

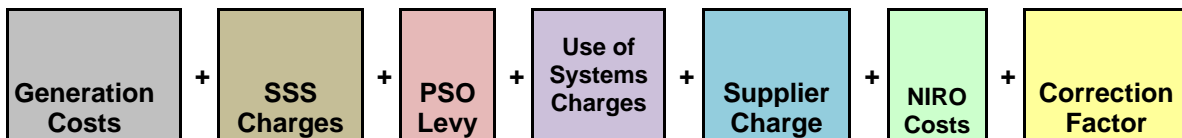
## Utility Regulator Briefing, 28 May 2007

### The Utility Regulator's Role in Regulating Prices and Tariffs

#### NIE Energy Final Retail Tariff

While the electricity market has been fully open to supply competition since 1 November 2007, in practice, for some classes of customers – particularly domestic consumers - NIEE does not face effective competition from other suppliers. The regulator therefore takes an active role in verifying NIEEs retail tariffs which are the final prices customers pay.

NIEE Retail tariffs are made up of a number of components:



Several of these components are common across all suppliers and the final customer must pay these regardless of who their supplier is:

Tariff	Service	Regulatory Instruments
<b>SSS Charges</b>	For system planning, operation and despatch	SONI Price Control 2007-10
<b>PSO Levy</b>	Costs which must be spread across all Northern Ireland customers	PPB Price Control 2007-2009 and annual approval of other costs
<b>Use of System Charges</b>	Costs of transmission and distribution of electricity across the wires network	T&D Price Control 2007-2012

These costs are regulated because they represent parts of the industry which remain under monopoly ownership and are therefore not open to competition. Independent suppliers are free to enter the market and purchase power however, but they must add on the tariffs outlined above before setting the final price to sell to customers.

The remaining components of NIEE tariffs, because of the level of competition in the market, are all subject to regulatory scrutiny:

Cost	Service	Regulatory Scrutiny
<b>Generation Costs</b>	Costs of procuring electricity	Competitive wholesale market; approval of NIEE hedging methodology
<b>Supplier Charge</b>	Charge to supply electricity to customers including operating costs	NIEE Supply Price Control 2007-2009
<b>NIRO Costs</b>	NIRO costs relate to government obligation on suppliers to sell a proportion of their output as renewables	Audited on behalf of NIAUR by Ofgem as part of its UK-wide audit
<b>'K' Correction Factor</b>	The difference between allowed revenue and actual recovered revenue; from year to year out-turn prices and volumes will be different from forecasts	Analysis of variances between forecasts used for setting tariffs and out-turn costs

### **In-Year Price Increase**

The current NIEE tariffs were introduced on 1 November, in line with the introduction of the SEM, and were set for an 11 month period with a view to a 12 month tariff cycle running from 1<sup>st</sup> October 2008 onwards. When tariffs were set for 1 November 2007 it was agreed between the Utility Regulator and NIEE that an in-year review of tariffs could be triggered if it looked likely that there would be an variance between the forecast revenue used to set tariffs and likely out-turn costs (the K correction factor). This threshold was set at 2.5% of turnover and was seen as necessary to:

- Limit the K factor in order to assist the development of a competitive retail market; the Utility Regulator is currently consulting on a retail market strategy;
- Ensure adequate cash-flows and on-going financial viability of the business in the event of an under-recovery; and
- In the event of an over-recovery, ensure that customers were not paying too much.

Because of the very significant increase in generation costs in recent months a breach of the trigger is expected. Only the generation cost component has been affected and the other regulated components of NIEEs final tariffs remain unchanged. Generation costs are a 100% pass-through part of the tariff and in a normal situation, where the 2.5% breach is not triggered, any variations (positive or negative) would, after scrutiny and verification by the Utility Regulator, be carried forward in the K tariff term (K correction factor) to the following tariff period.

It is estimated that, by the end of the current tariff year, NIEE will have under-recovered £13.7 million worth of electricity procurement costs. We have examined the detailed figures for these extra costs, satisfying ourselves that NIEE has purchased generation economically and regretfully accept the proposed 14% increase in prices from 1 July.