence of regulation.

The biggest benefits, however, arise from our work to create secure and sustainable services. The year was seminal in developing markets, creating sound investment frameworks and charting a sustainable balance between consumers' social, environmental and economic aspirations.

A key innovation this year has been our development of a five-year strategic view. This has been a process of unprecedented openness and breadth. During the year we undertook three separate thematic consultations: on the future of retail markets, on how we can best contribute to sustainable development, and on key risks and challenges for the Northern Ireland markets. Findings from these were

integrated into a draft strategy that was itself subject to consultation. The Utility Regulator is a

We work hard to build strong stakeholder relationships, and are not afraid to lead.

listening organisation. We work hard to build strong stakeholder relationships, and are not afraid to lead.

We have boldly proclaimed this orientation in the new Mission and Vision that we adopted during the year. Our Mission is: value and sustainability in water and energy; and our Vision: we will make a difference for customers by listening, innovating and leading.

These are backed up by corporate values, developed through a process that has engaged the whole staff group (these appear in the inside cover of this document). I would like to highlight our commitment to professionalism and best-practice. We aim high. We

have exemplary governance, for instance, with a majority of non-executives on our board, and work-plans developed through open consultation.

I would like to close by thanking my colleagues on the board, and our dedicated and talented staff for the many achievements of the year. I am proud of who we are, and what we deliver to Northern Ireland's consumers.

Peter Matthews
Chairman, Northern Ireland
Authority for Utility Regulation

2 Chief Executive's Report



The last year was one of unprecedented challenge for consumers of energy and water services in Northern Ireland. In response, the Utility Regulator has raised its game. Short-term, we have accelerated work to develop retail competition, taken a flexible and innovative approach to tariff setting, and reduced the industry cost-base that consumers have to pay for. Longer-term, we have continued to develop sound market arrangements providing a solid basis for the huge investments needed to provide reliable and efficient utility services into the future.

Wholesale gas and coal prices rose to unprecedented levels during spring and summer 2008, which led to painful increases in final energy prices for consumers. As a learning organisation, we responded to public concern by commissioning a review of our electricity tariff process. The published report showed that our work had been robust, and also made useful suggestions for how regulation and wider energy policy could evolve, many of which we have already taken on board. We maintained a flexible and pro-active stance throughout the year, and reduced tariffs as soon as underlying wholesale costs permitted. Northern Ireland customers were the first in the United Kingdom or the island of Ireland to benefit from falling wholesale costs.

Competition has a vital role to play in meeting consumer expectations in energy. The current lack of choice for

Northern Ireland households is not acceptable. The recent introduction of retail competition in the Republic of Ireland, coupled with the publicly stated intentions of suppliers to enter the market in Northern Ireland, give us grounds for optimism. We will work vigorously to make choice a reality. We consulted during the year on an action plan to address entry barriers and have set up a dedicated team to implement this plan.

High fossil fuel prices this year have given us a glimpse of what might be business-as-usual a decade hence. They have emphasised the importance of developing sustainable arrangements to protect our most vulnerable consumers. We were happy to work with the NI Executive's Fuel Poverty Task Force. As that Task Force requested, we are now developing proposals for consultation on an enduring framework for social tariffs. We have also reviewed the

We will work vigorously to make choice a reality.

operation of the Energy Efficiency Levy, and consulted on a new approach to improve the efficiency and fairness by which measures are delivered. Northern Ireland has a distinctive and innovative approach to addressing social issues within the utilities, which has been seen as a model, for example by the Republic of Ireland authorities.

In water, the year saw the new regulatory regime bed down and start delivering for customers. The overall bill (whether paid by businesses or taxpayers) was £3.2 million lower because of our efficiency work. Our willingness to take tough enforcement action established clearly that NI Water is accountable for its actions, and as a result, the company's

information and management systems are now being improved.

Meanwhile, we have made excellent progress in developing the first price control on NI Water, to run from April 2010. I am particularly pleased that, despite continuing uncertainties about political direction, our relationships with key stakeholders developed positively during the year. We are committed to working collaboratively, in order to deliver lower bills and better quality for customers.

We probably add most value for consumers through our longer-term programme to ensure efficient markets and investment frameworks. During the year the new wholesale Single Electricity Market operated extremely successfully. Prices were set competitively and transparently. The success of this market creates a sound basis for new entry and investment, and we were delighted to see two new, major utility companies buy into the all-island market (Scottish & Southern, and Endesa). These developments put us at the frontier of EU best practice in energy regulation.

We also made major strides towards fleshing out Common Arrangements for Gas. The regulators are now able to place

**Table 1:
Adding value through our work during 2008-09**

Protecting customer interests through pro-active, independent economic regulation

- we defended, in court our right to decide in customers' interests when to cancel generator contracts
- we took robust action to ensure that billing systems for water customers were improved
- we took prompt action to instigate a review of gas and electricity prices, which led to lower bills from January

Securing efficiency savings for energy and water customers

- price controls secured efficiency savings for consumers (relative to companies' plans) of around £2.3 million in electricity
- £11 million in gas
- enhanced efficiency targets in water saved £3.2 million on the overall bill

Facilitating a modern and sustainable energy and water infrastructure

- The Single Electricity Market delivers benefits to consumers through fair and cost reflective prices, and has increased competition, investment and security of supply
- we contribute to developing the electricity grid and gas network in Northern Ireland
- we have used our expertise to scrutinise investment plans for water and sewerage services in Northern Ireland.

before Ministers a developed programme to rationalise system operation and network tariffs. This will provide clear and large-scale benefits for consumers so long as independent system operation can be assured. These benefits arise, above all, from creating a sound basis for companies to invest hundreds of millions of pounds (e.g. in gas storage or liquefied natural gas terminals). We hope that this compelling business case will soon provide the basis for implementing legislation.

In water, the fact that regulation is independent and focused primarily on the consumer is a major safeguard and bulwark of public confidence.

This strategic work is fundamental to secure supplies. The bulk of our electricity is generated using gas, and our gas infrastructure is immature. We need to attract investment to gas storage and wind generation to improve security. This is a particular challenge in a recession. Attracting capital to Northern Ireland will be increasingly difficult or expensive, so sound and stable regulation is more important than ever. We monitor closely the financial stability of regulated companies.

This report shows that the Utility Regulator provided good value for money during 2008-09 (Table 1 on page 7 summarises the key elements). Our Forward Work Programme for each year is subject to as much or more scrutiny than any other government department in Northern Ireland. It is developed through open consultation, and approved by a board mostly composed of independent non-executives. The year under review has seen full implementation of best-practice governance processes within the office, and progress in this area has been recognised by our auditors both internal and external.

While we expect our regulated companies to run efficient businesses, we also strive to achieve the same goal. As an example of that, we have made a commitment to reduce our costs, and during the 2009-10 year this will lead to budget reductions through less use of consultancy, and deferral of planned recruitment.

In this year of unprecedented volatility, we have seen intense public and political interest in our work. In energy, Northern Ireland is uniquely fortunate among UK regions/nations in having devolved regulation. In water, the fact that regulation is independent and focused

primarily on the consumer is a major safeguard and bulwark of public confidence. We therefore consider it to be of great importance that the public know about the work we are doing on their behalf, and we have worked hard this year on communications. We are beginning to see fruit from this work. Our polling suggests that more people know about us, and more have confidence in us, than last year. We will continue to work hard to listen and explain.

The many achievements of the year are the fruit of hard work by my colleagues. I am extremely proud of our staff group: they work hard, and work smart. I would like to thank them for their efforts on consumers' behalf, and also extend those thanks to the many stakeholders who have contributed time and passion to helping us deliver better outcomes for consumers.

Iain Osborne
Chief Executive

Electricity

3



highlights

- Evidence that the Single Electricity Market is operating successfully.
- Decisions on price controls relating to the System Operator for Northern Ireland and the Single Electricity Market Operator secured efficiency savings for consumers of approximately £2.3 million.
- We have worked pro-actively with the Department of Enterprise, Trade and Investment and Northern Ireland Electricity to advance a grid development strategy that will bring economic and environmental benefits for customers.
- At a time of exceptional cost pressures on energy prices, we have challenged regulated companies to keep their prices as low as possible and our scrutiny received independent endorsement.

Ensuring efficient markets and investment – the Single Electricity Market

One year on from the launch of the Single Electricity Market (SEM), we have continued - along with our regulatory partner in the Republic of Ireland, the Commission for Energy Regulation (CER) - to take steps to enhance the efficiency of the market.

The evidence suggests that the SEM is having a positive impact. Towards the end of March 2009, the SEM Committee finalised its first Annual Report on the SEM (published in April 2009). The report provided evidence that the SEM was successfully delivering benefits for consumers through fair and cost reflective market prices and increased competition,

investment and security of supply. Specifically, it is worth pointing out that because of SEM (and the related changes to the NIE Energy Power Procurement Business regulation) large commercial businesses benefited from a 50% cut in unit prices. This would not have been the case under pre-SEM arrangements. A more technical report by the Market Marketing Unit (MMU) was also published in April 2009 providing a detailed analysis supporting the conclusions of the SEM Committee.

