

ANNUAL REPORT 2007-08



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ANNUAL REPORT 2007-08

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

The Utility Regulator, exercising its discretion under Article 5 (5) of the Water and Sewerage Services (Northern Ireland) Order 2006, has produced a combined energy and water and sewerage report. This fulfils the Utility Regulator's statutory duty to produce an annual report under Article 5 (1) of the Water and Sewerage Services (Northern Ireland) Order 2006 and Article 6 of the Energy (Northern Ireland) Order 2003.

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.

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I. CHAIRMAN'S FOREWORD

The last year has been momentous for Northern Ireland. The Utility Regulator was delighted to see the restoration of locally accountable government. We have a track record of developing local solutions for local problems and are committed to working with the Northern Ireland Executive to deliver robust utility industries that serve the short and long-term interests of consumers.

We are one of the most transparent public authorities in Northern Ireland as we consult with stakeholders before all significant decisions.

Devolution places more emphasis than ever on the transparency and accountability of public authorities. We are one of the most transparent public authorities in Northern Ireland, as we consult with stakeholders before all significant decisions. Although the industries we regulate are complex, we work hard to explain. We aim for an approach where all key stakeholders understand the

process by which we will take a decision; know how they will be consulted and understand the basis for our decisions. Stakeholders might not agree with us but there should be no surprises.

Northern Ireland does not have resources to waste, so we aim to work smart – following precedent where suitable for our own needs but without any fear of innovation where we see benefits to consumers. Working in partnership is particularly important to ensure an efficient approach: with government, with consumer representatives, with companies and with other regulators. Our collaboration with the Commission for Energy Regulation has been particularly fruitful this year: the Single Electricity Market has gone live and we have begun work to establish the maximum consumer benefits from Common Arrangements for Gas.

We are at the forefront of grappling with some of the major social and economic problems of our day. We are the only non-Ministerial government department here and so provide a resource to the whole Executive and indeed to the whole of Northern Ireland society. We offer an independent centre of expertise, solely focused on promoting consumers' long and short-term interests.

This expertise is a particularly valuable resource as Northern Ireland's utility industries face a period of rapid change. Promoting competitive energy markets, securing public support for efficient water investment and re-orienting the utilities to develop sustainably are enormous challenges. Northern Ireland will need to harness all available expertise to meet these challenges and innovative policy approaches will be required.

I would like to finish by paying tribute to the hard-working and able staff of the Utility Regulator. Our staff are strongly motivated to deliver consumer benefits through expertise and professionalism. The year saw much achieved with limited resources through the hard work and creativity of many individuals. Thank you.



Peter Matthews
Chairman, Northern Ireland
Authority for Utility Regulation

2. CHIEF EXECUTIVE'S REPORT

The Utility Regulator exists primarily to protect the interests of energy and water consumers. That means bearing down in the short term on costs and prices and ensuring that Northern Ireland has strong and sustainable utility industries to deliver long-term value.

The Utility Regulator exists primarily to protect the interests of energy and water consumers.

Stakeholder expectations of the regulator are rising. Devolution has ensured a very healthy scrutiny of our effectiveness. Our work has required more resources in recent years and so more outputs are expected. This Annual Report sets out how, during 2007-08, we rose to this challenge and delivered substantial consumer benefits.

Taking the immediately quantifiable effects alone (chiefly in the area of monopoly price controls), regulation this year delivered consumer benefits of around £60 million (Net Present Value - NPV), compared to regulatory costs of £6.4 million.

Our work to develop competitive markets will deliver even more benefit but this is over the long-term and not so easily assessed.

In electricity regulation, we broke new ground this year with the Go-Live of the Single Electricity Market (SEM). This is a project of international significance: the first cross-border market in Europe that embraces full integration of market operation and of regulation. SEM is expected to deliver more competition and investment and so ensure substantial long-term benefits to consumers. These are all the more important as global fossil fuel price trends are leading to higher electricity costs in the coming years.

While growing competition can protect consumers in wholesale and retail markets, regulation of energy monopolies remains central to consumer protection. On this front, we saw a busy year. We set new price controls for three NIE businesses (supply, power procurement and system operation), saving consumers around £5 million per year. The system operator control should enable the divestment by NIE of that business which will strengthen market confidence in its independence. We also finalized a new price control for Phoenix Gas's distribution network and largely completed the first Phoenix supply price

control. For the first time, this gives us direct control of the price paid by Phoenix consumers. We developed a new regulatory framework for Phoenix's transmission assets, enabling them to be mutualised at a low cost of capital. Taken together, these projects largely give effect to our 2006 agreement with Phoenix, which reduced the risks to that company in exchange for consumer savings. Taken together, the NPV of these benefits has been nearly £80 million (against an annual budget for our gas directorate of £1 million).

Our gas work since 2006 has saved consumers nearly £80 million.

During the year we laid the foundations of effective water and sewerage regulation, while contributing to debate about the future organisation of this sector. We developed a high-level plan for our first price control; developed processes to enforce regulatory obligations; worked with the Consumer Council to approve NI Water Limited's codes of practice for looking after customers; approved the company's asset disposals

plan; ensured the company has an efficient procurement plan; approved the scheme of charges for 2008-09 and undertook basic research to inform Northern Ireland's metering debate. We also reviewed the business plan left by direct rule ministers and, finding it wanting, proposed important changes: for instance, seeking higher operating efficiencies in 2008-09. The need for more challenging efficiency targets was one of the conclusions of the Hillyard review, to which we gave substantial input during the year and which endorsed the importance of economic regulation for NI water consumers.

We scrutinize closely any proposals for price changes to ensure that only valid costs are passed to consumers.

Because our budget and head count have grown recently, the year also saw considerable work on our governance systems. We have strengthened our risk management at directorate and corporate level, improved our

financial controls and controls on procurement and strengthened our HR systems. We expanded our headcount so that by year-end we were well on our way towards reaching our staffing complement.

Finally, we began work to develop a clearer strategic stance. Consultation processes began (although are not yet complete) on important issues like sustainable development and how to encourage retail competition. We also began an internal process to clarify our mission and values as an organisation.

2007-08 was a year of much activity and much achievement to the benefit of consumers. We are, however, not complacent: in the coming years, more still will be expected. Water regulation is only beginning to bite and create real transparency, accountability and impact. On energy, we scrutinize closely any proposals for price changes to ensure that only valid costs are passed to consumers. Nevertheless, and despite our firm control of network costs, electricity and gas prices are rising faster than for many years. Moreover, the challenges of producing a sustainable energy system are likely to require faster progress on key dossiers such as grid development and renewables. For all these reasons, we expect

public and political scrutiny of our work to intensify and expectations to be higher.

We are determined to meet these new challenges and to deliver ever-greater benefits to Northern Ireland's energy and water consumers. As a result of the foundations laid this year, we look forward with confidence and ambition.



Iain Osborne
Chief Executive

3. ABOUT THE UTILITY REGULATOR

Who we are

The Northern Ireland Authority for Utility Regulation (the Utility Regulator) is a non-Ministerial Government Department. We are responsible for regulating the electricity and gas industries and water and sewerage services in Northern Ireland.

We are governed by a Board of Directors, made up of a Chairman (Peter Matthews), six non-executive members (Etain Doyle, Clive Elphick, Philip Johnson, Christopher Le Fevre, James Oatridge and Alan Rainey) and the Chief

Executive (Iain Osborne). The Board is responsible for the overall strategic direction of the organisation and ensuring that it meets its legal obligations.

Although we are not a policy-making department of Government, we make sure that the utility industries in Northern Ireland are regulated and developed within Ministerial policy as set out in our statutory duties. The Utility Regulator is accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

Based at Queens House in the centre of Belfast, the Utility Regulator has 65 staff (full-time equivalent). The Chief Executive leads a management team made up of Directors representing each of the key functional areas in the organisation: Corporate Affairs (Director – Donald Henry), Water (Jo Aston), Gas (Brian McHugh), and Electricity (Dermot MacCann). The staff team includes economists, engineers, accountants, legal advisors and administration professionals. Figure 1 shows how the organisation is structured.

What we do

We carry out our work in line with statutory duties set out in the Energy (Northern Ireland) Order 2003 and the Water and Sewerage Services (Northern Ireland) Order 2006.

The Utility Regulator has three main objectives:

- to protect the interests of electricity consumers with regard to price and quality of service by promoting competition in the Generation, Transmission and Supply of Electricity;
- to promote the development and maintenance of an efficient, economic and coordinated gas industry and to protect the interests of gas consumers with regard to price and quality of service; and
- to regulate the water and sewerage industry in NI in a way that incentivises and encourages the company to achieve the highest possible service for customers in terms of both quality and value.

