

UR NEWS



Regulator investigating water supply disruptions across Northern Ireland

Following major disruptions to water supply across Northern Ireland over the Christmas period and into the New Year, the Utility Regulator announced an investigation into NI Water's handling of the situation on 7 January.

It was also announced that two persons appointed by the First and Deputy First Ministers, Heather Moorhead and Philip Holder, will also review the broader governance issues, including the role and responsibilities of the Minister for Regional Development in relation to the incident. The Executive appointees will also consider the Utility Regulator's recommendations.

Announcing the investigation, Shane Lynch, the Utility Regulator's Chief Executive said:

"We intend to get to the heart of what went wrong during the recent crisis, and will examine how NI Water planned and reacted to these events."

The final investigation report will be in two parts. The first part, which will deal with the performance of NI Water – in the context of the Regulator's statutory powers – will be produced by the Regulator and will be approved by its board. The second part will address the broader governance issues and will be produced by the two Executive appointees.

The final investigation report will be submitted to the Executive by the end of February. Further details about the Utility Regulator investigation can be found at www.uregni.gov.uk

Shane's welcome



Welcome to our second ezine, and my first as Chief Executive. I see our ezine as being a useful tool to communicate with stakeholders and provide a better insight into and understanding of the work we do.

My first month in the new position has been extremely busy and challenging. It has also been an intense learning experience which I have greatly

benefitted from. My profile on page 4 will go into further detail about my thoughts on the new role.

This month's ezine includes updates on key projects and consultations, a forward look at wholesale energy prices and our investigation into NI Water.

As with the previous ezine, if you have any queries, comments, or would prefer to be removed from the mailing list, please contact Adele Boyle on adele.boyle@uregni.gov.uk

New CEO takes up his position

Shane Lynch commenced his role as Chief Executive of the Utility Regulator on 4 January 2011.

Before joining the Utility Regulator as Director for Electricity in 2009, Shane worked in the electricity industry within Northern Ireland for 27 years.

Professor Peter Matthews, Chairman of the Utility Regulator board, said:

"We are delighted to appoint Shane Lynch as our new Chief Executive following an open competition, which attracted a high calibre field."

"Shane brings considerable commercial and management skills, and significant experience of economic regulation. He has already made a major impact as Director of Electricity at the Utility Regulator and he will provide leadership to the independent regulator of the energy and water industries in Northern Ireland."

ETI Committee report welcomed

The Utility Regulator welcomes the recently published report from the Enterprise, Trade and Investment Committee on 'barriers to the development of renewable energy production and its associated contribution to the Northern Ireland economy'.

The report identifies a recommendation for action by the Utility Regulator on the process and charges for grid connection. In relation to this issue, we carried out a consultation in November 2010 on 'electricity connection policy to the Northern Ireland distribution system'. The consultation has now closed and we are currently reviewing the responses. We expect to report on this in due course.



A word from

Brian McHugh, Director of Gas, on gas prices

The gas bill of a domestic consumer in Northern Ireland is made up with four main elements – transmission, distribution (both essentially costs for using the gas network), costs of the supply company and the cost of the gas itself.

What affects gas bills?

The transmission, distribution and supply costs are regulated by the Utility Regulator and are relatively stable. The main volatility comes from wholesale gas costs. This is set by international markets in the same way as other commodities e.g. oil. Northern Ireland gas companies buy gas in GB, which is the nearest large market. The purchase price of gas changes every day and the variation over a year can be quite significant.

The main drivers for consumer bill changes are supply and demand. In recent years there has been a significant drop in gas demand across the world largely due to the economic recession. This period has also seen an increase in the supply of natural gas, which is explained further below. The decrease in demand and increase in supply resulted in Phoenix Supply Ltd's (PSL) prices falling in October 2009 by 19% following our tariff review.

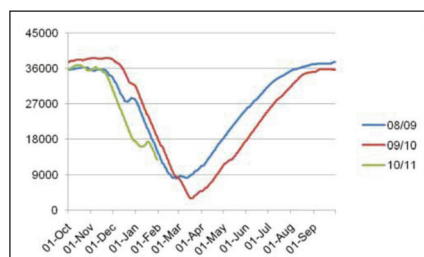
What change in costs have occurred?

In the US, increases in supply of natural gas have been driven by 'shale' gas. Shale gas is trapped in lots of small deposits in tight rock formations. Recent technological advances have made it possible to access this gas and significantly increase overall US gas supply. In GB the opening of new liquefied natural gas (LNG) ports has created a new source of supply. These facilities allow gas to be liquefied in countries such as Qatar and shipped to GB.

