



# 2016 Great Britain and Northern Ireland National Reports to the European Commission

**National Reports in relation to Directives 2009/72/EC  
(Electricity) and 2009/73/EC (Gas)**

# Ofgem 2016 National Report to the European Commission

## Overview

All National Regulatory Authorities (NRAs) are obliged to report annually to the European Commission, in accordance with Directives 2009/72/EC (Electricity Directive) and 2009/73/EC (Gas Directive). The structure of the report is agreed at the Council of European Energy Regulators (CEER).

Ofgem is the UK Office of Gas and Electricity Markets. It is governed by the Gas and Electricity Markets Authority (the Authority).<sup>1</sup> The terms 'the Authority', 'Ofgem', 'us' and 'we' are used interchangeably in this document. The Northern Ireland National Report is in the second section of this UK response.

The Great Britain (GB) report covers:

- Developments in the GB energy markets in 2015 and Quarter I + II of 2016;
- The regulation and performance of the GB electricity and gas markets along the themes of network regulation, promoting competition, and security of supply
- Our compliance with the Electricity and Gas Directives on consumer protection and dispute settlement

Since GB energy markets have been fully liberalised and the regulatory structures in place for a number of years, this report is intended as an updated version of the submissions made since 2007. The structure of this report and much of the information remains unchanged, although latest data is supplied.

Finally, for further information on Ofgem's activities, please consult our Annual Reports. The 2015-16 Ofgem Annual Report is available at the link below.<sup>2</sup>

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<sup>1</sup> The Authority determines strategy, sets policy priorities and takes decisions on a range of matters, including price controls and enforcement. See the Ofgem website for more information. <http://www.ofgem.gov.uk/About%20us/Pages/AboutUsPage.aspx>.

<sup>2</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-s-annual-report-and-accounts-2015-16>

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# 1. Chairman's Foreword

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Ofgem has once again been at the forefront in driving competition, promoting value for money and ensuring security of supply for the British energy consumer. As well as responding effectively to two RIIO-ED1 price control appeals, working alongside a new Government with new priorities, and starting to implement the CMA energy market remedies, Ofgem has strived to produce an enormous amount of work at both the national and European level, which this report clearly demonstrates.

This year, we have engaged with and played a leading role among the European energy regulators, through our work with both the Agency for the Cooperation of Energy Regulators (ACER) and the Council of European Energy Regulators (CEER). Engaging with the European Commission and feeding into its new Energy Market Design consultation, we aim to ensure a more secure, flexible and low carbon European energy system. We are also working closely alongside DECC, National Grid and CEER to ensure that any changes introduced through the European Commission's Winter Package publication deliver positive outcomes for GB energy consumers.

The Competition and Market Authority (CMA) continued its investigation into the competitiveness of the energy market in Great Britain and published its final report on 24 June 2016. This report sets out the CMA's findings on adverse effects on competition and intended remedies (including those for Ofgem to take forward). Over the course of the year, we supported the CMA's investigation and are now implementing remedies.

As the energy regulator for GB, we want to make sure that the rules governing how electricity is bought and delivered will allow consumers and industry to draw as much benefit as they can from network flexibility. We are prioritising a number of work areas to ensure that rules and regulations support an efficient, flexible and greener energy system.

2015 was also an important year for REMIT. In July, we were given powers to prosecute market manipulation and insider trading as criminal offences. It was also the year that the registration obligations under REMIT took effect, and by May 2016, GB had met its obligations under REMIT and registered almost 1000 REMIT market participants. We work with ACER and other NRAs on a range of REMIT-related issues, including clarifying policy, ensuring effective data security and monitoring for potential instances of market abuse that have negative impacts on wholesale energy markets.

Looking forward, we recognise that next year will be even more challenging for Ofgem. We will implement the remedies the CMA has recommended to Ofgem, encourage the development of new technologies to support the decarbonisation of the grid, and continue to implement European Network Codes to ensure a sustainable, secure and competitive energy market across Europe.

Ofgem will continue to participate constructively in EU institutions and the European Internal Energy Market pending any further decisions made by the UK government following Britain's decision to leave the European Union.

A handwritten signature in black ink that reads "David Gray". The signature is written in a cursive style with a long, sweeping underline.

David Gray, Chairman

## 2. Main developments in gas and electricity markets

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Ofgem strives to maintain and strengthen a competitive, stable and sustainable energy market that brings affordable and secure energy supplies to consumers. Transparent, integrated and liberalised European gas and electricity markets play an important role in helping us achieve these objectives. Over the past year we have focused on REMIT and European Network Codes implementation, governing rules to ensure network flexibility and working alongside the CMA to bring about effective changes to competition in the retail markets.

### **Promoting efficient infrastructure investment**

#### *A step change in interconnection investment*

The cap and floor regime continues to provide notable increases in investment for interconnection projects. In 2015, cap and floor frameworks were granted to two electricity projects – Nemo Link between GB and Belgium and NSN between GB and Norway – both of which are now under construction, and four more interconnectors are currently being planned. These are FAB Link and IFA2 – both to France, Viking Link to Denmark and Greenlink to the Republic of Ireland. Once these projects are realised, capacity from interconnection would rise to 11.7GW by 2023. Building on this success, we have opened a second window for applications for cap and floor frameworks during 2016.

#### *Making the energy system more flexible*

We have undertaken policy work to explore how to encourage greater flexibility in the electricity system. In September 2015 we published a position paper setting out five priority work areas to ensure that GB regulation supports an efficient, flexible electricity system that delivers benefits for consumers. The five priorities we identified are to:

- Encourage Distribution Network Operators (DNOs) to take a more active role in network management, moving to future Distribution System Operator roles and engaging effectively with the System Operator;
- Clarify the role of aggregators;
- Clarify the legal and commercial status of storage;
- Explore how to support more large industrial and commercial customers to participate in providing flexibility; and
- Examine and feed into European discussions on how future distribution charges may need to evolve. We see this as a longer term piece of work which we have initiated thinking on this year

We have been progressing these work areas as part of a broader programme of work with the Department for Energy and Climate Change (DECC), now replaced by the Department for Business, Energy and Industrial Strategy (BEIS), and expect to publish a joint call for evidence in Summer 2016.

We will work closely with other stakeholders across the energy sector, including UK Government and European institutions, to develop a flexible electricity system that uses new flexibility sources. Overall, this should contribute to a more dynamic, efficient and competitive market which delivers benefits for consumers.

#### *Focusing network regulation on what consumers value*

RIIO, our incentive-based price control framework was put in place for the electricity distribution companies in 2014. This framework determines the outputs, allowed revenues and other elements of the regulatory frameworks for network companies over an eight-year period. In September 2015, British Gas and Northern Powergrid appealed our decision to the CMA. We welcomed the CMA decision taken as a result of these appeals against specific elements of the 2015-2023 electricity distribution price control and are proud to say that we successfully defended five of the six of British Gas grounds and two of Northern Powergrid's three grounds. RIIO-ED1 will deliver £24.6 billion of investment in total over the next eight years and will result in an annual average saving of £10 for consumers.

As part of our RIIO-T1 price control for electricity transmission we included a Strategic Wider Works mechanism to enable network companies to bring forward major investment projects which were not part of the price control settlement. In early 2015 we modified the necessary licences to implement our decision to approve the Caithness-Moray reinforcement in Scotland, a £1.1 billion subsea link due to be built by 2018.

One of the major areas we have been working on this year has been in developing and implementing competition in the development of onshore transmission assets. We are continuing our work to extend the use of competitive tendering for onshore transmission assets that are new, separable and high value and are working with Government to develop legislation.

#### *An integrated approach to planning and regulation*

We have made changes to the Electricity System Operator's (SO) licence. It now has a more important and central role in identifying the system's long-term needs. It will be responsible for developing and assessing options to meet these needs. The SO produced its first Network Options Assessment in March 2016. We have engaged with the SO and Distribution Network Operators (DNOs) to look at how to get all parties to better share information and to help the networks develop efficiently. This is part of our work looking at how DNOs' roles will need to change in the future under our flexibility project.

In September 2015, we made decisions following applications under the uncertainty mechanisms for electricity and gas transmission networks (RIIO-T1), and the gas distribution networks (RIIO-GD1). These were for additional costs of physical site upgrades, street works and for implementing the Industrial Emissions Directive. For National Grid and Scotia Gas Networks, we allowed an additional £634 million from a requested £759 million. This funding will enhance the security for sites across GB that Government considers critical national infrastructure.

We have begun reviewing our approach to setting incentives on the Electricity System Operator (NGET) and are considering how to make them more efficient, longer term and transparent. We aim to consult on the new arrangements which will apply from the end of the current incentive scheme, i.e. the start of the financial year 2017 during the second half of 2016. We will also continue to monitor NGET's and NGG's (as the gas System Operator) performance against the existing incentives schemes and their licence to ensure costs are being minimised for energy consumers.

#### *Planning and Advanced Reservation of Capacity Agreements (PARCAs)*

In April 2015, we implemented the PARCA arrangements to allocate incremental entry and exit gas transmission capacity. PARCAs allow gas National Transmission System (NTS) users to reserve incremental capacity through a bilateral process with NGGT. Their implementation better matched the process to allocate incremental capacity to the requirements of planning and consenting legislation.

PARCAs replaced the previous arrangements where NTS users had to signal for incremental capacity at an entry capacity auction or exit capacity application window. This was considered problematic as NTS users would take on the financial commitment to pay for incremental capacity but be subject to a lengthy and uncertain planning process before it could be delivered.

The PARCA arrangements put in place a multi-stage process to allocate incremental capacity. The arrangements also include requirements for NGGT to inform the market that a PARCA has been requested and give other users an opportunity to purchase capacity that could be reserved.

### **Creating competitive, integrated and transparent wholesale markets**

#### *Increasing transparency in the European wholesale market*

Transparency is critical for stable and well-functioning wholesale markets. The EU regulation on wholesale energy market integrity and transparency (REMIT) imposes transparency requirements and prohibits insider trading and attempted or actual market manipulation in wholesale energy markets across the EU. The EU Regulation 543/2013 on submission and publication of data in electricity markets (the Transparency Regulation) which entered into force in January 2015 requires the timely publication of such data that allows market participants to take efficient production, consumption and trading decisions. This is particularly important with the deeper integration and rapid development of intermittent renewables.

We are committed to making the wholesale energy market more transparent to strengthen competition. We have used our monitoring and investigation powers to check compliance with REMIT and the Transparency Regulation and we continue to investigate areas that need it. We also received new powers to pursue criminal sanctions against market manipulation and insider trading. Our prosecution policy statement was consulted on and implemented this year.

We registered GB REMIT applicants in advance of the first reporting deadline on 7 October 2015 and by May 2016 we had almost 1,000 market participants. We also continued to support those who still needed to register. On 7 April 2016, the obligation for market participants to report wholesale energy supply contracts executed over-the-counter, transportation contracts and additional fundamental data under REMIT entered into application.

We also published our second annual Wholesale Energy Markets (WEM) report on 27th July 2016<sup>3</sup>. Through the WEM, we aim to provide independent and reliable information on the wholesale markets in GB. This promotes transparency, improves understanding and shows consumers, market participants and other interested parties how we monitor the markets.

### *Ensuring affordable and secure energy for the future*

In 2014, the Government introduced, as part of its electricity market reforms, a capacity market (CM) to provide incentives for investment in generation and secure energy supplies for GB consumers. After the second Four Year Ahead (T-4) auction and the first CM Transitional Arrangements (TA) Auction took place in December 2015 and January 2016, Ofgem invited stakeholders to submit proposals for Capacity Market Rule changes. Ofgem is now looking to simplify the arrangements for prequalification and at amendments to make the rules clearer. We took over managing the Capacity Market rules in January 2015 and since then we have consulted on over 90 rule changes proposals from stakeholders and made the first set of rule changes in June 2015. We are now working on the second set. Through this, as well as our other EMR roles, and by ensuring NGET delivers its EMR roles, we are making EMR run smoothly, and help it achieve its decarbonisation and supply security objectives.

In November 2015, the conclusions of our Electricity Balancing Significant Review (EBSCR) were implemented into the electricity market arrangements<sup>4</sup>. This made a number of significant changes to the way electricity cash-out prices are calculated which were designed to improve market price signals. These changes should increase the efficiency of balancing and the incentives on market participants to provide flexible capacity, ultimately reducing the cost of delivering secure electricity supplies to consumers.

As well as changes to the electricity network system operation, we implemented a number of changes to the gas cash-out arrangements in (case of) an emergency, in order to ensure that the market rules provide appropriate incentives on gas shippers to balance supply and demand. With an increasing reliance on gas imports, these changes are intended to avoid or minimise an emergency and protect consumers that incur high costs when interrupted.

### *Facilitating market integration*

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<sup>3</sup> <https://www.ofgem.gov.uk/publications-and-updates/wholesale-energy-markets-2016>

<sup>4</sup> For more information please see: <https://www.ofgem.gov.uk/electricity/wholesale-market/market-efficiency-review-and-reform/electricity-balancing-significant-code-review>

Since the adoption of the Third Package, we have worked hard to develop and implement both the rules and infrastructure needed to be part of fully integrated European markets.

In gas, we approved modifications to various TSO access rules and charging methodologies to facilitate the implementation of the Balancing and CAM network codes by October 2015 and 1 November 2015 respectively on five TSOs. These also ensured continued compliance with the CMP guidelines for the TSOs. This included a change of the gas day (starting at 05.00 UCT) in line with the rest of the EU from 1 October 2015.

We continue to engage with the European Commission on the finalisation of amendments to CAM network code (primarily to address how incremental capacity will be allocated) and the development of the network code on harmonising transmission tariff structures. We also engage with neighbouring NRAs on any issues arising from the Network Codes' development and implementation.

We have continued to play a central role in developing the rules for cross-border trading in electricity and are in the process of implementing those new laws in Great Britain. These codes promote competition, efficient use of transmission capacity, integration of energy markets and the harmonisation of rules for operating transmission and distribution networks. Currently six electricity Network Codes have reached implementation stage and three will do so shortly.

The Capacity Allocation and Congestion Management (CACM) and Forwards Capacity Allocation (FCA) Guidelines set the pan-European rules for cross border trading to facilitate more efficient flows on interconnectors and contribute to secure and sustainable energy supplies.

In July 2015, CACM entered into force. It is currently being implemented in GB and we are working with stakeholders to ensure an efficient implementation. The FCA has passed through comitology and its implementation work is already underway, with Ofgem taking the first steps in designating TSO responsibilities.

The System Operation Guideline has received a positive vote at the cross border committee meeting and is expected to enter into force early next year.

In 2015, the three Grid Connection Codes (GCCs) of the European Network Codes were voted upon and agreed by the Member States (ie the Requirement for Generators, Demand Connection Code and High Voltage Direct Current code). The GCCs will help ensure security of supply, help decarbonise the energy sector and create a competitive, pan-European market which benefits customers. We are expecting the GCCs to enter into force in this summer.

### **Ensuring Retail Markets deliver for consumers**

The health of our retail market is crucial for delivering benefits to consumers. We monitor how well competition is working in the interests of consumers, and how far it

supports consumer outcomes such as lower bills, better quality of service, benefits for society as a whole and reduced environmental damage. We help markets to operate more effectively by removing barriers, for example by ensuring there is greater transparency of information to all parties including customers. When necessary, we use our powers to monitor and address any anti-competitive behaviour or practices which may affect the market. In addition, we actively seek to ensure support is provided for society's most vulnerable people.

The key developments in the domestic retail markets over the previous year on supply side include the continued growth of independent suppliers which accounted for around 12% of all electricity and 13% of all gas consumers at the end of 2015, and high levels of new entry by historical standards, as 11 electricity and 12 gas suppliers entered the market in 2015. The overall level of domestic consumer engagement in 2015 was higher than that observed in 2014, with electricity switching rate up by 1.2% to 12.1% and gas switching rate up by 2.3% to 13.1%. There have been also some small but significant improvements in how clear consumers say they find routine communications (up 3% since 2014) and an increase in the proportion of consumers seeking out information to make comparisons (from 67% in 2014 to 69% in 2015). We have also found that micro-businesses are more aware of their contract terms but also that they still face a number of barriers to engagement (e.g. a lack of transparency around contract terms and customers not being aware of when they can switch supplier).

Over the course of 2015, the Competition and Markets Authority (CMA) continued its investigation of the energy market in Great Britain, initiated by our referral on 26 June 2014. In its 'Provisional Findings Report', published on 7th July 2015<sup>5</sup>, the CMA has highlighted a range of problems hindering competition in the market, including the extent to which consumers are engaged in the market and shortcomings in regulation and the ability to deliver change across the market. It also pointed to the need for a coherent and transparent approach to responsibilities and policy implementation by those overseeing the industry.

In its Final report, published on 24 June 2016<sup>6</sup>, CMA has set out a comprehensive and wide-ranging package of remedies to address the problems hindering competition and to reform the energy market, open up competition and help consumers get a better deal. It sets out the measures aimed directly at domestic consumers and microbusinesses to encourage more switching to competitively priced deals and a temporary safeguard price cap for prepayment meter consumers, who are often among the most vulnerable consumers. The CMA has also set out a wide range of measures to bring about changes in the electricity wholesale market, push forward technical developments and tackle regulatory and policy issues – all of which could ultimately help reduce consumers' bills.

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<sup>5</sup> [https://assets.digital.cabinet-office.gov.uk/media/559fc933ed915d1592000050/EMI\\_provisional\\_findings\\_report.pdf](https://assets.digital.cabinet-office.gov.uk/media/559fc933ed915d1592000050/EMI_provisional_findings_report.pdf)

<sup>6</sup> <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

We are now acting on the package of remedy recommendations which the CMA has made to Ofgem and are also supporting the CMA with its implementation of other remedies.

### *Acting decisively where rules are breached*

Energy companies must comply with the relevant European and national legislation, as well as the conditions in their licences. We monitor this compliance and where companies are found to be breaching the rules, we take action to ensure consumers benefit. From Jan 2014 – Dec 2015, our enforcement activity led to energy companies paying a total of more than £118 million in compensation and payments. Our most notable investigations included<sup>7</sup>:

- In January 2016, npower paid a total redress package of £26 million (less £7 penalty) following its failure to handle complaints effectively within a reasonable timeframe. This was our first investigation under our principles-based domestic Standards of Conduct, this requires suppliers to take all reasonable steps to treat customers fairly; this applies to the information suppliers provide to customers; and the effectiveness of suppliers' customer service arrangements.<sup>8</sup>
- In December 2015, E.ON agreed to pay £7 million (less £2 penalty) in redress payments to the Carbon Trust as a result of failing to meet its obligation to supply relevant business customers through advanced electricity meters by the April 2014 deadline.<sup>9</sup>
- In May 2015, we found that E.ON had failed to meet its licence obligations to notify its customers in advance of two price rises in 2013 and 2014. As a result, of Ofgem's actions E.ON paid a total redress package of £7.75 million (less £1 penalty) to Citizens Advice Energy Best Deal to provide one-to-one energy advice to vulnerable consumers. In addition, E.ON also paid over £490,000 in compensation to customers affected.<sup>10</sup>

### *Looking forward*

The next year will again be a very busy period for Ofgem. We will continue with steps to implement the package of remedies recommended by the CMA, while also ensuring implementation the European Network Codes and promoting the values of flexibility and demand side response. We will also continue our work on flexibility, and expect to

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<sup>7</sup> Our enforcement guidelines: <https://www.ofgem.gov.uk/ofgem-publications/89753/enforcementguidelines12september2014publishedversion.pdf>

<sup>8</sup> <https://www.ofgem.gov.uk/publications-and-updates/notice-decision-impose-financial-penalty-npower-following-our-investigation-its-compliance-standards-conduct-slc25c-slc27-final-bills-and-gas-and-electricity-consumer-complaints-handling-standards-regulations-2008>

<sup>9</sup> <https://www.ofgem.gov.uk/publications-and-updates/notice-decision-impose-financial-penalty-e-following-investigation-its-compliance-standard-licence-condition-12-electricity-supply-licence>

<sup>10</sup> <https://www.ofgem.gov.uk/publications-and-updates/notice-decision-impose-financial-penalty-e-following-our-investigation-their-january-2013-and-2014-price-rises>

publish a joint call for evidence with DECC in the Summer 2016. Following responses to this call for evidence, we will work with stakeholders and DECC to identify next steps. We expect to announce next steps towards the end of 2016 and take work forward on these in 2016 and 2017.

We must continue to work towards achieving our national renewables target by 2020 set by the EU Renewable Energy Directive.

We continually work alongside both our national and European stakeholders to ensure effective engagement and efficient cooperation while working towards the goal of completing the Internal Energy Market. We will aim to work alongside other regulators and the European Commission in implementing the Gas Winter Package and the Energy Market Design to ensure the best outcomes for GB energy consumers.

It is vital that we continue to work with our regulatory colleagues via CEER and ACER and colleagues in the European Commission in order to overcome the challenges that increasing levels of renewables in the generation mix will bring, the threat to cybersecurity and how we protect the market to ensure we secure safe and affordable energy for the future.

## 3. The electricity market

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This chapter contains details of developments in GB's electricity sector during 2015. This is broken down into sections covering network regulation, promoting competition, and security of supply in the wholesale and retail electricity markets.

### 3.1 Network regulation

Under this section unbundling, technical functioning, tariffs for connection and access, cross-border issues and compliance are discussed. We show briefly what has previously been done to ensure compliance with legislation as well as other regulatory activities and market developments in 2015.

#### 3.1.1 Unbundling

Articles 9, 10 11 and 26 of the Electricity Directive and Article 3 Regulation (EC) 714/2009 outline our obligations in unbundling certification of transmission system operators (TSOs). The Electricity and Gas (Internal Markets) Regulations 2011 (which entered into force on 10 November 2011) and the Gas and Electricity (Ownership Unbundling) Regulations 2014 (which entered into force on 15 January 2015) are together known as "the GB Regulations". The GB Regulations implement the Third Package into GB domestic legislation, including the ownership unbundling requirements set out in the Third Package Directives and Regulations in respect of TSOs and the requirements in respect of Distribution System Operators. The GB Regulations have amended the Electricity Act 1989 (Electricity Act) to include the requirement for the holders of electricity interconnector and electricity transmission licences to be certified as independent under one of the grounds for certification in the Electricity Act.

The GB Regulations have designated the Authority as the National Regulation Authority (NRA) for GB and have given it the responsibility for administering the certification process in GB. The Authority also has to notify the European Commission when it receives an application for certification where the applicant is from a third country or is controlled by a person from a third country. We have dealt with two such applications in 2015.

#### **TSOs**

Under Article 10 of the Electricity Directive, we have an obligation to ensure any undertaking which owns a transmission system is certified before it is approved and designated as a transmission operator.

In 2015, we published two final certification decisions to certify new Offshore Transmission Operators (OFTOs) (pursuant to sections 10D(6)-(8) of the Electricity Act and Article 3(2) of Regulation (EC) No. 174/2009 (Electricity Regulation). Under Article 10 of the Electricity Directive we also have an obligation to monitor the continuing compliance of certified TSOs with the requirements of Article 9. We

continue to monitor the certification status of the certified TSOs in GB, including through the review of annual declarations submitted by the relevant entities.

### **Distribution System Operators (DSOs)**

Under Article 26 of the Electricity Directive of the European Parliament and of the Council of 13 July 2009 we have an obligation to ensure that where the distribution system operator is part of a vertically integrated undertaking, it should be independent at least in its legal form, organisation and decision-making from other activities not relating to distribution.

During the year we reviewed the information submitted by DSOs relating to business independence, financial reporting and output performance. In that context we were satisfied that Directive requirements relating to unbundling were being properly observed.

### **3.1.2 Technical functioning**

The technical functioning of the network is of great importance to ensure safe, secure and reliable electricity supply for consumers. In the following, we report on our responsibilities and activities for: electricity balancing services; maintaining security and reliability standards; developing our transmission system; monitoring time taken to connect and repair; monitoring safeguard measures and reporting on the RES regulatory framework over the course of 2015, in the transmission and distribution networks.

#### **Balancing services**

Under Article 37(6)(b) of the Electricity Directive, NRAs are responsible for fixing or approving the methodologies used to calculate or establish terms and conditions for the provision of balancing services.

National Grid Electricity Transmission (NGET) is the System Operator (SO) for the high voltage electricity transmission system in GB, with responsibility for making sure that electricity supply and demand stay in balance and the system remains within safe technical and operating limits. NGET's licence contains conditions regarding the Balancing and Settlement Code – the document which defines the rules and governance for the balancing mechanism and imbalance settlement – and regarding the procurement and use of balancing services<sup>11</sup>. The Balancing and Settlement Code objectives are set out in NGET's licence and include the efficient, economic operation of the transmission system and compliance with relevant legally binding European Commission decisions.

The current electricity balancing arrangements are designed to provide commercial incentives for generators to physically match the amount that they notify they will deliver with what they ultimately deliver to the system. The current arrangements are also designed to provide commercial incentives for suppliers to physically match the amount they notify they will offtake, to the amount they ultimately offtake from the system.

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<sup>11</sup> <https://www.elexon.co.uk/bsc-related-documents/balancing-settlement-code/>

Generators' imbalances relate to the difference between the amount they physically deliver and their contracted volume. Suppliers' imbalances relate to the difference between that notified and that which is off taken. Where there is an imbalance, either the generator or supplier will incur 'cash-out' charges – thereby providing the incentive to balance.

In November 2015, significant changes were made to the balancing and cash-out arrangements as a result of our Electricity Balancing Significant Code Review, which we launched in 2012<sup>12</sup>. The reforms changed the cash-out arrangements in order to improve incentives to balance efficiently. They also improved the signals about the need for flexible capacity in the market, in particular by ensuring cash-out prices rise more appropriately during scarcity situations to reflect the value consumers place on electricity. This is becoming increasingly important as we transition into an electricity system with an increasing share of intermittent generation.

NGET recovers the costs of balancing the system through Balancing Services Use of System (BSUoS) charges, derived from the BSUoS charging methodology which is set out in the Connection and Use of System Code (CUSC)<sup>13</sup> and approved by Ofgem. We put financial and reputational incentives on the SO to encourage low operating costs within the safety and security bounds set out under the codes and licences. In addition, we are required to approve any change to the charging methodology. Further details of how BSUoS charges are levied are in section 3.1.3 of this report.

## **Security and reliability standards, quality of service and supply**

### *Transmission*

Under Article 37(1)(h) of the Electricity Directive, NRAs must monitor compliance with, and review past performance of, network security and reliability rules as well as set or approve standards and requirements for quality of service and supply. The National Electricity Transmission System Security and Quality of Supply Standard (NETS SQSS) is a technical standard that licensees are required to comply with.

NETS SQSS contains coordinated criteria and methodologies that Transmission Licensees and the SO are required by their respective licences to use when planning and operating transmission systems. Ofgem must approve any change to the NETS SQSS. In 2015 there were not any changes made to the technical standards. NGET, in its role as SO, submitted a report providing details of system security and quality of service and supply to Ofgem as required under its licence.

### *System Reliability*

The onshore TSOs are incentivised to maintain a reliable and secure system. For the incentive mechanism, network reliability is measured by the total volume of Energy Not Supplied (ENS) to customers due to loss of supply events. Each TSO has an annual target ENS volume and is either rewarded or penalised each year according to its level of performance against its target. We annually review each TSO's

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<sup>12</sup> <https://www.ofgem.gov.uk/electricity/wholesale-market/market-efficiency-review-and-reform/electricity-balancing-significant-code-review>

<sup>13</sup> See CUSC – Section 14: <http://www2.nationalgrid.com/uk/industry-information/electricity-codes/cusc/the-cusc/>

performance compared to its target. In 2014-15, all three TSOs outperformed the respective ENS target, earning an additional £5.4m in allowed revenue.

There is also a suite of network output measures that inform the safety and reliability of a TSO's network and will directly affect the funding at the start of next price control, RIIO-T2, in 2021.

OFTOs' system availability incentive targets are set out in each individual OFTO licence. The mechanism incentivises the OFTOs to maintain system availability and therefore export capacity available to offshore generators. OFTOs receive financial rewards or incur penalties for performance above or below this target.

### *System development*

In 2015, the three Grid Connection Codes (GCCs) of the European Network Codes were voted upon and agreed by the Member States (ie the Requirement for Generators, Demand Connection Code and High Voltage Direct Current Code). The GCCs will help ensure security of supply, but will also facilitate the decarbonisation of the energy sector and create a competitive, pan-European market which benefits customers. We are expecting the GCCs to enter into force in Q3 2016. We understand that industry intend to give effect to the GCC requirements through making modifications to the existing domestic connection codes (ie the Grid Code and the Distribution Code). We are currently engaging with the industry to prioritise our work and implementation plan.

### *Distribution*

In GB, licensed electricity DNOs are required to design their networks to meet the requirements of the Engineering Recommendation standard P2/6. This standard sets out the normal levels of security required for distribution networks, and the requirement for the provision of emergency network capacity. In the event that a licensee cannot comply with this licence condition, the licensee is able to apply to Ofgem for a derogation.

The electricity distribution price control, RIIO-ED1, began in April 2015 and will run from 2015 to 2023. The revenues that the 14 DNOs are allowed to recover for this period are linked to the delivery of outputs that provide for long-term reliability, minimise the number and duration of interruptions and ensure adaptation to climate change. RIIO-ED1 replaces the previous price control, Distribution Price Control Review 5 (DPCR5), which ran from April 2010 to March 2015.

The Electricity (Standards of Performance) Regulations 2015 (SI 2015/699) are a legal framework of specific minimum levels of service customers should expect from their DNO. If a company fails to meet a standard of performance, it must make a payment to the customer affected. The standards cover areas such as restoring supply during an unplanned interruption, connections and voltage quality. In 2014 we updated and tightened these standards in line with our RIIO-ED1 decision and a review following severe storms in December 2013.

We also have other financial incentives to encourage improvements in performance. The Interruptions Incentive Scheme incentivises DNOs to reduce the frequency and duration of power cuts experienced by their customers.

Innovation will play a key part for DNOs to deliver security and reliability of supply at an efficient cost, while dealing with uncertainty. In the RIIO-ED1 price control we established the Network Innovation Stimulus, to help network companies understand

what they need to do to provide security of supply at value for money as GB moves to a low carbon economy. Its equivalent in DPCR5, the Low Carbon Network Fund, sponsored four DNO projects in 2014 to trial new technology or arrangements. In addition, the cost efficiencies delivered from rolling out smart grid solutions and wider network innovation from Low Carbon Network Fund trials were reflected in reduced revenues for DNOs in the RIIO-ED1 period.

## **Monitoring time taken to connect and repair**

Regulators, under Article 37(1)(m) of the Electricity Directive, are required to monitor the time taken by transmission and distribution system operators to make connections and repairs. Here we report on how we have monitored this for transmission and distribution system operators during 2015.

### *Transmission*

Since 2011, under the Connect and Manage regime, generators have been able to connect to the system in GB ahead of wider system reinforcements. It is the responsibility of the SO to ensure that the power flows across major system boundaries are within the capabilities of the system. The additional cost of these actions and the resulting 'Constrained Dispatch' of generation (constraint costs) are socialised, ie spread across all generation and demand (levied 50:50) in GB, and are recovered through BSUoS charges.