We work to protect the interests of electricity, gas and water consumers in Northern Ireland by:

- issuing and maintaining licences for gas, electricity and water companies to operate in Northern Ireland;
- making sure that these companies meet relevant legislation and licence obligations;
- challenging companies to keep the prices they charge electricity, gas and water customers as low as possible;
- encouraging regulated companies to be more efficient and responsive to customers;
- working to encourage competition in the gas, electricity, water and sewerage services markets;
- setting the standards of service which regulated companies provide to customers in Northern Ireland;
- acting as an adjudicator on certain customer complaints, disputes and appeals.

In carrying out our work we also take account of the needs of vulnerable consumers. We also aim to contribute to the promotion of sustainable development in exercising our regulatory duties.

Who we work with

In order to help us protect the interests of electricity, gas and water consumers in Northern Ireland, we work with a range of partner organisations. These include:

- utility companies
- Consumer Council Northern Ireland (CCNI) – whose role as an advocate for consumers is complementary to our regulatory powers
- other Northern Ireland government departments
- other government departments and bodies in Great Britain and the Republic of Ireland
- non-governmental organisations.

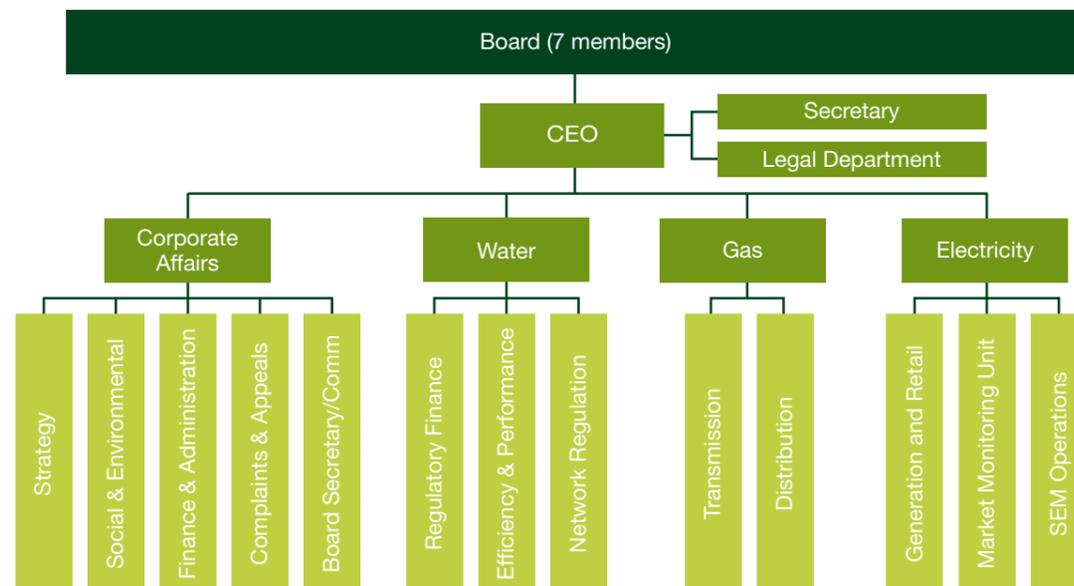


Figure 1: The Utility Regulator Organisational Structure

We aim to contribute to the promotion of sustainable development.



HIGHLIGHTS

- Along with the Commission for Energy Regulation we successfully delivered the Single Electricity Market, the only cross-border wholesale electricity market in the European Union.
- Our price control work continued to encourage efficiencies in regulated companies and secured savings for customers (e.g. £2 million in 2007-08 alone on the PPB control).
- We have initiated steps to introduce the innovation of smart metering, with the real benefits that this potentially can bring to consumers.

4. ELECTRICITY

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

The Single Electricity Market (SEM) started, as planned, on the 1 November 2007. The SEM created a single market for the trading of wholesale electricity on the island of Ireland. The creation of the SEM is the biggest change in the electricity industry in Northern Ireland in the 15 years since privatisation. It is also seen as having European significance, setting up a new way in which EU member states can co-operate to create effective energy trading arrangements. The success of the SEM was dependant on the political and legislative support of both Governments arising from the prospect of mutual benefits to consumers, North and South.

The creation of the SEM is the biggest change in the electricity industry in Northern Ireland in the 15 years since privatisation.

An important feature in making the SEM happen was our close working relationship with key

partners. We led a three-year project to deliver the SEM with the Commission for Energy Regulation (CER), our equivalent organisation in the Republic of Ireland. Our work on the SEM also involved close co-operation with the transmission system operators, System Operator of Northern Ireland (SONI) and EirGrid in the Republic of Ireland. The wider electricity industry throughout the island of Ireland also played an important role in delivering the SEM. Finally, the support of the two government departments north and south Department of Enterprise, Trade and Investment (DETI) and the Department of Communications, Energy and Natural Resources (DCENR) that are responsible for energy policy, was fundamental in delivering the SEM.

Before the SEM could start on 1 November, we worked closely with our partners to make the necessary preparations. This included finalising a Trading and Settlement Code (TSC – the rules of the market) and the completion of the licensing and contract arrangements for the new market. We also spent some time planning quite technical elements of the SEM, such as the implementation of market power arrangements – including directed contract process and the setting up of Market Monitoring Unit (MMU). In addition, our preparations

included work to complete transmission harmonisation arrangements and the capacity payment mechanism. Further work took place to set up the Single Electricity Market Operator (SEMO).

The SEM is a centralised or gross mandatory pool market, with electricity being bought and sold under a transparent market clearing mechanism. Generators receive the System Marginal Price (SMP) for their scheduled dispatch quantities, capacity payments for their actual availability and constraint payments for changes in the market schedule due to system constraints. Suppliers purchasing energy from the pool will pay the SMP, capacity costs and system charges. SEM market rules are set out in the TSC.

The SEM will bring benefits to energy consumers.

Although there is no doubt that aspects of the operation of the SEM are complex, the changes will bring benefits to energy consumers on the island of Ireland. This includes combining two smaller markets to provide greater competition and investment opportunities and security of supply and efficiency

benefits. It is estimated that the SEM will lead to net benefits equal to £100 million¹.

Since 1 November, the two Governments established the SEM Committee and parallel legislation, and appointed the Independent Member and Deputy Independent Member to take decisions in relation to any functions relating to SEM matters. The SEM Committee is

made up of three representatives from the Utility Regulator, two from CER and two independent members. The first meeting of the SEM Committee took place on 13 November, and four further meetings have taken place during 2007-08. A key focus of its work to date has been the monitoring of the new market, including its first MMU Inquiry (see 'About our work' below). Ongoing developments in the

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

¹A Cost Benefit Study of the Single Electricity Market – A Final Report for NIAER and CER, by NERA Economic Consulting, 2006.

About our work: Market Monitoring Unit

The Market Monitoring Unit (MMU) is based at our offices in Belfast though we work closely with our colleagues in CER. Guiding criteria for the MMU are transparency, accuracy and persuasiveness.

The MMU is a multi-disciplinary team consisting of economists, engineers and mathematicians who use their knowledge of energy and markets to understand how prices are being set in the SEM. It also assesses whether those prices are at a level expected in a competitive market.

Information from the SEMO and international energy markets is obtained to help us analyse individual events in the SEM. This may include working out why spikes in prices occur, the operation

of market rules and participant bidding – looking, for example, for evidence of manipulation or to understand the strategies behind bidding.

The MMU regularly circulates market information to staff in both regulators as well as providing monthly reports and advice to the SEM Committee. The MMU will also publish regular market assessments.

Overall, the MMU provides an assurance that a specialist team is constantly monitoring the SEM to make sure that there is no market abuse or dominance and to provide an objective basis for acting to prevent unfair market behaviour.

Promoting retail competition

Cross-border developments

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

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

A key control was the introduction of an Economic Purchasing Obligation (EPO) requiring NIE Energy and ESB Customer Supply to purchase hedging contracts in a manner that is fair, transparent and non-discriminatory, while at the same

time not overpaying for their contracts which would result in customers overpaying for their electricity. Both suppliers were required to produce hedging policy statements for approval by the RAs. They were required to submit for regulatory approval tariff methodology statements. Statements by both NIE Supply and ESB Customer Supply were published by the RAs in July.

We want to extend real choice to energy customers in Northern Ireland.