However, in the last year, the world has moved out of recession and demand for gas has followed. This is particularly evident in developing markets such as China. The recent cold weather has also significantly increased demand for gas. This has had a dramatic impact on levels of gas storage throughout Europe.

Gas storage is used as a reserve supply source of gas and the storage facilities tend to fill up in the summer and used for additional supply in the winter. This winter has seen very high levels of withdrawals and, as a result, capacity is at historically low levels. This can be seen in graph 1 where the position of the 2010/11 levels in January is significantly lower than in the previous two years. This reduction in potential supply, coupled with increasing demand has led to an increase in the cost of wholesale gas.

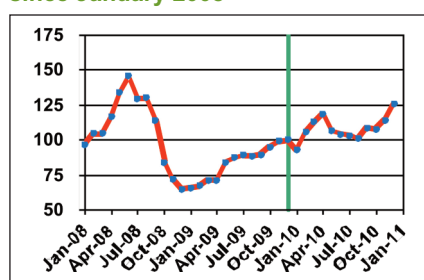
Graph 1: Movements in gas storage 2008 – 2011



Source: National Grid Data

The cost of wholesale gas is ultimately paid for by customers in Northern Ireland in their gas bills. Over the last three years this has resulted in some significant price changes and we foresee this volatility continuing. This is demonstrated in graph 2 which shows prices rising steeply in May 2008 and falling to their lowest levels in January 2009. The graph clearly demonstrates the current trend in wholesale gas prices is upwards.

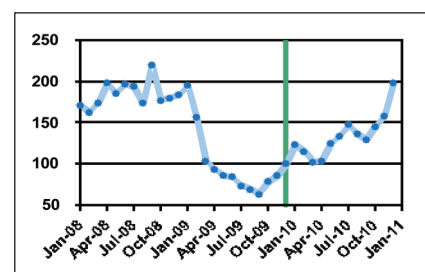
Graph 2: Movement in gas prices since January 2008



Source: firmus energy

Graph 3 shows the movement in oil prices over the past three years and further illustrates the volatility in prices over this period. It also provides further evidence of why the current trend in gas prices is upwards.

Graph 3: Movement in oil prices from Jan 2008



Source: firmus energy

Current outlook

At the time of writing, the cost of a barrel of oil has risen to \$100 – the highest price it has been in more than two years. This is partly due to concerns about the unrest in Egypt which could affect shipments passing through the Suez Canal, but it is also a further indication of increased demand and inflation. This increase is likely to affect wholesale energy costs and in turn, the cost of electricity and gas to Northern Ireland consumers.

The next tariff review for the Greater Belfast market is in April 2011. The Utility Regulator will continue to monitor the market and work with PSL, the Consumer Council and DETI on the next review. Over the last two years this process has led to standard gas prices in Northern Ireland being lower than the average in GB in spite of Northern Ireland paying much higher network charges.

Cost and Performance Report on NI Water

In mid December, we published our independent assessment of how NI Water has performed in their first three years of operation and compared the company's performance with other water and sewerage companies across the UK.

Our Cost and Performance Report on NI Water identified that while progress has been made, more needs to be achieved to ensure consumers receive value for money services.

Shane Lynch, Chief Executive of the Utility Regulator said:

"As the independent economic regulator, our role is to ensure that water and sewerage consumers receive value for money services. The Cost and Performance Report provides a method for us to measure how well efficiency targets are being met, the quality of service provided and the company's financial performance.

"During 2007-2010, the company largely met enhanced efficiency targets for operational expenditure¹, improved its rating for overall performance and level of service provided² and delivered the highest ever drinking water quality in 2009.

"The operational efficiency gap between NI Water and English and Welsh companies has been reduced from 49% to 40%. Whilst this shows a reduction has been achieved, it also highlights the need for a decrease in costs by 40% if NI Water is to become as efficient. For example, for every £1 spent by an efficient water company, NI Water spend £1.70.

"The company must also focus on improving its data and the quality of information it holds. We have acknowledged that progress has been made in this area, but we will continue to work with the company to ensure commitments made to us are met."

The Cost and Performance Report assesses NI Water's performance against targets set in the company's Strategic Business Plan 2007-2010. The targets were set prior to the Utility Regulator's appointment as water regulator (before 1 April 2007) and were agreed between DRD and NI Water, in consultation with the Drinking Water Inspectorate for NI, and the NI Environment Agency. NI Water's Strategic Business Plan 2007-2010 set out the allowed revenue, associated efficiency targets and key performance indicators for the company in its first three years.

1 NI Water was over budget by £0.3million.

2 Within economic regulation, the rating is referred to as the Overall Performance Assessment score.

ETI Committee appearance

On 25 November 2010 the Utility Regulator gave evidence to the ETI Committee on two issues.