The capacity payment mechanism in the SEM is designed to promote security of supply by incentivizing both the availability of existing generation and new investment in capacity when it is required. Substantial

work was completed to a very tight timescale to deliver the capacity pot value for 2009. This meant working with external experts to determine the cost of a new power station (peaking plant) as well as engaging with the Transmission System Operators (System Operator of Northern Ireland - SONI and EirGrid) in determining the electricity demand. A consultation paper on options for stabilisation of the value of the capacity pot was published by the SEM Committee in early March 2009. This was followed later in March with a consultation paper on the scope of a review of the capacity payment mechanism (CPM) with a view to examining if the current design of the CPM can be further improved to meet optimally the CPM objectives.

We have also been pro-active in enhancing the operation of the SEM through harmonization of the transmission system. New harmonised arrangements for the procurement of Ancillary Services have been developed in conjunction with the system operators and CER. These include reserve services which are in addition to energy generation and required by the system operators to manage the transmission system. New harmonized arrangements for generator charging for use of the transmission system and transmission losses have also been under development. Both of these are expected to be implemented during 2009-10.

Considerations about long-term investment in the electricity infrastructure on the island of Ireland have also been to the fore. Several factors prompted the SEM Committee to initiate work on future market arrangements: challenging targets on renewables, the substantial number of generation applications - both renewable and conventional, the planning of a large-scale network reinforcement programme, and material technical concerns over how much wind can be accommodated. The aim is to set out a set of guiding principles for dispatch of all generation in the SEM as well as establish

appropriate remuneration arrangements. Much work on this has been completed in consultation with the system operators and a consultation is expected in the first part of 2009, with a decision later in the same year.

The monitoring of the SEM is undertaken by the MMU, which is based at our offices in Belfast. During the past year, the MMU has actively engaged with participants in relation to adherence to the bidding principles upon which their commercial behaviours are to be defined. The MMU has on a number of occasions pursued with participants the enforcement of these principles and has issued directions where appropriate. A formal inquiry into participant commercial behaviour commenced in December 2007, with a decision published by the SEM Committee in June 2008.

During 2008, a judicial review was also sought by AES Kilroot regarding our decision that the SEM meets the criteria in the contract cancellation condition of Kilroot's licence. The judgment confirmed that the SEM enables us to cancel AES Kilroot's contract in 2010 if, of course, we decide this is in the interest of consumers.

Promoting efficiency by regulated companies

We continued to deliver efficiency savings for consumers and promote investment through price controls of regulated companies in 2008-09.

Along with CER, we carried out a price control on the Single Electricity Market Operator (SEMO) – a contractual joint venture between Eirgrid and SONI. SEMO's role can be summarised as being "to facilitate the efficient, economic and co-ordinated operation, administration and development of the Single Electricity Market in a financially secure manner" (from the Trading and Settlement Code which sets out the rules, procedures, and terms and conditions which all parties, including the SEMO must adhere to). After a full analysis of the SEMO submission, a saving of €0.85 million was achieved relative to the company's proposals – approximately 25% of this relates to an actual saving for electricity customers in Northern Ireland.

We also published our decision on the SONI price control in April 2008. After extensive analysis, our decision produced £2.1 million of customer savings compared to the company's proposals.

Towards the end of March 2009 we also published a consultation paper relating to a price control for NIE Energy Supply.

Improved arrangements for security of supply on the island of Ireland

Security of supply has been a major focus of our work, and we have participated in an all-island Security of Supply working group (a sub group of the DETI/Department of Communications, Energy and Natural Resources All-island Joint Energy Steering Group) and on the revision of the NI Fuel Security Code, to be issued by the Department of Enterprise, Trade and Investment (DETI) during 2009-10.

Among measures to increase the competition within the market last year was the introduction of Aggregated Generator Units (AGU). An AGU is actually a collection of smaller generators, typically diesel generators on customers' own sites, not currently in the market. These will soon be able to be dispatched as a single entity by the system operator. Consumers gain as the system has more capacity available outside the peak hours. This could lead to better system security and potentially reduced System Marginal Prices. The AGUs would benefit from being part of

The evidence suggests that the SEM is successfully delivering benefits for consumers through fair and cost reflective market prices and increased competition, investment and security of supply.

the SEM through receiving payment for all the hours they are available.

Planning future electricity networks

During 2008-09 we also worked with DETI and Northern Ireland Electricity (NIE) to lay the groundwork for a Grid Development Strategy for Northern Ireland. This will deliver the high voltage transmission network required to transport the expected increased levels of electricity from renewable generators to customers while ensuring that customers benefit from the economic benefits as well as the environmental ones. A fairer and more efficient basis for charging new generators for connection to the expanded system is also under development.

A key element in the Grid Development Strategy is the new North-South transmission line project. This will enable the

two transmission systems, north and south, to be operated and developed more efficiently and the full benefits of the SEM to be delivered. It is estimated that this project will save consumers on the island of Ireland up to €30 million per year on the cost of constraints alone. These costs result from the system operators having to dispatch generating plant available in a manner that is not the most efficient, due to the limitations of the transmission system. The new North-South transmission line will also improve security of electricity supply on the island.

SONI divestment

A fully independent system operator was a requirement for the creation of the SEM. The divestment of SONI was successfully completed and the necessary licence changes were made to enable this to take place. This has ensured the safe and secure operation of the network by an independent system operator that neither owns nor has any affiliates who own generation or supply interests in the island of Ireland.

Our decision on the SONI price control produced £2.1 million of customer savings

We were closely involved in the divestment and our view was reflected as part of the process to ensure Northern Ireland consumer interests were protected. This included making sure at the outset that there was transparency relating to the sale of the company and agreeing appropriate changes to governance arrangements by the successful purchaser EirGrid.

Advancing arrangements for competitive retail market in Northern Ireland

Stage One of a project to establish long-term switching systems for mass retail competition was completed. This project was designed to safeguard consumers' rights by transferring the switching systems (which is currently partly hosted on an ageing information technology (IT) system) to an enduring solution. This necessary re-investment also offers an opportunity to eliminate some limitations that arise from the current IT system, so it will facilitate unlimited customer switching in the domestic sector and promote competition in the supply of electricity. Stage One of the project identified the various high level options available after these had been agreed between us and NIE.



The second stage commenced in January 2009. This stage is concerned with procuring an implementation partner to help deliver the project and also the necessary software applications.

Scrutinising electricity tariffs on behalf of consumers

Increased fuel prices world-wide and a significant fall in the value of Sterling, combined to have an adverse impact on electricity bills paid by consumers.

After scrutiny by us, NIE Energy announced an in-year increase of 14% in May which was

followed by a further increase of 33.3% in October.

Despite the exceptional backdrop to the price increases, our job was to make sure that changes to consumer bills were justified in the circumstances that prevailed. Although our scrutiny reluctantly accepted the basis for price increases in May and October, we continued to exercise a regulatory challenge function. It is recognised, on the one hand, that prices have to cover costs so as to ensure a sustainable service to consumers. Yet it should also be stressed that the supply company, NIE Energy Supply,

has a very low profit margin (1.8 %) – in comparison with companies in Great Britain - and made no extra profit because of the price increases. Following changes in wholesale costs we initiated a review of electricity tariffs in November 2008. The outcome of our intervention was an announcement that prices would reduce by 10.8% from 1 January 2009.

More widely, we were conscious of the widespread public concern that arose from the significant electricity price increase and the impact on consumer bills. For that reason, and to instill public confidence in our scrutiny, we commissioned an independent review of the tariff-setting process –carried out by Douglas Mcldoon – in mid September. Mr Mcldoon's report was published in December 2008, and concluded that the scrutiny process by the Utility Regulator was fair and robust. He also addressed wider issues associated with areas such as the contracting process for energy processes. Several of his recommendations will be advanced during 2009-10.



Working for us – Juliet Corbett

Juliet Corbett leads the SEM Operations team which regulates the areas of networks and system operation and the Single Electricity Market Operator. Her varied background makes her the ideal person to deal with complexity - with a PhD in Physics and a MBA, eleven years in the energy industry in Great Britain and a varied career in business since returning to Northern Ireland. Among the challenges faced by Juliet and her team is developing the arrangements to ensure that future targets for renewable generation can be met. This will involve around £1 billion of investment in the electricity network over the next 15 or so years. While recognising the challenges associated with putting in place sound market arrangements for renewable generation and the level of investment required, Juliet is clear about the benefits for consumers: 'A greater investment in renewable generation will make our electricity supply more secure and sustainable, with real benefits for the environment and the consumer'.

Gas

4



highlights

- **Price controls relating to firmus energy distribution and Phoenix supply achieved £11 million of savings for consumers.**
- **Our work to examine the potential of an all-island approach to gas advanced significantly during 2008-09 and has established the benefits that such an approach could deliver for consumers in both parts of Ireland.**
- **In a year of volatile wholesale energy costs, we were proactive in making sure that price reductions were passed on as quickly as possible.**
- **A review commissioned by us provided an assurance on governance arrangements for Northern Ireland Energy Holdings – which owns three entities regulated by us.**

Promoting efficient, well-run gas companies

At the heart of our price control scrutiny is a desire to promote well-run, efficient gas companies who invest prudently in the future, for the benefit of consumers in Northern Ireland.