Extending choice in the Northern Ireland market

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

Internally we set up a cross-directorate project team to look at retail competition. A key part of the project has been to work out what the key barriers are to retail competition and how they may be addressed. We expect to produce a document for consultation in early 2007-08 that will help us identify how we may take further steps to promote competition for domestic customers in Northern Ireland.

Protecting consumers by regulating monopolies – price controls

We use price controls to ensure that monopolies do not abuse their position, providing them with a future level of revenue to meet their statutory and licence obligations, and putting in place incentives so that the companies can, for instance, offer a good quality of service to customers. During 2007-08, NIE Energy, SONI and Power Procurement Business (PPB) were subject to price controls.

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

retail electricity market. We also set the business's net profit margin at 1.8 per cent.

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

The new PPB price control is a major change from the previous arrangement, which was based around an incentive on sales volume and which is no longer appropriate in the new wholesale pool arrangements. The new control is based on a basket of incentives which measure the efficiency of the operation of the PPB contracts and PPB interaction with the SEM and is for the period November 2007 to March 2009. The overall incentive amount will be based on PPB's operating performance and also partially on savings to customers.

Our work on the PPB price control is projected to save customers around £2 million in the period November 2007 to March 2008 through a reduction in regulated entitlement (when compared with the equivalent period in financial year 2006-

07). Also, going forward, this price control will lead to a reduction of around £4 million in PPB's regulated entitlement for financial year 2008-09 when compared with either of the two years' price control outturn entitlements in financial years 2005-06 and 2006-07. This is in spite of PPB operating costs rising by around £1 million a year (post-SEM) owing to increased staff numbers. PPB has also established arrangements with the contracted generators that will provide additional benefits to customers for the duration of this new price control.

Innovating on metering

We have also started to consider the issue of smart metering, a modern system that allows two-way communication between customer and suppliers. Introducing smarter forms of metering for domestic customers has the potential to: improve customer service; increase domestic energy efficiency (helping to reduce greenhouse gas emissions); reduce fuel poverty and increase security of supply. The unique nature of the Utility Regulator also provides us with an opportunity to address the issue on a cross-utility basis.

The Utility Regulator is also specifically planning six smart meter pilot schemes

involving 200 customers each. Discussions with NIE have begun on delivering this initiative. A steering group (chaired by the Utility Regulator) is being set up and it will drive policy for the working/project management group who will control and give directions to two further working groups – one dealing with customer behaviour and the other with technical issues. The results of these pilots will help inform the decisions as to the best way forward for smart metering in Northern Ireland. Any future decisions on smart metering implementation will also take into account the results of similar pilot schemes in the Republic of Ireland and Great Britain.

Integrating European markets

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



1. Castlereagh sub insulators
2. Electricity Pylon, Castlereagh
3. Solar panels



HIGHLIGHTS

- **The sale of Phoenix transmission assets, facilitated by our regulatory work, resulted in savings of £25 million to gas customers.**
- **As a result of our price control work in reviewing Phoenix's costs, we removed an annual £6 million from customer bills – worth around £27 million (net present value).**
- **Working alongside our counterparts in Dublin, CER, we have initiated a cross-border project which we believe will deliver significant benefits to all gas customers on the island.**

5. GAS

Working for customers on gas prices

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

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

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

Work began in early 2008 on the second firmus energy price control. As with the work on the PNG distribution price control, we brought together an expert

team. This team will analyse firmus energy's cost projections to make sure that the company has sound plans for efficiently investing in the network. Having sound investment plans will allow firmus energy to continue making new network connections, making natural gas a viable alternative fuel for customers in each of the ten towns that are served by the network. We have completed our information request to firmus and have set out a clear template for dealing with the complex information requirements. This should allow a transparent flow of information and the achievement of the price control timetable in 2008.

The 2007 gas distribution price control reduced charges by around £6 million per year.

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

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

Having reviewed PSL's proposals for operating costs we have made reductions of around £500,000 for 2007 and 2008.

Supporting new ways of delivering benefits to gas consumers

During 2007-08 we were faced with making a judgement on the granting of a licence to a not-for-profit company limited by guarantee, Northern Ireland Energy Holdings (NIEH) in relation to the Phoenix Transmission assets. The granting of a licence was in order

to facilitate the sale of the assets. Our primary consideration was whether or not this licence grant would be in the interests of gas consumers in Northern Ireland. The 'About our work' section opposite provides more information on how we made our decision.

Overall, it is clear that the sale will lead to significant financial benefits. The immediate benefit

has been a reduction of £4.7 million in transmission tariffs in 2007-08. The following chart (Figure 2) compares the costs to customers following the mutualisation of PNG Transmission with the costs had the sale not gone ahead. In addition to the one-off benefits, the deal will deliver financial benefits to the Northern Ireland gas customers in the region of £25 million over 40 years.

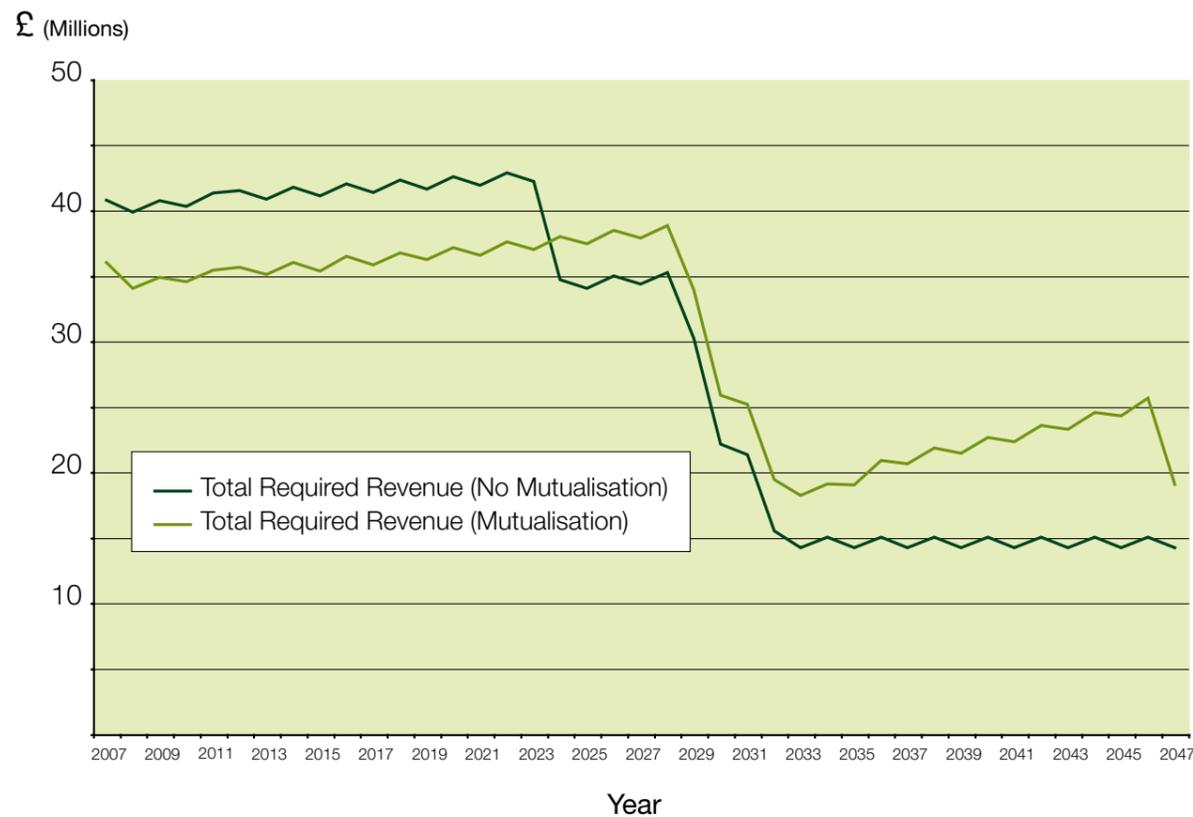


Figure 2: Post-aliased Tariff Required Revenue Pre and Post Mutualisation of Phoenix Transmission

About our work: Mutualisation – Phoenix Natural Gas Transmission (Phoenix Transmission)

The transfer of ownership in this case was from a private sector company to a not-for-profit company. The new owner has no shareholders but instead has a group of members whose job it will be to monitor the company’s obligations to gas customers. This process is referred to as mutualisation and the key benefit is that profits will not be distributed to shareholders but will either be re-invested into the company or used to reduce tariffs for customers.