We receive biannual 'Timely Connections' reports from the TSOs. These reports provide us with information on the factors affecting the connection dates offered to generators. This lets us assess whether any changes to the existing framework are needed. A non-confidential version of the report is on NGET's website.

Until now, we have submitted an annual report to the Secretary of State which monitors the impacts of the 'Connect and Manage' regime<sup>14</sup>. The most recent report (December 2015) noted that under the regime, connection dates continue to have been brought forward by an average of five years compared with previous arrangements. In December 2015, the Minister of State removed the Public Service Obligation on Ofgem to submit an annual report to it. We are currently considering the next steps for Connect and Manage and how we report on it.

To date all OFTOs own and operate the offshore transmission systems that are built by offshore generators to connect their generating stations to the National Grid. As such there have been no issues under the offshore transmission regime regarding the time taken to connect during 2015. OFTOs' licences require them to report, every quarter, offshore transmission system performance and whether that performance has fallen below target. Where the OFTO is able to demonstrate that performance has fallen as a result of an Exceptional Event, this period will not count against their availability target. When reviewing Exceptional Event claims we look at whether the OFTO has followed good industry practice to restore the outage promptly. We can impose a financial penalty on any OFTO that has failed to meet its system availability incentive target.

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<sup>14</sup>[https://www.ofgem.gov.uk/sites/default/files/docs/monitoring\\_the\\_connect\\_and\\_manage\\_electricity\\_grid\\_access\\_regime\\_sixth\\_report\\_from\\_ofgem\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/monitoring_the_connect_and_manage_electricity_grid_access_regime_sixth_report_from_ofgem_0.pdf)

## *Distribution*

For reporting 'time to connect', we consider that it is made up of two elements: time to quote and time to connect. Time to quote is the difference, in working days, between the date the customer applies for a new connection and the date a quotation is issued to the customer. Time to connect is the difference between the date on which the customer accepts the quote and the final connection date (when the connection has been installed, commissioned and left safe).

Historically, we have monitored the time taken by DNOs to provide connection offers and (since 2010) complete the connection. We have also established guaranteed standards for connections that provide compensation payments to customers if the DNO fails to deliver specified connection services within minimum timescales. These standards cover the provision of quotations, scheduling agreed dates for works with customers and completing works on the dates agreed with customers. Failure to meet these standards on 90 % of occasions in each quarter constitutes a breach of licence. In 2015 we updated the value of the payments made to connection customers for non-compliance with the standards.

As part of the new price control (which started in April 2015) we have introduced a new 'time to connect' incentive in RII0-ED1 which will reward DNOs if they are able to issue quotes and complete connections (for smaller connection projects) quicker than the target timescales. The companies have also set their own targets for the time taken to connect which they will report on annually.

We also monitor the time taken to repair faults through the Interruptions Incentive Scheme. The time taken to repair has been incentivised as part of the 'customer minutes lost' element of the Interruptions Incentive Scheme.

## **Monitoring safeguard measures**

In the event of a sudden crisis in the energy market which threatens the physical safety or security of people, apparatus or installations of system integrity, a Member State may temporarily take the necessary safeguard measures. Under Article 37(1)(t) of the Electricity Directive, regulators are required to monitor the implementation of those safeguard measures.

During a fuel crisis, the Government has the power to direct the behaviour of the operators of certain power stations and transmission licensees to ensure industry obligations are fulfilled. The details of these arrangements are in the Fuel Security Code<sup>15</sup> (standard licence condition B11) which transmission licensees must comply with. Under the Fuel Security Code, in an emergency the Energy Emergencies Executive Committee will establish the Joint Response Team to liaise between industry and Government and to practically manage the emergency.

The principal objective of this Fuel Security Code is to provide an administrative structure during a fuel crisis so that the Government can take appropriate measures with minimal interference to normal market arrangements. There were no such emergencies in 2015, hence the Joint Response Team was not established in 2015.

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<sup>15</sup> <https://www.gov.uk/government/publications/fuel-security-code>

## **Regulatory framework for Renewable Energy Sources**

Under Article 11 of Regulation (EC) 713/2009 NRAs are required to monitor access to the network, including access of electricity produced from renewable energy sources.

As part of RII0-ED1 we also introduced a specific incentive for large connection customers, the Incentive on Connections Engagement. This aims to drive DNOs to understand and meet the needs of major connection customers (larger metered demand, unmetered, distributed generation). If a DNO fails to do this, then it could incur a penalty. As part of the Incentive on Connections Engagement, DNOs must submit two reports, one at the start of the regulatory year (i.e. the financial year) outlining their commitments to improve services and another at the end of the year reporting back against the commitments made. We received the first submission in May 2015 which described the DNOs' workplans of activities and key performance outputs for 2015-16. Throughout the year we have consulted with stakeholders to understand their views on the DNOs' workplans and target outputs. The DNOs reported back on their performance in May 2016 and we are currently formally assessing performance, with a decision on whether any penalties are to be applied due by November 2016.

In 2014, we reviewed the market for new connections to the electricity distribution network. We made the decision to open our review in response to continued concerns about whether competition in this market is effective. In June 2014 we issued a 'call for information'. In October 2014, we published an update on our review. In January 2015 we published the findings of our review. We concluded that there were issues in the market that could limit competition. A number of these issues related to the DNOs' role in the connections process. To address these issues, in October 2015 we implemented a new licence condition which places a duty on DNOs to help facilitate effective competition in the market for connections to the electricity distribution network. The licence condition also requires the DNOs to comply with a new 'Competition in Connections Code of Practice' – which specifies how the DNOs must provide services to their competitors in the connections market. We will do a further review of the market in spring 2017 to determine the success of the remedies implemented.

In response to stakeholder feedback, in February 2015, we launched a project to deliver "quicker and more efficient connections" for all connection customers (including distributed generation customers). This project aims to find ways to make better use of the existing network and avoid the need for time-consuming (and costly) reinforcements to accommodate a new connection. The project also aims to identify new funding arrangements for connections, which could enable investment to be made in anticipation of a connection being requested. In September 2015, we published a plan for DNOs to complete by December 2015. We also invited stakeholders to identify case studies where we could trial alternative funding arrangements. In February 2016 we published an update on the DNOs' progress to make more efficient use of the network. We also published an update on the DNOs' trials for investment ahead of need.

### **3.1.3 Network tariffs for connection and access**

Under Article 37(1)(a), (3)(c),(d), (6)(a), (8), (10), (12), of the Electricity Directive, NRAs are required to fix or approve transmission or distribution tariffs or their methodologies. Here we report on our activities on the regulation of tariffs and network charges (for transmission and distribution) during 2015.

## Transmission

Users of the electricity transmission system are subject to three types of transmission charges in GB: Connection charges, Transmission Network Use of System (TNUoS) charges and BSUoS charges.

### *Connection Charges*

Connection charges relate to the provision and maintenance of connection assets which are solely required to connect a particular user (a generator, for example) to the main transmission system. The costs are recovered under NGET's connection charging methodology,<sup>16</sup> which is approved by Ofgem. NGET defines 'connection assets' as assets solely required to connect an individual user to GB's transmission system, which are not and would not normally be used by any other connected party. The costs of these assets are recovered directly from the generator via connection charges. During 2015, we did not make any decisions on change to the connection charging methodology.

### *TNUoS Charges*

The TNUoS charging methodology is applied by NGET in its role as SO and is approved by Ofgem. TNUoS charges recover the cost of the provision and maintenance of shared electricity transmission assets, or in other words, assets that cannot be solely attributed to a single user. TNUoS charges are recovered from all users of the GB electricity transmission system (excluding interconnectors). These charges vary by location, reflecting the costs that users impose on the transmission network to source (demand) or send (generators) their electricity.<sup>17</sup>

In July 2014, we approved a proposal (CMP213)<sup>18</sup> to introduce transmission charges that vary based on generator type and historical annual load factor, as well as based on location and capacity. Our decision was challenged by an electricity generation company but its claim for judicial review was dismissed in July 2015. Therefore, this modification was implemented on 1 April 2016, as originally planned.

In July 2015, we approved a proposal (CMP223)<sup>19</sup> to ensure that distribution connected generators who have an impact on the electricity transmission network do not face undue discrimination in how security requirements are passed on.

In August 2015, we rejected a proposal (CMP239)<sup>20</sup> which sought to implement "grandfathering" arrangements in the charging arrangements for the Small Generator discount.

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<sup>16</sup> <http://www2.nationalgrid.com/uk/Industry-information/System-charges/Electricity-transmission/Transmission-Network-Use-of-System-Charges/Statement-of-Use-of-System-Charges/>.

<sup>17</sup> See 2010 National Report for a more detailed description of the components of the TNUoS charge.

<sup>18</sup> <https://www.ofgem.gov.uk/publications-and-updates/project-transmit-decision-proposals-change-electricity-transmission-charging-methodology>

<sup>19</sup> <https://www.ofgem.gov.uk/publications-and-updates/connection-and-use-system-code-cusc-cmp223-arrangements-relevant-distributed-generators-under-enduring-generation-user-commitment-0>

<sup>20</sup> <https://www.ofgem.gov.uk/publications-and-updates/connection-and-use-system-code-cusc-cmp239-grandfathering-arrangements-small-generator-discount>

In September 2015, we rejected a proposal (CMP227)<sup>21</sup> to change the current generation to demand user split of TNUoS charges to 15:85 or less.

### *BSUoS Charges*

NGET recovers the costs of balancing the system through Balancing Services Use of System (BSUoS) charges, derived from the BSUoS charging methodology which is set out in Section 14 of the Connection and Use of System Code (CUSC) and approved by Ofgem. For all three charges (Connection, TNUoS and BSUoS) the form of the methodologies must be approved by Ofgem, but we do not set or approve the level of individual charges. In 2015, we did not make any decisions on changes to the BSUoS charging methodology.

### **Distribution**

The electricity distribution licence requires DNOs to have in force at all times a Use of System Charging Methodology and a Connection Charging Methodology (collectively known as the Charging Methodologies). Both must be approved by Ofgem.

DNOs have developed common approaches to connections charging and distribution use-of-system (DUoS) charging. These common approaches include:

- The Common Distribution Charging Methodology for all customers connected at the lower voltages.
- The Extra High Voltage Distribution Charging Methodology for all demand and generation customers at the higher voltages.
- The Common Connections Charging Methodology, incorporated into all DNO connection methodologies.

Each DNO's connection charging methodology incorporates a company-specific section as well as the common methodology. The licence requires DNOs to comply with their charging methodologies and to publish Charging Statements prepared in accordance with those methodologies except where explicit consent is given by us. The Electricity Act 1989 section 23 enables us to determine certain disputes including whether a DNO has applied charges in line with their Charging Methodologies.

Stakeholders can provide inputs to proposed changes to the methodologies or tariffs. This is done either through participation in industry working groups, or through the public consultation processes. We consider any inputs received when reaching a decision on methodologies or tariffs. Although we have the power to make a decision on proposed changes to the methodologies, we do not have the power to review these decisions thereafter (i.e. the appeal cannot be made to the Authority).

Stakeholders have the right to apply for a judicial review of any such decision. There has not been any application for judicial review of any decision regarding the methodologies or tariffs during 2015.

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<sup>21</sup> <https://www.ofgem.gov.uk/publications-and-updates/connection-and-use-system-code-cmp227-change-gd-split-transmission-network-use-system-charges-example-1585>

## **Prevention of cross-subsidies**

Each NRA, under Article 37(1)(f) of the Electricity Directive, is required to ensure that there are no cross-subsidies between transmission, distribution and supply activities.

In GB, licensed electricity distribution, gas distribution and transmission network operators (including offshore licensees) are subject to licence conditions prohibiting regulated businesses from giving cross-subsidies to, or receiving cross-subsidies from, related undertakings.

Electricity and gas transmission and distribution licences include a requirement for independent auditors to carry out a range of procedures, agreed with the Authority, to provide assurance that obligations to avoid discrimination and cross-subsidies are being respected. We review the auditors' reports and raise supplementary questions as appropriate.

The unbundling requirements as described in section 3.1.1 also provide for greater structural separation of transmission interests from generation, production and supply interests in order to prevent cross-subsidies.

A key area which we will continue to monitor is the interpretation and application of requirements for financial transactions to be completed at arm's length and on normal commercial terms. This is especially relevant for the terms of loans made to or by the licensee. Other key risk areas which we take into account are:

- the basis of recharging for services provided at a group level;
- the justification for any management fees charged to the licensee by related parties; and
- the interest rates charged on intra-group loans affecting the licensee.

A requirement to have at least two sufficiently independent directors has been in effect since April 2014.

### **3.1.4 Cross-border issues**

To reach a fully integrated European energy market, it is vital that NRAs coordinate effectively on cross-border issues. In this section we report on our interconnections (including allocation of capacity and congestion management), our investment plans (with regard to the Ten Year Network Development Plan (TYNDP)) and our cooperation with other NRAs during 2015.

#### **Access rules on interconnection**

The GB electricity market is interconnected to the Netherlands (BritNed), France (IFA), Northern Ireland (Moyle) and the Republic of Ireland (EWIC). A number of new interconnector projects are also at different stages of development.

The Third Package introduced new responsibilities for NRAs regarding the rules for granting access to cross-border electricity infrastructures, which in GB are reflected in

the standard licence conditions of the electricity interconnector licence.<sup>22</sup> These responsibilities can be summarised as follows:

- Licensees are required to submit any new or amended charging methodologies and access rules to Ofgem.
- Both Ofgem and the interconnector operator must ensure that charging methodologies and access rules, and any modifications to these, comply with the following objectives: objectivity, transparency, non-discrimination and compliance with any relevant legally binding decision of the European Commission (EC) or the Agency for the Cooperation of Energy Regulators (ACER).
- Interconnector operators are required to review and consult on their access rules at least once each year and to provide us with a report, that should highlight what amendments, if any, will be made to better facilitate the above objectives. The review must take into account the consultation.
- Ofgem has the power to request licensees to review and amend the access rules.

In 2015, Ofgem continued to monitor interconnector statistics, including information on auctions, capacity, nominations and flows.

### **Existing interconnection**

#### *Interconnexion France-Angleterre (IFA)*

The England-France Interconnector is jointly operated by NGIL and Réseau de Transport d'Électricité, the French TSO. IFA is a high voltage direct current line with a capacity of 2000MW.

Capacity is allocated explicitly in the long term, using a single coordinated capacity platform. 'Netting'<sup>23</sup> and 'use-it-or-sell-it' are applied to ensure that the maximum possible capacity is made available to market participants in all timeframes. Day-ahead capacity is allocated via implicit auctions following the implementation of market coupling. For intraday trading, explicit auctions are used.

In July 2015, IFA submitted proposed modified Access Rules to the Authority for approval. The changes were to enable IFA to introduce the Harmonised Allocation Rules (HAR) pilot project. We approved the modified Access Rules for IFA in October 2015.<sup>24</sup>

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<sup>22</sup> See standard conditions 10, 11 and 11A:

[https://epr.ofgem.gov.uk//Content/Documents/Electricity\\_Interconnector\\_Standard%20Licence%20Conditions%20Consolidated%20-%20Current%20Version.pdf](https://epr.ofgem.gov.uk//Content/Documents/Electricity_Interconnector_Standard%20Licence%20Conditions%20Consolidated%20-%20Current%20Version.pdf).

<sup>23</sup> Netting is the superposition of hourly nominations in two opposite directions, in order to release some capacity in the more congested direction for the next allocation step.

<sup>24</sup> <https://www.ofgem.gov.uk/publications-and-updates/approval-modified-access-rules-england-france-interconnector-ifa-2015>

### *BritNed*

The 1000MW BritNed high voltage direct current cable, between GB and the Netherlands, began operating in April 2011. As with IFA, BritNed allocates capacity on its cable through a blend of implicit and explicit auctions. It holds Annual, Quarterly, Monthly, and Multi-day explicit auctions, an implicit Day Ahead auction, and explicit Intraday auctions.

BritNed has a 25-year exemption from rules relating to the use of interconnector revenues and charging methodologies, and certain conditions are not in operation in its licence.<sup>25</sup> However, it must still comply with the interconnector licence condition relating to access rules, introduced as a result of the Third Package.<sup>26</sup> In July 2015, BritNed submitted proposed modified Access Rules to the Authority for approval. The changes were to enable BritNed to introduce the Harmonised Allocation Rules (HAR) pilot project. We approved the modified Access Rules for BritNed in October 2015.<sup>27</sup>

### *Moyle*

The Moyle interconnector, which links Scotland to Northern Ireland, offers around 450MW of capacity to the market through explicit long-term, daily and intraday auctions. In 2015 one cable on the Moyle interconnector was on a forced outage reducing its available capacity to 250MW. It offers a range of long-term products from one month to one year. To maximise the availability of capacity, the use-it-or-sell-it rule applies to all long-term capacity. Moyle is not exempt from any requirements relating to access rules and charging methodologies. In July 2015, Moyle submitted proposed modified Access Rules to the Authority for approval. The changes were to enable Moyle to introduce the Harmonised Allocation Rules (HAR) pilot project. We approved the modified Access Rules for Moyle in October 2015.<sup>28</sup>

### *EirGrid East-West Interconnector (EWIC)*

EWIC became operational in November 2012. It has a technical capacity of 500MW between Wales and Ireland and uses the same capacity allocation platform as Moyle. It offers capacity through explicit long-term (monthly and annual), daily and intraday auctions and applies 'use-it-or-sell-it' to long-term capacity. EWIC is not exempt from any requirements relating to access rules and charging methodologies. In July 2015, EWIC submitted proposed modified Access Rules to the Authority for approval. The changes were to enable EWIC to introduce the Harmonised Allocation Rules (HAR) pilot project. We approved the modified Access Rules for EWIC in October 2015.<sup>29</sup>

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<sup>25</sup> Standard conditions 9 and 10 of the Electricity Interconnector Licence.

<sup>26</sup> Standard condition 11A of the Electricity Interconnector Licence.

<sup>27</sup> <https://www.ofgem.gov.uk/publications-and-updates/approval-modified-britned-access-rules-2015>

<sup>28</sup> <https://www.ofgem.gov.uk/publications-and-updates/approval-modified-access-rules-and-notice-respect-charging-methodology-moyle-interconnector-2015>

<sup>29</sup> <https://www.ofgem.gov.uk/publications-and-updates/approval-modified-access-rules-and-notice-respect-charging-methodology-east-west-interconnector-2015>

## **New Interconnection**

### *Eleclink*

Eleclink Limited, a proposed 1000MW interconnector project between GB and France, has a partial exemption from use of revenues, third party access and unbundling under Article 17 of Regulation (EC) 714/2009.<sup>30</sup>

### *Nemo Link*

Nemo Link will be a 1000MW electricity interconnector to Belgium and is the first interconnector project to be regulated under our cap and floor regime.<sup>31</sup> We published our final decision to award the cap and floor regime to Nemo Link in December 2014.<sup>32</sup> Nemo Link is expected to connect to the GB transmission system in 2019.

### *NSL*

NSL (formerly NSN) is a proposed interconnector to Norway. At just over 700km, it will be the longest subsea interconnector in the world. It is expected to start operating in 2021 and will have a capacity of 1400MW. In 2015 we published our decision that NSL will be the second project to be regulated under our cap and floor regime.<sup>33</sup>

### *Cap and floor regime development*

In 2015 we granted a cap and floor regime to four further interconnector projects.<sup>34</sup> These projects will connect GB with France (FAB Link - 1400MW and IFA2 - 1000MW), Denmark (Viking Link - 1400MW) and the Republic of Ireland (Greenlink – 500MW). Our analysis showed that all four projects are likely to bring significant net benefits for GB consumers.

The GB transmission system currently has 4GW of interconnection. If these four projects and the other future projects illustrated below are realised, then interconnector capacity would rise to 11.7GW by 2022.

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<sup>30</sup> <https://www.ofgem.gov.uk/publications-and-updates/final-decision-eleclink-limited%E2%80%99s-request-exemption-under-article-17-regulation-ec-7142009-great-britain-france-electricity-interconnector> ; REGULATION (EC) No 714/2009 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003

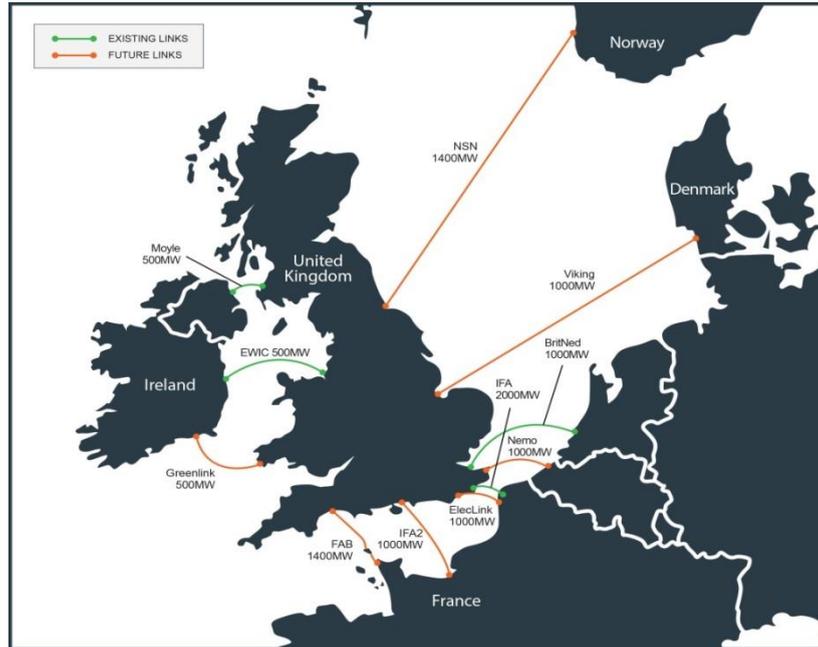
<sup>31</sup> The cap and floor regime is the non-exempt, regulated route for new interconnector investment in GB, which sits alongside the exemption route (whereby project developers apply for exemptions from certain aspects of European legislation).

<sup>32</sup> Our 2014 decision:

[https://www.ofgem.gov.uk/sites/default/files/docs/2014/12/final\\_cap\\_and\\_floor\\_regime\\_decision\\_for\\_nemo\\_master\\_-\\_for\\_publication\\_1.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2014/12/final_cap_and_floor_regime_decision_for_nemo_master_-_for_publication_1.pdf)

<sup>33</sup> Our 2015 decision: <https://www.ofgem.gov.uk/publications-and-updates/decision-initial-project-assessment-nsn-interconnector-norway>

<sup>34</sup> Under the cap and floor approach, if interconnector developers' revenues exceed the cap then revenue above the cap is returned to consumers. Conversely, if their revenues fall below the floor then consumers top up developers' revenues to the level of the floor.



We have recently opened a second application window for our cap and floor regulatory regime, with developer submissions due by 31 October 2016.<sup>35</sup>

## Monitoring TSO investment plans in view of the Ten Year Network Development Plan

### *Price Controls*

We set price controls for the UK electricity system operator (SO), National Grid. As part of this process we review the companies' investment plans. We explicitly require these plans to consider the interaction with wider European developments. We also require the companies to consider the various uncertainties across the period for which the control is set (and longer). Under the price control we require the transmission companies to regularly report on their performance against these plans.

### *Publications by the GB System Operator*

The GB SO produces, on an annual basis, the Electricity Ten Year Statement.<sup>36</sup> This publication describes the GB National Electricity Transmission System, the Transmission Operators' potential investment plans in the wider European network and details of how NGET, as SO, will manage the uncertainty of future energy scenarios in both planning and operating the system.

In addition to the Electricity Ten Year Statement, we have enhanced the SO's role to undertake a new network options assessment process to appraise major investment

<sup>35</sup> <https://www.ofgem.gov.uk/publications-and-updates/decision-open-second-cap-and-floor-application-window-electricity-interconnectors-2016>

<sup>36</sup> <http://www2.nationalgrid.com/UK/Industry-information/Future-of-Energy/Electricity-ten-year-statement/>

options and consider the value of potential additional interconnection to other countries.

### *Onshore Competition*

We are continuing our work to extend the use of competitive tendering for onshore transmission assets that are new, separable and high value. In October 2015 we published a consultation on the detailed regime for onshore competition, including details of the criteria we will use to identify suitable projects and how the competitive process will work. We are also working with Government to explore legislative change to support extending competitive tendering.

### **Cooperation**

Article 37(1)(c) of the Electricity Directive imposes duties on us to consult and cooperate with ACER and other NRAs on cross-border issues. This includes the requirement to provide ACER and other NRAs with the information they may need to carry out their responsibilities under the Electricity Directive. The changes also place a responsibility on us to cooperate with other NRAs to promote certain objectives. These include enabling an adequate level of interconnector capacity and promoting jointly managed cross-border trade in electricity as well as the allocation of cross-border capacity.

#### *Examples of cooperation*

In 2015, we cooperated with the NRAs of adjacent Member States on a number of issues over existing and new interconnectors. We are working closely with the Irish and Northern Irish regulators to develop and approve common trading arrangements for the Moyle and EWIC and on the Single Electricity Market European market integration project.<sup>37</sup>

Under the Electricity Directive, NRAs are required to certify TSOs, including interconnector operators, as compliant with the ownership unbundling requirements. See section 3.1.1. This has required cooperation with NRAs in connecting countries during 2015.

Ofgem, together with GB TSOs and power exchanges are working with European counterparts to voluntarily implement aspects of the European Network Codes and Framework Guidelines for the European electricity market in advance of the deadlines set out in the legislation. These are commonly referred to as pilot projects. Specifically, GB is part of multi-region coupling of day-ahead cross border markets. GB TSOs participate in Project Terre which relates to sharing balancing replacement reserves. In addition to this, we have been consulting with many other NRAs during 2015 on the cross-border intraday project.

We also contribute to ACER and CEER's work in the development of the ENCs and Guidelines for the European electricity market. We hold position of chair of the ACER

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<sup>37</sup> [http://www.allislandproject.org/en/sem\\_publications.aspx](http://www.allislandproject.org/en/sem_publications.aspx)

Board of Regulators and the Presidency of CEER. We hold vice chair in ACER and CEER Electricity Working Groups and CEER Distribution Systems Working Group and we contribute to ACER and CEER other working groups and task forces.

### **3.1.5 Compliance**

Ensuring that NRAs and market participants comply with mandatory obligations is essential for a well-functioning energy market. Below, we report on our powers to enforce the Agency's and European Commission's decision, as well as the investigations that have concluded during 2015 relating to existing legislation.

#### **Ensuring compliance with binding decisions of the Agency and the European Commission, and with the Guidelines**

Under the Third Package, NRAs are required to comply with and implement binding decisions of ACER and of the European Commission. To provide the Authority with the powers to carry out these functions, the Electricity Act 1989 has been amended.

#### **Compliance of transmission and distribution companies, system owners and electricity undertakings with relevant Community legislation, including cross-border issues**

Ofgem has powers to investigate compliance of distribution companies, onshore and offshore transmission companies, system owners and electricity undertakings with relevant EU legislation. If a breach is found, we have powers to impose penalties. As a condition of certification, Transmission System Operators (TSOs) are obliged to notify the Authority if they know (or reasonably should know) of any events or circumstances which have occurred, or are likely to occur, that may affect their eligibility for certification and must provide an annual declaration (approved by a resolution of the TSO's board of directors) on this. The Authority also has powers to require information to be provided by a TSO for monitoring the TSO's certification.

Ofgem, in close cooperation with other relevant NRAs, ensures TSOs are complying with Network Codes and Guidelines by monitoring GB TSO compliance with their licence conditions, business rules, standard transportation agreements and all other relevant operational rules and agreements. Ofgem requires TSOs to notify the Authority if they know (or reasonably should know) of any events or circumstances which have occurred, or are likely to occur, that may affect their compliance with the legislative framework.

#### **Update on Ofgem's Enforcement Investigations**

We continue to use our enforcement powers to protect the needs and interests of consumers. Below are investigations from 2015 and Quarter I + II of 2016 relating to electricity and cross-cutting (electricity and gas) undertakings.

## **Investigations Concluded:**

### *Transmission Constraints*

- New rules were introduced in 2012 to prevent electricity generators from exploiting market conditions and charging excessive prices. In March 2015, SSE agreed to make payments totalling £100,000 to Energy Action Scotland after SSE's pricing signal resulted in it receiving excessive constraint payments for helping to balance electricity supply with demand. SSE's payment was the first under the new transmission constraint rules. The £100,000 payment ensured SSE did not gain financially.

### *Capacity Market Rules*

- In December 2015, we completed five investigations into compliance with the Capacity Market Rules that govern the operation of the Capacity Market. The Capacity Market was established to provide a reliable source of electricity supply. To that end, National Grid runs an annual auction and award capacity agreements for the provision of capacity at times of system stress. We found that two of the generators under investigation, Adret Ltd and Berangere Ltd, provided inaccurate information when applying to prequalify their generation units for the first Capacity Auction in 2014. Both companies falsely claimed they had already secured planning consent for all their generating units. As a result of the failings Berangere Ltd had its capacity agreement terminated for the unit which it did not have planning consent for. Berangere Ltd will also be disqualified from entering that unit into the capacity auction for the next two years. Berangere Ltd and Adret Ltd are now subsidiaries of GF Energy Ltd.
- In March 2015, we found that UK Capacity Reserve Limited (UKCR) submitted inaccurate information when applying to be part of 2014's capacity auction. We found UKCR contravened a relevant requirement of the Capacity Market Rules for 11 of its generating units. As a result, these generating units have been excluded from submission for capacity auctions taking place in the next two years. UKCR has accepted the Authority's finding.

### *Tariff rules*

- In May 2015, we found that E.ON had acted in breach of licence conditions in relation to E.ON's January 2013 and 2014 price rises. Under Ofgem obligations, suppliers had to give customers 30 days' notice of a price rise; this allowed customers the chance to switch before the increase took effect and without incurring exit fees. E.ON admitted that it had breached the relevant licence conditions by incorrectly charging higher prices (in relation to both price rises) and termination fees (in relation to the 2013 price rise) to customers who had given notice to terminate their contact as a result of the price increases. We imposed a financial penalty of £1, in addition to £7.75 million (less £1) in redress that E.ON paid to Citizens Advice Energy Best Deal which will be used to provide one-to-one energy advice to vulnerable consumers across Scotland, England and Wales. E.ON also paid over £490,000 in compensation to customers affected.

### *Transfer blocking*

- In November 2015, Utilita Energy agreed to pay £450,000, less £1 financial penalty, to the UK debt charity StepChange for failing to comply with provisions relating to transfer blocking. Utilita Energy also agreed to refund up to £110,000 to customers who lost out financially after being wrongly stopped from switching. Any refund money unclaimed by customers will also go to StepChange.