We carried out a price control on firmus energy distribution running from 2009-13. The price control limits the charge that can be made for using the firmus distribution network. The distribution charge relates to the cost of distribution pipelines in the firmus licence area, covering the towns of Ballymena, Ballymoney, Coleraine, Londonderry, Limavady, Antrim, Armagh, Banbridge, Craigavon and Newry.

In order to make this determination we analysed each element of the capital and operating costs submitted from the company. We also took into consideration other factors: historic costs, forecasts for the period of the control, any changes in the gas industry and cost drivers and comparisons with Great Britain and the Republic of Ireland. Engineering experts were also commissioned to analyse the information provided by the companies.

Following extensive analysis, the outcome was to reduce the firmus cost proposals significantly. Our scrutiny achieved savings for consumers of £6 million over the period of the price control.

We also carried out a price control on Phoenix Supply Ltd. (PSL). Following a public consultation we concluded, in the absence of sufficient competition, that a price control was necessary on PSL to provide customers - with an annual consumption of less than 25,000 therms per annum (which includes domestic customers) - with an assurance that the prices they are paying are regulated. The price control on PSL therefore focused on determining the allowed operating expenditure and margin for the period 2009 to 2011.

We reviewed PSL's cost submission and compared this against historic costs and

industry benchmarks. The result was that we removed 25% of costs from the original PSL submission, representing savings for consumers of £5.1 million.

Our desire to promote efficiency for the benefit of gas consumers also led to us applying our price control scrutiny to two entities, the Scotland to Northern Ireland Pipeline (SNIP - owned by PTL) and Belfast Gas Transmission pipeline (owned by Belfast Gas Transmission Ltd – BGTL). Although the process is a monitoring exercise and does not prevent either PTL or BGTL from recovering their actual costs through their respective licences, it does firstly provide PTL and BGTL with a benchmark for what we feel their operating expenditure should be and secondly the process provides transparency of their operating costs to the wider industry and public.

We are committed to promoting the further roll-out of gas as a cleaner and generally cheaper fuel than heating oil. During the year we devised an incentive mechanism to encourage Phoenix to continue to drive connections, but without encouraging higher fossil fuel use. We are also working with DETI to examine the case for further roll-out of the gas network across Northern Ireland.

Exploring the potential benefits to consumers of an all-island approach to gas

The Common Arrangements for Gas (CAG) project - developed by us in conjunction with Commission for Energy Regulation (CER) - was set up to explore the scope to streamline and simplify the operation of gas transmission assets linking South West Scotland, the Isle of Man, Northern Ireland and the Republic of Ireland. Along with the CER we have spent a considerable amount of time analysing and consulting on how the project might be designed and what benefits it could deliver to consumers.

An agreed Memorandum of Understanding (MoU) between the Utility Regulator and CER set out a 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”. This shared vision is rooted in our confidence that a common approach is capable of delivering consumer benefits; work has focused on establishing how best to achieve that, and on building confidence in the benefits.

This aspect of the project has been addressed through a Cost Benefit Analysis (CBA) which set out in detail the costs and benefits that CAG could entail. We published our preliminary CBA in July 2008 which identified significant strategic benefits from the project, including security of supply and the potential for increased investment. In addition to this, the work also calculated an operational net benefit to consumers of £10.5 million over 10 years.

Other key elements of the CAG project were advanced during the year. This included 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. Work was also advanced on the Gas Industry Operation workstream which concentrates on integrating the operating system that controls the flow of gas around the island. A key challenge will be ensuring the independence of the system operator from gas trading or supply.



As part of both these workstreams we have carried out a significant amount of analysis to identify how harmonisation might be optimally implemented. This has been presented to the industry and stakeholders through a number of consultation papers and workshops. The outcome of this work and engagement with the industry was the publication of conclusion papers on both tariffs and operations setting out our position on tariff and operations harmonisation. Other workstreams where we have progressed through engagement and consultation with industry include Security of Supply, Gas

Quality and Network Planning.

Dedicated teams have been established in both the Utility Regulator and CER 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 the regulators to facilitate effective engagement

on the project. To be fully effective Ministerial endorsement of the project would be essential along with legislation to underpin joint arrangements. We will finalise the CAG workplan if and when the departments approve a legislative timetable. Ministers are currently considering the work to date alongside options for implementing the new EU directives.

Working to secure lower energy prices for consumers

Against a backdrop of volatile international energy costs, 2008 was a difficult year for gas consumers. Following scrutiny of submissions from PSL in April and September, we reluctantly agreed tariff increases of 28% and 19% respectively.

Although we agreed the increases in April and September, we were determined that we would closely monitor the wholesale markets to deliver any subsequent reductions as soon as possible. With this in mind, it became clear to us that wholesale gas costs were turning out to be significantly lower than the forecasts made when agreeing the PSL tariffs to domestic consumers in September 2008.

**Price controls achieved
£11 million of savings for
consumers.**

While the next review was not due until April 2009, we decided that it was in consumers' interests to initiate a review immediately. We informed PSL and stakeholders that we planned to finalise a review before Christmas 2008, so that consumers could benefit from the lower market price in advance of winter.

This process involved analysing gas prices in the forward markets over the coming year and all other costs that feed into the PSL tariff. We consulted with stakeholders and PSL before concluding that a reduction in tariffs of 22.1% would be appropriate. This reduction was then passed through to domestic customer in early January which amounted to a reduction in the average domestic annual gas bill of £153.

**Providing assurance
on the governance
of Northern Ireland
Energy Holdings**

Northern Ireland Energy Holdings (NIEH) is currently the

owner of three entities regulated by us – PTL (owner of the SNIP), Moyle Limited (owner of the Moyle electricity interconnector which links the electricity systems of Northern Ireland and Scotland) and BGTL (owner of the Belfast Gas Transmission Pipeline). Although the purchase of the three companies by NIEH has resulted in combined consumer benefits of £85 million (Net Present Value savings) there is a transfer of risk to consumers with the mutualised model.

As part of the review of the purchase of the BGTL assets by NIEH in 2008 we committed to carrying out a review of the NIEH corporate governance arrangements to ensure that they continue to meet best practice. In March 2009 a consultation paper was issued to inform interested parties of the corporate governance structure in place within the NIEH group of companies. The purpose of the review was to ensure NIEH has an appropriate corporate governance structure and suitable regulatory arrangements in place for a company of its size and nature.

The outcome from the review was very encouraging in that it concluded that the Combined Code on Corporate Governance

is an appropriate benchmark for NIEH and that current practices are in line with the provisions of the Code. A small number of recommendations for potential improvements to current governance arrangements within NIEH have been made but only with the intention to enhance the existing processes, rather than to address any deviation.

**The Common Arrangements
for Gas (CAG) project
has focused on how
best to deliver
consumer benefits**

The encouraging conclusion from the review provides both the Utility Regulator and energy customers in Northern Ireland (since NIEH owns electricity and gas assets) with confidence that the governance structure in place with NIEH is operating adequately and is robust for a company of NIEH's size and nature.

**Working to promote gas
retail competition**

Part of our role is to encourage competition for gas consumers. The Gas Market Opening Group (GMOG) was established by us

to address any operational barriers to entry into the gas supply market in Northern Ireland. The group includes representation from licence holders, the Department of Enterprise, Trade and Investment, the Consumer Council and the Commission for Energy Regulation (Roi). The GMOG is examining each of the barriers to entry raised by its members, with a view to making a decision on the best way to address each issue. Progress has been made in trying to focus the group on technical issues that can be resolved through code modifications, with the first modifications being proposed at the group during this year.

Over the past year we have moved forward on our plans to encourage competition. The gas directorate is working closely with the new retail unit. This unit is now represented at the GMOG.



Working for us – Neil Bingham

After over 18 years working in the energy industry, Neil Bingham knows a thing or two about how energy companies operate. As a head of branch in the Gas Directorate, Neil uses his experience and expertise to challenge gas companies to operate efficiently and to keep customer bills as low as possible.

The monitoring of gas prices and trends by Neil and his small team of economists and accountants was central to our decision to review the Phoenix Supply gas tariffs in October 2008. Conscious that we planned to finalise the review in advance of Christmas, so that consumers could benefit from lower bills in advance of the onset of winter, Neil and his team worked quickly to analyse all the costs that feed into the tariffs.

After this analysis was complete, Neil was at the forefront of consultation with stakeholders and the gas company, which reached the conclusion that a 22% reduction in gas bills would be appropriate. This reduction was announced in December 2008.

Water

5



highlights

- A formal and transparent Price Control process and timetable has been implemented to set prices from April 2010.
- Effective working groups have been established with the quality regulators, the Consumer Council and the Department for Regional Development.
- We produced our first Cost and Performance report on NI Water. This holds NI Water accountable for delivery of outputs for which they have been funded, transparently reporting their performance against targets.
- Our investigation regarding the re-apportionment of costs led to the company undertaking a programme of work to improve data systems that will benefit water customers.
- We continued to drive efficiencies for water customers, with the overall bill (whether paid by businesses or taxpayers) being £3.2 million lower because of our work.