Although we had previous experience of the ‘mutualised model’ with Moyle in 2003 and PTL in 2005, we decided to carry out a new assessment while making reference to our analysis conducted two years ago.

There are several things that we needed to do to enable the transfer to take place. We carried out an analysis of the costs and risks associated with the proposed sale. Our analysis also included an assessment of how Phoenix Transmission would be structured, operated and regulated should the sale proceed. We then examined the performance of another company, Premier Transmission Limited, which had

been re-structured as a company limited by guarantee in 2005. Our preliminary view after all this analysis had been conducted was that the sale had the potential to deliver significant benefits to customers. We issued a paper for public consultation in June 2007 that provided all of our analysis and set out our preliminary view.

At the end of the consultation we were able to consider responses to the June paper and to further update our financial analysis. Taking the comments alongside the previous analysis and updated information, we were still of the view that the sale was in the overall interests of gas customers and should proceed. A decision paper covering all the analysis and providing feedback on consultation responses was published in October.

The paper also set out the regulatory approval required to enable the sale to proceed. The first step in this process was the granting of a licence to Phoenix Transmission, which would enable the formal purchase of the assets by NIEH.

Exploring the potential for an all-island approach to gas

In late 2007, under the auspices of the All-island Joint Steering Group and within the All-island Energy Market Development Framework, established by the Northern Ireland and Republic of Ireland Governments, the Utility Regulator and the Commission for Energy Regulation (CER) came together to discuss the potential for an all-island approach to gas, in terms of Common Arrangements for Gas (CAG).

To start the project, a Memorandum of Understanding (MoU) between the Utility Regulator and CER on CAG was agreed. This MoU sets out the Utility Regulator's and CER's commitment and shared vision "whereby all stakeholders can buy, sell, transport, operate, develop and plan the natural gas market both north and south of the border effectively on an all-island basis". An important element of the joint vision is to ensure that customers will receive benefits from the common arrangements. The MoU identified main areas of work and both organisations have drafted a work plan for the project to set out how these areas will be addressed. The significant parts of the project will be developed to the point where Ministerial endorsement can be sought.

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

Extensive resources and time have gone into devising a high-level Cost Benefit Analysis (CBA) and the structural design has been completed. The Single Transmission Tariff Methodology which focuses on the best approach to harmonise the structure of the tariffs charged to network users across Northern Ireland and the Republic of Ireland is currently underway. Expert assistance is in place to assist in this workstream. Additionally, a lot of background work has been done in this area and is on track to be completed in late 2008. The Gas Industry Operation workstream, which concentrates on an integrated transmission system that

physically transports gas around the island, is also in progress. Again, both organisations have been involved in intensive discussions to prepare a consultation paper on the issues involved in moving to a single operational regime on the island, which will allow robust progress on the workstream in 2008.

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

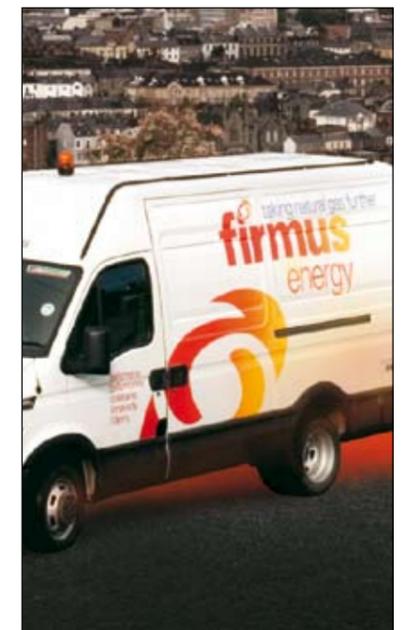
Achieving market harmonisation – working with European partners

We have been heavily involved in the North West (NW) region of the Gas Regional Initiative (GRI), a Europe-wide effort to achieve market harmonisation on a regional level, in advance of full European harmonisation. The

Utility Regulator, in conjunction with CER, led the development of an MoU between the national regulators in the NW region. The purpose of this MoU was to help facilitate better regulatory co-ordination on cross-border issues, for example on interconnectors and market design. The signing of the MoU took place in October 2007 and should lead to regulatory decisions and processes that are more effective, consistent and coordinated. For example, it now places a clear responsibility on Ofgem in Great Britain to consider the impact of any of its proposals on Northern Ireland and to engage with us in order to address any concerns.

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

The Utility Regulator and CER are committed to the implementation of common arrangements for gas, where consumers will benefit.





HIGHLIGHTS

- Putting the necessary systems in place to monitor robustly NI Water's performance.
- We provided significant evidence and analysis for the Independent Water Review Panel's assessment of water reform.
- We have reset the NIW operational efficiency targets for 2009-10 to deliver an additional saving of £3.2 million.
- We have made major progress on developing a process and timetable for the setting of prices from April 2010.

6. WATER

A new beginning for water and sewerage services

The Utility Regulator was given responsibility for regulating water and sewerage services in Northern Ireland on 1 April 2007. On this date, the provision of these services transferred from the Water Service, an agency of the Department of Regional Development (DRD), to a government-owned company, Northern Ireland Water (NI Water).

The reform of water and sewerage services, shaped by the direct rule administration, presents many challenges. We are aware of our crucial responsibility in making sure that NI Water, the single provider of water and sewerage services, delivers on its obligations for both present and future customers. In our first year, we have focused on meeting this responsibility by monitoring delivery of service (outputs), playing a key role in contributing to the water reform agenda and by developing our approach to setting prices from 2010.

The reform of water and sewerage services presents many challenges.

Robustly monitoring the delivery of water and sewerage services

NI Water's Strategic Business Plan (SBP), which was approved by the direct rule administration, set out the company's revenue stream and the associated outputs for the period 2007-10. The SBP also set out detailed planning targets for 2007-10, with an outline description of targets for the period 2010-15.

Our first task was therefore to review the SBP. This helped us to establish a baseline and develop monitoring processes for transparently measuring the outputs of NI Water (what is delivered for customers) rather than inputs (the resources committed by the water company). We found it necessary to request additional detail from NI Water to help us to establish a robust baseline which included information about both operational and capital expenditure and in some cases clarification of outputs. Having established the baseline, we developed a comprehensive Capital/Project/Output template for NI Water to return to us on a quarterly basis.

Taking these steps to get the monitoring information we need allows us to compare the performance of NI Water with other water companies. This

helps us to make sure that NI Water is performing to a level that water and sewerage customers in Northern Ireland can have confidence in. Further information on comparing NI Water with other water companies is set out in 'About our work' below.

The licence under which NI Water operates also requires the company to send us additional information returns which contribute to our overall and continuing assessment of its performance. Examples include Statutory Accounts, procurement plans and the development and revision of Codes of Practice for engagement with their customers.

We make sure that NI Water is performing to a level that customers can have confidence in.

Of course the ultimate purpose of our robust monitoring is to make sure that NI Water takes the steps necessary to deliver effective and efficient services for water and sewerage customers. An example of our delivery of this is our work on reviewing the SBP.

We were not satisfied that the efficiency targets set in the SBP were established from a sound basis. We undertook a review of the efficiency targets, utilising three well-known methodologies, to assure an informed decision in light of missing or poor data. Our work resulted in an enhanced operational expenditure target

being set that will deliver an additional £3.2 million saving for consumers from 2008-09.

Contributing to the Independent Review of Water Reform

On 11 June 2007, the Northern Ireland Executive (the Executive)

announced a comprehensive review of the water and sewerage reform process to be undertaken by the Independent Water Review Panel (IWRP).

The review was to be carried out in two strands. Strand One was to review the cost of water and sewerage services and

how they should be funded. Strand Two was to review the management, governance and delivery of high-quality water and sewerage services within a public-ownership model. The Regional Development minister, Conor Murphy, announced the Executive's response to a report on Strand One on 22 October.

programme to be planned and executed to support environmental sustainability;

- strong efficiency drivers are required to bear down on the cost of providing water and sewerage services.

We also carried out and submitted operational efficiency analysis to inform the IWRP's discussions.

As requested by the Minister for Regional Development, we formally responded to him giving our views on the Strand One and Two reports and attended the Regional Development Committee to present and discuss our views.

Strand Two – Management, Governance and Delivery

A detailed submission was requested by the IWRP in relation to this second strand of work. Additionally, we organised a governance seminar, carried out extensive financial business scenarios and again revisited and contributed to discussions on efficiency targets.