### *Mis-selling*

- In December 2015, we found that Economy Energy mis-sold energy contracts, did not have adequate processes and procedures in place to comply with its licence conditions between October 2012 and December 2013, and senior management failed to ensure it was complying with the regulator's rules. We found that agents quoted inaccurate comparative savings and failed to behave fairly and professionally. Economy Energy also failed to give adequate notice of price increases in April and November 2013, depriving customers of the opportunity to switch before price increases took effect. Economy Energy agreed to pay £250,000 (less £1 financial penalty) which will go to help Citizens Advice provide energy advice to vulnerable consumers with prepayment meters. Economy Energy also paid over £67,000 in compensation to customers affected.

### *Missed deadlines*

- In June 2016, ScottishPower agreed to pay £18m concluding an Ofgem investigation into the supplier's complaint resolution and billing practices. We found that ScottishPower failed to treat its customers fairly; it had insufficient contingency plans and did not do enough to protect its customers from issues that arose from the implementation of the new IT system. This resulted in a significant increase in the number of complaints the supplier received. ScottishPower also handled some of these complaints poorly with a significant number taking too long to resolve. The money will be paid to vulnerable ScottishPower customers that were affected by customer service issues (up to £15m) and the remainder to charity.
- In December 2015, E.ON agreed to pay £7 million (less £2 financial penalty) in redress payments to the Carbon Trust as a result of failing to meet its obligation to supply relevant business customers through advanced electricity meters by the April 2014 deadline. It was unable to demonstrate that it had been unable to install or arrange for the installation of an advanced meter despite taking all reasonable steps. We found that E.ON failed to plan and monitor its rollout and its senior management did not do enough to ensure it complied. The rollout is part of a national project to modernise the energy sector and provide better service by introducing next-generation, smarter meters to help customers control their usage and bills. Furthermore, E.ON has agreed to pay an additional £7 million if it has not achieved a further installation target for its outstanding meter points by 2 November 2016.

### *Contract terms, Standards of Conduct and complaints handling*

- In December 2015, we found that Business Energy Solutions ("BES") was in breach of licence conditions relating to communicating principal terms with its non-domestic customers, the Standards of Conduct, and objecting to customer

transfers (deemed contracts). In addition, we found that it had failed to handle consumer complaints in accordance with the Consumer Complaints Handling Standards 2008. The investigation was opened after we received a formal referral from Citizens Advice and a high number of complaints about BES from consumers and Members of Parliament on behalf of their constituents. We imposed a financial penalty of £1 on each of the two BES licensees after BES admitted that it breached the relevant conditions and agreed to pay £980,000 in total by way of settlement. This figure includes compensation of £311,000 which BES will pay to consumers affected by the breaches. BES also made a consumer redress payment of £669,000 to the charity The Money Advice Trust (Business Debtline).

#### *Standards of Conduct, complaints handling and final bills*

- In January 2016, we completed our first investigation opened under our principles-based domestic Standards of Conduct, which require suppliers to treat customers fairly and covers supplier behaviour towards customers generally; the information that suppliers provide to customers; and the effectiveness of suppliers' customer service arrangements. The investigation also covered compliance with the Consumer Complaints Handling Regulations 2008 and licence requirements to take all reasonable steps to send a final bill within six weeks of supplier transfer or termination of a supply contract. We found that npower breached its obligations on billing and had system problems related to billing generally which affected over 500,000 customers between September 2013 and December 2014. npower admitted it had breached relevant licence conditions and failed to handle complaints effectively. We imposed a fine of £1 on each of the seven npower companies (total £7) after npower agreed to pay £26m (less £7) as a consumer redress package. The redress money will be split between customers directly affected by the npower companies' failings and charitable organisations to benefit domestic energy consumers. In addition, the npower companies agreed to meet additional targets set on billing and complaints handling by 30 June 2016. If they fail to achieve these targets, the npower companies will stop all proactive domestic selling until they do so.

#### *Anti-Competitive agreements*

- In March 2016, we closed an investigation into whether third-party intermediaries or price comparison sites had engaged in an anticompetitive agreement and/or concerted practice by sharing commercially-sensitive information including commission rates. We closed this investigation on administrative priority grounds and sent advisory letters to the companies involved. We considered this was an appropriate way to achieve pro-competition outcomes from the investigation and directed resources to other areas of our work.

#### **Ongoing**

The following enforcement investigations are ongoing since 1 Oct 2014. All other investigations opened before this are now closed:

- Investigation into British Gas Trading Limited's compliance with obligations under the gas and electricity supply licences (Standard Licence Conditions 7A, 14, 14A and 21B).

- Investigation under Chapter I of the Competition Act 1998 and/or Article 101 Treaty on the Functioning of the European Union: Paid online search advertising.
- Investigation into whether SSE has infringed the requirements of Chapter II of the Competition Act 1998 and/or Article 102 Treaty on the Functioning of the European Union in respect of points of connection.
- Investigation into British Gas' compliance with its obligations under the electricity supply licence in relation to electricity meters (Standard Licence Condition 12)
- Investigation into npower's compliance with its obligations under the electricity supply licence in relation to electricity meters (Standard Licence Condition 12)

The fact that we have launched investigations does not imply that any company has breached its obligations. As part of the investigation processes, the evidence will be examined before conclusions are reached.

## 3.2 Promoting Competition

Promoting competition is an important part of the regulator's role of protecting the interests of consumers, as greater competition helps to reduce consumers' energy bills. Here we report on the current state of the wholesale and retail markets in GB and the main changes in 2015, as well as our monitoring activities in both the wholesale and retail markets during the past year. As a large amount of Ofgem's engagement with the retail energy market does not distinguish between electricity and gas sectors, this is covered below. Where we assess the electricity and gas retail sectors separately, this is noted and dealt with separately.

### 3.2.1 Wholesale markets

The following section is an overview of our monitoring under article 37(1)(i),(j),(k),(l),(u) and Article 41(3), and the main developments in the wholesale electricity market in GB during 2015. Details are in the following sections, and summarised below:

- Monthly averaged over-the-counter (OTC) day-ahead baseload and peakload electricity prices for 2015 were down on 2014.
- Lower gas prices fed through to power via generation. A combination of near-term fundamentals, falls in the oil price and a loosening of the global LNG market contributed to falls across the gas forward curve over the year.
- Annual churn rates for total traded volumes were down slightly between 2014 and 2015.
- The CMA has been carrying out an investigation into the energy market and notified its provisional findings and possible remedies in July 2015. The CMA published its final report in June 2016.

- The total traded volume of wholesale electricity decreased in 2015 by 1.8% to 1,052.8TWh. This was driven by a decrease in OTC trading, but total exchange trades rose.
- Net imports along GB's interconnectors increased by around 5% between 2014 and 2015 to 20.9 TWh.
- EDF again contributed the largest proportion of power generation in GB. Centrica, Drax, E.ON, RWE, Scottish Power and SSE all produced more than 5% of total GB generation.

Policy developments in several areas of GB's wholesale electricity market have continued throughout 2015. Some notable policy areas include:

- The launch of a set of wholesale market indicators on our website<sup>38</sup>.
- The publication in September of a Wholesale Market Conduct open letter, principally focused on market manipulation.
- We delivered the first set of changes for the capacity market rules.
- The development and implementation of European Network Codes and Guidelines.

### **3.2.1.1 Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition**

#### **Prices**

Wholesale prices are compiled and made available to market participants by a number of independent pricing agencies, energy market brokers, and exchanges.

Argus Media, ICIS Energy and Platts provide pricing based on reported OTC trades which are made available to the market via subscription services. Data providers produce pricing data for a wide variety of peak and baseload contracts up to several years ahead of delivery. Real time energy broker pricing based on OTC trades is also available via financial data providers.

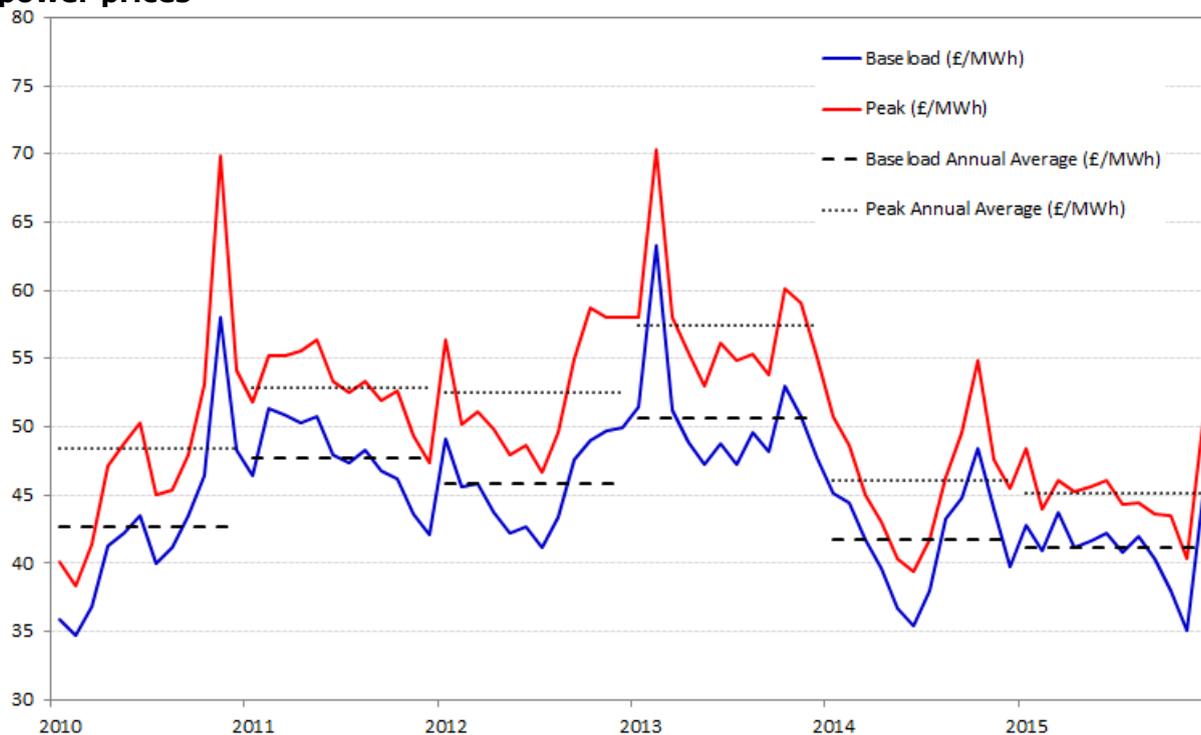
In addition to a wide range of OTC pricing data, the three power exchanges in the GB electricity market<sup>39</sup> all provide pricing data to the market.

Figure 1 shows monthly averaged OTC day ahead baseload and peakload electricity prices in GB since the beginning of 2010. Baseload and peakload prices continued their downward trend over the year and 2015 saw the lowest average power prices over the series. This was a result of falling fuel costs, with the decline in gas prices feeding into the power price because of the increasingly important role gas plays in the GB generation mix. Section 4.2.1 has more information on the trends in the GB gas market 2015.

<sup>38</sup> <https://www.ofgem.gov.uk/data-portal/wholesale-market-indicators>

<sup>39</sup> The APX Group, N2EX (a Nord pool Spot and Nasdaq OMX commodities joint venture) and the Intercontinental Exchange (ICE).

**Figure 1: GB monthly and annual averaged day-ahead baseload and peakload power prices**



Source: ICIS Energy

### *Liquidity*

On 31 March 2014, new regulatory requirements to promote liquidity in the wholesale electricity market came into effect. We introduced these reforms, known as 'Secure and Promote' because we were concerned (as were industry participants) that low liquidity was a barrier to effective competition. Secure and Promote was introduced as a special licence condition in the generation licenses of the largest six vertically integrated companies, and the two largest independent generators. The requirements aim to help independent suppliers access the wholesale market and ensure that it provides the products and price signals that all companies need to compete effectively.

The regulations include reforms to meet three objectives:

1. **A market-making obligation** which obliges firms to post prices at which they would be prepared to buy and sell electricity. It creates more transparency in the wholesale market as participants can see prices for delivery of electricity up to two years out. This is important for building trust and confidence.
2. **Supplier Market Access rules** to improve access to the wholesale market for small suppliers. These rules ensure that the largest eight generators cannot treat requests to trade by independents as a low priority. The rules also set deadlines for them to respond to these requests.
3. **A reporting requirement** of day-ahead trading of the six largest vertically integrated companies and the two largest independent generators.

We have been monitoring the effects of the reforms both to assess their impact and to make sure the obligated parties comply with them.

The results show that there has been an improvement in liquidity in the wholesale market in the first year, a subsequent fall from the second quarter in 2015 and a pick up in the last quarter of the year. Independent suppliers have largely told us they are finding it easier to access the products they need.

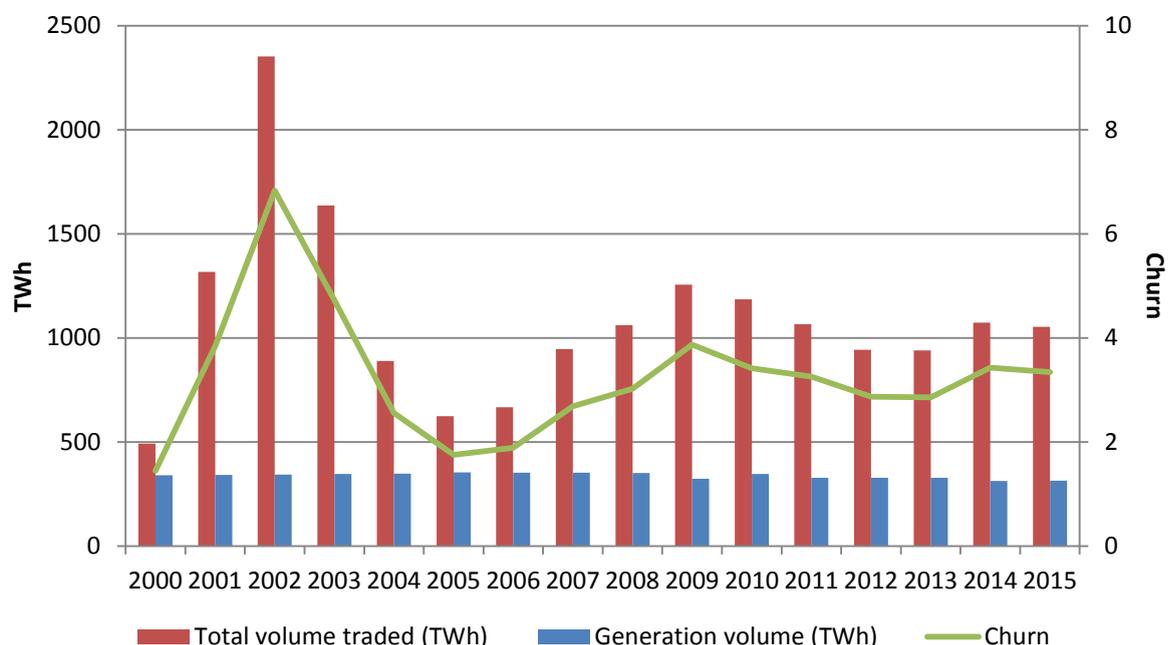
Our analysis shows a notable improvement in liquidity in the wholesale market over the two year period, but a decline in the middle two quarters of 2015. Independent suppliers have largely told us they are finding it easier to access the products they need.

In the backdrop of the overall positive trend in liquidity, we have also seen the key metrics reflect the low-volatile and benign market conditions in 2015.

We still have a relatively limited data set, and recognise that liquidity has been affected by many factors. Although it remains difficult to separate out the effects of our reforms from other factors that have impacted liquidity, the monitoring results allow us to be cautiously optimistic that Secure & Promote, alongside other factors, has contributed to increasing liquidity in the market.

We published our first annual report in September 2015<sup>40</sup> and will update this report in Summer 2016.

**Figure 2: GB total traded volume, generated volume and churn ratios from 2000 to 2015**



Source: ICIS Energy, APX, ICE, N2EX, DECC DUKES.

<sup>40</sup> <https://www.ofgem.gov.uk/publications-and-updates/wholesale-power-market-liquidity-annual-report-2015>

## Transparency

### *REMIT*

The EU Regulation on Wholesale Energy Market Integrity and Transparency (REMIT) is a tool for making sure prices in the wholesale energy market are transparent. It came into force in December 2011 and prohibits insider trading and attempted or actual market manipulation in wholesale energy markets across the EU.

On 23 June 2015, we published our decision on the updated REMIT Procedural Guidelines and REMIT Penalties Statements,<sup>41</sup> following a consultation in December 2014. Our updated guidelines and penalties statements outline the robust system we have in place for regulating the way market participants follow the REMIT rules.

On the 1 July 2015, an amendment to the 2013 Market Integrity and Transparency Regulations came into force providing Ofgem with enforcement powers for Articles 8 (Data Collection) and 9 (Registration of Market Participants) of REMIT.<sup>42</sup> This amendment extended the potential for Ofgem to impose unlimited fines for not complying with all REMIT obligations.

In September 2015, we published an open letter<sup>43</sup> on what we had encountered through our monitoring and investigation work, and which could be a breach of Article 5 of REMIT. It also reminded stakeholders of the upcoming deadlines for registration and transaction reporting and their duty to publish inside information promptly and effectively.

We registered GB REMIT applicants in advance of the first reporting deadline on 7 October 2015 and by May 2016 we had almost 1,000 market participants. We also continued to support those who still needed to register. On 7 April 2016, the obligation for market participants to report wholesale energy supply contracts executed over-the-counter, transportation contracts and additional fundamental data under REMIT entered into application

We regularly discuss REMIT issues with ACER and other NRAs as well as financial regulators such as the Financial Conduct Authority (FCA). This cooperation helps us deal effectively with potential instances of market abuse that have a negative impact on wholesale energy markets in more than one EU country or that affect financial markets.

### *The Transparency Regulation*

The EU Regulation 543/2013 on submission and publication of data in electricity markets (the Transparency Regulation) is a tool for making sure that the data needed for participants to take efficient production, consumption and trading decisions is made available in a timely manner. As of 4 January 2015 primary data owners have been required to publish data relating to the generation, transportation and consumption of electricity on a central European platform. Throughout the reporting period, Ofgem has continued to monitor compliance with the Transparency Regulation and in September 2015 published an open letter<sup>44</sup> highlighting the links between

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<sup>41</sup>[https://www.ofgem.gov.uk/sites/default/files/docs/2015/06/remit\\_procedural\\_guidelines\\_and\\_penalties\\_statement\\_decision.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/06/remit_procedural_guidelines_and_penalties_statement_decision.pdf)

<sup>42</sup> [http://www.legislation.gov.uk/ukxi/2015/862/pdfs/ukxi\\_20150862\\_en.pdf](http://www.legislation.gov.uk/ukxi/2015/862/pdfs/ukxi_20150862_en.pdf)

<sup>43</sup>[https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/20150814\\_remit\\_open\\_letter\\_september\\_2015\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/20150814_remit_open_letter_september_2015_0.pdf)

<sup>44</sup>[https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/20150814\\_remit\\_open\\_letter\\_september\\_2015\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/20150814_remit_open_letter_september_2015_0.pdf)

REMIT and the Transparency Regulation and the importance of primary data owners complying with their obligations.

## **Market opening and competition**

### *Market investigation referral to the CMA*

In March 2014, we published our first annual State of the Market report, in collaboration with the OFT and the CMA.<sup>45</sup> On 26 June 2014, we made a Market Investigation Reference to the CMA after a public consultation.<sup>46</sup> The CMA investigation phase is now complete. In July 2015, the CMA notified provisional hearings and is now considering responses to its possible remedies. In March 2016 the CMA published its provisional decision, including suggested remedies. The final decision was published in June 2016. Please see section 3.2.2 for more details.

### *Wholesale market trading*

A total of 1,052.8 TWh of wholesale electricity was traded in GB during 2015. This is a slight decrease (c.2%) on total traded volume in 2014.

### *OTC trading<sup>47</sup>*

Total OTC trading in 2015 also fell slightly, by 35.6 TWh to 870.6 TWh, from 906.2 TWh in 2014. The proportion of the total electricity volumes which were OTC traded was broadly stable year-on-year. Around 83% of all power traded in GB was OTC traded, marginally down from 85% in 2014.<sup>48</sup>

### *Exchange trading*

Volumes traded on the exchanges increased in 2015 to 182.1 TWh, from 165.5 TWh in 2014. Volumes on the APX intraday market were broadly unchanged on the year, at 14.6 TWh.<sup>49</sup>

The N2EX exchange, which mainly sees day ahead and future trading, saw some broad declines in traded volumes. Volumes in its day-ahead auction fell to 110 TWh, down 18% from 135.2 TWh in 2014. The APX day-ahead auction saw a significant increase in activity, with traded volumes quadrupling to 47 TWh in 2015, from 11.6 TWh in 2014.<sup>50</sup>

UK power futures exchange traded contracts are also available on the Intercontinental Exchange (ICE). Traded volumes on the ICE rose in 2015 to 10.5 TWh, from 4.4 TWh in 2014.

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<sup>45</sup> <https://www.ofgem.gov.uk/ofgempublications/86804/assessmentdocumentpublished.pdf>.

<sup>46</sup> <https://www.ofgem.gov.uk/publications-and-updates/consultation-proposal-make-market-investigation-reference-respect-supply-and-acquisition-energy-great-britain>

<sup>47</sup> Bilateral trading between two market participants or where an intermediary (the broker) brings together a buyer and seller.

<sup>48</sup> Please note, the values for 2013 have been revised compared to those published in the 2014 National Report.

<sup>49</sup> Includes both APX Continuous and Day Ahead auctions Data available from:

<http://www.apxgroup.com/>

<sup>50</sup> <http://www.icis.com/resources/news/2014/03/05/9759907/business-as-usual-for-uk-s-n2ex-auction-as-prompt-and-intraday-markets-set-for-revamp/>

### *Market integration*

For background information on GB interconnection, interconnection policy and market coupling please refer to section 3.1.4 of this report.

The GB market is broadly integrated with neighbouring markets with almost 4 GW<sup>51</sup> of interconnection. Prices for trades along these are established using market-based methods. GB typically imports from France (IFA) and the Netherlands (BritNed), and exports to Northern Ireland (Moyle) and the Republic of Ireland (East-West). The Moyle interconnector continued to operate at half capacity (250 MW).<sup>52</sup>

IFA (2 GW) and BritNed (1 GW) participate in the NWE Day Ahead market coupling pilot project that was launched in February 2014. Market coupling should make sure power is produced where it is most efficient and transported to areas of consumption where it is most valued. This should lower prices for consumers and support secure and sustainable supply.

Since the launch of the NWE project in 2014, market coupling has continued to show improved efficiency of GB interconnector flows. On 14 August 2015 the Commission Regulation establishing a guideline on capacity allocation and congestion management (CACM Regulation) entered into force. The CACM Regulation mandates the formal establishment and operation of market coupling, both in the day-ahead and intraday timeframe. The detailed rules are now being developed and approved through a number of regional and pan-European proposals required by the CACM Regulation.

Net imports of power along GB's four interconnectors increased between 2014 and 2015 to 23.3 TWh (up from 19.4 TWh). Gross flows (both imports and exports) reduced slightly from 26.8 TWh in 2014 to 25.5 TWh in 2015. In 2015, imports accounted for just over 90% of the gross flows.

Exports from GB to France were around 0.17 TWh in 2015, meaning almost 99% of the flows along IFA in 2015 were imports. BritNed similarly imported into GB for all but a few settlement periods in 2015. Moyle and East-West typically exported to the Irish Single Energy Market in 2015.

### *Market concentration*

Figure 3 below shows that seven generation companies once again had market shares exceeding 5%. The largest three companies generated almost half of the electricity supplied to the GB market 2015.<sup>53</sup>

Metered generation and interconnector volumes in 2015 indicate that EDF again contributed the largest proportion of power supply in GB. Based on this data, EDF's share increased year-on-year to 28% in 2015. EDF is the majority owner of most of GB's nuclear fleet, which operates as baseload generation capacity. Centrica, Drax, E.ON, RWE, Scottish Power and SSE all produced more than 5% of total GB generation. The market share of generators outside of the largest eight fell slightly from around 20% last year to 19% in 2015.

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<sup>51</sup> This figure does not account for the fault with Moyle.

<sup>52</sup> Mutual Energy has announced that the cable should be back to full capacity by 2016.

<sup>53</sup> Based on metered generation volume and interconnector imports. Generation shares are based on proprietary data. Station demand has been excluded. Interconnectors were not included in the 2015 analysis.

**Figure 3: 2015 wholesale electricity market share in GB based on metered volume**

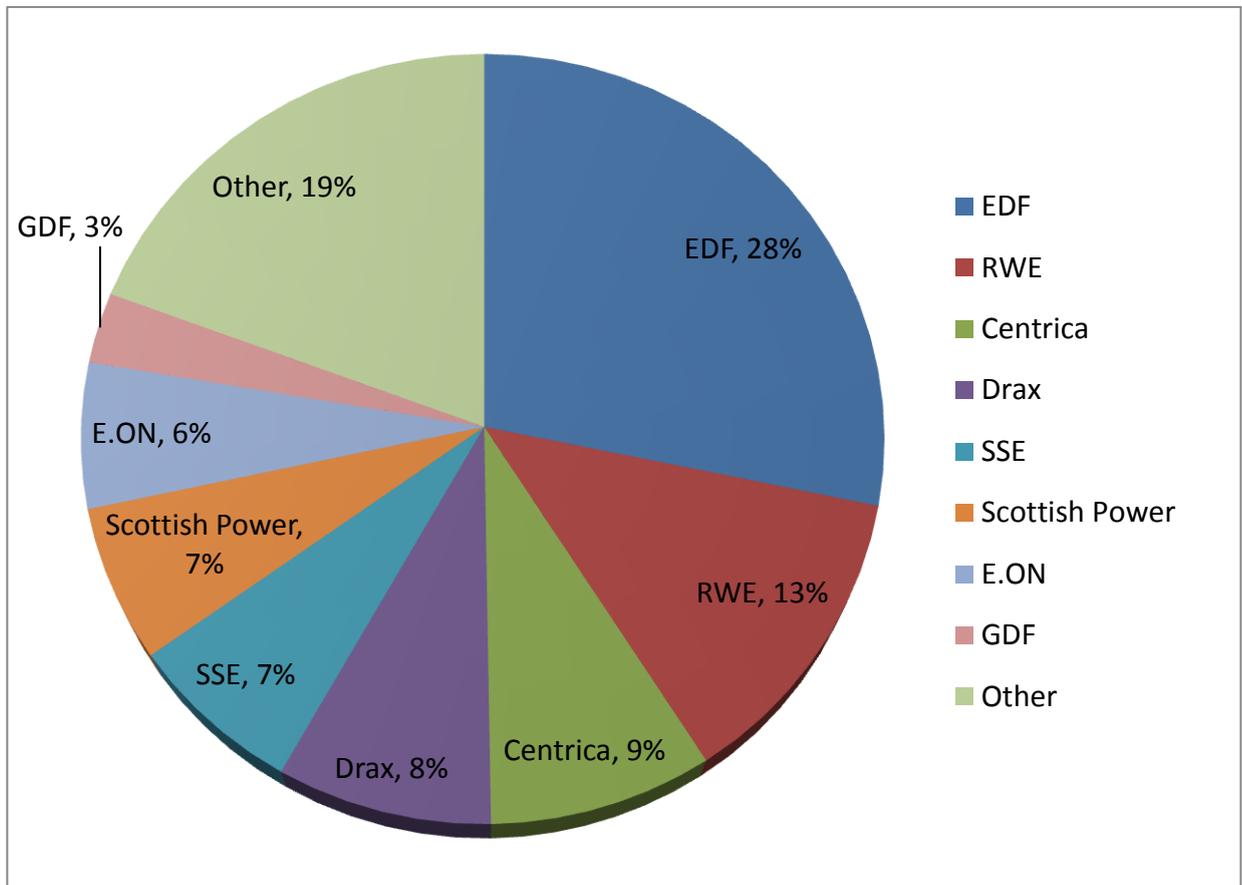


Table 1 provides the Herfindahl-Hirschman Index (HHI) analysis based on the same data as the market shares. The HHI is an indicator for the level of competition in a specific market. The largest individual HHI by capacity is EDF (HHI of 800), which is higher than 2014. The total HHI increased to 1,267 in 2015.

**Table 1: HHI based on 2015 metered volumes**

Company	HHI
EDF	800
RWE	162
Drax	71
SSE	48
Centrica	76
E.ON	37
Scottish Power	42
GDF	9
Other	22
Total	1,267

### *Market power concerns in the electricity wholesale sector*

The Transmission Constraint Licence Condition (TCLC) came into force on 29 October 2012. It is complementary to powers under competition law to tackle abuse of a dominant position. On the same day, we published guidance on the way we intended to interpret and enforce the TCLC.

TCLC prohibits generators from obtaining an excessive benefit for electricity generation in relation to periods of transmission constraints. This may occur either where a generator creates or exacerbates a transmission constraint by taking uneconomic action, or where the generator obtains an excessive financial benefit from the System Operator in return for reducing their generation. These can significantly increase the costs of balancing the electricity system during periods of transmission constraint.

Throughout 2015, we continued to monitor the bids and offers submitted in the balancing mechanism and generators' compliance with TCLC. In 2015, the average price paid to onshore wind farms to reduce generation was £70/MWh compared to £79/MWh in the previous year.<sup>54</sup>

In March 2015, Ofgem secured a payment of £100k for the charity Energy Action Scotland following an admission of a breach of TCLC by SSE<sup>55</sup>. This sanction was due to SSE charging higher prices to National Grid for reducing generation during periods of constraint in 2014.

TCLC will cease to have effect five years after Section 18 of the Energy Act 2010 came into force on 16 July 2012. There is the possibility of a two-year extension which could be granted by the Secretary of State.

### **3.2.2 Retail market**

Ofgem's assessment of and engagement with the retail energy market may not always distinguish between the electricity and gas sectors – rather, the market is considered as a whole. This is reflected below, for example in section 5 which looks at consumer protection and dispute settlement. Nevertheless, where Ofgem does assess the electricity and gas retail sectors separately, we have grouped the information accordingly, ie this section (3.2.2) primarily covers the electricity market and 4.2.2 largely considers the gas market.

The following section describes our monitoring activities of the retail electricity market in 2015. To this end we look separately at the domestic and non-domestic markets and distinguish between small and medium enterprises and large industrial consumers.

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<sup>54</sup> The averages were calculated using the weighted average price of bids accepted for system reasons by NGET from all onshore windfarms in the balancing mechanism and are rounded to the nearest pound.

<sup>55</sup> <https://www.ofgem.gov.uk/publications-and-updates/sse-pay-100000-energy-action-scotland-over-constraint-payments>

### 3.2.2.1 Monitoring the level of prices and the effectiveness of market opening and competition

#### Monitoring the level of prices

Ofgem monitors the effectiveness of market opening and competition in retail markets, in particular through regularly collecting market participants' data. We publish our analysis on our website<sup>56</sup>, in monitoring reports and commission consumer research to inform our view of market engagement and the quality of service consumers receive.