Regulating water and sewerage services: two years on

We became responsible for water and sewerage services regulation in Northern Ireland from 1 April 2007. Our key functions in this area are to protect customers, promote value and safeguard the future of water and sewerage services in Northern Ireland. We achieve this through constant monitoring of and, where necessary, enforcement against the water company.

This year brought a number of external challenges. These included the postponement of water charges to April 2010,

continuing consideration by the Northern Ireland Executive of the review of water reform and the onset of the current economic downturn.

Against this backdrop, we set ourselves further testing targets. We developed our financial and econometric models for the first price determination for Northern Ireland in the latter part of 2009. An investigation into NI Water's apportionment of costs between its domestic and non-domestic customers - together with the necessary enforcement to deliver the resulting recommendations was also completed. Our first annual cost and performance report on the

company was prepared and published. Finally, we established and cemented the price control process with all key stakeholders.

Setting revenue and prices for 2010 to 2013

During the past year, our work has been focussed on developing and planning the price control process that will establish NI Water's revenue and charging levels from April 2010 to March 2013 (PC10).

Our approach to this significant piece of work, has been to engage in pro-active and sustained consultation with key

stakeholders. We strongly believe that consultation with stakeholders provides the opportunity to enrich the development and direction of our work. Initially, our original plan was to carry out a two-year price control. However the consultation process with our key stakeholders lead to the agreement that a three -year control would provide a more practicable timeframe to meet challenging targets and may also facilitate a higher degree of accuracy and confidence factors in the datasets.

More widely, we worked closely with our key stakeholders in developing and programming for PC10 to ensure an open and transparent process. This is reflected in our involvement in and input to the stakeholder working groups feeding into the Minister for Regional Development's Social and Environmental Guidance and our work with the environmental regulators on NI Water's commitments regarding its abstractions and its wastewater discharge standards.

Our commitment to an open dialogue on our plans was demonstrated when we published our Approach to the 2010 – 2013 Overall Cost and Price Control for Northern Ireland Water setting out our proposals for PC10.

We worked closely with our key stakeholders in developing and programming for PC10 to ensure an open and transparent process.

We have continued to set out our plans for delivering PC10. Several important milestones in the process have been met during the year. For example, in August 2008 we issued a draft of our reporting requirements from NI Water for its business plan submission due on 1 June 2009. The company was given the opportunity to comment on the requirements. The final requirements were issued in March 2009 following our work to address the company's concerns and comments. The business plan submission will be a critical contribution to the formulation of a PC10 draft determination, planned to be published in September 2009, and a final determination to be published in December 2009 following consultation.

Overall, we are confident that the PC10 process will meet its objectives of setting revenues and charging levels for 2010 to 2013 so that the real investment needs of the water and sewerage industry can be met

and ministerial objectives delivered. The process will ensure that the planned investment will bring about overall improvements in water quality, the environment and service for the benefit of customers in an efficient and effective manner delivering value for money.

Monitoring the performance of NI Water

As part of our open and transparent regulation of NI Water we will carry out an annual cost and performance report on the company which we will publish each winter. This robust process assesses NI Water's performance in meeting the objectives it set out in the Strategic Business Plan for 2007 – 2010 and draws comparisons with similar companies in the water industry in England, Scotland and Wales. Financial performance, efficiency, levels of service and information and data integrity are all examined and reported on.

The basis of the report is a detailed data submission from NI Water, called the Annual Information Return (AIR), which provides a response to our guidelines prescribing the information needed to carry out the assessment of the company's regulated business



areas. NI Water submitted the AIR for 2007-08 in August 2008.

The overall level of service provided by NI Water is determined through our Overall Performance Assessment (OPA) which, in the main, uses the information from the AIR to generate performance scores across a number of the water company's key standards and objectives which when totalled, provides a comparison with other water companies in Great Britain (GB). Strictly on the information presented, the 2007-

08 OPA for NI Water compares unfavourably with GB water companies. However, we recognise that comparator companies have already gone through the reform process in which NI Water is now embarking. The large gap in OPA scores therefore represents a challenge to NI Water, not a criticism. Indeed, the precedents give grounds for optimism. Companies in GB have proven that once initial large efficiency gains are made, improvement in OPA is possible without increasing operating expenditure

or capital investment. We expect NI Water to identify how it intends to close this gap within its business plan submission for PC10.

Our first Cost and Performance Report, published in March 2009, indicates that NI Water made real progress in certain areas over the 2007-08 year. However, there is a need for the company to deliver further efficiencies, produce robust capital investment plans and address its data systems and processes. We expect NI Water

to identify how it intends to deliver these improvements within its business plan submission for PC10.

For further detail on how NI Water performed, visit our website www.niaur.gov.uk where we have posted our Annual Cost and Performance Report, guidance for AIR08 and AIR09 (issued in March 2009) and the company's submission for AIR08.

Investigating the re-apportionment of costs

After it became clear that a problem existed, regarding the re-apportionment of costs between NI Water's domestic and non-domestic customers, we announced our intention in April 2008 to carry out a formal investigation.

A robust two-stage investigation ensued. The first stage of the investigation focused on collecting the necessary information, to inform a second stage, which would consider whether NI Water had breached its licence conditions.

We published a report of our investigation in July 2008. Key findings of the investigation were that significant weaknesses were identified in NI Water's systems of planning and governance procedures. As a

consequence of the investigation, we insisted that NI Water committed to an action plan to improve major deficiencies identified in the investigation report.

This led to NI Water offering legally binding undertakings in January 2009, in lieu of enforcement action by the Utility Regulator, to meet the requirements set out in our report within a given timeframe. We will monitor NI Water's performance against these undertakings on an ongoing basis.

Scrutinising NI Water's Scheme of Charges

We are required under the Water and Sewerage Services (NI) Order 2006 to approve NI

Water's annual Scheme of Charges. The key purpose of this approval is to ensure charges are cost-oriented. It therefore gives confidence to businesses that are paying water bills, that they are only paying costs actually incurred to serve them. We took the opportunity during our assessment of the company's first scheme of charges to put in place a robust annual consultation process whereby key stakeholders such as the Consumer Council can consider NI Water's proposed charges for the following financial year. The process led to the approval of the 2008-09 scheme of charges and the completion of our first report on NI Water's annual Scheme of Charges in September 2008.



During the compilation of the report we identified a cross-subsidy between sewerage (both domestic and non domestic) and trade effluent customers. It was agreed that NI Water would unwind this cross-subsidy over 5 years commencing with the 2009-10 charging year.

Our advice to the Minister for Regional Development on efficiency targets for NI Water in 2008-09 provided robust and evidence-based advice to inform his setting of efficiency targets for 2009-10.

Advising on efficiency

Following on from our advice to the Minister for Regional Development on efficiency targets for NI Water in 2008-09 we again provided robust and evidence based advice to inform his setting of the efficiency targets for 2009-10. The overall bill (whether paid by businesses or taxpayers) was £3.2 million lower because of our efficiency work.



Working for us – Sean Lyons

Much of our regulatory work is specialist, complex and technical. That's why we're glad to have people like Sean Lyons from the Water Directorate, who not only has financial and business qualifications but recently completed an MSc (with distinction) in Infrastructure Engineering.

Sean put this knowledge to good use leading the Regulatory Finance team on the NI Water Scheme of Charges. This involved collecting a range of data and information to analyse the rationale behind the water company's proposed charges for non-domestic customers. Key to the analysis was making sure that the proposed charges reflected the cost of the service and avoided disadvantaging any customer group.

A positive outcome of Sean's work was establishing a basis for consulting on the scheme of charges, which proved beneficial during the 2008-09 year and will provide an opportunity to seek comment on future scheme of charges.

Energy efficiency, alleviating fuel poverty, sustainability and social action

6



highlights

- Following consultation we published a decision paper which outlined a range of actions for us to take to contribute to sustainable development.
- A major review of the Energy Efficiency Levy Programme was delivered, and we published our decision paper proposing changes to the Programme.
- After carrying out joint research with the Consumer Council we published a draft Social Action Plan for consultation.
- We have been actively involved in contributing to the discussion on addressing fuel poverty in Northern Ireland through membership of high level fora.

Contributing to sustainable development

Our major strategy paper on sustainability, 'Sustainability – the Regulator's Role', was published on 31 March 2008 for consultation. We published the twenty-two responses to the consultation in September 2008.

Following consideration of the responses received, we published a decision paper as an annex to our Corporate Strategy consultation in November, which articulated our contribution to sustainable development. Among the range of actions outlined in the decision paper were the following: the further development of the gas industry; the intention to ensure that renewable generation can be

equitably accommodated on the network; and, putting information and reporting systems in place to facilitate informed environmental decision making.