Although a report on Strand Two was published in January 2008, the Executive has yet to make a response or identify a timetable for consultation.

Developing our approach for setting prices from 2010: Price Control 2010

In carrying out our duties to 2010, we have to approve NI Water's Scheme of Charges on an annual basis, taking account of the water company's SBP and ministerial direction. We recognise the importance of the latter given the substantial level of government subsidy required in the years to 2010 and the changes to be implemented from the IWRP recommendations. NI Water's Scheme of Charges for non-domestic customers was approved by us on 21 March 2008.

The prices we set should be such that NI Water can meet all the required objectives at the lowest reasonable overall cost, providing value to customers now and in the future.

From April 2010 we will be responsible for setting price

About our work: Comparing the performance of NI Water with other water companies

Being able to compare the performance of NI Water with other water companies (for example, in England, Scotland and Wales) is important in making sure that the company can meet the standards expected and deliver levels of efficiency associated with the sector's best performers.

A key part of our benchmarking is a quality information return for comparison with other water companies. After considering several options, we decided to modify the Ofwat Annual Information Return to meet our needs. (Ofwat is the English and Welsh water companies' economic regulator.)

The Annual Information Return for 2007-08 (AIR08) was issued to NI Water and consists of an extensive range of performance information data (amounting to over 62 tables). Having

this extensive information will help us easily compare NI Water's performance with other water companies across a wide range of variables and trend performance over time.

NI Water is required to make the AIR08 return in August 2008 and we will produce a related Cost and Performance report on the company in December 2008. A copy of our request to NI Water to produce the AIR08 is available on the Utility Regulator website, www.niaur.gov.uk

Although we recognise that data quality and availability may initially be an issue with AIR08, we will encourage NI Water to address data deficiencies. Indeed, we have asked NI Water to grade the robustness of the data and indicate how it intends to improve data quality.

limits for NI Water for the period of the review, which will normally be every five years. The price limits set are informed by ministerial guidance on objectives to be achieved for improvements in water quality, environmental performance and customer service in the Northern Ireland water industry. The prices we set should be such that NI Water can meet all the required objectives at the lowest reasonable overall cost, providing value to customers now and in the future. We will determine the price limits by assessing the cost of meeting the ministerial objectives and by providing a framework for incentives that will encourage NI Water to exceed performance targets.

Planning for setting prices from 2010 involves significant preparation. A detailed and staged approach over a two or three-year time horizon must be developed, engaging all stakeholders. We must detail our information requirements for the company. After an initial delay on progress on this workstream – owing to the work loading arising from the IWRP and resource limitations – a programme and timetable are now in place, and discussions are ongoing with key stakeholders.

This process will be referred to as a Price Control and, in

light of uncertainties around water reform and issues around data quality, we have taken the decision to apply a two-year price control period from 2010 to 2012 (PC10) to be followed by a five-year price control 2012 to 2017 (PC12).

A programme and timetable for the 2010 water price control are now in place.

Other areas of our work

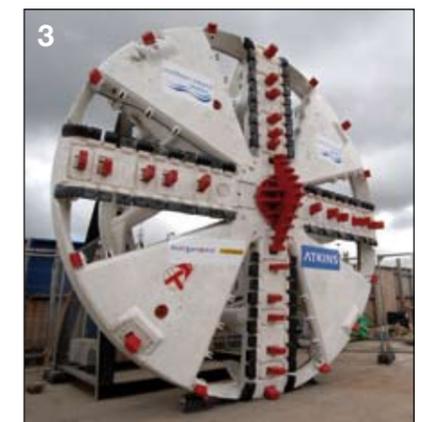
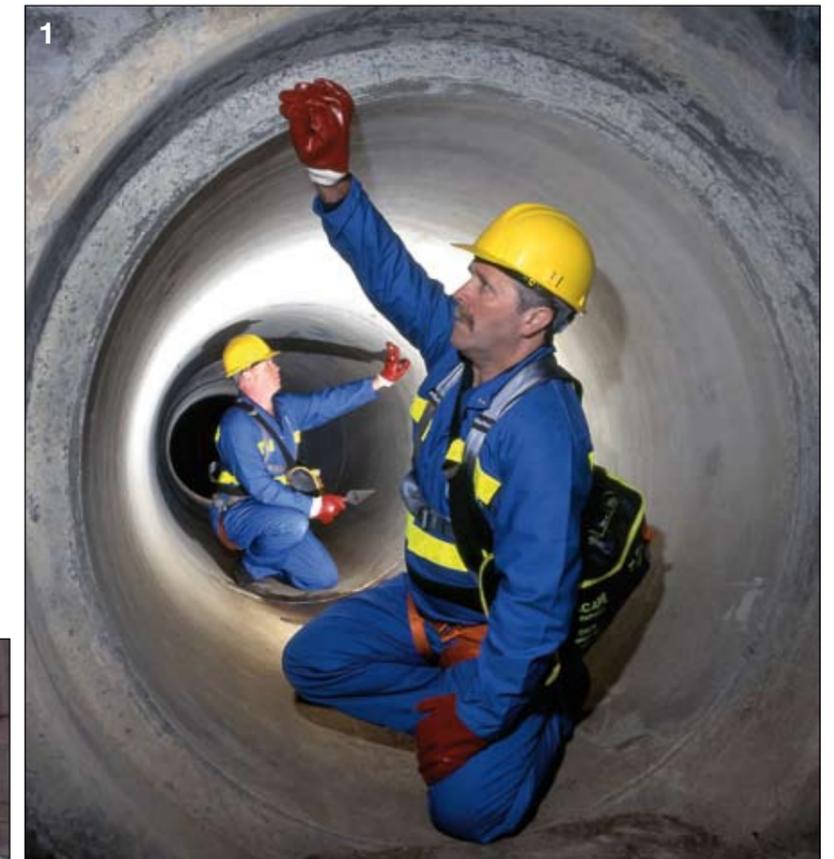
During the past year we also advanced work in the following areas.

- We were consulted, along with the Consumer Council, on NI Water's proposed Codes of Practice, and approved them as required under the licence. The level of service provided to the customer is fundamental, as is the monitoring of its delivery, which forms part of the Annual Information Return from the water company.
- We also began an objective assessment of domestic water metering. This involved the commissioning of independent research and the holding

of a related stakeholder seminar. We have provided our assessment to the Minister for Regional Development and the IWRP to inform deliberations on this matter.

- Following the reporting of NI Water mis-apportionment of costs between domestic and non-domestic customers, we announced our investigation into the matter and this is ongoing.
- Processing and monitoring of licence and Order requirements.

- 1 Work on the Belfast Sewer project
- 2 Water pumping station
- 3 NI Water tunnelling machine





7. ENERGY EFFICIENCY, ALLEVIATING FUEL POVERTY, SUSTAINABILITY AND SOCIAL ACTION

Supporting energy efficiency – the Energy Efficiency Levy Programme

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

Government provided a grant of £5.6 million to defray the

2007-08 EEL, thereby reducing the tariffs by around 1 per cent below what they might have been.

In 2006-07 thirty schemes were run under the EEL – twice as many as the previous year. £5,006,756 was made available for these schemes from the EEL. Fourteen schemes were in the Priority (Fuel Poverty) sector and the remainder were non-Priority domestic (11) and non-domestic (5). Last year the definition of eligible priority schemes was widened to include homes with existing solid fuel central heating systems and that was continued in 2007-08.

Table 1 summarises the key benefits from the EEL.

The EEL was last reviewed in March 2006. At that time, and following consultation, we said that the EEL would continue for a further 3 years. In February

2008 we published a terms of reference for the next review of the EEL. As part of that review, we will seek the views of stakeholder groups in all sectors including environmental and fuel poverty groups. Among other things the review will consider the implications of the European Directive 2006/32/EC on energy end-use efficiency and energy services.

Working with others to address fuel poverty

We recognise that fuel poverty is a major issue and understand that addressing the problem involves action across government. Although there are several major factors that contribute to fuel poverty that are outside the remit of our work (e.g. income), we have a contribution to make on the wider issue. The EEL is one aspect of this but we are keen

HIGHLIGHTS

- Our first-ever comprehensive document consulting on the role of the regulator in relation to sustainable development was published.
- We continued to effectively operate the Energy Efficiency Levy and published a terms of reference for a review.
- We successfully delivered the support mechanisms for renewable energy and the necessary changes to accommodate the SEM.