In September 2015, we published our annual market monitoring report 'Retail Energy Markets in 2015'.<sup>57</sup> The report highlighted key developments in the domestic retail markets over the previous year, including the continued growth of the independent suppliers which accounted for around 10% of all consumers at the end of 2014 and levels of new entry, high by historical standards. The report has also found that microbusinesses are more aware of their contract terms but also that they still face a number of barriers to engagement. One problem has been a lack of transparency of contract terms and customers not being aware of when they can switch supplier. Many smaller business customers have never switched supplier. Smaller non-domestic customers pay significantly more for their energy than larger business customers.

Over the course of 2015 and the first half of 2016, the CMA continued its investigation of the market. Further details are provided in Chapter 2 above and section 3.2.2.2 below. We supported the CMA in its investigation and the final decision and recommendations were published in June 2016.

Here we report on results of our monitoring activities during 2015 with regard to the supply side of the market (ie market structure and prices on the market), the demand side (ie consumer switching and consumer experience), contractual practices and capability of data exchange processes.

#### Market structure

##### *Domestic market share*

In December 2015, there were 27.8m domestic electricity consumers in GB. As Figure 7 shows, the largest six suppliers (British Gas, E.ON, EDF, RWE npower, ScottishPower and SSE) supplied 88% of these consumers<sup>58</sup>.

In 2015, 11 new suppliers became active in the domestic segment resulting in a total of 29 active smaller suppliers in the electricity market. The combined market share of

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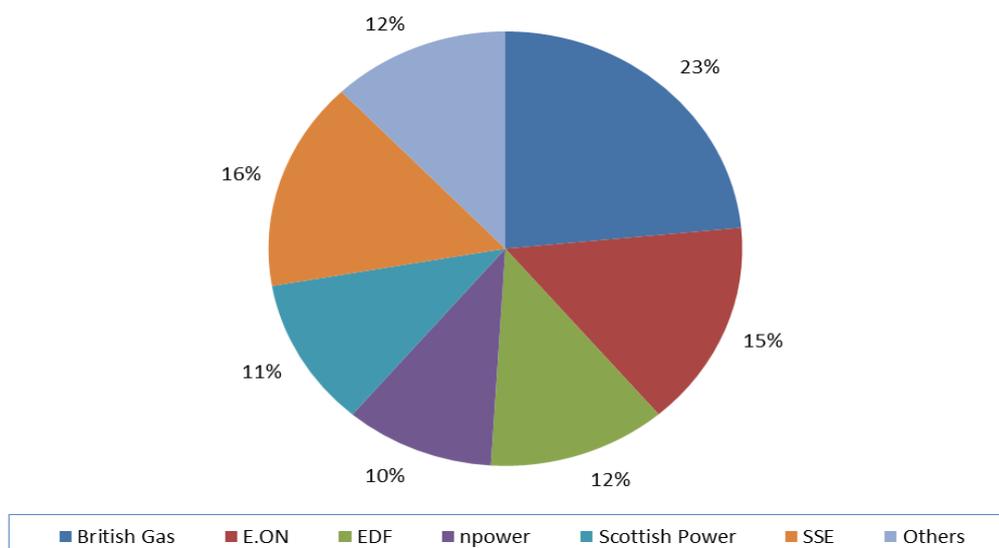
<sup>56</sup> <https://www.ofgem.gov.uk/data-portal/retail-market-indicators>

<sup>57</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/retail\\_energy\\_markets\\_in\\_2015\\_report\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/retail_energy_markets_in_2015_report_0.pdf)

<sup>58</sup> The figures relating to the national market shares do not reveal regional characteristics of the electricity market, which are a legacy of the regional monopolies that existed in the electricity sector prior to market liberalisation. The former electricity incumbents retain, on average, a market share of 30% in their home regions.

these smaller suppliers has increased by 3 percentage points relative to December 2014 at 12%. More stable conditions in wholesale markets and the exemption from some environmental charges for smaller suppliers are among the main drivers for the growth. The new entrants are competing on price, quality of service and simplicity (eg offering only one or two tariffs), but some are also using product differentiation strategies to enter into 'niche' markets (eg renewable energy or smart technology).

**Figure 4: GB Domestic electricity suppliers' market share, December 2015**



Source: Ofgem analysis of DNOs' data  
Non-domestic market shares – (p 43-44)

We also regularly monitor non-domestic suppliers' market shares.<sup>59</sup> The six largest suppliers in the domestic market are less present in the non-domestic market, which has seen a lot of independent suppliers enter since 2008. In the segment of non-domestic sites with non-half hourly meters, which mostly correspond to small businesses, the aggregate market share of the largest six suppliers was 83%, down from 87% in 2014. In the segment of the larger non-domestic sites, those with half hourly meters, the joint market share of the largest six suppliers was 74%, down from 77% in 2014.

In 2015, independent suppliers supplied 17% of non-half hourly sites and 26 % of half hourly sites.

<sup>59</sup> The data presented in this report are based on number of supply points. However, it should be noted that market shares by volume may show a different story as some suppliers may have a low number of supply points which have however very high volumes of energy supplied.

**Table 2: Electricity suppliers' non-domestic market share in December 2015**

Electricity supplier	Non Domestic Sites		
	Non-half hourly	Half hourly	All Non-Domestic
SSE	17.0%	14.3%	16.9%
E.ON	16.3%	11.8%	16.1%
British Gas	16.8%	4.3%	16.1%
npower	13.2%	20.0%	13.5%
EDF	11.7%	18.6%	12.1%
Opus	8.9%	2.6%	8.5%
Scottish Power	7.6%	5.4%	7.5%
Total Gas and Power	1.7%	4.2%	1.8%
Haven Power	1.2%	6.5%	1.5%
Extra Energy	1.3%	0.0%	1.2%
BES Commercial Electricity	1.2%	0.0%	1.1%
Others	3.2%	12.3%	3.7%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Ofgem analysis of DNOs data

#### *Herfindahl–Hirschman Indices (HHIs)*

HHIs<sup>60</sup> are often used to gauge market concentration. Though HHIs are not conclusive evidence of the level of competition, they suggest whether there are potential risks to the market not delivering competitive outcomes. The relevant HHIs for electricity in December 2015 were as follows (2014 figures in brackets):

- domestic: 1,552 (1,574)
- non-domestic, non-half hourly metered sites: 1,302 (1,395)
- non-domestic, half hourly metered sites: 1,355 (1,322).

In comparison with 2014, the HHIs for the domestic and non-domestic non-half hourly metered sites have fallen, while the HHI for the non-domestic half hourly metered sites has increased slightly. All three electricity markets are judged to be 'concentrated' according to the threshold HHI levels (1,000) used by the CMA.

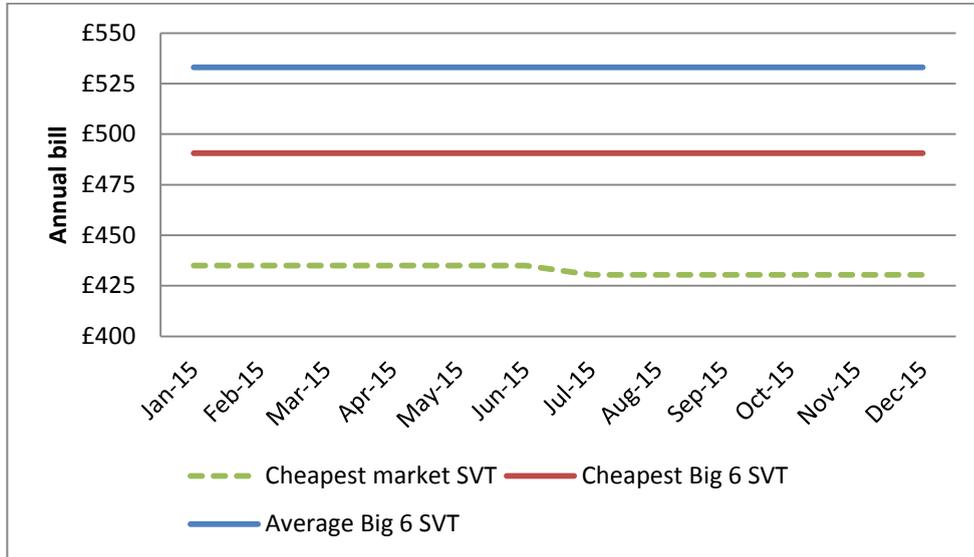
#### **Prices for domestic consumers**

All final consumer prices in the GB retail energy markets are determined by market forces. There are elements of the final price which are attributable to the regulated aspects of the market, in particular distribution and transmission charges, which are price controlled. Ofgem monitors domestic suppliers' electricity prices across GB. We receive price change notifications from Energylinx, an independent data provider and one of the comparison sites accredited by the Confidence Code run by Ofgem. We use this information to calculate the implications for domestic customers' retail bills based on characteristics such as their consumption level, payment type, and region. Figure 5 shows the change in typical domestic electricity bills based on standard variable tariffs available in GB's electricity market between January 2015 and December 2015. As can be seen in the graph, electricity price levels remained largely

<sup>60</sup> HHI is commonly used to assess market concentration, ranging from 10,000 for a monopoly to just above zero for perfect competition. The Competition Markets Authority in the UK categorize a market as 'concentrated' if its HHI exceeds 1,000 and 'highly concentrated' if its HHI exceeds 1,800.

constant over the year, despite a significant price differential between the largest six and some independent suppliers. In December 2015, there was a price differential of £60 between the cheapest variable tariff available from the largest six suppliers and independents.

**Figure 5: Domestic retail electricity price levels, Jan – Dec 2015**

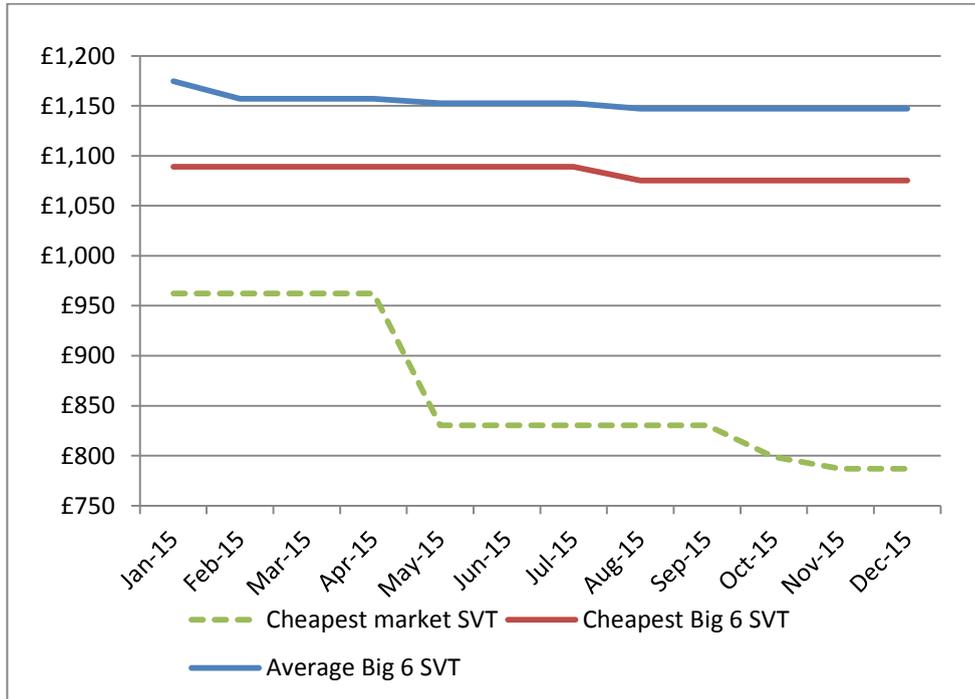


Source: Ofgem analysis of Energylinx data

Notes: Price level is based on revised consumption level of 3,100 kWh per year

Figure 6 shows the change in typical domestic bills based on standard variable tariffs in GB's dual fuel market between January 2015 and December 2015. Over the year the cheapest available tariff from the largest six suppliers fell by 1.2% (£13) in line with the decrease in average large supplier tariff prices, while the cheapest available tariff on the market fell by 18.2% (£175). In December 2015, there was a price differential of £288 between the cheapest tariff available on the market and the cheapest tariff available from the largest six suppliers.

**Figure 6: Domestic retail dual fuel price levels, Jan – Dec 2015**



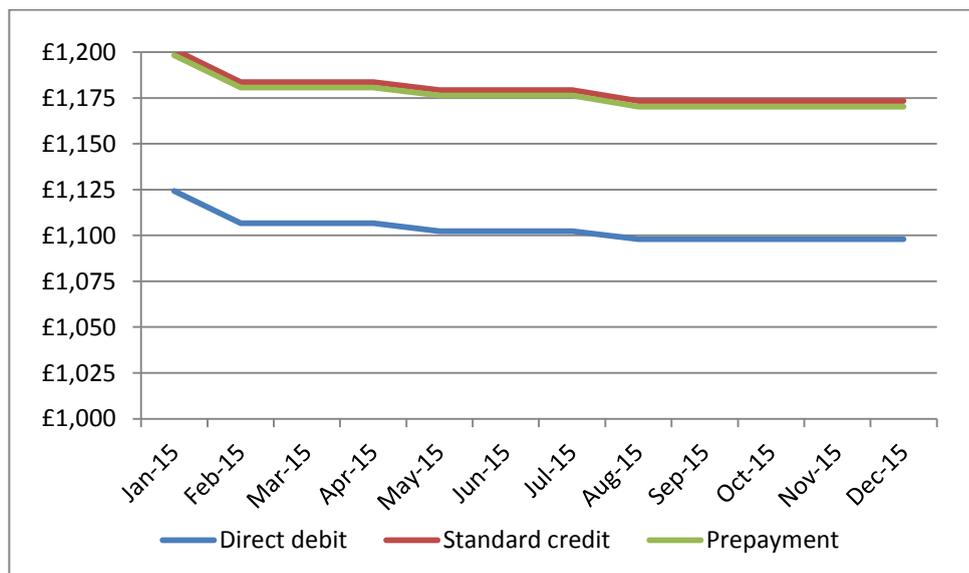
Source: Ofgem analysis of Energylinx data

Notes: Price level is based on revised consumption level of 3,100 kWh per year for electricity, 12,500 kWh per year for gas

Over the year, suppliers continued to offer fixed tariff deals often priced at a discount relative to variable tariffs. In December 2015, the average bill of a one-year fixed tariff across all suppliers was £927, while the average bill of a standard variable tariff was £1098. The cheapest fixed deals over 2015 were generally offered by independent suppliers, with the cheapest in December 2015 offered by an independent at an average annual bill of £793.

Figure 7 shows the change in typical domestic dual fuel bills by payment method in GB's dual fuel market between January 2015 and December 2015. Change was constant across all payment methods over the year, with an annual decrease of 2.37% for each payment method based on average variable tariffs offered by the largest six suppliers. Payment via direct debit continues to be offered at a discount relative to prepayment and standard credit, and in December 2015 the average payment method differential between direct debit and other payment methods amounted to £75.

**Figure 7: Typical domestic dual fuel bills by payment method, Jan – Dec 2015**



Source: Ofgem analysis of Energylinx data

Notes: Average of Big six's standard tariffs and revised consumption level: 3,100 kWh per year

As well as monitoring domestic electricity bill levels, we also assess the extent to which particular costs have an impact on these bills. Suppliers face a range of costs that influence how they set retail electricity prices. These costs can vary within and between years, and include wholesale energy costs, the costs of the UK Government's environmental and social policies such as the Renewables Obligation and the Warm Home Discount, and transmission and distribution costs.

## **Consumer engagement and experience**

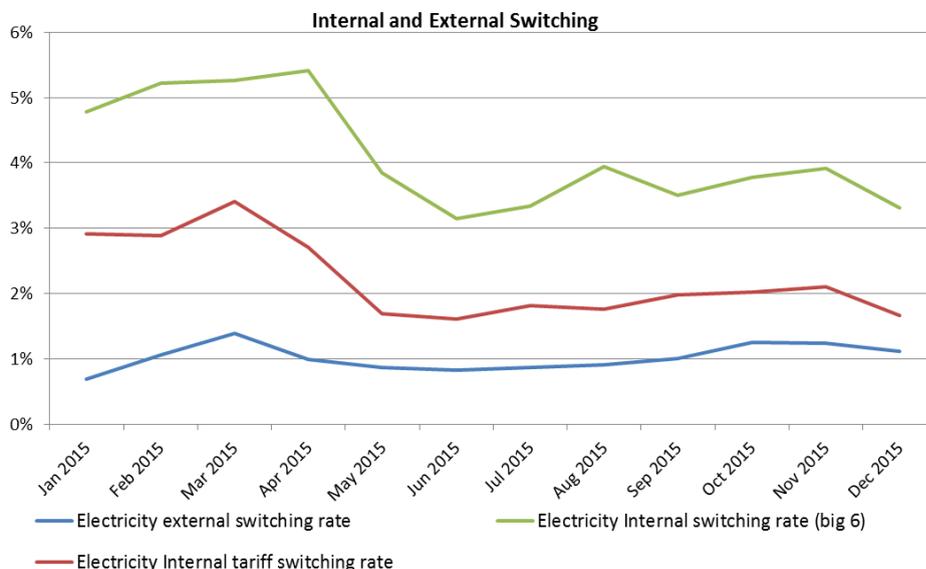
### *Domestic switching rates*

Consumers' ability to switch their energy supplier is important for a well-functioning, competitive energy market, although it must not be considered in isolation. Ofgem monitors switching rates together with pricing and market structure data.

In 2015, 3.4m domestic consumers switched their electricity supplier, equivalent to an average of approximately 282,000 per month. This represents an annual switching rate of 12.2%, 1.2% higher than observed in 2014. We also saw an increase in switching away from the six largest suppliers, an average of 43% of customers that switched during 2015 moving to smaller suppliers.

We also noted an increase in customers switching internally to different tariffs, payment methods and type of account management with their existing supplier. The rate of total internal switching was approximately four times higher than external switches in 2015. Internal switching rates, representing an active tariff choice (rather than automatic tariff switching at the end of a contract) were approximately double the rate of external tariff switching but converged towards the end of 2015.

**Figure 8: External and internal electricity switching rates in 2015**



Source: Ofgem analysis of suppliers' data

The speed and reliability of switching is also important (see section 5.1 for our change of supplier project in our smarter markets programme of reforms). In December 2015, the system average time<sup>61</sup> to complete a switch remained stable at 16 days in electricity.

Our consumer surveys are an additional source of information on the consumer switching experience. They show that most of those who switched did so to save money. In the TNS survey<sup>62</sup> we find that 91 % of consumers who switched supplier, changed tariff or compared tariffs in the last 12 months. Their main motivation was to save money. From those who did switch in the last year, 83 % expected to pay less for energy as a result of switching supplier or tariff. However, the number of consumers that are confident that they are on the best energy deal has decreased by 7 percentage points relative to 2014 at 48%.

#### *Non-domestic switching rates<sup>63</sup>*

In 2015, approximately 370,000 nHH (Non-Half Hourly) and 24,000 HH (Half Hourly) electricity consumers switched electricity supplier and 141,000 non-domestic gas consumers switched gas supplier. This represents an annual switching rate of 15.58% for nHH electricity, 17.44% for HH electricity and 17.6% for gas, with an upward trend in switching since March 2014 for both gas and electricity (we do not have data for before March 2014).

In May 2016 we published our quantitative survey on micro and small business consumer engagement. It showed that one in four smaller business customers (25 per cent) reported having switched suppliers in the last 12 months (up 2% on 2014).

<sup>61</sup> This is the average number of calendar days from the day when the supplier notifies the switching request to the network operator system until the day the switch is executed.

<sup>62</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/ofgem\\_rmr\\_survey\\_2015\\_technical\\_report\\_for\\_publication\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/ofgem_rmr_survey_2015_technical_report_for_publication_0.pdf)

<sup>63</sup> Electricity and gas

Businesses appear to be making informed switching decisions. On average, businesses that have switched in the last 12 months contacted four suppliers, either directly or through brokers. Businesses using brokers reported a higher number of quotes obtained than those that did not use brokers at all (5, compared with 2.5). One in five businesses that switched in the last 5 years contacted one or two suppliers when they last considered switching (21%), with a slightly higher proportion having contacted three (23%) and fewer having contacted four (16%) or five (15%). Another fifth (21%) contacted more than five suppliers for a quote.

Non-domestic switching is primarily price-driven and cost saving was by far the most likely reason for switching (89% of those who had switched in the last 12 months found or were offered a lower price contract or tariff the last time they switched). Knowing that their contract was coming to an end and receiving a renewal notice from an existing supplier was a significant trigger for switching (82% and 70% respectively), as was the price increase from the previous supplier (57%) recommendation from a broker (44%).

This research also showed that a third of businesses (33%) have not switched in the last 5 years and nearly half of these (44%; 16% of all businesses) have never considered switching. Among businesses that have not switched in the last 12 months, satisfaction with the current supplier was a key reason for not switching (77% of non-switchers). Being tied to an existing contract was also significant (51%). The scepticism of the savings that could be made from switching (46%) and the perceived complexity and the time it takes to switch (31%) are also cited as reasons for not switching.

We have recently carried out a review of objections in both domestic and non-domestic markets. This investigation responded to our commitment to keep the objections policy under check and ensure it operates in the best interests of consumers. We have concluded that the benefits of the current regime for business customers outweigh its costs, therefore objections should be retained. However, in light of the Competition and Market Authority (CMA) recent findings on microbusinesses' barriers to market engagement[1], we may consider investigating objections further in future in relation to a narrower definition of microbusinesses. Our analysis highlighted that there are some areas with residual consumer detriment particularly with respect to microbusiness customers. During our investigations, we found a number of concerns around compliance with licence conditions which may be a driving factor of detriment. As a result, we have asked suppliers to review their compliance processes in these areas and announced our programme of enhanced monitoring .

Ofgem has proposed to lead the industry towards reliable next-day switching by 2019. We want to take a fresh look at whether objections should be part of a redesigned switching process or whether suppliers should develop other ways of managing risk. This work has started, with a recent call for evidence.

#### *Complaints by household consumers*

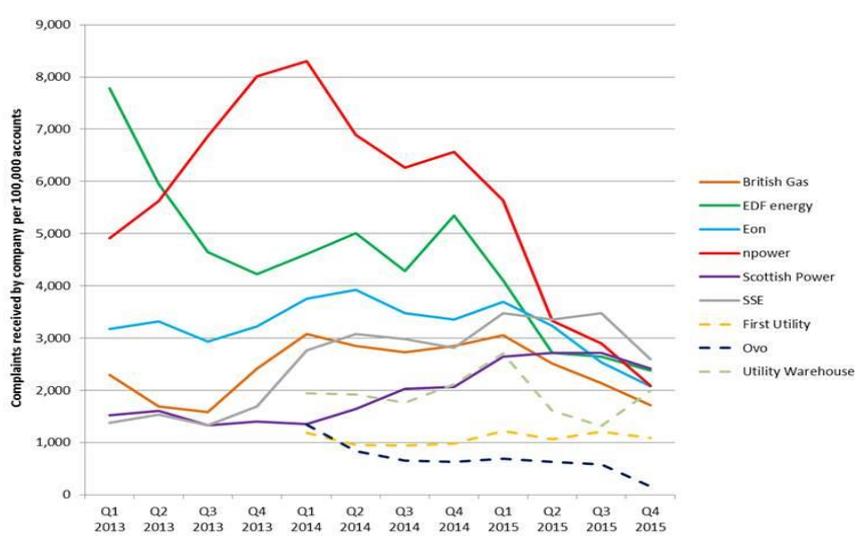
Ofgem does not directly investigate domestic customer complaints. If a complaint is raised, suppliers are required to meet the complaints handling standards set by Ofgem.

If a complaint is not resolved to the consumer's satisfaction and either eight weeks have passed since the complaint was made or it has reached a point of deadlock (where the energy company says it can do no more to resolve the complaint), it must

write to the consumer to tell them they can seek redress through the Ombudsman (alternative dispute resolution). The Ombudsman received over 65,000 complaints in 2015 compared with 52,000 in 2014.

All domestic suppliers publish their complaints data on their websites in a common format agreed with Ofgem. Figure 6 shows that complaints per 100,000 customers have decreased for the former incumbent suppliers over 2015. RWE npower remained the most complained-about company on this measure. Complaints per 100,000 customers received by the largest independent suppliers remain lower than for the former incumbents.

**Figure 9: Complaints received by supplier per 100,000 customers**



Source: Ofgem analysis of suppliers' data

Following the publication of research into customers' satisfaction with suppliers' complaints handling in September 2014<sup>64</sup>, we now require the former incumbent suppliers to detail on their websites their plans for improving complaints handling and to audit their processes for the closure of complaints. We will be monitoring the progress of their plans for improvement, and repeating the research in 2016.

### Consumer satisfaction

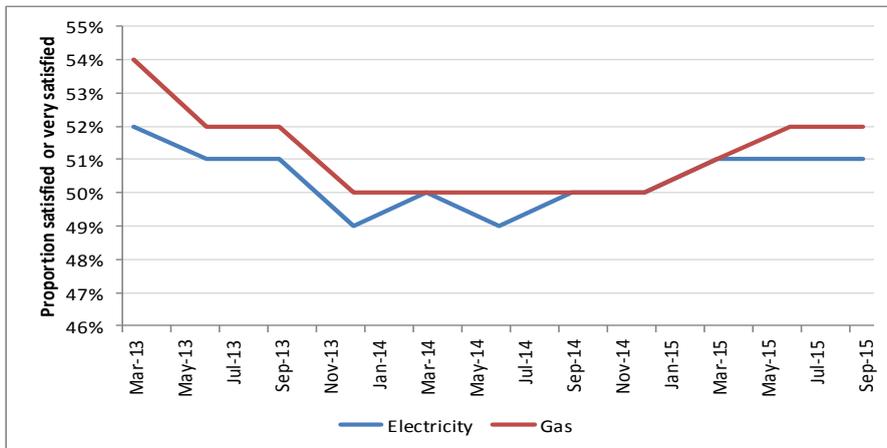
We expect certain things from our energy suppliers, like making it easy for consumers to contact them when needed and providing clear energy bills which consumers can understand. Figure 7 below shows a positive trend in the quarterly customer satisfaction for electricity and gas suppliers in GB in 2015, compared to 2014. The data is based on an aggregate of those reporting being 'satisfied' or 'very satisfied' with their supplier<sup>65</sup>. Further details are published and updated regularly on our website<sup>66</sup>.

<sup>64</sup> <https://www.ofgem.gov.uk/publications-and-updates/complaints-energy-companies-research-report-2014>

<sup>65</sup> This data comes from the GfK Energy Research Panel. It's a semi-continuous, nationally representative panel of 10,000 homes in Great Britain.

<sup>66</sup> <https://www.ofgem.gov.uk/data-portal/customer-service>

**Figure 10: Consumer satisfaction with their supplier**



Source: GfK Energy Research Panel

### **Contractual practices**

Under Article 37(1) paragraphs (k) and (l), Ofgem is required to monitor restrictive contractual practices and ensure contractual freedom. We have dedicated Consumers and Competition and Enforcement teams that engage with a variety of stakeholders, ensuring that we are both proactively monitoring the market, and that we are open to any issues that may be brought to our attention. Additionally, the suppliers' licences contain conditions relating to the provision of clear contractual information to household and small business consumers.

Household customers are also protected by the general national rules which transpose Directive 2011/83/EU of 25 October 2011 on consumer rights and Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. These rules were transposed by the Consumer Contracts (Information, Cancellation and Additional Charges) Regulations 2013 and the Consumer Rights Act 2015. In respect of contracts concluded before October 2015, transitional provisions exist in the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs) and UCTA (Unfair Contract Terms Act 1977). Ofgem is one of the public bodies with enforcement powers.

### **Compatibility of data exchange processes**

Under Article 37(1)(u), Ofgem is required to contribute to the compatibility of data exchange for the most important market processes. All licensed suppliers and network operators must comply with industry codes (changes to which must be approved by Ofgem) in order to operate in the gas and electricity markets.

As described in more detail in section 5.1, access to consumption data from smart meters is managed centrally, through the Data and Communications Company (DCC), regulated by Ofgem.

#### **3.2.2.2 Monitoring transparency**

Under Article 37(1)(i) Ofgem is committed to ensuring the energy market is transparent to the benefit of consumers. In this section, we explain the rules in place regarding the transparency of suppliers' activities and how we have monitored compliance in 2015.

## **Financial transparency**

Over the past few years, we have put in place measures to make suppliers' revenues, costs and profits more transparent. Since 2009 we have required large, vertically-integrated suppliers to publish annual Consolidated Segmental Statements (CSS) on their websites. These statements provide a breakdown of suppliers' revenues, costs and profits and are reconcilable to audited accounts. In previous years, we have produced an annual review summarising the large suppliers' CSS, the archive of which is on our website. In 2015 we published this summary as part of our annual report on the retail energy markets.

We have made improvements to the reporting requirements for the statements. We now require companies to audit their statements, to publish them within four months of the end of their financial year, to provide a detailed cost breakdown, and insight into their trading activities. In addition, in 2014 we commissioned an in-depth review of the large companies' transfer pricing policies which concluded that they were appropriate and in line with global accounting standards.

We continue to keep the reporting requirements under review in order to ensure they remain fit for purpose. One priority for 2016 is to consider the financial reporting requirements that we place on suppliers in the light of the recommendations made by the CMA in its final report on the GB energy markets. In particular, in its final decision<sup>67</sup>, the CMA proposed remedy which seeks to revise current financial reporting regime by way of recommendation to Ofgem to introduce licence conditions for industry to: (i) report their generation and retail supply activities along market lines; (ii) report balance sheets as well as profit and loss accounts for these activities; (iii) disaggregate wholesale energy costs for retail supply across broad tariff types between a standardised purchase opportunity cost and a residual element; and (iv) report prior year figures prepared on the same basis as current period figures.

## **Transparency for domestic consumers**

As part of the measures to increase transparency in our Retail Market Review (RMR) reforms, we required suppliers to inform their customers about their cheapest tariff in their bills and other communications, whether the tariff is under a white label brand or the licensed supplier's brand.

In GB, consumers can compare suppliers' gas and electricity prices using a wide range of online energy price comparison websites. Ofgem currently administers a code of practice, the 'Confidence Code'.<sup>68</sup> This helps ensure that consumers can use a site they trust to provide accurate and reliable pricing information. In 2015 we made changes to the Confidence Code which further strengthened requirements on accredited price comparison services to provide accurate and reliable price comparisons.

In addition, we consider that effective information exchange between suppliers and Third Party Intermediaries (TPIs) is important in ensuring that consumers have a positive experience when engaging in the energy market. In 2015 we released an open letter<sup>69</sup> which clarifies existing licence conditions related to supplier provision of

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<sup>67</sup> <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

<sup>68</sup> <https://www.ofgem.gov.uk/information-consumers/domestic-consumers/switching-your-energy-supplier/confidence-code>

<sup>69</sup> <https://www.ofgem.gov.uk/publications-and-updates/information-flows-between-suppliers->

tariff data to TPIs. This will help TPIs to support consumers in more confidently engaging in the market.