Delivering sustainable energy for vulnerable customers – the Energy Efficiency Levy Programme

Since its introduction in 1997-98 the Energy Efficiency Levy Programme (EELP) has represented an important element of the Utility Regulator's duty to protect customers, and in particular vulnerable customers. It also in a key element in being able to carry out our functions in a manner best calculated to secure a diverse, viable and environmentally sustainable long-term energy supply.

As initially conceived, the EELP was introduced to implement energy efficiency schemes for domestic and non domestic customers with the aim of reducing carbon emissions. However in 2002, as a result of a consultative process, it was decided that the majority of funding (80%) would be targeted at helping to alleviate fuel poverty.

Twenty-two schemes (twenty-six in 2007-08) were run under the EELP during 2008-09 with funding of some £5.9 million (£5.6 million in 2007-08). Seven schemes were in the Priority (Fuel Poverty) sector and the remainder were non-Priority domestic (8) and non-domestic (7). Table 1 summarises the key benefits from the EELP.

Table 1: Benefits of the Energy Efficiency Levy Programme (EEL) 2007-08

Benefits	Amount
Lifetime energy savings	576.645 GWh
Lifetime customer energy cost savings	£55,222,786
Lifetime carbon savings	122,368 tonnes

Note: Lifetime energy savings refers to the energy savings through the useful lifetime of the specific measure.

Review of the Energy Efficiency Levy Programme

We conducted a review of the EELP in 2006 and at that time promised a further review in 2009. The process for the 2009 review began in August 2008, with a public consultation on the EELP.

A key consideration was the synergy between efforts to improve energy efficiency and efforts to reduce fuel poverty. This had been demonstrated by successive Home Energy Conservation Reports which show how improving energy efficiency can reduce fuel poverty.

Following consultation, we took account of the views received to develop our final decision on the EELP, which we published in March 2009. Key to our decision on the EELP is the proposal to have arrangements in place for

a staged opening of the programme. We propose that, by the September 2009 call for schemes, natural gas licence holders should be permitted to apply directly for funding and by September 2010 organisations other than licensed energy suppliers will be invited to bid for funding. Moreover, initiatives eligible for funding under the programme will be widened so that funding will be available not only to energy efficiency measures, but also to renewable energy measures. The choice between energy efficiency and renewable energy schemes will depend upon cost effectiveness expressed in terms of £ per tonne of carbon saved. In addition innovative measures will be encouraged. The scheme will be reviewed again in three years.

Supporting renewables development

The Utility Regulator has statutory responsibility for the Northern Ireland Renewable Obligation (NIRO). The primary mechanism for incentivising large scale renewable generation of electricity. It operates in tandem with the GB Renewable Obligation as part of a trading market for Renewable Obligation Certificates (ROCs). The past year has seen a significant increase in interest in renewable generation, both large scale and small, with many projects coming online. Within the year 2007-08, 153 additional generating stations in Northern Ireland received accreditation to claim ROCs.

The NIRO is a statutory requirement on electricity suppliers to source an increasing portion of their electricity from renewable sources. It commenced in 2005-06, when suppliers had to source 2.5 per cent of their power from renewable generation and for the last reporting period (2007-08) the target was 2.8 per cent. The NIRO continues until 2027, by which time electricity suppliers in Northern Ireland will have to ensure 6.3 per cent of their electricity is from renewables.

We have contributed to efforts to tackle fuel poverty in Northern Ireland

Suppliers can meet their obligation by either presenting ROCs or paying into a buy-out fund. ROCs issued in Northern Ireland are referred to as NIROCs. In 2007-08 the total number of NIROCs issued was 431,052 compared with 347,848 in 2006-07. Each NIROC represents one MWh of renewable output produced in Northern Ireland.

The NIRO is managed by us although administered by our sister organisation, Ofgem, via an Agency Services Agreement (ASA) between both parties. This arrangement facilitates the maintenance of a seamless UK Renewable Obligation and reduces costs.

Ofgem introduced a new IT system (effective from April 2008) which has automated, consolidated and streamlined many processes in order to reduce the administration cost per generator.

The Climate Change Levy Exemption Scheme

We continue to manage and administer the Climate Change Levy (CCL) scheme, issuing Levy Exemption Certificates (LECs) to accredited generators in Northern Ireland and the Republic of Ireland.

The CCL is a tax on energy used by businesses. It was announced in the March 1999 budget, and the scheme commenced on 1 April 2001. In relation to electricity the CCL requires suppliers to charge commercial customers (i.e. business not domestic, governmental or charitable customers) an extra 0.44p per kWh (i.e. £4.41 per MWh). The UK Government uses the levy to fund a national insurance contribution break and energy saving programs. Electricity produced from designated renewable and good quality Combined Heat and Power (CHP) sources is exempt from CCL, as are business users of natural gas until 2011, and is issued with exemption certificates which can be bundled with the power when sold to a supplier. In the year 2007-08 the Utility Regulator issued 300,823 LECs (each LEC represents one MWh of renewable or good quality CHP electricity supplied in Northern Ireland). It also should be noted

that business users of natural gas are also exempt from the CCL until 2001.

Renewable Energy Guarantees of Origin

The Electricity (Guarantees of Origin of Electricity Produced from Renewable Energy Sources) Regulations (Northern Ireland) 2003 legislates that the Utility Regulator should issue Renewable Energy Guarantees of Origin (REGOs) to accredited renewable generators. We have arranged an ASA with Ofgem to administer our REGO scheme. REGOs will be issued to generators on request and in future years will be accepted from suppliers to verify fuel mix disclosure claims relating to renewable energy.

Fuel Mix Disclosure

Fuel Mix Disclosure is a benefit to consumers because it empowers them to make choices based on the environmental impact of the electricity they purchase. Under Article 3(6) of Directive 2003/54/EC, Member States are required to ensure that electricity suppliers specify in or with bills and in promotional materials made available to final customers the contribution of each energy source to the overall fuel mix of the supplier over the previous year. In

addition, suppliers are required to provide at least a reference to existing sources of information regarding the environmental impact resulting from the electricity produced by the fuel mix of the supplier in question over the same period.

Acting in conjunction with CER, as the Regulatory Authorities, we have determined how the above requirement can be met in the SEM. The Fuel Mix Disclosure will be accommodated by a combination of REGOs, Generator Declarations, and a calculation of average pool mix. Further consultations on interim procedures for fuel mix disclosure and on the detail of how Generator Declarations and REGOs will operate on the Island of Ireland are planned.



Callagheen Wind Farm, County Fermanagh by Esler Crawford Photography courtesy of RES.



Altahullion Wind Farm, County L'derry, Callagheen Wind Farm, County Fermanagh by Esler Crawford Photography courtesy of RES.

A co-ordinated approach to protecting vulnerable utility customers – the Social Action Plan

Our work to develop a Social Action Plan (SAP) has advanced substantially during the past year.

In order to inform the plan, and in partnership with the Consumer Council for Northern Ireland (CCNI), we carried out consumer research to inform the SAP. This consisted of setting up focus groups of disadvantaged customers and asking their opinion on the various schemes provided by the energy suppliers and a survey 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.

Our draft SAP has two main strands. The first strand focuses on removing barriers and providing services so that services are more accessible to vulnerable customers such as pensioners, the chronically sick and/ or disabled customers. Conditions set out in energy suppliers' licences oblige them to provide services for these customers. All utility suppliers also publish codes of practice, stating how they can and will help customers with special needs. We monitor activity and ensure the utility suppliers

comply with their licences and codes of practice. There is a reasonable provision of special services, with all the utility suppliers offering a wide range of methods to help potentially vulnerable customers.

The second strand of the SAP focuses on financial vulnerability. We continue to contribute to the work on reducing financial vulnerability by, for example, regulating utility suppliers to ensure only efficient costs are passed through to customers; by promoting competition in energy markets; by encouraging more efficient use of energy and water, and by contributing our expertise to the debate on issues such as Social Tariffs. The Utility Regulator received 29 responses to the Social Action Plan consultation. These responses are now being considered in detail.

More widely, we have contributed to efforts to tackle fuel poverty in Northern Ireland. In particular, we participated in the Fuel Poverty Task Force established by the Minister for Social Development, Margaret Ritchie, on 14 May 2008, which delivered its report in July 2008. Moreover, we have played an active role in the Northern Ireland Fuel Poverty Advisory Group, which brings together statutory and voluntary agencies to discuss ways of tackling fuel poverty in Northern Ireland.



Working for us – Alison Farr

'Knowing that the funding can be used to allow vulnerable customers to insulate their homes and keep warm, while at the same time helping to reduce energy costs, makes the programme worthwhile', says Alison Farr, who works in our Social and Environmental branch. Alison is referring to the Energy Efficiency Levy Programme (EELP), which provides funding to improve energy efficiency and address fuel poverty. Apart from being responsible for making sure that the £5.6 million funding (in 2007-08) is administered effectively, Alison has been involved in the review of the programme – which has involved extensive consultation with stakeholders. Having worked in a previous job that focused on supporting the needs of disadvantaged people, Alison says that the review provides an opportunity to take a fresh look at how the needs of this group in particular can be met.