The main purpose of the appearance was in relation to renewable energy barriers. We gave support for the North South interconnector, which has been referred to the Planning Appeals Committee. We also outlined the need for further grid development in order to meet the renewable energy targets set by the Department of Enterprise, Trade and Investment, and expressed support for speeding up the planning process for such work.

The second issue was in relation to the supply exclusivity period for firmus energy in the ten towns outside Greater Belfast which have access to natural gas. We updated the committee on our consultation proposal to better coordinate the dates when exclusivity across the ten towns will end. We consider that the proposal will result in a better coordinated market opening across the ten towns, which is a small area in terms of customer numbers, and could have potential to reduce the costs associated with market opening. Further details on the consultation are available on page 5.

New board members announced

In December 2010, the Finance Minister, Sammy Wilson, announced two appointments to the Utility Regulator board.

Mr William Cargo and Mr Richard Rodgers have been appointed for three-year terms from 1 January 2011. Both are expected to devote around 20 days a year to Utility Regulator business.



William Cargo has held a number of senior management posts in both the private and public sector UK and international energy industry. From 2004 to 2010 he was an executive director of Mutual Energy and managing director of its gas business. Prior to this he worked for the BG Group which included a time as chief executive for Premier Power and engineering director with Phoenix Natural Gas during the introduction of natural gas to Northern Ireland. Mr Cargo has served on the boards of private and mutual energy companies and has a detailed understanding of the gas and electricity industries.



Richard Rodgers has over 20 years experience in the gas industry. He has been employed since 2008 by Eaga plc and is currently divisional managing director, with responsibility for Eaga's heating businesses and its operations in Ireland. Prior to this he worked for Phoenix Natural Gas from 1996 to 2008, initially with responsibility for business planning and regulatory matters. In 2000, he was appointed business development director with responsibility for a wide range of areas including marketing communications, PR, public affairs, gas procurement and regulation. He is a member of the Northern Ireland Committee of the Institute of Directors.

Shane Lynch Chief Executive

How are you finding the job so far?

I love it – it is very challenging and exciting. I have always liked a job that involves building new relationships and provides me with the opportunity to make a difference. Having spent so long in industry, I am very focused on creating shareholder value. In this job the fact that my 1.7m shareholders live in my local community makes it so much more rewarding. Having to deal with the freeze/thaw incident in the first few days of the job was probably one of the best learning experiences of my career to date.

What do you think will be your biggest personal challenge(s) in your new role?

This job requires a combination of technical and economic skills and an awareness that we operate in a political context. I have developed my regulatory experience and knowledge as a practitioner in the industry. If you like, I was on the receiving end of regulation. I learnt so much from working with my predecessor, Iain Osborne, for about 15 months on the underlying economic concepts and principles. Together, I think we made a very effective team. Regulatory principles and concepts continue to evolve. A big challenge for me will be to stay abreast of these and weigh them up in light of my significant practical experience.

As an organisation what do you feel are the biggest challenges facing the Utility Regulator in 2011?

In energy, our biggest challenge will be trying to manage price increases. We are seeing an upward trend in wholesale gas prices which we don't regulate. Increasing wholesale gas prices also has a large bearing on wholesale electricity prices. Essentially, wholesale gas prices are set by international markets, which we have to accept. However, where we can make a difference is through our rigorous scrutiny of the regulated elements within energy tariffs to ensure prices are as low as they can be for consumers.

In water our challenge is to work with our key stakeholders and ensure value for money for water consumers in the context of a constrained economy and reduced availability of public expenditure.

What did you do before you joined the Utility Regulator?

I spent 27 years of my career in the electricity industry in Northern Ireland. The first 10 years was working with NIE in various engineering positions. I then worked for the AES Corporation, as Managing Director of Belfast West power station, then Managing Director of Kilroot power station and finally as Development Director for the island of Ireland. I believe my experience of the

electricity industry is very transferrable to both gas and water. The technical and economic aspects are similar and all three utilities operate in the same political context.

What advice would you give to someone thinking about a career path in the electricity industry?

I would always advise young people to pick a career path which they think they will enjoy and will be good at. Don't worry too much about getting it spot on first time, because often you can diversify later. At school I was good at maths and physics and did mechanical engineering at Queens. But later in my career, I gravitated towards the business end and went back to college to do a part time masters in finance and investment. Don't pick a career which you think will make you lots of money. If you are good at something and you enjoy it, you will be successful and the rewards will flow.

In my spare time.....