Benefits	Amount
Lifetime energy savings	615.260 GWh
Lifetime customer energy cost savings	£38,811,902
Lifetime carbon savings	132,087 tonnes
Note: Lifetime energy savings refers to the energy savings through the useful lifetime of the specific measure.	
Source: Energy Savings Trust, Summary of the NI Energy Efficiency Levy Scheme 2006-07	

Table 1: Benefits of the Energy Efficiency Levy Programme (EEL).

to contribute our expertise on energy to discussions on addressing fuel poverty. During 2007-08 we attended the Northern Ireland Fuel Poverty Advisory Group, which brings together organisations from the statutory and voluntary sectors to provide a forum for addressing fuel poverty issues.

Contributing to sustainable development

Sustainability – the Regulator’s Role

We have a vital role to play in promoting sustainability as we are the main gatekeepers to infrastructure investment in three sectors with high

environmental impact: water, gas and electricity. In recognition of our role, we developed a major strategy paper, Sustainability – the Regulator’s Role, which we launched for public consultation in March 2008. Further detail on the development of the strategy paper and the key proposals are outlined in ‘About our work’ below.

About our work: Sustainability – the Regulator’s Role

In developing our thinking on sustainable development we were conscious of the need to consult with key stakeholders. For this reason we planned and carried out a series of discussions and consultation meetings with other government organisations (in Northern Ireland and elsewhere), industry and the voluntary sector. Between January and March 2008, we had face-to-face meetings involving 52 different people representing 30 organisations to discuss sustainable development.

We used this extensive engagement to develop a paper that would be published for consultation. In the strategy paper that was published on 31 March, we were clear that we have a role to play by gathering and publishing more information, contributing our expertise and experience to wider government

policy, and, by regulating differently.

There is no doubt that our proposals for regulating differently will generate debate, and we outlined 11 draft proposals.

1. Cross-utility licence condition requiring licensees to have in place environmental policies.
2. Cross-utility requirement to report annually on sustainability activities and initiatives.
3. Requirements on licence-holders to provide customers with environmental information in relation to fuel mix in a uniform and easy to understand format, on all bills and promotional literature.
4. Strategic investigation into the use of “Smart Meters” as a mechanism for delivering better quality and timely information to customers.

As an organisation, we also recognise that we have a role to play in promoting sustainability in carrying out our business. Initial steps have been taken regarding recycling of our office waste and we expect to advance this further during 2008-09.

The Northern Ireland Renewable Obligation

The Utility Regulator has statutory responsibility for the operation of the Northern Ireland Renewable Obligation (NIRO), which supports renewable development by placing a statutory requirement on electricity suppliers to account

for an increasing proportion of their electricity as having been generated from renewable sources.

We recognise that we have a role to play in promoting sustainability in carrying out our business.

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

There has been an increase in interest in renewable generation in the last year, both large scale and small with many projects coming on line. At the start of NIRO in 2005-06, suppliers had to account for 2.5 per cent of their power as been from renewable generation. In 2007-08 this now stands at 2.8 per cent. The Obligation continues until 2027. However, at this stage, future NIRO levels have not been projected above their 2012 levels of 6.3 per cent. Suppliers can meet their obligation by either presenting Renewables Obligation Certificates (ROCs), by paying into a buy-out fund or by a combination of both these methods. ROCs are issued

5. Work with energy licence-holders to assess current tariff structures.
6. Continue to work with partners and stakeholders to ensure renewable generation can be equitably accommodated on the electricity network.
7. Ensure price control processes take into consideration the effect of climate change on electricity and gas networks.
8. Carry out a full strategic review of energy efficiency delivery mechanisms.
9. Develop a strategy in relation to gas promotion, which considers

- the potential benefits of common arrangements for the transmission and distribution of gas on the island of Ireland.
10. Developing sustainability within the NIW price control.
11. Improving our own practices and procedures.

These draft proposals for regulating differently will be developed into a sustainability action plan with those responding to the consultation invited to score the proposals using defined criteria.

to renewable generators for each MWh of renewable output produced. ROCs issued in Northern Ireland are referred to as NIROCs. In 2006-07 the total number of NIROCs issued was 347,848 compared to 273,439 in 2005-06.

The NIRO is managed by us although administered by our sister organisation Ofgem, via an Agency Services Agreement (ASA) between both parties. This is cost-effective and facilitates NIRO alongside the Obligations in GB in a UK-wide market for ROCs. The April 2008 report covering the operational year 2006-07 on the running of the Renewables Obligation – which includes comparisons between Northern Ireland, Scotland and England and Wales – can be found at www.ofgem.gov.uk

The Climate Change Levy Exemption Scheme

Throughout the year the Utility Regulator has also managed and administered the Climate Change Levy scheme (CCL), issuing Levy Exemption Certificates (LEC) to accredited generators in NI and RoI. The CCL is a tax on energy used by businesses. In relation to electricity, the CCL requires that suppliers charge commercial customers (i.e. business not domestic, governmental or charitable customers) an extra

0.44p per kWh (i.e. £4.41 per MWh), and these monies are then remitted to the government, where they are used to fund a national insurance contribution break and energy-saving programs. Electricity produced from designated renewable and good quality Combined Heat and Power (CHP) sources is exempt from CCL and is issued with exemption certificates which can be bundled with the power when sold to a supplier. In the year 2006-07 the Utility Regulator issued 349,349 LECs (each LEC represents one MWh of renewable or good quality CHP electricity supplied in Northern Ireland).

Social action

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

We are in the process of developing a social action plan. In order to inform the plan, and in partnership with the Consumer Council for Northern Ireland, we have carried out consumer research to inform the Social Action Plan. This consisted of setting up focus groups of disadvantaged customers and

asking their opinion on the various schemes provided by the energy suppliers, plus an omnibus report asking views on energy prices, supplier schemes and other issues. Energy and water suppliers were also asked to complete a questionnaire on the effectiveness of their schemes, as were bodies that represent disadvantaged or vulnerable customers.

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



1 Artist's impression of Seagen tidal energy converter in action
 2 Seagen tidal energy converter
 3 Wind farm



8. EFFECTIVE AND EFFICIENT REGULATOR

We aim to carry out our work in a way that best uses our resources to produce a consistently high level of performance. In doing this we take account of the principles of best practice regulation: proportionality, accountability, consistency, transparency and targeting – and government accounting requirements.

Making the best use of our resources

Our finances

As a Non-Ministerial Government Department, we are funded through 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).

More information on our financial position for the year ended

31 March 2008 is set out in Appendix 2. The cost of running the Utility Regulator in the financial year ended 31 March 2008 was £6.4 million against the Spring Supplementary Estimate position of £1,586,000. This is a saving against estimate of £88,000 or approximately six per cent of expenditure. Operating costs have increased as the scope and value of our work has expanded.

Most of our regulation costs were recovered from annual fees paid by electricity, gas and water licensees. Electricity licence fees are recovered on the basis that one-third of the total fees due should be charged to the holders of generation licences, one-third to transmission and distribution licensees and one-third to those engaged in supply.

Gas licence fees were recovered on the basis of 80 per cent to the holders of conveyance licences and 20 per cent to the holders of supply licences. Conveyance

licence holders who also engage in distribution activities pay a premium of £50,000 as well as the balance of costs to be charged to conveyance licenses, which are apportioned on the basis of volumes conveyed in the previous year. Holders of gas supply licences pay a minimum fee each year of £1,000. Also the balance of the costs to be charged to gas supply licensees are apportioned on the basis of volumes supplied in the previous year.

There is a sole licensee in respect of water regulation, namely Northern Ireland Water, which bears the whole cost of water regulation.

The mechanisms for working out energy licence fees will be reviewed during 2008-09.

For the financial year ended 31 March 2008, licence fees were collected as set out in Table 1 below.

- HIGHLIGHTS**
- Our focus on organisational development led to further progress on restructuring, and setting up a staff committee to give staff a say in future developments and work to articulate our mission, vision and values.
 - We made major progress on enhancing corporate governance arrangements (improved risk management processes and internal controls; improved financial reporting).
 - Significant progress was made to communicate more effectively with stakeholders, and we put in place a comprehensive plan for achieving this.

Licence Fees by Utility	Total Licence Fees (£000s)
Electricity	2,545
Gas	1,010
Water	1,317
Total	4,872

Table 1: Licence Fees by Utility

Developing our staff

We want to be an employer of choice and wish to support the development of the staff who work for us. During 2007-08 there was a significant change to our staffing complement as we recruited new personnel to help us meet our additional regulatory responsibilities. At the 31 March 2008, our staffing complement consisted of a staff on loan/seconded from other departments (DETI, DFP, DRD and DEL), and directly recruited staff. The split of staff in each category at the year end was roughly 50/50.