Effective and efficient regulator

7



highlights

- We developed a Corporate Strategy 2009-14 as a basis for delivering our strategic aspirations.
- Working closely with our staff team, we developed organisational mission, vision and values.
- In order to engage more effectively with stakeholders we developed accessible information, enhanced our website and delivered a stakeholder engagement programme.
- Our desire to encourage retail competition led to the establishment of a dedicated Retail Unit.

We aim to do our job in such a way that we use the resources given to us to produce a consistently high level of performance. In doing this we take account of the principles of best practice regulation; proportionality, consistency, transparency and targeting as well as government accounting standards

Making the best use of our resources

Our finances

As a Non-Ministerial Government Department, funds are voted by the Northern Ireland Assembly and accounted for on an annual basis through the Resource Account. The published accounts are available from the Stationery Office or can

be downloaded from our website (www.niaur.gov.uk).

A commentary on the Utility Regulator's financial position for the year ended 31 March 2009 is set out in Appendix 2. In summary, the cost of running the Utility Regulator in the financial year ended 31 March 2009 was £6,410,000 and net costs (after taking account of the fee income received from licensed businesses in the electricity, gas and water sectors) amounted to £288,000 against the Spring Supplementary Estimate position of £315,000, resulting in a saving against estimate of £27,000. In net terms, this represents a saving of just under 9% of expenditure.

Most of the Utility Regulator's costs are recouped from annual

fees paid by electricity, gas and water licensees.

For the financial year ended 31 March 2009, licence fees were collected as set out in Table 1 below.

**Table 1:
Licence Fees by Utility**

Total Licence Fees (£000s)	
Electricity	2,641
Gas	1,454
Water	2,027
Total	6,122

In addition, the Utility Regulator is responsible for collecting fees on behalf of the Consumer Council and its costs in carrying

out the duties assigned to it by the Energy Order and Water and Sewerage Order. Costs for the financial year ended 31 March 2009 totalled £979,025, of which £199,087 was attributed to electricity, £149,316 to gas and £630,622 to water.

Developing our staff

Our aim is to be an employer of choice and we want to support the development of the staff who work for us.

During 2008-09, a number of staff who had been on loan/seconded from other departments elected to transfer to directly employed status as part of the progress towards reaching the required complement. At the 31 March 2009, our staffing complement consisted directly recruited staff and around 12 seconded from other departments (the Department for Enterprise, Trade and Investment (DETI), the Department of Finance and Personnel (DFP), the Department for Regional Development (DRD) and the Department of Education and Learning (DEL)).

One of the key processes that we are committed to is performance management and development. We have been developing a framework that matches the skills, experiences and demands of working in a

regulatory environment. This process has included the development of a tailored competence framework.

We also recognise that being an employer of choice and developing our staff requires a strategic approach. A review of human resources policies is being undertaken with the aim of developing policies that are associated with a best practice employer.

Performing effectively as a regulator

Corporate Strategy 2009-14

During 2008-09 we took an important step towards defining our longer term strategic aspirations. A five year Corporate Strategy was published at the start of April following extensive consultation with stakeholders. The vision behind the Strategy was to formally and transparently plan, consult on, agree and then undertake a set of strategically considered themes and priorities. The Corporate Strategy (2009-2014) will thus set the overarching framework for our future annual Forward Work Programmes (FWP). It specifically identifies a number of threads that will shape our work:

Wholesale cost of energy
Delivering effective competition

During 2008-09 we took an important step towards defining our longer term strategic aspirations.

Assimilating the regulation of water and sewerage into our organisation

Sustainability

The trend towards “internationalisation”
Technological and information advances

Forward Work Programme

Our Forward Work Programme (FWP) is the key annual planning document that sets out projects and activities that we want to deliver each year. Overall we achieved or partially achieved 84 per cent of the time limited tasks listed to be completed within the 2008-09 year.

Appendix One sets out in detail the FWP projects and activities for 2008-09 and a status report on the achievement of these.

Appeals, complaints and disputes

We have continued to discharge our appeals, complaints and disputes role over the past year.

We have arrangements in place for dealing with complaints referred to us and have worked closely with relevant stakeholders to resolve issues raised by customers.

Freedom of Information

Our commitment to providing access to information by the public about our work continued during 2008-09. A paper setting out our approach to the routine release of information under new Freedom of Information obligations, was approved by our Board in December 2008. This committed us to pro-actively organising information for routine release, and placed an emphasis on disseminating this information through our enhanced website.

During the 2008-09 year we received seven requests for information under the Freedom of Information Act. All requests were responded to within the statutory period prescribed by the Freedom of Information Act.

Absence Management

We continue to strive to keep absence levels as low as possible. Through our Employee Wellbeing programme, which we will be introducing later in 2009, we will continue encourage staff to maintain a healthy work/life

We defined more clearly our organisational mission, vision and values through an extensive conversation with the staff and board members.

balance so that staff are motivated in work, productivity levels are high and sickness absence levels are as low as possible.

Over the last year, the sickness absence for the organisation was 1.84% or an average of 4.2 days per employee. This compares with UK-wide public sector absence rate of 9.8 days per employee (CIPD Annual Survey Report, 2008), and a Northern Ireland Civil Service level of 12.7 days per employee (Report to NI Assembly Public Accounts Committee, 2008).

Developing our organisation

Setting our mission, vision and values

Another important development for our organisation over the past year was that we defined more clearly our organisational mission, vision and values. These statements describe the

type of organisation we want. They were developed through an extensive conversation with the staff and board members. Central to our involvement of our staff was an away day in March 2009, which provided an opportunity to listen to a range of views about our organisation and its purpose. After extended discussion, with input from all of our staff, the agreed mission is : "Value and sustainability in energy and water" and the vision is that "we will make a difference for customers by listening, innovating and leading"..The full list of the values agreed by staff are in the inside cover of this Annual Report.

Providing further impetus to the retail competition agenda

In order to demonstrate our commitment to encouraging retail competition we made changes to our structure. The key change was the creation of a retail unit charged with driving forward, across the organisation, efforts to stimulate retail competition in the utility sector. The Unit – led by an acting Director reporting directly to the Chief Executive - was established towards the end of the financial year, and had already made significant progress on outlining a programme of work before the end of March 2009.

Corporate Governance

Accountability

The following summarises some of the key aspects of the accountability arrangements currently in place at the Utility Regulator:

DFP appoints the Chairman and, in conjunction with the Chairman, also appoints the seven other members of the board of the Utility Regulator. All members, apart from the Chief Executive, operate in effect as independent board members. The board of the Utility Regulator takes collective responsibility for all decisions made by it.

The Chief Executive is appointed by the board of the Utility Regulator and is also appointed as a member of the board and as the Accounting Officer by DFP.

The Utility Regulator has statutory duties, as set out in relevant legislation, including the Water and Energy Orders, enforceable by action for breach of statutory duty or judicial review.

The Utility Regulator has an obligation to make an annual report on energy to DETI and on water to DRD or alternatively may make a combined report to DETI, which the Department lays before the Assembly. Decisions taken by the Utility



Regulator are subject to external review if referred appropriately, notably by the Competition Commission Appeals Tribunal on compensation cases.

The Utility Regulator can also be called to give written or oral evidence to various Assembly Committees which may include the Public Accounts Committee.

corporate risk register and the associated reporting to the board.

The senior management team continued to meet on a weekly basis during 2008-09. A terms of reference was developed during the year to provide a reference point for the senior management team.

Our board and board sub-committees

Our board now meets at least every second month. During 2008-09 the board met 9 times. Corporate Governance continues to be strengthened with the refinement of the

The Audit Committee met on six occasions during 2008-09. Its membership is entirely non executive and comprises James Oatridge (Chair), Etain Doyle, Chris Le Fevre and Clive Elphick supported with attendance by members of the executive team

It was evident that more people than ever in Northern Ireland were aware of us and our work. 60% of those questioned also felt confident that we were achieving our remit.

by invitation. The Committee's annual timetable of business continues to provide a structured approach to ensure that key elements of the control environment are regularly reviewed for effectiveness. The Committee has been active in developing risk management and has actively engaged in the development of key control documents such as a refreshed risk strategy (including the development of thinking on reputational risk) and a corporate governance manual which brings together in one place the control frameworks that govern the way that we do our business. This work is not intended as an academic exercise but rather as a basis for staff to enhance their understanding of the control frameworks that define the way we do our work. The Northern Ireland Audit Office attends the Audit Committee's meetings as a matter of course.

The Remuneration Committee comprises two non-executive directors, Etain Doyle (Chair)

and Philip Johnson. The Chair of the Authority, Peter Matthews, also attends. The Committee met eight times during the year to contribute to pay policy matters affecting directly recruited staff and specifically to consider and approve recommendations regarding the remuneration of the Chief Executive and senior managers.

Board Advisory Groups (BAGs) for Water and Energy (covering Electricity and Gas) meet bi-monthly. Membership comprises non executive directors (with relevant utility experience) and senior staff working in the utility directorates. They continue to provide a useful vehicle for detailed technical scrutiny of key policy issues and inform the decision making processes at board level.