### **Transparency for non-domestic consumers**

The CMA investigation has found that a general lack of price transparency concerning the contracts available to microbusiness customers is causing an adverse effect on competition in the market. In response, it has decided to introduce new rules governing how contracts are offered to microbusiness consumers on change of supply and further restrictions on automatic rollovers, which apply when a microbusiness reaches the end of a fixed-term contract and is moved to a new tariff. It proposes that suppliers must:

- disclose the prices of all available acquisition and retention contracts to smaller microbusiness consumers, either through an online quotation tool made available on their website, or through one or more third party online platforms
- allow microbusiness consumers to give a termination notice up to the last day of the initial fixed-term contract or last day of the fixed-term roll-over period
- not impose a termination fee and/or 'no exit' clause for the roll-over period.

The CMA also examined the transparency of non-domestic TPIs. TPIs act as brokers between non-domestic customers and suppliers, assisting customers in finding the most appropriate energy deal for their needs. The CMA's findings have confirmed previous Ofgem findings that TPIs are not always delivering the best outcomes for consumers, for example companies pressurising customers into accepting unnecessary long-term contracts. The CMA considers that its requirement on suppliers to disclose the prices of all available acquisition and retention contracts should aid consumers in assessing whether the prices they were quoted by TPIs were reasonable.

In addition to this, it has encouraged Ofgem to proceed with our proposed code of practice for non-domestic TPIs. The code is intended to enhance safeguards for consumers who use TPIs. We propose to prevent suppliers from providing tariff information to any TPI that does not comply with the code. The development and implementation of this code forms part of our forward work programme.

### **3.2.2.3 Recommendations on supply prices, investigations and measures to promote effective competition**

#### **Supply prices**

As mentioned above, all final consumer prices in the GB retail energy markets are determined by market forces. All price controls on final consumer prices were lifted by April 2002. Retail prices can be affected by numerous costs, including wholesale energy prices, costs of environmental and social programmes such as the Renewables Obligation<sup>70</sup> and the Warm Home Discount,<sup>71</sup> and transmission and distribution costs.

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[and-third-party-intermediaries-tpis](#)

<sup>70</sup>

<http://www.ofgem.gov.uk/Sustainability/Environment/RenewablObl/Pages/RenewablObl.aspx>.

<sup>71</sup> <http://www.ofgem.gov.uk/Sustainability/Environment/WHDS/Pages/WHDS.aspx>.

As a result electricity prices in the supply market are not within Ofgem's direct control and we do not make annual recommendations on supply prices nor provide these to the competition authorities. Ofgem's primary role is to protect the interests of present and future consumers. By fulfilling this, we aim to ensure the electricity and gas markets deliver the best outcomes for consumers. Through our licence conditions, our market monitoring and our regular market reviews, we aim to ensure supply prices comply with the relevant paragraphs in Article 3 of the Electricity and Gas Directives.

## **Investigations**

The Authority has concurrent competition and consumer protection powers with the CMA. We will work with the CMA, including as members of the United Kingdom Competition Network which aims to promote best practice and coordination between the sectoral regulators in the use of their concurrent competition powers.

## **Measures to promote effective competition/monitoring distortions or restrictions of competition**

The previous sections have outlined the findings from our report Retail Energy Markets in 2015<sup>72</sup> and our regular ongoing monitoring to assess distortions and/or restrictions of competition. These workstreams are helping us to identify where further intervention in the market is needed to promote effective competition and improve outcomes for consumers.

In its final decision<sup>73</sup>, the CMA published the full details of its package of remedies to reform the energy market, open up competition and help customers get a better deal. The main remedies which the CMA intend to take forward (or have recommended are taken forward by Ofgem or Government) include:

- an Ofgem-controlled database of "sticky" customers (recommendation includes testing the operation of the database and aspects of the marketing letters sent to consumers and opt-out from being included on the database);
- an Ofgem-led programme of trials to promote consumer engagement;
- transitional price cap for the 4 million households which are on prepayment meters (will no longer apply to SMETS2 PPM meters);
- removing restrictions on new suppliers to compete for prepayment customers;
- strengthening the ability and incentives for third party intermediaries such as; price comparison websites (PCWs) to help customers find better deals;
- removing the four-tariff rule to promote competition and innovation;
- a requirement that suppliers make available single rate tariffs to customers on restricted meters;
- helping microbusinesses through improved price transparency, tackling 'rollover' contracts with greater notice periods and ending termination fees;
- ensuring that the contracts for difference process (where the Government supports investment in low carbon generation) is carried out transparently so that the impact on customer bills is assessed beforehand;
- ensuring that both electricity and gas settlement processes are reformed to lower costs to consumers by enabling more accurate measurement of consumption and more efficient supply – and to let the full benefit of smart meters be realised;

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<sup>72</sup> <https://www.ofgem.gov.uk/publications-and-updates/retail-energy-markets-2015>

<sup>73</sup> <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

- introducing a locational pricing system to take account of transmission losses incurred when transporting electricity, to reduce the overall cost to customers; and
- improving the policy and regulatory framework to provide a clear division of responsibilities and transparency in relation to policy creation and implementation and changes to industry codes.

## 4. The Gas Market

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This chapter details developments in GB's gas sector in 2015. This is broken down into sections covering network regulation, promoting competition, and security of supply in the wholesale and retail electricity markets.

### 4.1 Network regulation

Under this section unbundling, technical functioning, tariffs for connection and access, cross-border issues and compliance are discussed. We show briefly what has previously been done to ensure compliance with legislation, as well as other regulatory activities and market developments in 2015.

#### 4.1.1 Unbundling

Articles 9, 10, 11, 26 of the Gas Directive and Article 3 Regulation (EC) 715/2009 outline our obligations in relation to unbundling certification of TSOs. The Electricity and Gas (Internal Markets) Regulations 2011 (which entered into force on 10 November 2011) and the Electricity and Gas (Ownership Unbundling) Regulations 2014 (which entered into force on 15 January 2015) are together known as "the GB Regulations".

The GB Regulations implement the Third Package into the GB domestic regulatory regime including legislation, licences and industry codes. Ownership unbundling requirements are included alongside Regulations in respect of TSOs, storage and Liquefied Natural Gas (LNG) system operators, and the unbundling requirements for DSOs. The GB Regulations have amended the Gas Act 1986 ('Gas Act') to include the requirement for the holders of gas transporter and gas interconnector licences to be certified as independent from generation and supply interests pursuant to one of the grounds for certification set out in the Gas Act.

The GB Regulations have amended the Utilities Act 2000 to designate the Authority as the NRA for GB and have given it (through amendments to the Gas Act and the Electricity Act) the responsibility for administering the certification process in GB. The Authority is also required by Article 11(1) of the Gas Directive to notify the European Commission upon receipt of an application for certification where the applicant is from a third country or is controlled by a person from a third country. The Authority received no applications which relate to third countries in 2015.

#### **TSOs**

Under Articles 9 and 10 of the Gas Directive we have an obligation to ensure any undertaking which owns a transmission system is certified as independent from generation and supply interests before it is designated as a TSO.

In August 2015 the Authority received an application from GNI(UK) to be certified under the full ownership unbundling certification ground.<sup>74</sup>

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<sup>74</sup> Having taken "utmost account" of the European Commission opinion, on 4 April 2016 the

We continue to monitor the certification status of the other four certified gas TSOs in GB, including through the review of annual declarations submitted by the relevant entities. Having reviewed these annual declarations and other information submitted to us by the following certified TSOs during 2015 we remained satisfied that the grounds for their certifications remain valid:

- Balgzand Bacton Leiding Company (BBL): second package exemption still valid<sup>75</sup>
- Premier Transmission Limited<sup>76</sup>
- National Grid Gas (NGG) plc<sup>77</sup>
- Interconnector (UK) Limited (IUK): on 5 March 2015 the Authority opened a review of IUK's ownership unbundling certification in accordance with section 8K of the Gas Act 1986. On 16 October 2015, the Authority, having taken "utmost account" of the European Commission's opinion, published its final decision that IUK continues to be certified as independent, under the ground set out in section 8G(3) of the Act.<sup>78</sup>

## DSOs

In 2015, there were 23 gas DSOs, eight incumbents and fifteen embedded, the same numbers as 2014.

We continue to have eight incumbent gas DSOs (no change in 2015): four network areas for NGG plc (in November 2015 NGG announced that it is planning to sell a majority stake in these gas distribution businesses), Northern Gas Networks Ltd, Scotland Gas Networks plc, Southern Gas Networks plc and Wales and West Utilities Ltd.

There are fifteen independent (embedded) gas distribution system operators: Energetics Gas Ltd, ES Pipelines Ltd, ESP Connections Ltd, ESP Networks Ltd, ESP Pipelines Ltd, Fulcrum Pipelines Ltd, GTC Pipelines Ltd, Independent Pipelines Ltd, Quadrant Pipelines Ltd, Indigo Pipelines Ltd, Severn Gas Transportation Ltd, Greenpark Energy Transportation Ltd, SP Gas Transportation Cockenzie Ltd, SP Gas Transportation Hatfield Limited and Energy Asset Pipelines Ltd. Each independent DSO owns and operates a number of relatively small networks at various geographical locations.

We reviewed the returns submitted by DSOs relating to business independence, financial reporting and output performance. In that context we were satisfied that the Gas Directive requirements relating to unbundling were being properly observed.

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Authority has published its decision that GNI(UK) is certified and designated as TSO:  
<https://www.ofgem.gov.uk/publications-and-updates/certification-decision-gniuk-limited>

<sup>75</sup> Certification decision can be found on our website: <https://www.ofgem.gov.uk/publications-and-updates/certification-decision-bbl-company-vof>

<sup>76</sup> <https://www.ofgem.gov.uk/publications-and-updates/certification-decision-premier-transmission-limited>

<sup>77</sup> <https://www.ofgem.gov.uk/publications-and-updates/certification-decision-national-grid-gas-plc>

<sup>78</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-s-final-decision-review-interconnector-uk-limited-s-iuk-certification>

## Storage and LNG System Operators

The Second and Third Packages established a number of unbundling requirements for storage operators as part of the mandatory third party access arrangements.

In GB, the default access regime for a gas storage facility is negotiated third party access (nTPA). Under nTPA, storage system operators cannot produce gas, except as an unintended consequence of storage activities. They also cannot supply, ship, or sell gas except for the efficient operation of the storage facility or of another storage facility. Legal and functional separation is required from any parent or associated undertakings involved in these activities. These provisions, contained in Articles 15-16<sup>79</sup> of the Gas Directive, were transposed in Section 8(R) of the Gas Act. Ofgem published the latest version of its guidance on compliance with nTPA requirements in September 2015.<sup>80</sup>

In GB, two storage facilities are subject to nTPA: Rough and Hornsea. Rough is owned and operated by Centrica Storage Limited. Hornsea is owned and operated by SSE Hornsea Limited. They must operate their respective storage facilities independently of the interests of affiliates carrying out any of the above restricted activities. This includes establishing an independence programme to ensure non-discrimination against other parties, and the appropriate disclosure or use of information. In addition, the storage system operator must publish an annual report setting out compliance with the independence programme.

All other storage facilities (eight operational) in GB have been granted Minor Facilities Exemptions (MFEs) from nTPA. MFEs are granted on the basis that the facility is not economically and/or technically necessary for providing efficient access to the system for the operation of an efficient gas market. The nTPA unbundling requirements set out above do not apply to facilities with an MFE.

For LNG facilities, the default access regime under the Third Package is regulated Third Party Access (rTPA). Under rTPA, LNG system operators must keep their (financial) accounts separate from any other business. These provisions, contained in Article 31 of the Gas Directive, were transposed in Section 19E(2)-(4) of the Gas Act. Ofgem published guidance on rTPA in April 2012.<sup>81</sup> All three LNG facilities in GB<sup>82</sup> have been granted an exemption from rTPA requirements under the Gas Act Section 19(C).

### 4.1.2 Technical functioning

The technical functioning of the network is of great importance to ensure safe, secure and reliable gas supply for consumers. In the following we report on our responsibilities and activities for: gas balancing services, maintaining security and reliability standards, developing our transmission system, monitoring time taken to connect and repair, monitoring safeguard measures and reporting on the RES

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<sup>79</sup> A system storage operator shall be independent at least in terms of their legal form, organisation and decision making from other activities not relating to transmission, distribution and storage.

<sup>80</sup> <https://www.ofgem.gov.uk/publications-and-updates/guidance-regulatory-regime-gas-storage-facilities-great-britain-version-2>

<sup>81</sup> <https://www.ofgem.gov.uk/ofgem-publications/40393/guidance-regulated-third-party-access-regime-liquefied-natural-gas-facilities-gb.pdf>.

<sup>82</sup> Isle of Grain, South Hook and Dragon LNG

regulatory framework over the course of 2015, in the transmission and distribution networks.

We recently published the RIIO-GD1<sup>83</sup> and RIIO Gas Transmission<sup>84</sup> 2014-15 Annual Reports. These reports review the progress made by the relevant companies during the 2014-15 period of the RIIO price control and provides stakeholders with information of how the companies are performing against their obligations and incentives.

### **Balancing services**

Under Article 41(6)(b) of the Gas Directive, regulators must fix or approve the methodologies used to calculate or establish the terms and conditions for the provision of balancing services. These balancing services must be in the most economic manner and incentivise network users to balance their inputs and off-takes.

NGG is the gas transmission System Operator (SO) responsible for balancing the system across GB. To do this, NGG buys and sells gas and procures associated services. It also provides information to market participants such as demand forecasts. NGG is obliged to perform its balancing roles in an economic and efficient manner.

Balancing arrangements in GB are designed to provide gas shippers with strong commercial incentives to balance their positions. Market-based imbalance charges are the primary tool used by NGG to balance the system. Shippers who are not in balance at the end of a gas day incur imbalance charges, known as cash out. The cash out price is set when NGG buys or sells gas in the market. Rather than procure the entire system imbalance, NGG trades small volumes to set the cash out price and incentivise shippers to balance their inputs and off-takes.

In 2015, our changes to sharpen these incentives through our gas security of supply Significant Code Review were implemented. These achieve this by facilitating demand side response during situations of system stress and pricing emergency consumer interruptions into cash-out prices. Furthermore we approved a number of Uniform Network Code (UNC) modification as necessary for implementation of the European Network Code on Gas Balancing of Transmission networks. We discuss this further under 4.1.4 Cross-border issues.

Ofgem sets incentives on NGG to promote behaviours that improve the efficient operation of the system. These incentives cover areas such as residual balancing, demand forecasting, shrinkage and maintenance. The current incentives are in place until March 2018.

In 2015, we continued our monitoring of NGG's performance against these incentives and relevant licence conditions. This is detailed in the RIIO Gas Transmission Annual Report 2014-15.<sup>84</sup>

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<sup>83</sup> [https://www.ofgem.gov.uk/system/files/docs/2016/03/riio-gd1\\_annual\\_report\\_2014-15\\_final.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/03/riio-gd1_annual_report_2014-15_final.pdf)

<sup>84</sup> [https://www.ofgem.gov.uk/system/files/docs/2016/03/riio\\_gas\\_transmission\\_annual\\_report\\_2014-15\\_for\\_publication.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/03/riio_gas_transmission_annual_report_2014-15_for_publication.pdf)

## **Security and reliability standards, quality of service and supply**

Under Article 41(1)(h) we are required to monitor the compliance with, and review the past performance of network security and reliability rules for both the transmission and distribution networks. We also have an obligation to set and/or approve standards and requirements for quality of service and supply.

Gas quality is regulated through both the Gas Safety (Management) Regulations 1996 (SI 1996/551) and the Gas (Calculation of Thermal Energy) Regulations 1996 (SI 1996/439). These regulations set rules relating to the gas composition, calorific value and measurement standards to ensure the safety and quality of the gas supply.

### *Transmission*

The long term reliability standards to which the National Transmission System (NTS) has to be planned and operated are provided for by the gas transporter licence and are enforceable by Ofgem.

We enforce quality of service by:

- Requiring National Grid NTS to comply with standard special condition A9 of the gas transporter licence.
- Monitoring the quality of service and supply to individual users as the standards are set out in the Uniform Network Code (UNC).

### *Distribution*

Standard special licence condition D10 of the gas transporter licence for the distribution networks sets timescales within which Gas Distribution Network companies (GDNs) must provide connection services, attend/respond to gas emergencies and respond to telephone calls to its emergency services and enquiry service obligations telephone line. GDNs must provide services within these timescales at least 90 or 97 % of the time (dependent on the obligation) in order to comply with their licence obligations. The guaranteed standards of performance also require GDNs to meet expected levels of service or pay customers compensation if they fail.

We monitor quality of service by:

- Requiring GDNs to comply with and monitoring performance against standard special licence condition D10 – quality of service standards of the gas distribution licence.
- Monitoring GDN performance against guaranteed standards of performance which are contained in the Gas (Standards of Performance) Regulations 2005 (SI 2005/1135), and standard special licence condition D10.

## **Monitoring time taken to connect and repair**

Article 41(1)(m) of the Gas Directive requires regulatory authorities to monitor the time taken to make connections and repairs. We do this by requiring the GDNs to report on their performance in this regard. In the following paragraphs we report how we have monitored this for transmission and distribution system operators during 2015.

## *Transmission*

Connections to the NTS are governed by the UNC. Connections to the NTS are infrequent and for major pipeline developments they can take many years. The UNC requires National Grid Gas Transmission (NGGT) to provide quarterly data on connections agreements. NGGT has published this data for their 2015 quarterly reporting periods under 'Connection Offer Performance Reports'.<sup>85</sup>

## *Distribution*

We have proposed the same definitions for time to quote and time to connect as for electricity distribution (see section 3.1.2). We are currently discussing these proposed definitions with GDNs.

Historically, we have adopted a proactive approach to monitoring connections services and repairs by setting a minimum level of service that we expect GDNs to deliver through connections guaranteed standards. Those standards require GDNs to restore and/or repair customers' supplies within prescribed periods. They also cover the provision of connection quotations, scheduling agreed dates for connection works with customers and completing works on the dates agreed with customers.

In 2011 we amended standard licence condition 24.1 of the gas transporter licence to facilitate the performance of the Authority's functions in accordance with the Gas Directive as well as domestic legislation. We are in the process of developing the associated instructions to ensure that the GDNs report this data on a consistent basis. We expect these instructions to be in place and effective by 2016.

## **Monitoring access to storage, linepack and other ancillary services**

Under Article 41(1)(n) of the Gas Directive regulators are required to monitor and review the access conditions to storage, linepack and other ancillary services. In the GB gas market, the default regime is for all storage facilities to offer nTPA unless the facility has been granted an exemption. Key requirements for storage facilities are:

- To be legally unbundled from related undertakings
- To offer access to third-parties on non-discriminatory terms.

Ofgem published the latest version of its guidance on compliance with nTPA requirements in September 2015.<sup>86</sup>

National Grid is required by its licence to procure Operating Margins on an annual basis as an ancillary service. The Operating Margins service is used to maintain system pressures in the period before other system management services become effective (e.g. national or locational balancing actions). Ofgem assesses the tender process and carries out a test to ensure the tender is competitive. In 2015 we were satisfied that competition was effective for the provision of Orderly Rundown and Non Locational requirements.

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<sup>85</sup> <http://www2.nationalgrid.com/uk/services/gas-transmission-connections/connect/performance-reports/>.

<sup>86</sup> <https://www.ofgem.gov.uk/publications-and-updates/guidance-regulatory-regime-gas-storage-facilities-great-britain-version-2>

## **Monitoring correct application of criteria that determine model of access to storage**

Under the Article 41(1)(s) of the Gas Directive, regulators must monitor the correct application of the criteria that determine whether a storage facility falls under negotiated or regulated access. As noted above, the GB default regime for all storage facilities is to offer nTPA unless the facility has been granted an exemption.

Ofgem grants a MFE where we are satisfied that access to the storage facility by other persons is not technically or economically necessary for the operation of an efficient gas market. The owner of a storage facility may apply to Ofgem for such an exemption, and Ofgem may revoke an exemption if the criteria are no longer met. More details of our approach are set out in an open letter.<sup>87</sup>

## **Monitoring safeguard measures**

Under Article 41(1)(t) of the Gas Directive we are also required to monitor the implementation of safeguard measures. These will be used in the event of a sudden crisis in the energy market as referred to in Article 46 of the Gas Directive. Article 46 is taken forward by and further specified in Articles 10 (6) and (7) of the EU Gas Security of Supply Regulation (Regulation (EU) No. 994/2010). As such, under Article 10 of the Gas Security of Supply Regulation, the competent authority (in the case of GB this is the Department of Energy and Climate Change, DECC) is required to prepare an emergency plan that outlines the action that it intends to take in an emergency.

In 2014, DECC published the National Preventive Action Plan: Gas,<sup>88</sup> which describes the arrangements established between the gas industry, DECC, and the European Commission for the safe and effective management of gas supply emergencies. Ofgem provided comments to DECC on the National Preventive Action Plan throughout the drafting process and as such we are comfortable that the appropriate safeguard measures have been implemented. The next update of the National Preventive Action Plan: Gas will be conducted later this year.

## **4.1.3 Network and LNG tariffs for connection and access**

Under Article 41(1)(a), 41(6)(a), 41(8), 41(10) and 41(12) of the Gas Directive, NRAs are required to fix or approve transmission or distribution tariffs or their methodologies. Here we report on our activities surrounding the regulation of tariffs and network charges (for transmission and distribution) during 2015.

NGGT is the sole owner and operator of the GB gas NTS. There are eight GB GDNs. The revenues that both NGGT and the GDNs can collect from users of the NTS and GDN via network charges are determined by us at the price control review. The current gas transmission and distribution price controls are based on the RIIO model (RIIO-T1<sup>89</sup> and RIIO-GD1<sup>90</sup>) and began on 1 April 2013, running until 31 March 2021.

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<sup>87</sup> <http://www.ofgem.gov.uk/Markets/WhlMkts/CompanEff/TPAccess/Documents1/Storage%20Exemptions%20Open%20Letter%2009%20For%20publication.pdf>.

<sup>88</sup> <https://www.gov.uk/Government/publications/national-preventive-action-plan-gas>

<sup>89</sup> <https://www.ofgem.gov.uk/network-regulation-%E2%80%93-riio-model/riio-t1-price-control>.

<sup>90</sup> <https://www.ofgem.gov.uk/network-regulation-%E2%80%93-riio-model/riio-gd1-price-control>.

Following an assessment, we establish cost allowances and performance targets which form the basis of the price control and incentive framework. Included in these arrangements is an incentive which allows allowed revenue to increase in response to user signals for new capacity. Together, these elements determine the total amount of revenue (the 'allowed revenue') that NGGT and the GDNs may earn in each year. All are required by the regulatory regime to set charges for use of their networks to comply with the limits on allowed revenue that have been set. Should more or less than the permitted revenue be earned in any formula year, then a compensating adjustment is made in the following year.

## **Transmission**

Users of the gas NTS are subject to three main elements of transmission charges:

- Transmission Owner (TO) entry charges
- Transmission Owner (TO) exit charges
- SO charges.

TO charges are for the provision and maintenance of transmission network assets. NGGT has in the past recovered all of its TO allowed revenue on the basis of TO entry and exit capacity charges, but subsequently TO entry and exit commodity charges (charges based on actual gas flows) have been levied where NGGT has forecast a shortfall in collected revenue versus target revenue. NGGT collects its SO allowed revenue via SO commodity charges which are levied on the basis of gas flows at entry and exit. SO charges are costs incurred by the SO in its day to day operation of the NTS.

Connection charges are levied on new connections to the NTS and reflect the costs incurred by NGGT in providing any assets required to connect a user to the NTS. These connection costs are not determined by the price control review.

Under its licence, NGGT is obliged to develop and maintain a methodology which sets out how NTS charges are determined and must comply with the following objectives: that the methodology results in charges that are reflective of the costs incurred by NGGT in its transportation business; that it facilitates effective competition between gas shippers and between gas suppliers; that it takes account of developments in the gas transportation business; and that it is in compliance with the Gas Regulation (Regulation 715/2009) and legally binding decisions of the European Commission and/or ACER.

We have approved NGGT's charging methodology. Following its implementation, the charging methodology has been incorporated into the contractual framework between GB gas network users and operators, the UNC.<sup>91</sup> This means that modification proposals to the charging methodology are subject to the governance procedures of the UNC. Consequently, modification proposals can be raised by any UNC party. Implementation of charging methodology modification proposals are subject to approval by us, and our assessment of the extent to which the proposed methodology changes better meet the relevant licence objectives described above. Self-governance provisions exist within the UNC governance procedures to allow low-impact modifications to be implemented without approval by us. A proposal must meet certain criteria, set out in the licence, in order to be classified as self-governance.

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<sup>91</sup> Published on the [Joint Office of Gas Transporters](#) website.

We do not approve the network charges levied, only the charging methodology used to determine them. NGGT is obliged to provide a 150 day indicative notice of proposed changes to the level of charges, and a 60 day final notice of actual changes. Subject to the methodology, TO entry and exit capacity charges are levied on all network users, including storage sites, LNG terminals, and beach terminals, in a non-discriminatory way. TO and SO commodity charges are not levied on gas storage users as it is not considered cost reflective to do so. NGGT is also required to submit a report each year to us which notes developments in the gas transmission charging methodology in the previous formula year and what further changes may be necessary to improve compliance with the relevant objectives.<sup>92</sup> In 2015, no significant changes were made to the gas transmission charging methodology.

In June 2013 we launched the Gas Transmission Charging Review (GTCR).<sup>93</sup> The current charging regime has served consumers well by promoting the effective use of the network and facilitating effective competition. However, significant and ongoing structural changes to the GB gas market since the system was designed, and emerging EU legislation to harmonise transmission charges across Member States (EU Network Code on Tariffs), have prompted us to conduct a review. We wanted to consider what changes to the charging regime, if any, might further the interests of current and future consumers.

Following the publication of our policy position relating to the GTCR,<sup>94</sup> we ran a consultation between December 2014 and March 2015. After a careful review of the consultation responses, we published an open letter in November 2015, confirming our policy views and presenting our next steps in this process. We decided to maintain our policy position of introducing floating capacity charges and reducing the discounts applied to short-term capacity products at all entry points. We asked the industry to take forward these recommendations, in conjunction with the wider process of implementing the EU Network Code on Tariffs. We expect no changes to be made until after the text of EU Network Code on Tariffs is finalised and its implementation date is known.

We explain these findings in detail in our November 2015 open letter.<sup>95</sup>

## **Distribution**

The GDNs recover their allowed revenues via a combination of Local Distribution Zones (LDZ) capacity and commodity charges and an LDZ customer charge. The GDNs are obliged to provide a 150 day indicative notice of proposed changes to the level of these charges and 60 days final notice for actual changes.

In common with NGGT, under the licence the GDNs are obliged to develop and maintain a methodology which sets out how LDZ charges are determined and which complies with the same NTS charging methodology objectives listed above. There is an additional objective that the licensee shall not show any undue preference towards, or undue discrimination against, any person who operates or proposes to operate, a

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<sup>92</sup> <http://www2.nationalgrid.com/uk/Industry-information/System-charges/Gas-transmission/Forecasts/>.

<sup>93</sup> <https://www.ofgem.gov.uk/gas/transmission-networks/gas-transmission-charging-review>.

<sup>94</sup> <https://www.ofgem.gov.uk/publications-and-updates/gas-transmission-charging-review-our-policy-position-future-charging-arrangements>

<sup>95</sup> <https://www.ofgem.gov.uk/publications-and-updates/gas-transmission-charging-review-confirmation-policy-view-and-next-steps>

pipeline system in relation to the connection of that system to the pipeline system to which the licence relates. These objectives also apply to the GDNs' connection charging methodology which the GDNs are also obliged to maintain under the licence.

We do not approve the LDZ charges levied, but only the charging methodology used to determine them. The GDN charging methodologies have also been incorporated into the UNC and as such, any modification proposals to the charging methodologies are subject to the UNC governance procedures. The UNC contains provisions for stakeholders to input into the process too. This is done either through participation in various industry working groups, or through the more formalised public consultation processes. We consider any inputs received in reaching a decision on methodologies or tariffs. Stakeholders have the right to request a judicial review of any such decision and the right of appeal to the CMA on modifications to industry codes.

In respect of judicial reviews, on 23 July 2015, the High Court dismissed a claim for judicial review by RWE Generation UK PLC of our decision, resulting from Project TransmiT, to approve a modification to the CUSC in order to address defects in the existing transmission charging arrangements. The High Court decided that our decision to modify the charging methodology relating to the recovery of costs incurred in connection with investment in the transmission system for electricity was lawful. RWE has told us that it does not intend to appeal the Court's decision.

Project TransmiT was an independent and open review of electricity transmission charging and associated connection arrangements. The aim of the project was to ensure that we have in place arrangements that facilitate the timely move to a low carbon energy sector while continuing to provide safe, secure and high quality network services at value for money to existing and future consumers.

## **LNG facilities**

The three<sup>96</sup> LNG facilities currently operating in GB have an exemption<sup>97</sup> from third party access and therefore the provisions of Articles 41(10) and 41(6) of the Gas Directive do not apply to them.

Any exempted LNG facility is required to operate under the terms and conditions of its exemption. Commercial terms and conditions are agreed between the facility operator and its primary capacity holders. However, in the event that we believe terms and conditions published<sup>98</sup> by LNG operators are discriminatory we are able to take actions under the enforcement provisions contained in the Gas Act 1986 - in particular section 28.

## **Prevention of cross-subsidies**

Each NRA, under Article 41(1)(f) of the Gas Directive, is required to ensure that there are no cross-subsidies between transmission, distribution, storage, LNG and supply activities.

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<sup>96</sup> Isle of Grain, South Hook and Dragon LNG.

<sup>97</sup> Ofgem published its decision to revoke the exemption for the 'phase 4' expansion of the Isle of Grain LNG terminal, as construction of the facility had not started within 2 years of the date the exemption was approved: <https://www.ofgem.gov.uk/publications-and-updates/grain-lng-phase-4-revocation-third-party-access-exemption>

<sup>98</sup> Under section 19D Gas Act 1986.

In GB, licensed gas transmission operators and DNOs are subject to licence conditions prohibiting regulated businesses from giving cross-subsidies to, or receiving cross-subsidies from, related undertakings. The regular information submissions that licensees are required to make, principally those relating to their price control arrangements, allow us to assess whether any risk or incidence of cross-subsidisation has arisen.<sup>99</sup>

Gas distribution licences include a requirement for independent auditors to carry out a range of procedures, agreed with us, to provide assurance that obligations to avoid discrimination and cross-subsidy are being respected. We review the auditors' reports and raise supplementary questions as appropriate.

A key area which we will continue to monitor is the interpretation and application of requirements for financial transactions to be completed on an arm's length basis and on normal commercial terms. This is especially relevant with respect to the terms of loans made to or by the relevant licensee. For gas distribution licensees, we also monitor the risk of licensee owned freehold sites being sold to related parties at insufficient value. This particularly relates to gas holder sites in major cities, where land value for development is especially high at present.