We want to support the development of our staff.

In relation to the development of our staff, we operate a performance management system, in conjunction with DETI that helps us maximise the individual and the team contribution to the achievement of organisational objectives. The system in operation involves setting 'SMART' individual objectives that are clearly linked to, and stem from, branch plans and outline development needs and priorities.

More significantly, we recognise that being an employer of choice and developing our staff requires a strategic approach. For this reason, we started a major review of Human Resource policies and frameworks (due for completion in summer 2008). The completion of this work will lead to the introduction of new systems, policies and procedures and will support the development of our staff.

We also want to make sure that our staff and our wider stakeholders understand the strategic context in which we operate. To that end we launched in May 2007 an Interim Corporate Strategy, which set out the strategic direction for that year and described our proposed approach to developing a rolling three-year strategy. The main items covered included sustainability, metering and how to regulate non-competitive markets so as to stimulate competition. It also explained that we would consider the themes of social action/fuel poverty and of accountability and efficiency, in taking forward a range of work items. The launch of our first ever full 5 year Corporate Strategy will take place during 2008-09.

We also started to develop our thinking on the organisation's mission, vision and values and ways of working, called

Operation Symphony. It is intended that staff will be involved in developing our thinking on these issues. Additionally, we also took the first steps in 2007-08 towards the formation of a staff committee as a mechanism for making sure that staff are informed and can contribute to organisational development.

Performing effectively as a regulator

Forward Work Plan 2007-08

Our Forward Work Plan (FWP) is a key planning document that sets out projects and activities to be achieved by us. Overall we achieved or partially achieved 91 per cent of the time limited tasks listed to be completed within the 2007-08 year. Appendix 1 sets out in detail the FWP projects and activities for 2007-08 and a status report on the achievement of these.

Cross-utility working

As an organisation, our multi-utility focus is unique. We recognise that bringing together professionals with experience of regulation across various industries provides opportunities for developing approaches in specific areas. During the last year we took steps to use our unique

organisational focus to best effect. This involved the setting up of cross-utility projects to deliver best practice approaches in the following areas: retail competition, sustainable development, metering, price controls, guaranteed standards of service, online communication and records management. We set up project teams in each of these areas and have made significant progress (e.g. we published consultation papers on sustainable development and retail competition).

Appeals, complaints and disputes

We have carried out significant work in our appeals, complaints and disputes role over the past year. To help us meet new demands, we established a section to deal with appeals, complaints and disputes. This section played a significant role in agreeing codes of practice and establishing standards of performance in relation to NI Water. The introduction of the SEM also required us to update the codes of practice relating to electricity. Significantly, we worked with all the regulated companies across each industry area to put in place a comprehensive mechanism for dealing with complaints referrals.

Freedom of Information

We continue to take our obligations under the Freedom of Information Act seriously and responded to requests during 2007-08 within the statutory timetable.

Corporate governance

Our Board and Board sub-committees

Our Board now meets at least every second month. During 2007-08 the Board met 12 times. Corporate governance continues to be strengthened with the introduction of formal financial reporting to each Board meeting, the embedding of risk management across the organisation and relevant training for Board members. A senior executive team has been established following the recruitment of directors of gas, water and corporate affairs. The executive team normally meets weekly. These appointments have also provided the opportunity to initiate regular directorate performance reviews covering budget, risk management and performance against the objectives set out in the forward work programme.

The Audit Committee met on five occasions during 2007-08. 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 by invitation. The Committee undertook a review of its terms of reference and an annual timetable of business was established to ensure that key elements of the control environment are regularly reviewed for effectiveness. The Audit Committee had a particular focus on monitoring improvements to both risk management and financial monitoring processes in 2007-08. During the year, the Chair began to develop links with Audit Chairs in other regulators in order to facilitate sharing of best practice. An invitation was extended to the Northern Ireland Audit Office (NIAO) to attend meetings of the Committee and this was taken up twice during the year.

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 five times during the year. A terms of reference has been developed to underpin its independent role in considering and approving recommendations regarding the remuneration of the Chief Executive, directors

and staff. The Committee has also contributed to wider pay policy issues affecting directly employed staff.

Board Advisory Groups (BAGs) for Water and Energy (covering Electricity and Gas) meet on a regular basis. Membership comprises non executive directors (with relevant utility experience) and senior staff working in the utility directorates. They have provided a useful vehicle for detailed technical scrutiny of key policy issues and informing the decision making processes at Board level.

Following the “go live” of the SEM on 1 November 2007, an SEM Committee has been established. Its primary function 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 an SEM matter on behalf of each regulator. SEM Committee members, appointed by the Department for Enterprise, Trade and Investment, representing the Utility Regulator are Iain Osborne (CEO), Dermot MacCann (Director of Electricity) and Alan Rainey (Member of Board).

Audit

The statutory annual accounts are audited by the NIAO. The internal audit service

is tendered through open competition and is currently provided by the Helm Corporation. Following the “limited” overall assurance rating given by the internal audit report for 2006-07, the report for 2007-08 highlighted evidence of substantial improvement across the areas tested as the recommendations made in 2006-07 have been implemented. Financial reporting, risk management, contract procurement and management and human resource management systems and processes have all improved during the year. These improvements have resulted in the overall assurance rating being increased to “satisfactory” for 2007-08.

Payment policy

The Utility Regulator complies with prompt payment guidelines set out by government, which specify payment within 30 working days. We endeavour to pay all undisputed invoices within 30 working days from receipt of invoice. During the financial year, 2007-08, 97 per cent of creditors were paid within 30 working days.

Equality

We are fully committed to the promotion of equality and in ensuring compliance with

relevant statutory legislation. We have initiated a review of equality policies and practices to be completed in early summer 2008 to ensure full compliance with its obligations under Section 75 of the Northern Ireland Act 1998. Board members also received equality awareness training during the year.

Communicating with stakeholders

Our work relies on engagement with a range of stakeholders. We recognise that communicating effectively with stakeholders helps us to deliver our objectives. Our approach to consultation is grounded in a belief that effective engagement with stakeholders can lead to more effective policy outcomes.

During 2007-08 we invested in our communications by recruiting a communications manager. This led to the development of a communications strategy that set out our priorities and described key workstreams on stakeholder engagement, corporate identity, online communications, and media management. Our work in the area of online communications is described in ‘About our work’ opposite.

About our work: Enhancing our website

We have known for some time that a key communications medium for us, our website, needed further enhancement. Our stakeholders use the website to find out information about our work, key organisational decisions (e.g. from Board minutes) and to track new developments (e.g. the publication of consultation papers). We were conscious that our stakeholders also told us that we needed to improve our website so that they could more easily find information and download documents.

A cross-utility project team was set up to advance the online communications project. We also asked external website

experts to help deliver the project. By the end of March 2008 the project team had identified important things that we wanted from an enhanced website: better navigation options to find information more easily, restructuring the content to help users find information quickly, improving the website’s accessibility for all users, providing a better way for more staff to provide and update content on the website, and a more appealing design.

Having a developed a project plan, we hope to deliver on the first phase of website enhancements during the summer of 2008.

Landbank

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

The two major Landbank projects during 2007-08 both 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 has progressed well during the year and is scheduled to be completed in May 2008.

A contract for the decommissioning, asbestos removal, demolition and remediation of the redundant oil-fired power station at Coolkeeragh was awarded on 8 August 2007, with the contractor taking possession of the site on 28 August 2007. This project has progressed to schedule during

the year and is due to be completed in early 2010. Through its appointed specialist representatives, Mott MacDonald, the Utility Regulator is represented on both project boards and receives monthly reports on costs and other key aspects of project performance.