The Single Electricity Market Committee meets on a regular basis is to take decisions in respect of the exercise of relevant functions of the Commission for Energy Regulation or the Utility Regulator in relation to a SEM matter on behalf of each regulator. Northern Ireland's SEM Committee members, appointed by the Department for Enterprise, Trade and Investment, are Iain Osborne (CEO), Dermot MacCann (Director of Electricity) and Alan Rainey (Member of Board).

Audit

The statutory annual accounts are audited by the Northern Ireland Audit Office (NIAO). The 2008-09 Resource Account was given an unqualified certificate by NIAO (subject to confirmation).

The internal audit service is tendered through open competition and is currently provided by Tribal Helm. The report for 2008-09 highlighted evidence of further improvements, building on the progress made in 2007-08, across the areas tested. Significant improvements have been delivered in financial reporting, risk management, contract procurement and management and human resource management during the year. These improvements have contributed to an overall assurance rating of "satisfactory" (the second highest rating available) for 2008-09.

Recommendations accompanying this report will be acted upon as a matter of priority in 2009-10.

Payment policy

The Utility Regulator is committed to the prompt payment of bills for goods and services. Unless otherwise stated in the contract, payment is due within 30 days or receipt

of goods or services or on presentation of a valid or undisputed invoice, whichever is later. During 2008-09, 94% of undisputed invoices were paid within 30 working days. In response to the current economic position, the Department for Business, Enterprise and Regulatory Reform (BERR) announced on 21 October 2008 that central Government had committed to paying invoices within 10 days. In line with other Northern Ireland departments, the Utility Regulator has aimed to comply with this target and has paid 95% of undisputed invoices in this timescale in the period since the target was introduced.

Equality

We are fully committed to the promotion of equality and in ensuring compliance with relevant statutory legislation. We have engaged with the Equality Commission and have plans in place to ensure that our equality policies and practices are compliant with our obligations under Section 75 of the Northern Ireland Act 1998.

Communicating with stakeholders

Communicating effectively with our stakeholders helps us deliver our objectives. In the past year we have taken

significant steps to enhance our communication.

We have developed a series of corporate literature documents that help us explain our work. This has included a corporate promotional folder which outlined key information about the Utility Regulator and can be used for a variety of purposes and in a range of settings. We began developing a Guide to Regulation resource which we hope will be an important means of communicating information about us and our work to a wider audience. This resource will be available in 2009-10.

Everyone affected by our work is important to us. A survey of the public commissioned by us elicited encouraging responses. For example, it was evident that more people than ever in Northern Ireland were aware of us and our work. 60% of those questioned also felt confident that we were achieving our remit. The same survey provided important views for us to consider about the services provide by utility companies, opinion on energy prices, and priorities for us to consider.

We sought to reach out to stakeholder through a structured programme of events during the past year. This included engagement with specific organisations, set piece events

bringing together a range of stakeholders (e.g. to launch our Annual Report) and the use of specific formats to engage with a wide circle of interests. Specifically, we embarked on the organisation of a seminar series on issues affecting utility regulation which attracted between 150-200 invited guests as a whole.

Finally, we made major progress with enhancing our website. This involved delivering a project which enhanced the organisation of content on the website, added increased functionality and improved the design and structure. We hope to develop the website as a major channel of communication to our stakeholders and the wider public.

Landbank

Landbank consists of the portfolio of land used or held for generating purposes and is managed by Northern Ireland Electricity, under direction by the Utility Regulator, on behalf of customers as a condition it its transmission and distribution licence.

The major Landbank projects during 2008-09 concerned the decommissioning of redundant generating facilities. Belfast West Power Station had been handed back to the Landbank in

2003 by AES and a project to dismantle and demolish the station initiated. This was successfully completed in May 2008 on schedule and to budget. Work is progressing well on the decommissioning, asbestos removal, demolition and remediation of the redundant oil fired power station at Coolkeeragh. This project has progressed to schedule during the year and is on target for completion in early 2010.

A more general review and survey of the Landbank estate has also been undertaken during the year and a number of actions identified as a result will be taken forward in 2009-10.

The Utility Regulator has been represented on both decommissioning project boards and receives monthly reports on costs and other key aspects of project performance supported by specialist engineering support from Mott MacDonald. Representatives of NIE and the Utility Regulator meet on a monthly basis to discuss issues arising from the estate more generally.



Working for us – Charlene Bennett

Our goal is to ensure that regulated companies operate efficiently. We also wish to operate an efficient business. This is where people like Charlene Bennett - who works in our Finance and Administration branch – have an important job. Charlene's role involves working closely with colleagues throughout the organisation to make sure that all financial transactions are processed correctly and quickly. The need to work quickly but accurately in dealing with the payment of bills, for instance, is something that Charlene takes pride in. 'Given the current recession, it is vital that we pay our bills to our suppliers on time, and I work hard to meet the ten-day turnaround for the processing of payments', says Charlene.

Appendices

8



Appendix 1:

Progress against Forward Work Programme targets 2008-09

Electricity

Theme	3 Year Aims	Programme for Year 1	Outcome
Retail Markets	Review of directed & non directed contracts process with CER	Agree process for hedging in SEM	Achieved
	Harmonise retail regulation in conjunction with CER	Agree tariff timetable / inputs with CER	Achieved
		Review K factors to achieve common approach	Partially achieved – studies underway, being developed by retail team
		Review with CER tariff structure	Partially achieved – studies underway, being developed by retail team
	Position on Enduring Solution to retail market opening systems	Agree with NIE T&D programme for new system requirements	Achieved
	SONI Divestment	Ensure divestment in place	Achieved
Wholesale Markets	Security of Supply	Consideration in conjunction with DETI of the NI/RoI co-operation on common issues arising from each administration's respective security policy post SEM	Achieved
	Kilroot contract cancellation	Contest JR of the determination that SEM satisfies the criteria for the 2010 cancellation of the contract.	Achieved
	MMU - effective tackling of dominance/market abuse	Ongoing monitoring of bidding activity in SEM	Ongoing
	Capacity Payment Mechanism *	Calculate capacity pot by August	Achieved
	T&SC Compliance & development *	Review T&SC parameters	Achieved
		Monitor section 7 issues Complete priority 'Day 2' issues	Achieved Achieved
Monopoly Controls	Continue ongoing cycle of price controls for electricity businesses	SEM Harmonisation *	Achieved
		PPB and NIE Supply price controls for period commencing 1 April 2009	Partially achieved – to be completed early 2009-10
		T&D price control- review capex annual report for efficiency savings	Achieved
		Price control for MO for period commencing 1 April 2009 *	Achieved

Electricity

Theme	3 Year Aims	Programme for Year 1	Outcome
Metering	Implement long-term policy on smart metering	Carry out consultation on metering policy	Revised (Work deferred until after policy is clarified by DETI and data from studies in GB and RoI become available)
		Approve pilot project	Revised
		Identify cross utility aspects and identify best practice	Revised
Environment	Treatment of Wind in SEM	Following receipt and analysis to initial discussion, SEM Consultation paper early summer followed by decision paper	Partially achieved - work commenced with consultation planned early 2009-10 and decision late 2009
	All-island Grid Study	Consider our workings of the grid study recommendations and associated funding improvements with DETI and grid owner/operator	Achieved
Quality of Service	Review and enforce new guaranteed and overall standards	Complete survey research, draft new standards	Partially achieved - being progressed by retail team

** These are SEM Committee areas in which the Utility Regulator takes the lead*

Water

Theme	3 Year Aims	Programme for Year 1	Outcome
Retail Markets	Monitor developments in E&W and Scotland	Keeping informed regarding the process of business retail competition in Scotland	Ongoing
Wholesale Markets	Monitor developments in E&W and Scotland	Keeping informed of review of competition in England and Wales and in particular the Cave Report	Ongoing
Monopoly Controls	2-year price review (2010 to 2012) and begin work on a longer-term control (2010-17)	Price Control process and programme being implemented with agreement and co-operation of principal stakeholders	Achieved
Metering	Implement long-term NI policy on domestic metering Universal and accurate non-domestic metering	Consult on metering proposals	Revised – pending Executive consultation and decision
Environment	NI Water develops clear environmental drivers – incentives to this identified in consultation with environmental regulators and embodied in Ministerial guidance	Consultation on PR10 methodology and engagement of quality regulators in process via formal working groups	Achieved
	Effective monitoring and enforcement in co-ordination with EHS	Establishment and monitoring of Capital Investment Monitoring return	Achieved
	Clarify with NI Water its corporate social responsibility commitments in this area	Feeding into DRD consultation on draft Environmental and Social Guidance to inform PC10	Achieved
Quality of Service	Put in place and enforce guaranteed and overall standards	Complete survey research Draft guaranteed and overall standards scheme in consultation with key stakeholders (DRD, CCNI and NI W) Implementation (if appropriate by submission to DRD) Agree monitoring arrangements with NI Water	Revised in light of Independent Water Review Panel's report and pending subsequent decisions from Executive consultation