Other key risk areas we take into account are:

- the basis of recharging for services provided at a group level;
- the justification for any management fees charged to the licensee by related parties; and
- the interest rates charged on intra-group loans affecting the licensee.

### **Regulated and negotiated access to storage**

Under article 41(1)(s) of the Gas Directive, regulators must monitor the correct application of the criteria that determine whether a storage facility falls under negotiated or regulated access. In the GB gas market, the default regime is for all storage facilities to offer nTPA unless the facility has been granted an exemption. Key requirements for storage facilities are:

- to be legally unbundled from related undertakings if the related undertaking does certain other activities eg, supplies, sells or ships gas (more information on unbundling can be found in chapter 4.1.1) and,
- to offer access to third-parties on non-discriminatory terms.

Ofgem grants a MFE where we are satisfied that access to the storage facility by other persons is not technically or economically necessary for the operation of an efficient gas market. The owner of a storage facility may apply to Ofgem for such an

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<sup>99</sup> The prohibition on cross subsidies is prescribed by: Internal Markets Electricity Directive (IMED) 2009/72/EC at Article 31(3); the Internal Markets in Natural Gas Directive 2009/73/EC at Article 31(3); Standard Licence Condition 4 of the Electricity Distribution Licence; Standard Special Condition A35 of the Gas Transporter Licence (Standard Condition 41 for independent gas transporters); and Standard Condition B5 of the Electricity Transmission Licence (Standard Condition E6 for offshore transmission network operators).

exemption and Ofgem may revoke an exemption if the criteria are no longer met. More details of our approach are set out in an open letter.<sup>100</sup>

In 2015, Ofgem rejected an application for an MFE from SSE Hornsea in respect of the Hornsea gas storage facility.<sup>101</sup>

#### 4.1.4 Cross-border issues

In order to reach a fully integrated European energy market, it is vital that NRAs coordinate effectively on cross border issues. In this section we report on our access to cross-border infrastructure, LNG terminals and storage facilities, our investment plans and cooperation with other NRAs during 2015.

##### **Access to cross-border infrastructure including allocation and congestion management**

Under Article 41(6)(c), 41(8) and 41(9) of the Gas Directive, NRAs are responsible for: fixing or approving methodologies used to calculate or establish the terms and conditions used for access to cross-border infrastructures, ensuring transmission and distribution system operators are granted appropriate incentives, monitoring congestion management of national gas transmission networks including interconnectors and the implementation of congestion management rules and capacity allocation mechanisms.

The British gas system is interconnected with Belgium, the Netherlands, Northern Ireland and the Republic of Ireland. These interconnections play an important role in gas security of supply by allowing for gas to flow to where it is valued most and allowing for a more integrated European gas market.

The paragraphs below give an overview of the arrangements on each of the interconnectors. Each interconnector is licensed by Ofgem and must submit their access rules and charging methodologies to us for approval.

##### *IUK*

The interconnector with Belgium, Interconnector UK (IUK) became operational in 1998. IUK can physically flow gas in both directions and has an import capacity of 25.5bcm/year and an export capacity of 20bcm/year.

IUK has sold all of its capacity in long-term contracts until 2018. IUK is also making post-2018 capacity available through CAM auctions.

##### *BBL*

BBL was established in July 2004 to design, construct and operate an interconnector to transport gas from the Netherlands (Balgzand) to the UK (Bacton). Transportation of gas started in December 2006, with a total capacity of ~15bcm/year. In April 2011, a fourth compressor was installed, increasing capacity by ~3bcm/year to 18bcm/year.

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<sup>100</sup> <https://www.ofgem.gov.uk/ofgem-publications/41204/storage-exemptions-open-letter-09-publication.pdf>.

<sup>101</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2015/06/hornsea\\_mfe\\_decisionletter\\_fina\\_l\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/06/hornsea_mfe_decisionletter_fina_l_0.pdf)

BBL has an exemption from the 2<sup>nd</sup> Package requirements and has certain licence conditions switched off relating to third party access and approval of charging methodologies for 80% of its forward capacity.<sup>102</sup>

### *Moffat*

The Moffat interconnector with the Republic of Ireland became operational in 1993 and is a physically uni-directional interconnector. The capacity available to exit the NTS at Moffat is 32.8 mcm/day. In December 2011, a virtual reverse flow service was introduced. This allows shippers to nominate flows from Ireland to GB on an interruptible basis. The maximum entry capacity at Moffat is 31.1 mcm/day.

From 1996 a branch-off from the Moffat pipeline at Twynholm in Scotland became operational to flow gas from GB to Northern Ireland. This is also known as the Scotland to Northern Ireland Pipeline. In February 2013, a virtual reverse flow service was introduced to nominate flows from Northern Ireland to GB.

### **Access to LNG Terminals and Storage Facilities**

In GB, we do not have a separate licensing regime for LNG system operators and they are regulated through requirements set out in the Gas Act. All LNG system operators currently have an exemption from third party access and therefore Article 41(10) does not apply to them.<sup>103</sup> However, in the event we believe that the terms and conditions published by owners of LNG import or export facilities are discriminatory, we are able to take action under the enforcement provisions contained in the Gas Act - in particular section 28.

Storage is also a non-licensed activity in GB and is regulated pursuant to the Gas Act provisions under a nTPA regime, which itself derives from the Gas Directive, part of the Third Package. Under the nTPA regime, we do not have the responsibility to approve tariffs or charging methodologies for storage facilities. Instead, it is up to the Storage System Operators to ensure that their tariffs meet the requirements of the Gas Regulation. We have the power to proactively monitor Storage System Operators' compliance with the Gas Regulation and can take enforcement action if we believe any conditions relating to a grant of storage rights by owners of a gas storage facility are discriminatory.<sup>104</sup>

The Gas Directive gives the right to any party affected to submit a complaint for review by the NRA regarding a decision on methodologies used or concerning the proposed tariffs or methodologies. Changes have been made to the Gas Act to extend the scope of the dispute resolution mechanism in order to cover disputes arising out of complaints to the Authority against owners of gas storage facilities and owners of LNG import or export facilities.<sup>105</sup> We did not receive any complaints in 2015.

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<sup>102</sup> Standard conditions 10,11 and 11A of the Gas Interconnector Licence.

<sup>103</sup> See Article 41(10) of the Gas Directive 2009/73/EC ; and see <https://www.ofgem.gov.uk/gas/wholesale-market/market-efficiency-review-and-reform/third-party-access-exemptions>

<sup>104</sup> See section 19B of the Gas Act 1986.

<sup>105</sup> Regulation 28 amends sections 27B-27D of the Gas Act

## Implementation of the Third Package

The Third Package introduced new responsibilities for regulatory authorities regarding the rules for granting access to cross-border gas infrastructures.<sup>106</sup> In GB, changes have been made to the standard conditions of the Gas Interconnectors Licence<sup>107</sup> to take full account of these new responsibilities. In 2015, various TSOs proposed a number of modifications to their access rules and charging methodologies to Ofgem for approval. These modifications were mainly to implement the European Network Codes which resulted from the Third Package.

IUK proposed modifications to its access rules and its charging methodology on 8 May 2015 and 26 June 2015, respectively. After a review of these modifications, we deemed these to be transparent, non-discriminatory, objective and compliant with the relevant legally binding decisions of the European Commission and/or ACER (such as the CMP Guidelines, CAM and Balancing Network Codes). We therefore approved these proposed modifications to both the access rules and charging methodology of IUK.<sup>108</sup>

BBL provides a physical flow of gas from the Netherlands to GB, but does not provide physical flow from GB to the Netherlands. Under the terms set by the European Commission, BBL has an obligation to provide interruptible reverse flow (IRF). As BBL is a uni-directional pipeline, it must instead provide a virtual flow. In order to align with the CAM regulation,<sup>109</sup> BBL proposed some minor changes concerning the charging methodology for IRF capacity. We approved the proposed modifications to the charging methodology as they better meet the relevant access rules objectives set out in the licence.<sup>110</sup>

In addition to the modifications mentioned above, BBL also proposed changes to its forward flow charging methodology and a set of access rules for both forward and interruptible reverse flow. These were required to ensure compliance with CAM, CMP and relevant parts of BAL. As with the aforementioned proposals, we approved these modifications due to the fact they were deemed to be transparent, non-discriminatory, objective and compliant with the relevant legally binding decisions.<sup>111</sup>

In September 2015, we approved the access rules proposed by GNI (UK), in accordance with the provisions of Standard Licence Condition 11A of GNI (UK)'s gas interconnector licence.<sup>112</sup>

NGG proposed the UNC modification 500 in May 2014 with the aim of facilitating compliance with CAM. We approved the modification on the basis that it will better

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<sup>106</sup> See Articles 41(6)(c), 41(8), 41(9) and 41(10) of the Gas Directive 2009/73/EC

<sup>107</sup> See standard conditions 10, 11 and 11A of the Gas Interconnector Licence.

<sup>108</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2015/07/decision\\_iuk\\_modified\\_accessrules\\_chargingmethodology\\_30jul2015\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/07/decision_iuk_modified_accessrules_chargingmethodology_30jul2015_0.pdf)

<sup>109</sup> Commission Regulation (EU) No 984/2013 of 14 October 2013 establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems and supplementing Regulation (EC) No 715/2009 of the European Parliament and of the Council Text with EEA relevance; *OJ L 273, 15.10.2013, p. 5–17 (BG, ES, CS, DA, DE, ET, EL, EN, FR, HR, IT, LV, LT, HU, MT, NL, PL, PT, RO, SK, SL, FI, SV)*

<sup>110</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2015/11/15\\_10\\_30\\_ofgem\\_approval\\_bbl\\_access\\_rules\\_and\\_charging\\_methodology\\_for\\_interruptible\\_reverse\\_flow\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/11/15_10_30_ofgem_approval_bbl_access_rules_and_charging_methodology_for_interruptible_reverse_flow_0.pdf)

<sup>111</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2015/11/15\\_11\\_02\\_ofgem\\_approval\\_of\\_bbl\\_access\\_rules\\_and\\_charging\\_methodology\\_for\\_forward\\_flow\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/11/15_11_02_ofgem_approval_of_bbl_access_rules_and_charging_methodology_for_forward_flow_0.pdf)

<sup>112</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/accessrulesgniuk\\_approval.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/09/accessrulesgniuk_approval.pdf)

facilitate the achievement of the relevant objectives of the UNC.<sup>113</sup> The modification was implemented with effect on the 19th of June 2015.<sup>114</sup>

In February 2015, we published our decision to modify NGG's gas transporter licence to split the existing Bacton entry point into two points – Bacton UKCS and Bacton IP.<sup>115</sup> This is because gas enters the NTS at Bacton from both domestic production and the BBL and IUK interconnectors. CAM does not apply to domestic production so we concluded that the existing Bacton entry point needed to be split to facilitate implementation. To manage future capacity bookings already made at the single Bacton entry point, NGG proposed modification UNC501V. This modification introduces a one-off process that invites capacity holders to indicate whether they wish their entry capacity rights at the existing Bacton entry point to be reallocated to the Bacton UKCS, or at the Bacton IP, entry point following implementation of CAM. We approved the modification on the basis that it would better facilitate the achievement of the relevant objectives of the UNC.<sup>116</sup> The modification was implemented in summer 2015.

Furthermore, NGG also raised modifications UNC510V, UNC519 and UNC525 to facilitate implementation of the Interoperability and Data Exchange network code (INT). We considered that each of these proposals better facilitated the achievement of the relevant objectives of the UNC. We published our decision on UNC510V on 21 September 2015.<sup>117</sup> We published our decision on UNC519 on 25 June 2015.<sup>118</sup> Finally, we published our decision on UNC525 on 19 August 2015.<sup>119</sup>

INT describes the reference conditions for calculating volume and energy. Article 13(3) allows adjacent TSOs to use other reference conditions in specific circumstances subject to NRA approval. NGG wrote to us on 3 August 2015 requesting our approval to maintain the use of other reference conditions at the Moffat interconnection point for the purposes of capacity booking, nominations and allocations. We granted this request on 18 September 2015.<sup>120</sup>

## Cooperation

Article 41 (1)(c) of the Gas Directive requires us to cooperate in regard to cross-border issues with the other NRAs concerned and with ACER. These cross-border issues include the integration of national gas markets, jointly managed cross border trade in gas and the allocation of cross-border capacity. Changes have been made to the Gas Act 1986 to reflect this.<sup>121</sup>

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<sup>113</sup>[http://www.gasgovernance.co.uk/sites/default/files/UNC%20500%20and%20UNC%20493%20decision%20letter-1\\_0.pdf](http://www.gasgovernance.co.uk/sites/default/files/UNC%20500%20and%20UNC%20493%20decision%20letter-1_0.pdf)

<sup>114</sup><http://www.gasgovernance.co.uk/sites/default/files/Notice%20of%20implementation%2000%20V1.0.pdf>

<sup>115</sup><https://www.ofgem.gov.uk/publications-and-updates/modification-special-conditions-1a-and-5f-national-grid-gas-plc%E2%80%99s-gas-transporter-licence-facilitate-implementation-capacity-allocation-mechanisms-network-code>

<sup>116</sup>[http://www.gasgovernance.co.uk/sites/default/files/UNC501V UNC501AV UNC501BV UNC501CV\\_decision.pdf](http://www.gasgovernance.co.uk/sites/default/files/UNC501V UNC501AV UNC501BV UNC501CV_decision.pdf)

<sup>117</sup><http://gasgovernance.co.uk/0510>

<sup>118</sup><http://gasgovernance.co.uk/0519>

<sup>119</sup><http://gasgovernance.co.uk/0525>

<sup>120</sup><https://www.ofgem.gov.uk/publications-and-updates/decision-approve-arrangements-implementation-european-network-codes-moffat>

<sup>121</sup> See Regulation 34 of the Electricity and Gas (Internal Market) Regulations 2011, which inserts section 4D into the Gas Act 1986.

### *Examples of cooperation*

In 2015, we continued to cooperate with neighbouring NRAs over a number of issues concerning interconnectors and full implementation of the European Network Codes. In particular, Ofgem has been working with the Northern Ireland, Republic of Ireland, Dutch and Belgian regulators to facilitate ENC implementation.

We have also continued our cooperation on a European level in 2015:

- We co-chaired ACER's incremental capacity and gas balancing work streams.
- We co-chaired the INT task force with ACER from November 2015. We worked with other regulators across Europe, ACER and the European Commission to ensure that proposals to amend INT to include a gas quality standard first look at the impacts of making such a change and are backed by a robust evidence case. We continue to work on this as well as ongoing implementation monitoring.
- We have also been very actively involved at CEER. For example, we co-chair the Gas Storage Task Force, and in 2015 worked with regulators across Europe to develop a vision for gas storage, including holding a workshop in Eastern Europe.

### **Monitoring investment plans and assessment of consistency with Community wide network development plan**

We set price controls for the gas TSO (NGG) and as part of this process we review the company's business plans. We explicitly require the business plans to consider the interaction with wider European developments as part of the context of the plan. We also require the company to consider the various uncertainties across both the period for which the control is set and beyond.

In practice, major changes to the gas transmission network including those related to community-wide network developments will arise through the commercial incremental entry and exit arrangements for which we will be aware and involved at major stages of development e.g. setting revenue drivers to make sure that National Grid receives an appropriate revenue adjustment. We will therefore have sufficient information to fulfil our duty under Article 41(1)(g).

Currently, we are establishing a monitoring approach to review ongoing performance against the outputs determined in the price control. We are involved in work comparing the domestic investment plans with the EU-wide plan.

### **4.1.5 Compliance**

Ensuring that market participants comply with mandatory obligations is essential for a well-functioning energy market. Below, we report on our powers to enforce the Agency's and European Commission's decisions, as well as the investigations that have concluded during 2015 relating to existing legislation.

### **Compliance of regulatory authorities with binding decisions of the Agency and the European Commission, and with the Guidelines (Article 43)**

Under the Third Package we are required to ensure compliance with and implement binding decisions of ACER and of the European Commission and with the Guidelines. In order to enable Ofgem to do this, our principal objective under the Gas Act has been amended so as to provide that the Authority has to carry out its functions under

Part I of that Act in the manner that it considers is best calculated to implement or ensure compliance with any binding decision of ACER or of the European Commission.

### **Compliance of transmission and distribution companies, system owners and natural gas undertakings with relevant Community legislation, including cross border issues**

We have powers to investigate compliance of transmission and distribution companies, system owners and natural gas undertakings with relevant Community legislation. If a breach is found, we have powers to impose penalties. As a condition of certification, Transmission System Operators (TSOs) are obliged to notify the Authority if they know (or reasonably should know) of an event or circumstances which has occurred, or is likely to occur, that may affect their eligibility for certification and must provide an annual declaration (approved by a resolution of the TSO's board of directors) in this regard. The Authority also has powers to require information to be provided by the TSO for the purpose of monitoring the TSO's certification.

IUK and BBL are obliged to give quarterly reports to the Authority on progress in complying with conditions set out in the Authority's final certification decision.

Ofgem, in close cooperation with other relevant NRAs, ensures TSOs are compliant with Network Codes and Guidelines (as required by GB TSO licences) by monitoring GB TSO business rules, standard transportation agreements and any other relevant operational rules and agreements. As with certification, we require TSOs to notify the Authority if they know (or reasonably should know) of an event or circumstances which have occurred, or is likely to occur, that may affect their compliance with the legislative framework.

#### **Failure to meet price control target**

In March 2016, National Grid agreed to pay out £3m to fuel poverty charity National Energy Action (NEA) after failing to meet the target for repairing non-urgent gas escapes on its gas distribution networks. In addition, we also cut the amount of revenue National Grid can earn from its gas distribution networks by £2m after the company failed to meet targets on customer satisfaction. National Grid missed the target for carrying out non-urgent repairs on three of its four distribution networks. The target was missed for the two years 2013/14 and 2014/15. National Grid assured us that no lives were put at risk by their failure to meet this output.

## **4.2 Promoting Competition**

In the following chapter we report on the current state of the wholesale and retail markets in GB and the main changes in 2015, as well as our monitoring activities in both the wholesale and retail markets during the past year. As a large amount of Ofgem's engagement with the retail energy market does not distinguish between electricity and gas sectors, this is covered below. Where Ofgem does assess the electricity and gas retail sectors separately, this is noted and dealt with separately.

## 4.2.1 Wholesale markets

The following section provides an overview of our monitoring under Article 37(1)(i),(j),(k),(l),(u) and Article 40, and the main developments in the wholesale gas market in GB during 2014. Detailed information can be found in the following sections, a summary of which is presented below:

- A healthy supply and demand picture placed downward pressure on gas prices throughout most of the year.
- As a result of these trends, average day-ahead gas prices in 2015 were down 15% year-on-year.
- A combination of near term fundamentals, falls in the oil price and a loosening of the global LNG market contributed to falls across the gas forward curve over the year.
- Traded volumes increased marginally (less than 1%) in 2015 to 1,898 bcm, with annual churn falling from 24 to 23.
- Futures volumes increased 11% in the year, to account for 51% of total annual traded volume.
- LNG imports to GB were up 22% year-on-year, to 12.41bcm.
- The UK switched from being a net importer from the continent in 2014 (842mcm) to being a net exporter in 2015 (6.06bcm)<sup>122</sup>.
- The CMA carried out an investigation into the Energy market and notified its provisional findings and possible remedies in July 2015. The CMA published its final report in June 2016.

Policy developments in several areas of GB's wholesale gas market have continued throughout 2015. Some notable policy areas include:

- Implementing cash-out reform under the Gas Significant Code Review.
- Approval of a MFE for Stublach gas storage facility.
- Development and implementation of European Network Codes and Guidelines.

### 4.2.1.1 Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition

#### Prices

Wholesale gas prices in GB are compiled and made available to market participants by a number of independent pricing agencies, energy market brokers and via exchanges. Argus Media, ICIS Heren and Platts provide pricing based on reported OTC trades, made available to the market via a subscription service. In addition, financial data providers (such as Bloomberg Professional service) provide close to real time energy broker pricing based on OTC trades.

In addition to a wide range of OTC pricing data, the Intercontinental (ICE) exchange also provides pricing data to the market, both through the OCM and through the ICE Futures market.

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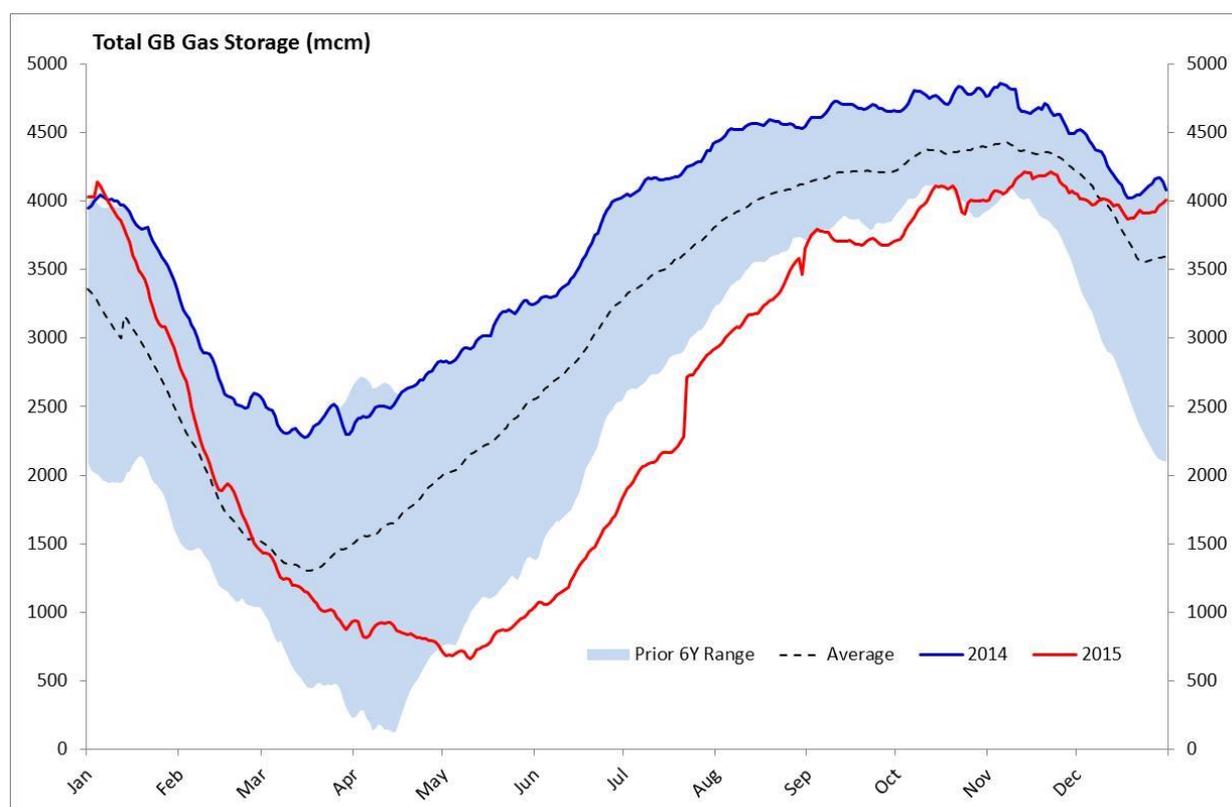
<sup>122</sup> Source: DECC Energy Trends 2016 Table ET 4.3

## Fundamentals

A healthy supply and demand picture placed downward pressure on gas prices through most of the year.

GB storage stocks reached record highs in 2014 (see Figure 11) following the mild winter of 2013/14, reducing demand for summer storage injections and improving the supply outlook for winter 2014/15.

**Figure 11: Total GB gas in storage during 2015 (red line), compared with 2014 (blue line), 6Y average (dotted) and prior 6 year range (blue bands)**



Source: National Grid/Bloomberg/Ofgem.

LNG flows also contributed to the strong supply picture in 2015. In total, LNG imports to GB were up 22% year-on-year, to 12.41bcm.<sup>123</sup> This was largely a result of price trends in the global LNG market, with both market fundamentals and oil-gas links putting downward pressure on global prices.

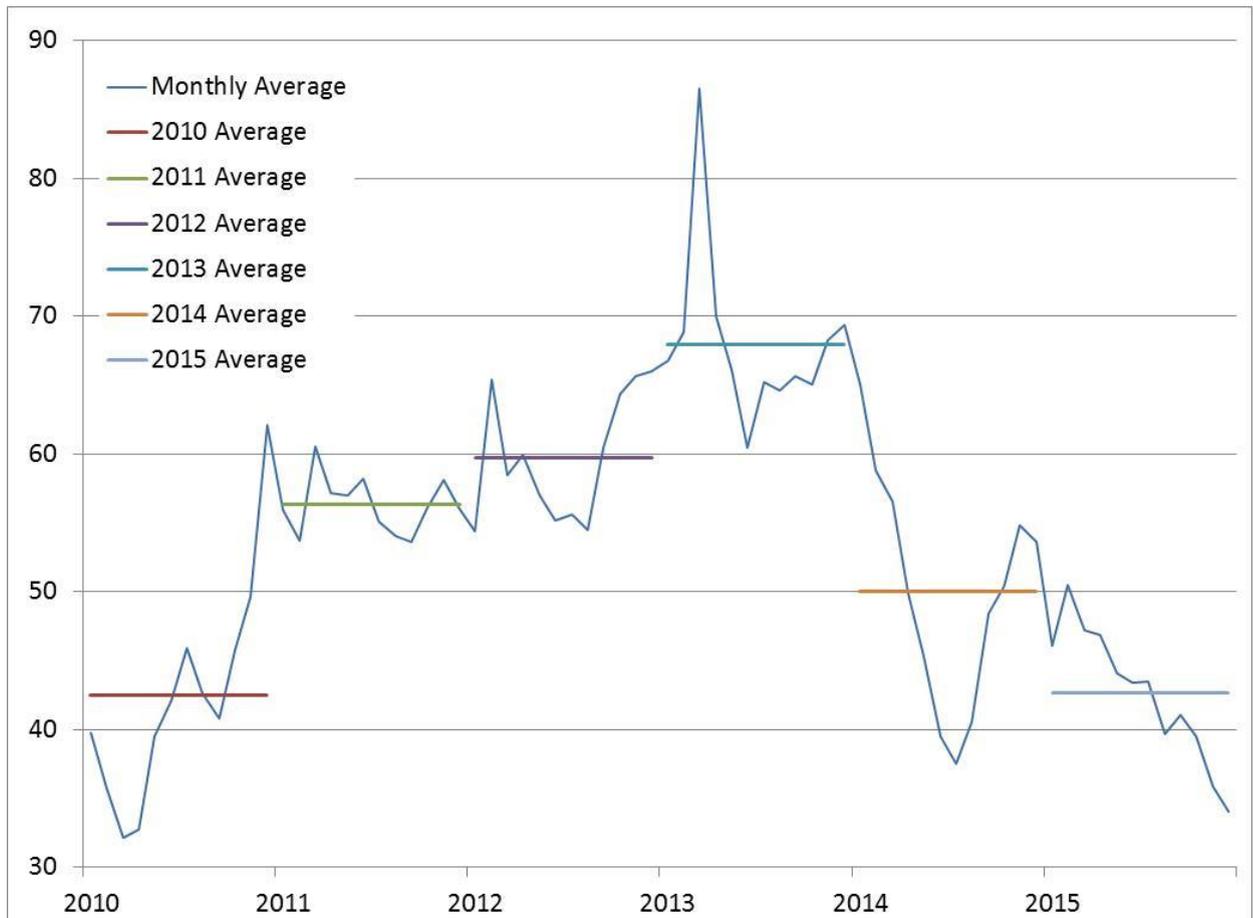
Total GB gas demand was up slightly in 2015, increasing 1.7 bcm year-on-year to 72.2 bcm/year. Of this increase, 1.5 bcm was due to an increase in domestic consumption, with colder temperatures than 2014 leading to increased heating demand. Total annual gas demand for electricity consumption was largely unchanged in 2015.

<sup>123</sup> <https://www.gov.uk/Government/statistics/gas-section-4-energy-trends>.

### Price developments

GB wholesale gas prices both for near-term and forward delivery generally fell throughout 2014, driven by a combination of healthy fundamentals and a feed through of oil price drops. The average day ahead gas price in 2015 was the lowest since 2010 at 42p/therm,<sup>124</sup> compared with 50p/therm in 2014 (see graph below). Similarly, the forward contract for delivery of gas in winter 2016/17 finished the year 19p/therm (35%) lower than at the end of 2014.

**Figure 12: Monthly average day ahead NBP price (p/therm, light blue) and yearly average day ahead prices since 2010**



Source: ICIS Energy

### Liquidity

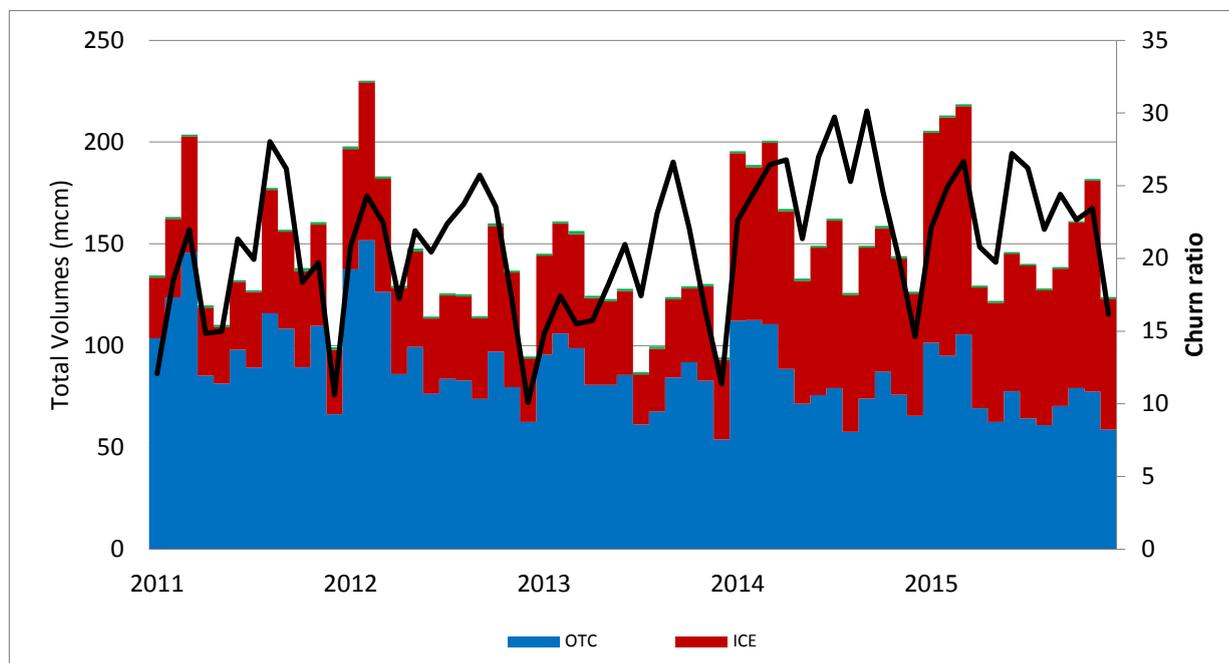
Traded volumes and churn were fairly similar in 2015 compared with 2014.<sup>125</sup> Traded volumes increased fractionally year-on-year to 1,898 bcm, with annual churn falling from 24 to 23.