We have three young children aged between five and 13, and I enjoy spending most of my spare time on the usual family stuff. Occasionally Eileen and I manage to get some spare time to ourselves and with friends. I increasingly look forward to summer holidays. After many years on European campsites, we went on a family cruise for the first time last year. I managed to leave my blackberry at home for the first time in years – something I would highly recommend.

Open consultations

SONI Price Control 2010 -2015

We published a consultation paper to consider SONI's (System Operator Northern Ireland) allowed revenue to recover its operating costs, depreciation and a reasonable return on investment. To respond to questions raised, please forward your comments to billy.walker@uregni.gov.uk and kevin.o'neill@uregni.gov.uk by 12noon on 4 March 2011.

Review of supplier transmission use of system charging

We have received recommendations from SONI on changes to the methods used to calculate charges for the use of the electricity transmission system. SONI consulted upon these changes in July 2010. We are currently consulting on these recommendations from SONI. Comments should be sent to sarah.friedel@uregni.gov.uk by 5.00pm on 16 March 2011.

Phoenix Supply price control

We have launched a consultation to seek views on the principles that will be used to determine the third price control for Phoenix Supply Ltd, which will take effect from 1 January 2012. To respond to questions asked in the consultation paper, please send your comments to lesley.robinson@uregni.gov.uk by 5.00pm on 29 April 2011.

Events

- **Early March:**
Public announcement regarding NI Water investigation
- **10 March:**
Utility Regulator Board meeting
- **20 April:**
NIE T&D price control (RP5) stakeholder event

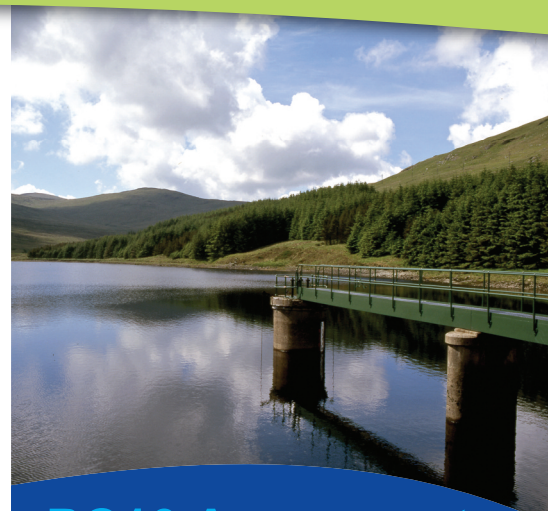
Regulator hosts major conference on Financing Infrastructure

The Utility Regulator organised a major conference on 'Financing Infrastructure', which was held at the Ulster Hall in Belfast, on 12 January. Over 70 attendees from industry, government, academia and the third sector attended the event, which was aimed at promoting discussion on strategic issues associated with the funding of infrastructure investment.

A high quality line-up of speakers addressed a range of perspectives around the financing issue, and the second part of the conference discussed a recently published paper by First Economics, which had been commissioned by the Utility Regulator. Details about the First Economics paper, which has been published for comment by 18 February, can be found at www.uregni.gov.uk/news. Copies of the conference presentations can be accessed at www.uregni.gov.uk/publications



Among the speakers at the conference were Patrick Holland (RBC Capital Markets), Shane Lynch (UR), Peter Warry (Mutual Energy), Victor Hewitt (Economic Research Institute of NI), Brian McHugh (UR) and Peter Matthews (UR).



PC10 Agreement

In December, the Utility Regulator and NI Water formally confirmed that the Price Control for 2010 – 2013 (PC10) had been accepted. The price control is subject to public funding and is underpinned by a Memorandum of Understanding between the Department for Regional Development and the Utility Regulator.

The PC10 determination sets out NI Water's priorities for 2010 – 2013 and makes recommendations on the finances needed to deliver them.

Further details on the agreement can be found at www.uregni.gov.uk/news

Decision issued on the ten towns/firmus energy exclusivity consultation

In August 2010, the Utility Regulator issued a consultation paper on the relinquishing of firmus energy's supply exclusivity in the ten towns area to consider the best way to coordinate market opening.

We received 17 responses to the consultation which we carefully considered and reviewed. Two further documents were then published in December 2010 and a statutory consultation took place on the necessary modifications to firmus energy's gas conveyance license.

The final decision, as per the 'minded to' paper issued in December, will result in a better coordinated market opening across the ten towns and could have the potential to reduce the costs associated with market opening. In the most cases, customers will experience competition earlier than if the original staggered market opening timetable had stood. From October 2012 the market will be open to competition for large industrial and commercial (I&) customers. Small I&C and domestic customers will have a choice of supplier from April 2015. The decision paper was published on 24 February 2011 and can be viewed at www.uregni.gov.uk/news.