Gas

Theme	3 Year Aims	Programme for Year 1	Outcome
Common Arrangements for Gas	Identify and introduce all island structures where beneficial	Scope exercise	Achieved
		Develop common understanding of tariff issues	Achieved
		NTS Exit Reform	Ongoing
Retail Markets	Facilitate competition	Address domestic market entry barriers	Ongoing
		Work with GMOG to identify and implement code changes and appropriate IT	Ongoing
		Clarify and consult on Licence Fee Methodology	Partially achieved – industry consultation completed
Wholesale	All-island balancing point	Scope benefits	Revised – part of the CAG workstream
	Implement robust price controls	firmus, PTL and Phoenix Supply price controls	Achieved
Monopoly Controls	Review of licences & network codes	Implementation of NIEH corporate governance review	Achieved
	European work including new directive	Create a better process for monitoring network development and costs between price controls	Revised – to be progressed in 2009-10
		Initiate review of standard licence conditions.	Revised – to be progressed in 2010-11
		Participate in RGI and Directive consultations	Ongoing
Metering	Clarify approach to metering for industry and consumers	Metering review on smart and pre-payment meters	Ongoing
Environment	Promote gas as lower carbon alternative to oil	Work with industry to implement appropriate marketing support regime in Northern Ireland	Ongoing

Gas

Theme	3 Year Aims	Programme for Year 1	Outcome
Quality of Service	Put in place and enforce guaranteed and overall standards.	Complete survey research	Revised (to be progressed in 2009-10)
		Draft guaranteed and overall standards scheme in consultation with key stakeholders (DETI, CCNI and Phoenix, firmus)	
		Implementation (if appropriate by submission to DETI)	Revised
		Agree monitoring arrangements with Phoenix, firmus	Revised
		Develop/consult on review of licence fee calculation methodology.	Revised

Strategy

Theme	3 Year Aims	Programme for Year 1	Outcome
Retail Markets	Consult on and finalise the Utility Regulator strategic approach to retail energy competition	Complete consultation phase on strategic development	Achieved
		Develop a final strategic approach paper by end June. Handover implications to the Utility Regulator operational groups	Achieved
Monopoly Controls	Assess the Utility Regulator strategic approach to control of monopolies and cross-utility approach to price controls and regulation issues	Set up cross directorate group	Achieved
		Undertake internal thinking/work	Achieved
Metering	Cross utility aspects of metering to be investigated and best practice approach identified	Assess cross directorate implications of retail strategy for metering issues and ensure communication across the Utility Regulator	Partially achieved – further work to be advanced in 2009-10
	Consider implications for retail strategy.		

Social and Environmental

Theme	3 Year Aims	Programme for Year 1	Outcome
Environment	Ensure continued smooth operation of Renewables Obligation, Climate Change Levy and REGOs.	Ensure efficient delivery of environmental support schemes – Renewables Obligation, Climate Change Levy Exemption Certificates and Renewable Energy Guarantees of Origin	Achieved
	Ensure sound basis for, and effectiveness of, all energy efficiency delivery programmes.	Ensure administration and operation of support schemes continues to operate smoothly within the SEM	Achieved
	Ensure systems in relation to Energy Services Directive (2006/32/EC) are effective	Review the operation and administration of the EEL	Achieved
	Establish and clarify Utility Regulators role and position in relation to sustainability	Work with DETI in relation to the Energy Services Directive implementation	Achieved
	Ensure customers are given accurate and easily understood information regarding the environmental impact of the energy they consume.	Complete consultation on sustainability, publish responses and set out priorities	Achieved
		Establish effective system for Fuel Mix Disclosure	Partially achieved – further consultation required
Quality of Service	Major progress in tackling fuel poverty in Northern Ireland	Complete research in respect of Social Action and publish comprehensive Social Action Plan for consultation	Achieved
	Enhanced understanding of social issues in relation to water		
	Further improve and consider policy approach and communication with consumer groups		

Corporate Affairs

Theme	3 Year Aims	Programme for Year 1	Outcome
Organisational Development	Develop and improve HR processes	Implement HR strategy	Achieved
		Develop T&D plan for the Utility Regulator	Achieved
		Review provision of HR services within the Utility Regulator	Achieved
		Develop performance management framework	Achieved
		Roll out best practice HR policies	Partially achieved - Key contractual policies addressed and programme being developed to review all other applicable NICS Handbook policies
	Ensure compliance with equality legislation and promotion of diversity	Review and implement as necessary policies and procedures to support the Utility Regulator's activities	Achieved
		Annual fair employment monitoring by 1 May 2008	Achieved
		To complete annual equality scheme progress report by 31 August 2008	Achieved
		Review equality scheme timetable	Achieved
		Review Disability Action Plan	Achieved
	Develop and implement a three year corporate strategy	Issue and consult on strategy paper	Achieved
	Further embed and improve procurement processes	Maintain cross directorate procurement group	Achieved
	Performance Management	Develop a call list in respect of specialist consultancy advice to advance in house procurement capability	Achieved
	Monitor developments in EU and competition issues and relevant legislation	Live within the Utility Regulator's budget	Achieved
	Enhancing Board and Executive Governance processes and performance	Submit annual resource accounts for audit by 2 June 2008	Achieved
	DETI Strategy Review	Further embed risk management processes	Achieved
		Deliver internal audit plan	Achieved

Corporate Affairs

Theme	3 Year Aims	Programme for Year 1	Outcome
Organisational Development		Formally review performance against workplan every quarter	Revised – formally reviewed every fourth month
		Review methodology for calculation and appointment of licence fees	Achieved
		Establish key contacts and undertake GAP analysis of issues to be tackled Assess implications for Utility Regulator duties	Achieved
		Develop the organisation's online communications	Achieved
		Develop the organisation's corporate branding	Achieved
		Enhance organisational internal communications	Achieved
		Co-ordinate Utility Regulator input in medium term and ongoing work required on policy/strategy development	Achieved

Appendix 2:

Financial report

Central Government Financing

Amounts of £288,000 in respect of the financial year end 31 March 2009 were borne by central government in respect of expenditure on areas not covered by current licences such as the management on behalf of HM Customs and Excise of the Climate Change Levy Exemption scheme, the Electricity (Guarantees of Origin of Electricity Produced from Renewable Energy Sources) scheme, the Renewables Order (Northern Ireland) 2005 scheme and notional costs.

Accounts

The Operating Cost Statement shows that salary costs rose in line with the increase in staff numbers and inflation from the previous year - £3,541,000 for 2008-09 against £2,553,000 for 2007-08.

The percentage of staff costs to total costs has risen from 40% in 2007-08 to 55% in 2008-09. This is mainly due to the progress made towards reaching the required headcount.

The Utility Regulator's gross expenditure in pursuit of its objectives as detailed in the Statement of Operating Costs by Departmental Aim and Objectives (see Table 1 below) was as follows.

Table 1: Expenditure by Objective

	2008-09 (£000s)	2007-08 (£000s)
Objective A (electricity)	2,764	4,043
Objective B (gas)	1,537	1,010
Objective C (water)	2,109	1,317

The reduction in costs for Objective A is due mainly to the post implementation SEM cost requirements being lower than the pre implementation costs.

Objective B costs have increased as the Gas team resourcing has increased towards complement and additional resources have been required to deliver the firmus and PNG price controls and initiate the Common Arrangements for Gas.

The 2007-08 costs of Objective C represented the first year costs of beginning the process of establishing the water regulation related function and processes. The higher cost in 2008-09 compared to 2007-08 reflects the fact that the team was being established in the first year, and that work on the Price Control did not commence in earnest until 2008-09, the Independent Water Review Panel workstream taking precedence.

More detailed financial information on costs can be found in the Utility Regulator's Resource Accounts.

The Operating Cost Statement (the public sector equivalent of an Income and Expenditure Account) and a schedule setting out the Utility Regulator's financial performance in pursuit of objectives are set out below at tables 2 and 3. These figures were subject to final audit at the time of publication of this Report.

Table 2: Operating Cost Statement

	2008-09 (£000s)	2007-08 (£000s)
Programme Costs		
Staff Costs	3,541	2,553
Other (Non-Staff) Costs	2,869	3,817
Total Costs	6,410	6,370
Operating Income	(6,122)	(4,872)
Net Operating Cost	288	1,498

Table 3:
Costs by Utility Regulator Aims and Objectives
for the year ended 31 March 2009

	2008-09 (£000s)			2007-08 (£000s)		
	Gross	Income	Net	Gross	Income	Net
Objective A: To promote competition in the generation and supply of Electricity and to protect the interests of electricity consumers with regard to price and quality of service	2,764	(2,641)	123	4,043	(2,545)	1,498
Objective B: To promote the development and maintenance of an efficient, economic and co-ordinated gas industry and to protect the interests of gas consumers with regard to price and quality of service	1,537	(1,454)	83	1,010	(1,010)	0
Objective C: to protect the interests of water and sewerage consumers with regard to price and quality of service, where appropriate, by facilitating competition in the supply of water and the provision of sewerage services.	2,109	(2,027)	82	1,317	(1,317)	0
Total	6,410	(6,122)	288	6,370	(4,872)	1,498



Utility Regulator
Queens House
14 Queen Street
Belfast
BT1 6ER

www.niaur.gov.uk