Some growth was seen in futures trading on the exchange (ICE Futures Europe). ICE's share of total traded volume of GB gas rose from 46% in 2014 to 51% in 2015, with volumes on ICE increasing 11% year-on-year.

<sup>124</sup> Price data from ICIS Energy.

<sup>125</sup> Based on data from London Energy Brokers' Association, ICE and National Grid.

**Figure 13: NBP trading volumes and churn, 2011 to 2015**



Source: Combined data from LEBA, ICE, ICE Endex, Bloomberg and National Grid.

## Transparency

### REMIT

The REMIT legislation is a key tool in ensuring the transparency of prices within the wholesale energy market. For further information, please refer to the Electricity section (3.2.1).

## Market opening and competition

### Market investigation referral to the CMA

The CMA has been carrying out an investigation into the Energy market and published their final report on their energy market investigation in June 2016. Please see section 3.2.2 for more details.

### Market integration

The GB gas market is well-integrated with both European and global gas markets. IUK interconnector connects GB with Belgium, while BBL connects GB with the Netherlands. GB is connected to the LNG market through the Isle of Grain, South Hook and Dragon LNG terminals. The Teeside GasPort facility for energy bridge regasification vessels was decommissioned in 2015.

For IUK, each shipper has a share of the Forward Flow and Reverse Flow Standard Capacity. Historical analysis<sup>126</sup> indicates that IUK is price responsive to a relatively

<sup>126</sup> <https://www.ofgem.gov.uk/ofgem-publications/75776/interconnector-flows-further-analysis-next-steps-final.pdf>.

high level of efficiency. In the case of BBL, experience suggests that flows to GB may be becoming more flexible under normal operating conditions.

In 2015, the UK switched from being a net importer from the continent in 2014 (842mcm) to being a net exporter in 2015 (6.06bcm)<sup>127</sup>.

#### *Market concentration*

The GB market receives its gas supplies from a variety of different sources comprising indigenous supplies from the UK continental shelf, imports from Norway (via the Vesterled, Langeled and Tampen Link pipelines), imports from Continental Europe (via IUK and BBL) and from the LNG market (via the above terminals). With this diversity of supply also comes a diversity of shippers on the wholesale market.

For the interconnectors, originally nine shippers acquired Capacity Rights in IUK for a period of 20 years from 1 October 1998 through to 30 September 2018. Currently, 13 Shippers hold primary capacity rights.<sup>128</sup> On BBL, there are currently 14 shippers, three of which have primary capacity rights.<sup>129</sup>

For LNG, six shippers (BP, Centrica, GDF Suez, E.ON, Iberdrola and Sonatrach) import gas through the Isle of Grain. The South Hook Terminal is owned by a UK joint venture of Qatar Petroleum (67.5%), ExxonMobil (24.15%) and Total (8.35%). Dragon LNG is equally owned by two shareholders, BG Group and Petronas.

Rough remains the largest GB storage facility, with no change to this status projected in the near term. There are approximately 20 capacity holders at Rough.

## **4.2.2 Retail market**

A large amount of Ofgem's engagement with the retail energy market does not distinguish between the electricity and gas sectors. Rather, the market is considered as a whole and all common themes are covered in section 3.2.2. Where Ofgem does assess the electricity and gas retail markets separately, the information has been documented in 3.2.2 and 4.2.2 respectively.

### **4.2.2.1 Monitoring the level of prices and the effectiveness of market opening and competition**

#### **Monitoring the effectiveness of market opening and competition**

##### *Domestic market shares*

Before the full introduction of competition in 1999, British Gas had a monopoly to supply all domestic gas consumers in GB. In the subsequent years, competition developed, especially from the former Public Electricity Suppliers (PESs). As a result, the majority of the domestic gas supply market is now accounted for by British Gas and by the five large vertically integrated electricity suppliers (which evolved from the PESs through mergers and acquisitions). There were also 31 small domestic gas

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<sup>127</sup> Source: DECC Energy Trends 2016 Table ET 4.3

<sup>128</sup> Information correct as at Q1 2015. Shippers are listed on IUK's website: <http://www.interconnector.com/access-services/the-service/current-shippers/>.

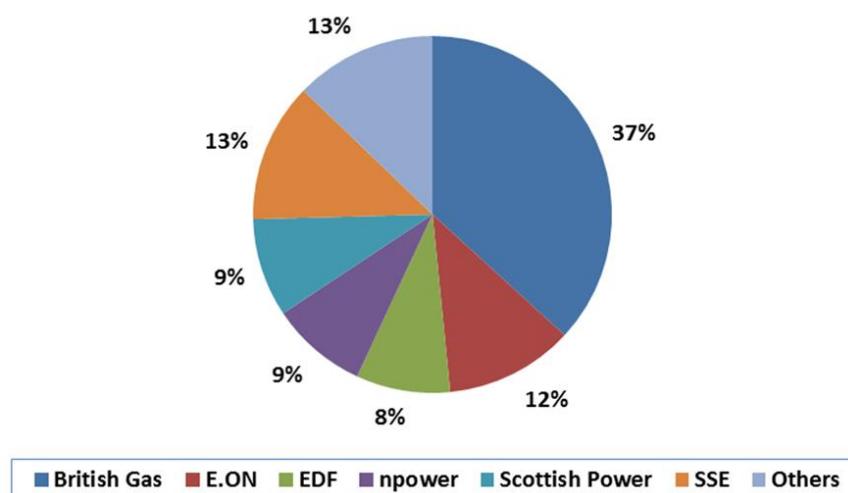
<sup>129</sup> Shippers are listed on BBL's website: <http://www.bblcompany.com/commerce/shippers-list>.

suppliers in December 2015. We have seen growth in small supplier numbers during 2015, with six new companies entering the market.

In December 2015, there were 21m domestic gas consumers in GB. As Figure 12 shows, the former incumbent suppliers accounted for 87% of gas supply to these customers, down from 91% in 2014.

In 2015, 12 new suppliers became active in the domestic segment resulting in a total of 31 smaller active suppliers in the gas market. The combined market share of these smaller suppliers' has increased by 4 percentage points up to 13% relative to December 2014.

**Figure 14: GB Domestic Gas Suppliers' Market Shares, December 2015**



Source: Ofgem analysis of Xoserve gas meter point data

### *Non-domestic market shares<sup>130</sup>*

The non-domestic gas market is characterised by a larger number of independent suppliers compared to the domestic gas market. In addition to the former incumbent suppliers, there are 41 independent suppliers, with varying focus and market share across two main segments: one for meter points with annual average consumption below 732,000 kWh (Small Annual Quantity, proxy for small business customers), and the other for meter points with annual average consumption above 732,000 kWh (Large Annual Quantity, proxy for large business customers).

As Table 2 shows, in the segment of small business customers British Gas is the leading supplier, as in the non-domestic market as a whole. Its market share has eroded over time and has fallen by 4 percentage points relative to 2014. Independent suppliers Gazprom, Opus and Total Gas and Power have increased their market shares approximately by 1 percentage point each, while other suppliers' shares have remained relatively unchanged.

International producers have a strong presence in the segment of large business customers, the leading one being Total Gas and Power. Its market share has

<sup>130</sup> The data presented in this report is based on number of supply points. However, it should be noted that market shares by volume may show a different story as some suppliers may have a low number of supply points which have however very high volumes of energy supplied.

remained unchanged compared to 2014. Gazprom has registered the largest increase, of around 1 percentage point. The largest loss, of 2 percentage points, was recorded by British Gas. EON has also recorded a loss of over 1.5 percentage points. SSE, Total Gas and Power and Business Energy Solutions Corona all saw small losses (below 1 percentage point).

**Table 3: Gas Suppliers' non-domestic market shares December 2015**

Gas Supplier	Non Domestic Sites		
	<732 MWh Annual Quantity	>732 MWh Annual Quantity	All Non Domestic
British Gas	29.9%	6.1%	29.1%
EON	13.6%	6.4%	13.4%
Total Gas and Power	12.2%	26.8%	12.7%
Corona	7.4%	18.8%	7.8%
Gazprom	6.1%	15.7%	6.5%
Npower	6.3%	3.3%	6.2%
Contract Natural Gas Ltd	5.8%	0.8%	5.7%
Opus	5.3%	0.1%	5.1%
SSE	5.0%	7.1%	5.1%
Scottish Power	1.8%	0.0%	1.7%
Business Energy Solutions	1.5%	0.1%	1.4%
EDF	1.1%	0.0%	1.1%
Dong	0.8%	5.2%	0.9%
GDF Suez	0.6%	5.2%	0.7%
Regent Gas	0.6%	2.2%	0.6%
Others	2.0%	2.2%	2.1%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Ofgem analysis of Xoserve meter point data

#### *Herfindahl-Hirschman Indices (HHIs)*

HHIs<sup>131</sup> indicators are often used to gauge market concentration. Though HHIs do not provide conclusive evidence on the level of competition, they offer pointers as to whether there are potential risks to the market not delivering competitive outcomes. The relevant HHIs for gas in December 2015 were as follows (2014 figures in brackets):

- domestic – 2,042 (2,094)
- non-domestic, small businesses – 1,459 (1,861)
- non-domestic, large businesses – 1,524 (1,510)

The domestic gas segment is 'highly concentrated' according to the threshold HHI levels (1,800) used by the Competition Markets Authority. The HHI has fallen in 2015 relative to 2014. Both the gas non-domestic small and large business segment is judged to be 'concentrated', being above the 1,000 threshold. The non-domestic large

<sup>131</sup> HHI is commonly used to assess market concentration, ranging from 10,000 for a monopoly to just above zero for perfect competition. The Competition Markets Authority in the UK categorise a market as 'concentrated' if its HHI exceeds 1,000 and 'highly concentrated' if its HHI exceeds 1,800.

business has remained almost unchanged relative to 2014, while the non-domestic small business has fallen.

**Prices for domestic consumers**

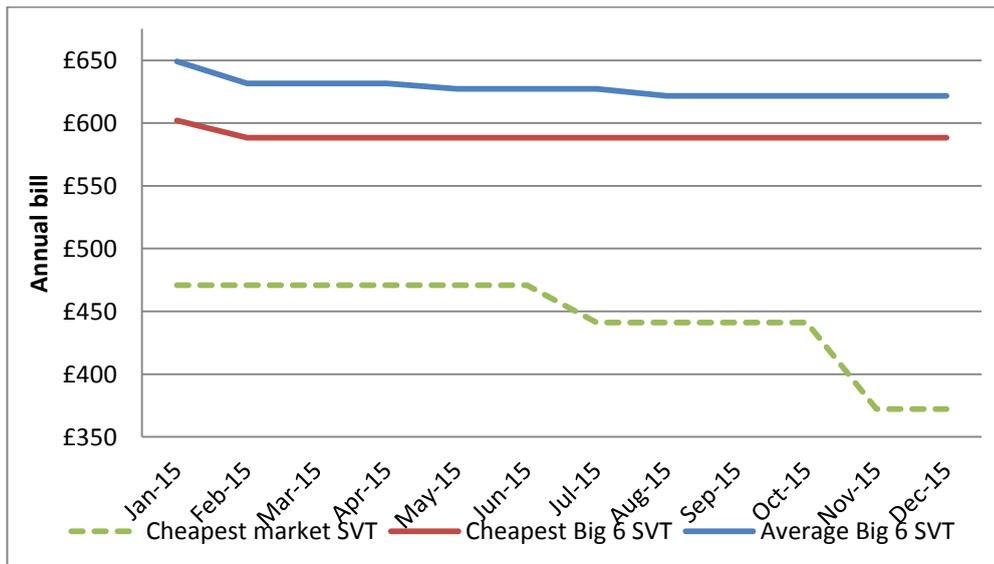
*Prices for household consumers including prepayment systems*

All final consumer prices in the GB retail energy markets are determined by market forces as all price controls on final consumer prices were lifted by April 2002. However, there are elements of the final price which are attributable to the regulated aspects of the market, in particular distribution, metering and transmission charges, which continue to be price controlled. There are also a number of other costs that influence how suppliers set retail gas prices including wholesale energy costs, and the costs of the UK Government’s environmental and social policies such as the Renewable Obligation and the Warm Home Discount which can vary over time. As for electricity, Ofgem actively monitors domestic suppliers’ gas prices across GB.

Figure 9 shows the change in average domestic gas bills based on standard variable tariffs in GB’s gas market between January and December 2015. Over the year, the cheapest gas bill offered by the largest six suppliers decreased by 4.2% (£14) in line with the decrease in average large supplier tariff prices, while the cheapest tariff on the market decreased by 20.9% (£98). In December 2015, the price differential between the cheapest tariff offered by the largest six suppliers and independent suppliers had increased to £216.

As in the electricity market, over the year suppliers continues to offer fixed tariff with most fixed deals being priced at a discount relative to variable tariffs. Again as the electricity market, the cheapest fixed deals were generally offered by smaller suppliers.

**Figure 15: Domestic retail gas price levels, Jan– Dec 2015**



Source: Ofgem analysis of Energylinx data

Notes: Price level is based on revised consumption level of 12,500 kWh per year

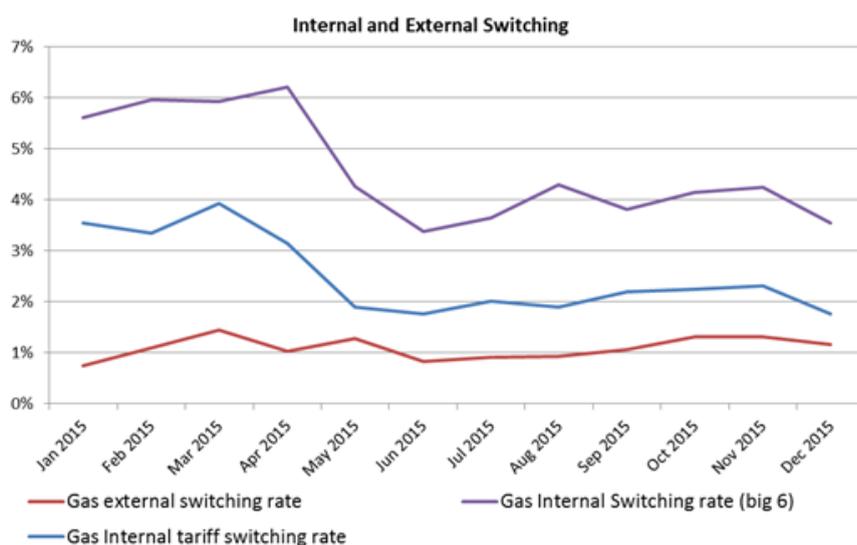
## Consumer engagement and experience

### Domestic switching rates

Consumers' ability to switch their energy supplier is important for a well-functioning, competitive energy market, although it must not be considered in isolation. Ofgem monitors switching rates together with pricing and market structure data on an ongoing basis.

In 2015, approximately 2.7m domestic consumers switched their gas supplier, equivalent to 230,000 per month. This is a switching rate of 13.1%, 2.3 percentage points higher than in 2014. We also saw an increase in switching away from the six largest suppliers, on average 43% of customers that switched during 2015 moving to smaller suppliers, and a slight increase in December 2014.

**Figure 16: External and internal gas switching rates in 2015**



Source: Ofgem analysis suppliers' data

On the other hand, we noted an increase in customers switching internally to different tariffs, payment methods and type of account management with their existing supplier. The total internal switching rate (i.e. the purple line in the above chart) has been approximately four times higher than the switching rate between suppliers in 2015. Internal switching rates that only reflects an active tariff choice were approximately double the rate of external switching but converges towards the end of 2015.

The speed and reliability of switching is also important (see section 5.1 for our change of supplier project within our smarter markets programme of reforms). In December 2015, the system average time<sup>117</sup> to complete a switch was down to 18 days in gas (from 21 days in September). Our consumer surveys provide an additional source of information on the consumer switching experience.

#### **4.2.2.2 Recommendations on supply prices, investigations and measures to promote effective competition**

Ofgem's work in accordance with the above heading is cross-cutting, i.e. it applies to both the electricity and gas markets. As a result, it has been covered in the retail market overview in section 3.2.2.3.

### **4.3 Security of Supply**

Under Article 5 of the Gas Directive, Member States have to ensure the monitoring of security of supply issues.

In GB, no single body is responsible for ensuring security of supply; we rely on the market to do this. However, Government sets overall energy policy on energy security, Ofgem is responsible for regulating the market and National Grid as operator of GB gas system has responsibility for ensuring that supply meets demand each day.

In October 2015, we published our joint Statutory Security of Supply Report (SSSR)<sup>132</sup> alongside DECC. This was part of an obligation<sup>133</sup> on Government to report annually to Parliament on the availability of electricity and gas for meeting the reasonable demands of consumers in GB. The report concluded that GB's gas market has delivered security to date and is expected to continue to function well, with sufficient capacity to deliver to meet demand. The report noted that sufficient gas is available from a combination of domestic, regional and global gas markets and the GB gas system is robust to all but the most extreme and unlikely combinations of infrastructure and supply shocks.

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<sup>132</sup> <https://www.gov.uk/government/publications/statutory-security-of-supply-report-2015>

<sup>133</sup> Under section 172 of the Energy Act 2004 as amended by section 80 of the Energy Act 2011.

## 5. Consumer protection and dispute settlement in electricity and gas

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The following chapter contains details of our consumer protection and dispute settlement work in both the GB gas and electricity sectors during 2015. This includes developments in the domestic and non-domestic sectors and further information on smart metering and smarter markets, our consumer vulnerability strategy and protecting consumers.

### 5.1 Consumer protection

According to Articles 37(1)(n) of the Electricity Directive and 41(1)(o) of the Gas Directive, Ofgem must help to ensure that consumer protection measures are effective and enforced, especially as new technology enters the market. Here we report on the following aspects of current and future consumer protection during 2015: smart metering; the smarter markets programme; access to consumption data, consumer vulnerability strategy and how we protect vulnerable consumers.

#### **Smart metering**

The Government has decided to implement the smart meter rollout through regulation and the rollout will be led by energy suppliers. Licence conditions require suppliers to take 'all reasonable steps' to ensure that smart metering systems are installed in homes and small businesses by the end of 2020.

Ofgem continued throughout 2015 to provide independent advice and expertise for the Government's Smart Meter Implementation Programme. We now play a key role in monitoring and, where appropriate, enforcing compliance with the new regulatory obligations relating to smart meters to ensure that the interests of consumers remain protected during the transition to smart metering.

#### *Regulating energy suppliers*

The deadline for rollout of advanced gas and electricity meters to larger non-domestic was April 2014. By that time, only 75% of electricity meters and 86% of gas meters had been upgraded to 'advanced meters'. This outcome was disappointing and suppliers are continuing to install the advanced meters.<sup>134</sup> Ofgem opened investigations against three suppliers regarding their rollout performance<sup>135</sup> and we are monitoring the progress of all suppliers in improving their April 2014 completion rate.

In October 2014, we published our decision that during the domestic smart meter rollout, suppliers must provide us with their plans for the rollout, set annual milestones spanning the roll-out, and which are enforceable through the licence. Through 2015 we carried out a dry-run process of receiving draft roll-out plans and

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<sup>134</sup> <https://www.ofgem.gov.uk/ofgem-publications/89289/amropenttrfinal.pdf>.

<sup>135</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-opens-investigation-british-gas-e.-and-npower-over-advanced-meter-roll-out-performance>.

annual milestones and engaging with suppliers on these. On 19 February 2016 we received the formal roll-out plans from the larger suppliers, which contained binding annual milestones.

### *Regulating the Data and Communications Company (DCC)*

The Smart Communication licences were awarded by the Secretary of State to Smart DCC Ltd<sup>136</sup> on 23 September 2013 (referred to as 'DCC') under the Gas Act 1986 and under the Electricity Act 1989. The DCC has an important role in providing secure communications between energy suppliers, network operators and authorised third parties.

A key objective of the DCC is to secure the interoperability of the operation of smart meters when a customer switches supplier. Industry is working closely with Government on the establishment of technical standards that will enable smart meters to be operated by the suppliers and for suppliers to be able to communicate with the DCC.

The DCC is governed by its licences which set out its core obligations, restrictions and entitlements. It is also bound by the industry's Smart Energy Code, which outlines the DCC's contractual relationship with its users (energy suppliers) and allows them to gain access to DCC services. Ofgem has monitored the DCC during 2015 to ensure it abided by its licence conditions.

Our monitoring included annual ex post price control arrangements and the approval of DCC's charging statements. During 2015, we assessed DCC's costs, revenues and activities during its first full year of operation, and published our price control decision in February 2016. An operational performance regime is to be in place by late 2016 to incentivise DCC to provide a good level of service and value for money once operational.

Suppliers are currently installing the first generation of meters that comply with the Government's Smart Meter Technical Equipment Standard. Meter manufacturers are currently finalising the development of the second generation of equipment that will be operated by the DCC. A programme of development and testing is planned before the main installation phase is expected to begin in late 2016.

The roll-out of smart metering has the potential to make retail energy markets work better for consumers. However, this will require reforms to the arrangements that govern how market participants interact with each other and consumers. We are continuing to progress work to deliver necessary reforms. Our work covers the change of supplier process, the electricity settlement process and consumer empowerment and protection. Key achievements in 2015 are covered below.

#### *Change of supplier*

In early 2015, we published a decision on moving to reliable next-day switching and a draft Target Operating Model (TOM) which describes how we expect new business arrangements will support reliable and fast switching using a Centralised Registration Service (CRS). The TOM set out our intention to bring together the existing separate gas and electricity switching arrangements into a single centralised service run by the DCC. We consulted on this over the summer and, in November 2015 we published an updated TOM and launched the Switching Programme. The aims of the Programme are to design and implement a new switching process that is reliable, fast and cost-

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<sup>136</sup> 124 Smart DCC is a subsidiary of the Capita Group.

effective thereby improving customers' experience of switching, leading to greater engagement in the retail energy market. Since launch we have convened a number of industry workgroups to both design the new switching arrangements and determine how best we transition to these new arrangements.

### *Electricity settlement*

The settlement process places incentives on suppliers to match the electricity they buy in the wholesale market with their customers' demand in each half hour of the day. Currently the majority of consumers in the UK are settled 'non-half-hourly' using estimates of when electricity is consumed based on a profile of the average consumer. This is because most sites do not have meters that can record consumption in each half-hour period.

Smart meters are able to record and export consumption data to a half-hourly granularity, allowing consumers to be settled using this data. This could have a number of benefits for consumers:

- make the settlement arrangements more efficient, reducing barriers to entry to the market, for example reducing credit/collateral requirements;
- facilitate uptake of smart tariffs to incentivise consumers to shift load away from peak periods, reducing consumer bills;
- promote innovation and competition in the energy market by facilitating demand side response, flexibility and innovative business models;
- shift demand away from system peak, helping to alleviate security of supply concerns and reducing the need for network reinforcement. This will deliver increasing benefits as the share of intermittent, inflexible and distributed generation grows in the future;
- allow suppliers to forecast demand more accurately, supporting competition and reducing costs.

In 2015, we agreed to take forward a project to reform the electricity settlement arrangements as smart meters are rolled out in the UK. This seeks to remove barriers to suppliers wishing to settle their customers using half-hourly consumption data on an elective basis, while also progress the long-term strategy for mandating half-hourly settlement for all of these consumers. Changes also came into force in that mandate half-hourly settlement for all larger non-domestic consumers by April 2017 and a start to that migration from November 2015.

### *Consumer empowerment and protection in smart metering world*

In 2015, we continued our work to ensure that the regulatory arrangements empower and protect consumers in a market with widespread deployment of smart metering and the transition to it.

In August 2015, we published a consultation document on smart billing focussed primarily on minimising back-bills and minimising estimated bills<sup>137</sup>. In March 2016 we published our decision<sup>138</sup>. We have decided to protect consumers by putting in place measures to reduce their exposure to back-billing, and to improve the transparency of

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<sup>137</sup> <https://www.ofgem.gov.uk/publications-and-updates/smart-billing-smarter-market-our-proposals>

<sup>138</sup> <https://www.ofgem.gov.uk/publications-and-updates/smart-billing-smarter-market-our-decision>

suppliers' back-billing policies. Many suppliers will voluntarily apply a six month back-billing limit, and will implement this as soon as practicable. We will provide transparency of each supplier's commitments by publishing comparative information on our website of suppliers' smart back-billing time limits. We will also work with suppliers to publish their smart billing performance data.

In September 2015, we consulted on measures that we believe will help achieve the right consumer outcomes for smart prepayment. We identified smart prepayment as a priority area that we needed to get right from the outset of smart meter rollout. This was in part due to the opportunity smart metering offers to radically improve the experience and outcomes for traditional prepayment meter customers. In March 2016<sup>139</sup> we published our decisions which focus strongly on monitoring. This is in line with our move to more principles-based regulation. This reflects that smart prepayment is still in its early stages. We aim to get the balance right between allowing innovation and ensuring the right protections. Monitoring supports this approach by sending the right signals to the industry and staying up-to-date with market developments so we can act if and where appropriate.

### **Ensuring access to consumption data**

Suppliers are required to provide gas and electricity consumption data to their customers, if requested by the customer. Following the introduction of the data access and privacy licence conditions, Ofgem has monitored these in 2015 and will continue to do so, enforcing breaches as required.

The Government also introduced licence obligations as part of the implementation of the Energy Efficiency Directive, which require suppliers to give domestic consumers easy access to certain consumption data on their smart meters. Ofgem monitor and, where appropriate, enforce any licence obligations on suppliers.

### **Consumer Vulnerability Strategy**

The Consumer Vulnerability Strategy and associated work programme, published in July 2013<sup>140</sup>, was updated in 2015 to reflect new research, activity and insight<sup>141</sup>.

In May 2015, we published the decision to make modifications to the gas and electricity supply licences to reform the switching process for indebted prepayment meter customers – the Debt Assignment Protocol.<sup>142</sup> The aim of this and associated work undertaken also in 2015<sup>143</sup> is to ensure that prepayment customers can switch easily, are treated fairly and costs do not fall disproportionately on those who can least afford them. This report is based on information provided by the suppliers who offer prepayment tariffs plus our own market analysis.

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<sup>139</sup> <https://www.ofgem.gov.uk/publications-and-updates/smart-prepayment-smarter-market-our-decisions>

<sup>140</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2013/07/consumer-vulnerability-strategy\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2013/07/consumer-vulnerability-strategy_0.pdf)

<sup>141</sup> <https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/protecting-vulnerable-consumers>

<sup>142</sup> <https://www.ofgem.gov.uk/publications-and-updates/decision-make-modifications-gas-and-electricity-supply-licences-reform-switching-process-indebted-prepayment-meter-customers-debt-assignment-protocol>

<sup>143</sup> <https://www.ofgem.gov.uk/publications-and-updates/prepayment-review-understanding-supplier-charging-practices-and-barriers-switching>

In December 2015, we published our final proposals regarding Priority Services Register (PSR)<sup>144</sup>, which sets out our final proposals for consultation for the PSR following our review to ensure that the existing services relating to safety, access and communication in the energy market meets the needs of consumers in vulnerable situations. Subject to stakeholder responses we issued a statutory consultation in June 2016<sup>145</sup>.

### *Guaranteed Standards of Performance*

Following the consultation on reforming the supplier Guaranteed Standards of Performance undertaken in 2014, we finalised our reforms in 2015<sup>146</sup>. Our proposals led to a revised performance standards regime featuring standards on appointments, fixing faulty metering, fixing faulty prepayment meters, and reconnection following disconnection for debt. Our proposals will see consumers receive £30 where a supplier fails a performance standard<sup>147</sup>.

### *Consumer insight and engagement*

In 2015, we continued to commission and publish a wide range of research to inform policy decisions and put consumer perspectives at the heart of our regulatory processes.

We listen to consumers through regular quantitative surveys and qualitative focus groups, and deliberative forums such as the Ofgem Consumer First Panel. Some examples from 2015 include:

- Quantitative research with micro and small business consumers to track their engagement and satisfaction with the energy market.
- Qualitative research with micro and small business consumers to understand their views of energy broker services and third party intermediaries.
- Ofgem's Consumer First Panel (of domestic consumers) discussed a range of key policy issues, including:
  - Trust in the energy market,
  - Consumer preferences for billing in a smart metering world,
  - Exploring consumer attitudes to how suppliers manage the switching process for customers with debt.
- A large quantitative survey with domestic consumers to help with our understanding of how market engagement changes over time.

Going forward, and following the recent publication of the CMA's final remedies, we are going to expand our behavioural insights programme. As part of this work we propose making greater use of randomised controlled trials (RCTs) to test the behavioural impact of various consumer-facing interventions that aim to promote market engagement ahead of implementation.

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<sup>144</sup> <https://www.ofgem.gov.uk/publications-and-updates/priority-services-register-review-final-proposals>

<sup>145</sup> <https://www.ofgem.gov.uk/publications-and-updates/priority-services-register-review-statutory-consultation-and-notices>

<sup>146</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2015/11/gosp\\_reforms\\_-\\_consultation\\_response\\_10th\\_nov\\_final\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/11/gosp_reforms_-_consultation_response_10th_nov_final_0.pdf)

<sup>147</sup> Electricity and Gas (Standards of Performance) (Suppliers) Regulations 2015 have been made by the Authority and received Ministerial consent. The new Regulations commenced from 1 January 2016 and have been published at: <http://www.legislation.gov.uk/ukxi/2015/1544/contents/made>

## **Monitoring suppliers' social obligations (*domestic consumers*)**

In 2015, we continued to collect social obligations reporting from domestic suppliers. This data helps us to:

- identify areas for future policy work
- monitor supplier performance and determine if suppliers are complying with their licence conditions (relating to customers who have a disability, a chronic sickness, are of pensionable age, or are on low incomes)
- identify and assess particular issues of concern with supplier performance
- encourage best practice through the publication of data.

Our latest quarterly and annual reports can be found at our Social Obligations Monitoring webpage.<sup>148</sup>

### *Disconnections for debt*

We require suppliers to provide us with information about disconnections for debt for domestic consumers as part of their Social Obligations Reporting. Monitoring supplier performance in this area allows us to identify issues of concern with supplier performance and take action. Our latest data related to domestic energy debt and disconnection can be found at our Social Obligations Monitoring webpage.<sup>149</sup>

## **Energy Best Deal (domestic consumers)**

The eighth year of a successful partnership with Citizens Advice (a registered charity that provides free and independent advice to consumers) delivering the Energy Best Deal continued in 2015. The campaign provides Citizens Advice advisers and other advice workers with the training needed to deliver face-to-face advice to lower income households on energy rights and how to get the best from their energy deal.

## **Back billing (microbusiness consumers)**

A back-bill is a request for payment issued to a customer for previously unbilled or incorrectly billed consumption. Back-bills can cause significant consumer detriment. They represent unexpected charges that businesses had not budgeted for and can cause cash flow problems.