APPENDIX I Progress against Forward Work Plan Targets

ELECTRICITY			
Work Area	Task	Targets	Outcome
SEM general and external relations	1.General work/briefing 2.Legislation issues 3.SEM/JRC 4.Licensing 5.Capacity payment mechanism 6.Market management 7.Market monitoring 8.External relations	Q2 commencement Jun-JRA published Sep-SEMC May-distribution Jun-SO lic Jul-MOA Finalise LOL Aug-publish CPM Aug-MMU set-up	Achieved Achieved Achieved Achieved Achieved Achieved Achieved Achieved
SEM Operations	1.General work/briefing 2.SEM project 3.Transition 4.Participant readiness 5.Licensing & contracts 6.TSO harmonisation 7.SMO regulation	Jul 07-Market Systems in place Nov-complete market trialling Jul 07-Go Active Nov 07 go live Jul-licences ready Nov 07 Agreements in place Nov-Transmission issues cleared and ready Nov-SMO and oversight Committee	Achieved Achieved Achieved Achieved Achieved Achieved Achieved
SEM Market Monitoring Unit	1.General work/briefing 2.Cancellations 3.Gen licences 4.MMU set-up 5.Renewables 6.Training 7.MMU operation 8.PPB licence and issues	May-licence Jun-consultation Qtr1-consultation, decisions In place by August	Achieved Achieved Achieved Achieved
Regulation (Non SEM)	1.General work/briefing 2.Price control work 3.Regulating companies 4.Tariff approvals 5.SONI divestment 6.FEMO 7.Regional Electricity Market 8.Metering issues 9.Licencing issues 10.Interconnector issues 11.Micro Gen & wheeling	Nov-Determination By Aug 07 Complete before Nov 08 By Nov 07 Commence Q2 Complete by Jul 07	Achieved Achieved (On Schedule) Achieved Achieved Achieved
Other	1.Director/admin resourcing		

GAS			
Work Area	Task	Targets	Outcome
Transmission	1.General work/briefing 2.Phoenix T mutualisation 3.NTS Exit Reform 4.Gas Regional Initiative 5.Price controls 6.Code/licence mods 7.EU Regs and Directives 8.AIP Gas 9.Storage issues 10.Security of Supply 11.Kilroot	Qtr2-preferred bidder & licence Aug-final Code of Practice Jun-BGE decision Q1-BGE licence Q1-transparency implementation Aug-set up working group Oct-initial paper Jun-SNIP capacity Apr-note to DETI Sep-capex regime decision	Achieved Achieved Achieved Achieved Revised – due for implementation in early 2009-09 Achieved Revised – to be now considered in 2008-09 Revised – work reprioritised Revised – work reprioritised Revised – work reprioritised
Distribution	1.General work/briefing 2.Phoenix distribution price control 3.Phoenix supply price control 4.Firmus price control 5.EU Directive implementation 6.Phoenix T mutualisation input 7.Licence fee methodology 8.Gas Market opening 9.Phoenix re-financing 10.Phoenix tariff review 11.Standard licence conditions 12.Metering issues	Jun-minded to Aug-determination Q1-consult Q2-determination Mar 05-minded to Jul-consultation	Achieved Achieved Achieved Achieved Achieved Achieved
Other	1.Director/admin resourcing		

WATER ¹			
Work Area	Task	Targets	Outcome
Comparative Efficiency and performance	1.General work/briefing 2.Benchmarking analysis 3.Guaranteed Standard Scheme 4.SBP review and targets	Q3-Complete analysis Q3-GSS live Q2-SBP review complete	Achieved Partially achieved – pending outworking of IWRP consultation and potential legislative change Achieved

WATER continues on next page

WATER continued...

Comparative Efficiency and performance	5.MOUs	Q3-MoUs in place	Partially Achieved – sign off deferred pending outcome of IWRP consultation and potential legislative change
	6.Water re-sale order	Q4-order finalized	Revised – reprioritised Achieved
Networks Regulation	7. Annual Information Return AIR08	Q4 final AIR requirements identified	Partially achieved – programme well advanced
	8.Price Control 2010 to 2012 (PC10)	Q4 establish requirements and publish PC10 plan	– consultation ongoing
	9.New Directives and Competition	28 Feb – analyse and report on NIW transformation programme	Achieved
Regulatory Finance	10. BIP Review (All branches involved)		
	1.General work/briefing	Q4 – issue AIR08 reporting requirements	Partially achieved, revised timetable completed on 7/05/08
	2.W&S information management		Achieved
	3.Quality enhancement. Capital maintenance and supply-demand balance	Q4 – Develop & implement capital investment monitoring system	Achieved
	4.Reporter co-ordination	Q1 – approve reporter appointment	Achieved
	5.PC10	Q3 – PC10 framework & approach developed in consultation with NIW	Achieved
	6.NIW Procurement Plan	Q4 – initial guidance and info requirements confirmed with NIW	Achieved
	7.Metering Report	Q3 – Review NIW procurement plan	Achieved
Other	8.Approval of NIW Codes of Practice	Q4 – Submission to DRD Minister and Regional Development Committee	Partially achieved – NIW submission inadequate – subsequently Achieved
	1.Financial Model	Q4 Construct & deliver new financial model governing NIW	Revised timetable due to significant resource demand for IWRP submissions
	2.PPP/PFI Review	Q2 Strand 1	Achieved
	3.IWRP submissions 1 and 2	Q3 Strand 2	Achieved
Other	4.Scheme of Charges Approval	Q4 Review and approve NIW SoC	Achieved
	1.Director/Admin resourcing		

CORPORATE AFFAIRS			
Work Area	Task	Targets	Outcome
Social/ Environment	1.General work/briefing	Q2/3-Grid Study	Achieved
	2.EEL	Oct-call for projects	Achieved
	3.NIRO	Mar-project approvals	Achieved
	4.CCL Exemption	Q2-decisions on way forward	Achieved
	5.SAPs	Q1-SAP way forward	Partially achieved – to be carried forward during 08-09
	6.Environmental Strategy	Q3-report	Achieved
Complaints	1.General work/briefing	Q2-finish input	Achieved
	2.The Utility Regulator restructuring work	Q2-way forward	Achieved
	3.Retail competition strategy	Q4 report	Achieved
	4.Review of Metering Strategy	Q2-way forward	Partially achieved – further work dependent on outcome of metering pilots
	5.Complaints & disputes	Q4 report	
Finance/ Admin/HR	1.General		
	2.HR		
	3.Comms/Board support		
Other	1.Director/Admin resourcing		

CHIEF EXECUTIVE GROUP			
Work Area	Task	Targets	Outcome
Chief Exec Group: CEO Office	General		
Chief exec Group: Legal	1.Support to CEO and Board 2.Legal management/strategy 3.Support to Corp Affairs 4.Reactive work 5.CWP and competition advice 6.Support to Gas 7.Support to Electricity 8.SEM support 9.Support to Social/ environment 10.Support to water 11.Support to complaints	Q2/3-legal recruitment	Achieved

¹ Work programme and timetables for the Water Directorate were fundamentally revised to reflect the evolving water reform context.

APPENDIX 2 Financial Report

Central Government Financing

Amounts of £1,498,000 in respect of the financial year end 31 March 2008 were borne by central government expenditure on areas not covered by current licences such as the Single Electricity Market development costs, 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 and the Renewables Order (Northern Ireland) 2005 scheme.

Accounts

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. These figures were subject to final audit at the time of publication of this Report.

Operating Cost Statement	2007-08 (£000s)	2006-07 (£000s)
Programme Costs		
Staff Costs	2,553	1,444
Other (Non-Staff) Costs	3,817	2,612
Total Costs	6,370	4,056
Operating Income	(4,872)	(1,466)
Net Operating Cost	1,498	2,590

Table 1: Operating Cost Statement

The rise in salary costs reflects an increase in staff numbers and inflation. The percentage of staff costs to total costs has risen from 36 per cent in 2006-07 to 40 per cent in 2007-08. This is mainly due to the increase in staff resources across the directorates. The staffing increases have followed the taking on of responsibility for water and sewerage services regulation as well as the findings of an independent review which recommended a significant increase in resources. The recruitment programme is scheduled to be completed in 2008-09.

Consultancy expenditure increased from £2,071,000 in 2006-07 to £2,681,000 in 2007-08. This increase was mainly due to the costs associated with the development of the Single Electricity Market and the significant requirement for consultancy support to enable this programme to bed down.

The Authority's gross expenditure in pursuit of its objectives is detailed in the Statement of Operating Costs by Departmental Aim and Objectives (see Table 2 opposite).

The significant rise in costs for Objective A is due mainly to the development of, and consultancy costs associated with, the Single Electricity Market. The increase in costs for Objective B mainly reflects the recruitment of staff towards the approved complement for the Gas Directorate.

Costs by NIAUR Aims and Objectives for the year ended 31 March 2008						
	2007-08 (£000s)			2006-07 (£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	4,043	(2,545)	1,498	3,352	(763)	2,589
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	1,010	(1,010)	0	704	(703)	1
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	1,317	(1,317)	0	n/a	n/a	n/a
Total	6,370	(4,872)	1,498	4,056	(1,466)	2,590

Table 2: Costs by NIAUR Aims and Objectives for the year ended 31 March 2008



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