Most major microbusiness suppliers with a combined market share of over 90% have voluntarily introduced a one year duration back-billing limit by early 2015. As part of our ongoing scrutiny, we sought updated information from suppliers on back-billing performance and published it in March 2016<sup>150</sup>, as we consider that it is in the interest of microbusiness consumers to help them understand how suppliers collectively and individually are performing in relation to back-billing.

We welcome that most major suppliers have limited their back-billing duration when they are at fault to one year. We are not planning to introduce a new licence condition to regulate back-billing at present, but do expect that suppliers to improve their back-

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<sup>148</sup> <https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/supplier-performance-social-obligations>.

<sup>149</sup> <https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/supplier-performance-social-obligations>

<sup>150</sup> [https://www.ofgem.gov.uk/system/files/docs/2016/03/back-billing\\_letter\\_ofgem\\_final.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/03/back-billing_letter_ofgem_final.pdf)

billing performance and make further progress in terms of consistency and robustness of their processes.

## **5.2 Dispute settlement**

Under Article 37(11) of the Electricity Directive any party that has a complaint against a transmission or distribution system operator in relation to that operator's obligation under the Directive may refer the complaint to the regulatory authority. Each regulatory authority is required to issue a decision within two months following receipt of the complaint. Member States are required to ensure that regulatory authorities have the powers to enable them to make such decisions.

Sections 44B-D of the Electricity Act set out our determination functions and procedures under Article 37 of the Electricity Directive. These sections were amended by the Electricity and Gas (Internal Markets) Regulations 2011. Under Article 37, any dispute that is referred to us for determination is determined by us or, if we think fit, by an arbitrator appointed by us. The decision is binding on the parties to the dispute. However, any party can seek a judicial review of our decision.

No new Article 37 disputes were raised in 2015. In March 2014, the Authority reached a decision on one Article 37 dispute, first raised in 2012. The dispute related to which party had responsibility for enabling third party access to a licence exempt distribution system at Heathrow Airport. One of the parties subsequently sought a judicial review of this decision. In November 2014 the judicial review was granted and the matter was remitted to the Authority for our reconsideration. Our decision on reconsideration was reached and communicated to the parties to the dispute in April 2015.

Sections 27B-D of the Gas Act 1986 set out our dispute resolution functions and procedures under Article 41(11) and Article 41(4)(e) of the Gas Directive. They were amended by the Electricity and Gas (Internal Markets) Regulations 2011. Under Article 41, any dispute that is referred to us for determination is determined by us or, if we think fit, by an arbitrator appointed by us. The decision is binding on the parties to the dispute. However any party can seek a judicial review of our decision. No Article 41 disputes were raised in 2015.

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## Foreword

As the economic regulator of energy utilities in Northern Ireland (NI) we are ever mindful that our work impacts both directly and indirectly on businesses, households and communities across NI.

Along with the Commission for Energy Regulation (CER), work is progressing to deliver an enhanced new wholesale electricity market, the I-SEM, and is on-track to open in October 2017. We have also been reviewing our energy supply market to make sure that it works for the benefit of NI consumers.

Our work contributes to the achievement of energy policy in NI. Working closely with the Department of Enterprise Trade and Investment (DETI, which from May 2016, is now the Department for the Economy DfE) we have ensured that consumers have a safe and secure electricity supply. Our focus on making sure that consumer prices reflect costs, chimes with key recommendations from the Economy Minister's advisory panel on energy prices for manufacturing businesses. We note and welcome that energy prices for most consumers in NI compare favourably with the UK and the Republic of Ireland (RoI).

As an economic regulator we add value through independent, expert analysis which both incentivises and ensures that regulated companies provide services that protect the short- and long-term interests of their consumers. We are active in support our goal of being an ever better regulator by learning from others and sharing experiences and insights.

I am pleased that significant progress has been made towards achieving the objectives we set in our Corporate Strategy 2014-2019.

Finally, during the last year we said goodbye to David Strahan and I thank him for his excellent contribution to the work of the board. Jon Carlton and Alex Wiseman joined the board in November and they have already made a positive impact. I thank all my board colleagues for their ongoing support and dedication.



Bill Emery  
Chairman

## Main developments in the gas and electricity markets

Main conclusions of the report and a general evaluation of market development and regulation.

### Electricity

The Single Electricity Market (SEM) continues to deliver benefits to consumers. The SEM ensures there is greater transparency around the costs of generation ensuring appropriate costs for consumers. Further development of new generation on the island of Ireland has increased investment and competition in the wholesale market.

Further progress has been made to ensure that our electricity market is compatible with the European Target Model. The SEM will require significant modifications to implement the Target Model. The magnitude of change required for the SEM to achieve this is considerably greater than most other markets in Europe. This is due to its centralised, gross mandatory pool design which differs in a number of key respects from the prevailing market design in most other European Member States.

The first key deliverable is increasing the efficiency of cross border electricity trading in all European electricity markets by 2014. For the island of Ireland this will be 2017 (given the greater changes required to the market). This will be a legal requirement on Member States.

Working with CER colleagues on the SEMC will create a new electricity market for the Republic of Ireland and Northern Ireland from 2017. We call this the Integrated Single Electricity Market (I-SEM). It is expected that the benefits of the I-SEM will be market transparency and efficiency of interconnection with the wider European market. The I-SEM will also facilitate increased competition in the electricity market in Northern Ireland and Ireland.

We progressed the work across all the significant I-SEM workstreams: energy trading arrangements, capacity remuneration mechanism, governance and licensing, forwards and liquidity and market power.

The next NIE Networks (NIEN) price control (RP6) will run from October 2017. We have made significant progress on RP6, the next price control for the electricity networks company (NIEN). A key development was setting out an agreed approach to the price control. We consulted on this and published a final

approach document in December 2015.

We also established, along with NIEN, the Consumer Council for Northern Ireland (CCNI) and DETI, a Consumer Engagement Advisory Panel (CEAP). This will provide consumers with an opportunity to give their views. We have also worked closely with NIEN on the information structure and definitions that the RP6 submission should follow.

Our price control approach document sets out the timetable for RP6 with the final determination due in May 2017.

The Market Monitoring Unit (MMU), which is based at our offices, has continued to monitor the SEM over the past year. The MMU engaged with generators and operators to monitor compliance with the market rules.

We also completed the price control for the electricity system operator in NI, SONI. Our final determination was published in February 2016, for a five-year period (2015–2020). A total of £9.5m of IT project-related investment is proposed while also setting out an overall efficient set of allowances. The additional investment includes funding to deal with an increased amount of wind on the system and sets out clear outputs. The price control will also facilitate the operation of the I-SEM and DS3 projects.

Power NI is the regulated electricity supplier providing services to over 500,000 customers. We announced the initiation of the review of Power NI's tariffs in early 2016. It was clear from our scrutiny that wholesale electricity costs, which make up a large portion of the tariff, had fallen along with the forecast of future costs. As a result, we approved a 10.3% reduction in consumer bills.

## Gas

By the end of 2015 the rollout of the gas distribution network in Northern Ireland (NI) continued across both distribution areas with 214,000 properties now connected in the Greater Belfast distribution area of Phoenix Natural Gas Ltd (PNGL) and 25,000 properties now connected in the ten towns distribution area of FE(firmus energy). The number of properties that are readily connectable, including connected properties, is 383,000. This represents nearly 54% of properties within NI.

Natural gas is not available in much of the west of NI. During 2014 the Utility Regulator conducted a competitive process to award high pressure and low pressure gas conveyance licences that will see the Northern Ireland network extended to a number of towns and major industrial facilities in the western half of

the region. The Utility Regulator announced its [final decision](#) in November 2014, with the high pressure network licence being awarded to Northern Ireland Energy Holdings and the low pressure licence being awarded to SGN.

The work to extend the natural gas network to the west of NI continues apace. During 2015-2016 construction of the Strabane element of the project has started. For the high pressure pipeline, work has progressed on finalising the design and route and preparing for the planning submission. We expect that construction will be complete on the connection to Strabane in October 2016 with construction on the high pressure pipeline to commence in 2017, subject to planning approval.

Work on the next price control for the gas distribution companies – Phoenix Natural Gas (PNGL), firmus energy (fe) and SGN (called GD17) has reached a significant stage. This builds on the progress delivered during the previous price control and covers costs which make up around 35% of the final customer gas bill. Our price control proposals were published, as scheduled, in March 2016 with a final determination to be published in September 2016.

Two regulated gas tariff reviews were completed for SSE Airtricity Gas Supply NI in the Greater Belfast area. We approved a reduction of 10.1% in October 2015 and a further reduction of 10.2% in April 2016.

In the Ten Towns gas distribution area, we reviewed firmus energy's tariffs and approved a reduction of 5% in October 2015. In April 2016 we approved a further reduction of 7.7%.

We are continuing to progress arrangements for harmonising gas transmission systems as required by the EU Gas Regulation (EC) 715/2009 and the network codes. We also work closely with OFGEM and Commission for Energy Regulation (Ireland) on cross-jurisdictional issues.

# The electricity market

## Network regulation

### Unbundling

*Report on TSO certification, DSO provisions regarding branding and resources and new developments regarding certification revisions*

- Articles 10,11 2009/72/EC and Article 3 Regulation (EC) 714/2009
- Article 26

NIE (the transmission owner) applied for certification under Directive 2009/72/EC on 30 January 2013 on the grounds of Article 9(9) of the Directive. By the date of application NIE ownership had been acquired by ESB which had extensive generation and supply interests in the SEM. The SEM Committee (SEMC), which had determined that TSO certification was a SEM matter, issued its preliminary decision to the EC on 12 February 2013. This recommended certification subject to certain qualification measures including transfer of the transmission planning function from NIE to System Operator Northern Ireland (SONI). The EC made a decision to approve the certification of SONI subject to the qualification measures in the SEM Committee preliminary decision and to some additional measures. The decision on certification for SONI was taken in June 2014, and the relevant licence changes have now been implemented.

Moyle Interconnector Limited, which owns the electricity interconnector between Northern Ireland and Scotland, applied for certification on the grounds of ownership unbundling on 25 January 2013. The SEM Committee issued a preliminary decision to the EC on 7 May 2013 recommending certification subject to certain qualification measures. The European Commission did not raise any objections to certification of Moyle Interconnector Limited as a fully unbundled TSO. The decision on certification for SONI was taken in June 2014, and the relevant licence changes have now been implemented.

## Technical functioning

- Balancing services (Article 37(6)(b), Article 37(8))
- Security and reliability standards, quality of service and supply (Article 37(1)(h),)

*Report relevant security and reliability regulation and data*

- Monitoring time taken to connect and repair (Article 37(1)(m))

*Clarify here at least if there is in your country a definition for “time to connect” for consumers and for producers*

- Monitoring safeguard measures (Article 37(1)(t))
- RES regulatory framework: Report on connection, access and dispatching regimes for RES-E, in particular on priority issues. Report also on the balancing responsibility for RES-E. (Article 11 Regulation (EC) 713/2009)

The wholesale electricity market in Ireland (SEM) is a gross mandatory pool, with energy prices set ex-post. Balancing services are paid for through imperfections charges, constraint payments and make whole payments. These are pass-through costs; generators recover their short-run marginal costs. SONI is obliged under its licence to take into account the quantity, nature and cost when purchasing System Support Services.

Monitoring of security and reliability standards, time taken to connect and repair and safeguard measures are currently conducted through licence compliance. Transmission licences are held by NIE, Moyle and SONI.

The loss of load expectations statistic is used by SONI as a security standard, which is concerned with the likely number of hours of shortage in a year. The security standard for NI is 4.9 hours per annum and if this standard is exceeded it indicates a higher than acceptable level of risk.

The System Operator, SONI, annually publishes the Generation Adequacy Statement which provides its forecast of generation capacity and forecast electricity demand for the upcoming ten-years. This allows for the assessment of capacity margins and identifies areas in which these could be increased, which highlights area of potential future investment. Above all the Generation Capacity Statement provides an estimation of future security standards based on expected generation capacity margins.

## Network tariffs for connection and access

- Article 37(1)(a), Article 37(6)(a), Article 37(8), Article 37(10), Article 37(12) , art 37(3)(c) and (d)

### *Report on relevant new tariff regulation provisions*

- Prevention of cross-subsidies (Article 37(1)(f))

*Specify the methodology used in tariff regulation (i.e. cost plus vs incentive regulation), the method of checking undertaking's cost data, methodology for allocation of costs to grid users and if benchmarking is used please describe methodology used by NRA*

Electricity Suppliers in Northern Ireland pay a number of regulated charges which they pass on to their customers. Regulated charges for the use of the electricity distribution network in Northern Ireland and a levy known as the Public Service Obligation (PSO) are set by NIE Networks (NIEN) and SONI, and the maximum amount recoverable is approved by the Utility Regulator. The “Regulated Tariffs Values” for the tariff year beginning October 2015 was published by the Utility Regulator in September 2015<sup>151</sup>, detailing the use of system tariffs for that year.

The transmission network owner in NI is NIEN. NIEN is also the distribution system owner and operator. The current five-year price control commenced in 2012. NIEN is allowed revenue and therefore annual Distribution Use of System tariffs (DUoS) are determined by the terms of this price control. It also receives a Use of System allowance (UoS) from the TSO. The allowed capital expenditure (CAPEX) is limited (e.g. replacement of assets.) with exceptional items individually approved by the regulator.

The next NIEN price control (RP6) will run from October 2017. We have made significant progress on RP6, the next price control for NIEN. A key development was setting out an agreed approach to the price control. We consulted on this and published a final approach document in December 2015.

Our approach document sets out, in high level terms, how we will carry out the price control. This includes the approaches to innovation and incentives for NIEN, the duration of the price control, reporting and benchmarking and consumer and stakeholder engagement.

We established, along with NIEN, the Consumer Council for Northern Ireland (CCNI) and the Department for Enterprise Trade and Investment, a Consumer

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<sup>151</sup>[http://www.uregni.gov.uk/publications/information\\_note\\_on\\_regulated\\_entity\\_values\\_2015\\_16\\_tariff\\_year](http://www.uregni.gov.uk/publications/information_note_on_regulated_entity_values_2015_16_tariff_year)

Engagement Advisory Panel (CEAP). This will provide consumers with an opportunity to give their views. Consumer views will therefore play a much bigger role in the overall price control process. A number of focus groups and workshops have taken place and stakeholder views will be reflected within NIEN's business plan submission.

We have worked closely with NIEN on the information structure and definitions that the RP6 submission should follow. It is based on the significant work with NIEN on regulatory information and guidance (RIGS), and allows comparison with GB electricity companies and provides transparent annual cost reporting.

Our price control approach document sets out the timetable for RP6 with the final determination due in May 2017.

NIEN is prohibited under licence obligations to provide or receive any cross-subsidy from any other business of the Licensee, this also includes any affiliate or related undertaking of the Licensee (whether or not a Separate Business).

We have a statutory duty to promote competition, where appropriate, in the generation, transmission, distribution and supply of electricity. Connections to the electricity grid by developers and micro generators continue to be an area of extensive external interest. We have ruled on a number of disputes in this area. Work continues to introduce competition in providing connections. We published our decision on the implementation of contestability and the draft of NIEN/SONI implementation processes.

Given the innovative nature of this work we have sought to work closely with stakeholders. We have set up an expert working group to ensure contestability moves forward in a timely way. NIEN and SONI have indicated that limited contestability will be available in spring 2016 while the market will be fully open in 2017.

### Cross-border issues

- Access to cross-border infrastructure, including the procedures for the allocation of capacity and congestion management (Article 37(6)(c), Article 37(8), Article 37(9), use of revenues for interconnectors (article 37(3)(f))

*Report in particular on cases where specific cross-border cooperation between NRAs happened besides the general activity of the NRA in the frame of ACER/FG*

- Monitoring technical co-operation between Community and third-country TSOs (Article 37(1)(s))
- Monitor TSO investment plans in view of TYNDP art 37(1)(g)
- Cooperation (Article 37(1)(c))

*Other relevant cooperation agreements/activities of the NRA besides the RI*

The Moyle Interconnector between Scotland and Northern Ireland lies within a Member State and has not previously been regarded as an interconnector for the purposes of the Electricity Directive. Nonetheless, Moyle has aimed to comply with the requirements of the directive regarding congestion management.

The interconnector owners are required to prepare relevant access arrangements in respect of the Interconnector. The purpose of these rules is to set out the auction mechanism including how participants can make an offer to acquire capacity units, together with the requirements on the Interconnector owner in terms of accepting an offer for capacity units from a participant. The access rules also address other areas including the curtailment approach should capacity become unavailable due to an outage.

Moyle Interconnector access rules are approved annually by both us and Ofgem with input from the Regulator in Ireland regarding the East-West Interconnector.

The export and import capacity of Moyle had previously been limited due to a number of technical faults. In this regard, Mutual Energy has signed a contract with suppliers to install new low voltage cables to restore the Moyle interconnector to full capacity by late 2016.

## **Compliance**

- Compliance of regulatory authorities with binding decisions of the Agency and the Commission (Article 37(1)(d)) and with the Guidelines (Article 39))

Which decisions/actions have been taken following binding decisions of the Agency or the Commission.

- Compliance of transmission and distribution companies, system owners and electricity undertakings with relevant Community legislation, including cross-border issues (Article 37(1)(b), Article 37(1)(q), Article 37(3)(a),(b),(e) and Article 37(5) all but (a) and (c) + imposing penalties (Article 37(4)(d))

*Report in particular on monitoring systems for TSO certification compliance and in the next future NC compliance. Report on other compliance cases and existing active monitoring methods*

Compliance of transmission and distribution companies, system owners is through their licences. There are no issues to report.

## Promoting Competition

### Wholesale markets

*Please provide a brief illustration of the state of competition of wholesale market and the main changes in the recent year*

The all-island Single Electricity Market is the combination of two separate jurisdictional electricity markets in Ireland and Northern Ireland and is governed by the SEMC. The SEMC comprises of representatives from: the Commission for Energy Regulation for Ireland, the Utility Regulator and an independent member.

The Single Electricity Market (SEM) has been in place since 2007 and ensures that the price of electricity charged to consumers reflects the costs of producing the electricity.

The SEM Committee meets monthly to take decisions on SEM matters. It comprises members of our board, the CER Commissioners and two independent members.

2015 was the eighth full year of operation of the Single Electricity Market. The SEM is a gross mandatory pool with gate closure at 10.00 hrs day ahead. The ex-post market schedule sets the half hourly system marginal price and allocates infra marginal rent to those included in the schedule. Capacity payments are made to all available generators based on an annually calculated capacity pot. Regulated directed contracts and also non directed contracts provide hedging for market participants. The market is operated by SEMO – the Single Electricity Market Operator which is a joint venture between the system operators in NI and Ireland.

Along with CER we have taken major steps to deliver the new electricity market, the I-SEM. This includes ensuring that the market design is compliant with the European target model, as well as delivering key benefits for consumers.

This has resulted in the advancement of a significant project to integrate the current SEM so as to facilitate a pan European electricity market. The new I-SEM project is timely, allowing the two regulators to take account of other changes in the electricity market since its opening, changes which include a substantive increase in renewables on the system and interconnection with GB with the east west interconnector. The redesign is focused on ensuring the most efficient deployment of all the power on the system and achieving an acceptable level of security of supply.

It is expected that the benefits of the I-SEM will be greater market transparency and efficiency of interconnection with the wider European market.

We progressed the work across all the significant I-SEM workstreams: energy trading arrangements, capacity remuneration mechanism, governance and licensing, forwards and liquidity and market power.

A number of industry liaison groups have been formed and we are working, along with the system operators (SONI and EirGrid), to ensure the necessary systems and processes are in place to aid market readiness.

Additionally, as part of a wider communications strategy, the SEM Committee commissioned a new website. The website went live in early April and will provide a basis for communications with all stakeholders on the wholesale electricity market.

We also took steps to promote sustainability. In order to address the impacts that increasingly high levels of wind place on the electricity system, we have been progressing the delivery of a secure, sustainable electricity system (DS3) programme with CER. The objective of DS3 is to facilitate increased levels of renewables and effectively decrease the levels of curtailment.

Curtailment and increased levels of renewable penetration will also be a major factor in the implementation of the I-SEM. The current operational limit on fluctuating generation (such as wind) at any given time is 50%. The DS3 programme's objective is to increase 50% penetration level to 75%.

The past year has also seen the development of the detailed design phase for the DS3 procurement. Six significant consultations have been carried out in relation to a number of key workstreams for this project. Interim arrangements will be in place for 2016 with further steps to an enduring process for system services scheduled to be in place by October 2017.

These additional system services will allow the electricity system to respond more flexibly to fluctuations in wind on the system. These services will be procured through a competitive process where sufficient competition exists or through regulated tariffs where this is not the case. Along with CER, we have limited the level of spend on such systems to reflect the level of benefit that will be received by consumers of such services.

### **Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition**

- Article 37(1)(i),(j) (k), (l) (u) and Article 40 (3)

*Report separately the three issues: prices, transparency and effectiveness of competition. In particular regarding prices report on fundamentals, price developments and liquidity. Regarding*

*transparency report on the access to prices and on how robust prices are and if at national level transparency obligations regarding pricing exist.*

## **Price**

We continue to examine where competition can be enhanced and costs reduced for consumers. While demand levels in 2015 exhibit similar seasonal fluctuations to those in 2014, average prices were lower in almost all calendar months during 2015.

The SEM market monitoring unit (MMU) is based at our offices and has continued to monitor the SEM over the past year. Our MMU has carried out a number of internal investigations into bidding in the SEM. A quarterly market update is published that provides an overview of the SEM and sets out recent trends in the market on pricing, demand, scheduling and directed contract prices. This report also provides additional transparency on the SEM market.

The MMU forms part of a Market Power Mitigation strategy developed by the Regulatory Authorities (RAs) during 2006. The MMU reviews the behaviour in the market on an ex-post basis. This includes investigating the exercise of market power and monitoring the compliance of market participants with their licence obligations in relation to participation in the market.

The MMU<sup>152</sup> publishes a public report on the Single Electricity Market (SEM) for each quarter, the latest publication covers Q4 2015<sup>153</sup>. These reports provide a particular focus on recent trends in the market in relation to pricing, demand, scheduling and forward contract prices.

MMU quarterly reports (Q4 2015) - key facts:

- the system marginal price (SMP) in the SEM reduced from €57/MWh in 2014 to €46/MWh in 2015;
- gas continued to be the dominant fuel in the SEM, contributing 40% of the fuel mix in 2014; and
- levels of demand were broadly similar to those seen in 2014.

The MMU continuously reviews generator participants' behaviour in the market,

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<sup>152</sup> <https://www.semcommittee.com/market-monitoring-unit>

<sup>153</sup> <https://www.semcommittee.com/sites/semcommittee.com/files/media-files/SEM-16-014%20MMU%20Quarterly%20Report%20Q4%202015.pdf>

including investigations into the exercise of market power. It also monitors the compliance of market participants with the bidding code of practice and other market rules. The MMU is also the point of contact for participants who wish to register complaints relating to market behaviour.

In the retail sector, Power NI is the regulated electricity supplier providing services to over 500,000 customers. We announced the initiation of the review of Power NI's tariffs in early 2016. It was clear from our scrutiny that wholesale electricity costs, which make up a large portion of the tariff, had fallen along with the forecast of future costs. As a result, we approved a 10.3% reduction in consumer bills.

### **Transparency**

The Market Operator for the SEM (SEMO) publishes all commercial and technical data relating to bids for any trading day.<sup>154</sup> This information is published four days after the trading day, and also includes all relevant price information for each half hour period.

### **Market opening**

Introducing incentives to help pool generation resources and reduce electricity usage is also an area where there have been developments.

We moved forward the licensing arrangements for aggregated generator units (AGUs) and demand side units (DSUs). AGUs and DSUs have a role to play in the electricity market, providing some further flexibility on the system and a means to incentivise and access demand side management.

In May 2015 we granted our first licence for a DSU.

### **Effectiveness of competition**

The SEM Committee publishes quarterly market monitoring reports which set out recent trends in the market in relation to pricing, demand, scheduling and forward contract prices

A report on generators' financial performance is being developed and is expected to be published later in 2016.

### **Retail market**

*Please provide a brief illustration of the state of competition of retail market and*

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<sup>154</sup> <http://www.sem-o.com>

*the main changes in the recent year*

Competition in the retail market was set up in Northern Ireland in a progressive way, starting with the non-domestic sector in 1999, and extending to the domestic market in 2007.

New suppliers entered the electricity market from June 2010 in the electricity market. Since then, more suppliers have been attracted to the Northern Ireland market. At the end of 2015, there were 9 active suppliers in the electricity sector, 6 of them operating in both, domestic and industrial sectors.

We initiated a review of retail market competition, in both electricity and gas, in 2014-2015. Phase Two of this review started in 2015-16. This examines the potential options for a future regulatory framework which could be implemented once the current form of price regulation on the former incumbents ends.

Cornwall Energy was commissioned to help us determine what these options could be, which included considering the regulatory frameworks in other countries. The consultation for this was published in December 2015 and closed in March 2016. The responses are now being considered and final decisions are due in the autumn. We are also considering the relevance of any findings from the retail market review being undertaken by the CMA in Great Britain.

A final report on our review of the retail energy market will be published in 2016-2017.

To keep the development of the retail energy sector in Northern Ireland under closer review, we regularly gather and analyse market information. Our duty to keep the development of the retail energy market under review was further enhanced by the IME3 directive which requires us to monitor how the market is working. In order to fulfill our statutory duties we also wish to provide consumers with access to clear and easily understood information on suppliers, products and tariff/service choices.

As part of the existing market monitoring we carry out in the gas and electricity retail sectors we publish quarterly reports (QTRs) at the end of February, May, August and November. These reports deliver transparency for stakeholders and consumers and examine in detail essential indicators which are also used by other National Regulatory Authorities (NRAs) in Europe when monitoring their retail markets.

We consulted on proposals for an enhanced monitoring framework, called the Retail Energy Market Monitoring (REMM) framework, in January 2015. Following a consultation and a series of bilateral meetings we published the final decision paper in June 2015. Subsequently we began a testing phase to ensure suppliers and network companies had a full understanding of the REMM indicators and how

they should be collated. We are expecting our first live submission of data in April 2016 and will begin a process of publishing the new indicators. There will be a further consultation on the form in which the indicators will be published.

The total number of domestic electricity customers in NI at the end of December 2015 was 786,102. A large share of these domestic customers (65%) remain with the previous incumbent Power NI.

However, as the retail energy market matures this position has been gradually changing.

Power NI's share in the domestic credit market is 75% and their share of the prepayment market is 53%. Overall, there have been 407,000 switches by electricity customers since 2010. In the gas sector too, increased competition and switching has begun to erode the domestic market share of the incumbent suppliers.

### **Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition**

- Article 37(1)(i),(j),(k),(l),(u) and Article 40 (3)

*Report separately the three issues: prices, transparency and effectiveness of competition. In particular regarding prices report on fundamentals, price developments and liquidity. Regarding transparency report on the access to prices and on how robust prices are and if at national level transparency obligations regarding pricing exist. Please report here separately dual fuel prices*

In the monitoring of the energy retail market, the key indicators are: market shares, active suppliers in each market segment, market activity per market segment, rates of switching, domestic prices in Northern Ireland and a price comparison with other EU countries. Future work in terms of collecting and assessing further retail information will be included into this series of reports.

Northern Ireland electricity domestic price for medium customers (2,500 – 4,999 kWh consumption per annum) for semester 2 (July – December) 2015 fell below the EU median and UK medium domestic tariff to 16.6p/kWh.

The customer complaints procedure in Northern Ireland is detailed on our website: [www.uregni.gov.uk/customer\\_information](http://www.uregni.gov.uk/customer_information). In the first instance customers are asked to resolve any difficulty with their supplier. All domestic suppliers are required by licence to have a Code of Practice on complaint handling. This details a procedure to facilitate the fair and prompt settlement of complaints and disputes as well as a system for reimbursing or compensating complainants. They are also required under the licence to inform customers of the role and contact details of

the Consumer Council Northern Ireland (CCNI)<sup>155</sup> both in contracts and on bills.

If customers are not satisfied with the supplier's handling of, or response to, a complaint, they may ask CCNI to intervene on their behalf. The CCNI has statutory responsibility to assist energy customers with complaints at the second stage (after the supplier process has been exhausted).

We also deal directly with complaints and disputes, with regard to the transmission and distribution operator. Details of our process are given on our website

[www.uregni.gov.uk/publications/appeals\\_complaints\\_and\\_disputes\\_policy\\_updated\\_june\\_2013](http://www.uregni.gov.uk/publications/appeals_complaints_and_disputes_policy_updated_june_2013)

With regard to complaints, IME3 has been implemented and all suppliers are fully compliant with the Code of Practice on Complaints Handling. We continue to work with suppliers on their Codes of Practice to ensure provision of an accessible, equitable and transparent, simple and inexpensive complaints procedure.

- Article 37(1)(k)

Under its Competition Law powers, we have not been involved in any cases of restriction of competition or restriction of contractual practices.

- Article 37(1)(l)

The EU's IME3 directives set out a series of measures to make sure consumers are adequately protected in the energy markets.

We have implemented some of the requirements to protect consumers in energy markets through supply licence modifications. Potential supplier mis-selling and poor customer information at the point of sale are barriers to promoting consumer confidence in energy markets.

Final decisions on minimum standards guidance on supplier codes of practice were published in June 2015. This will ensure that consumer protection is enhanced in several areas. This includes arrangements for the payment of bills, complaint handling, prepayment meters and the provision of services for persons who are of pensionable age or disabled or chronically sick.

We received draft codes of practices from all suppliers operating in the NI energy market. As part of the approval process for these codes we are undertaking a

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<sup>155</sup> Consumer Council for Northern Ireland <http://www.consumercouncil.org.uk/>

compliance review. We expect to grant final approval of the codes of practice in spring 2016.

### **Recommendations on supply prices, investigations and measures to promote effective competition**

- Article 37(1)(o)

*Report on recommendations at national level on supply prices and competition*

*Describe system of regulated prices (if they exist)*

- Article 37(4)(b)

*Report on investigations carried out, main results and possible measures adopted*

*Report on tariff deficit if it exists*

Electricity supply licensees require transparency of customers' terms and conditions, including price. These conditions apply to all licensees and are legally binding. Electricity customers are guaranteed the right to be supplied under fair and transparent terms. They cannot be discriminated in terms of price and the regulatory framework includes legally binding supplier of last resort provisions.

We have the powers necessary to investigate and enforce effective competition and the functioning of the retail market. We regularly request information to the network and supply companies, and monitor the received data.

## Security of supply (if and insofar as NRA is competent authority)

Implementation of safeguard measures Art. 42

The Fuel Security Code is designed as a Northern Ireland response to a Fuel Security Event. The Fuel Security Code currently in force in Northern Ireland under the Electricity (Northern Ireland) Order 1992 as amended (the 1992 Order) was drafted in 1992.

The objectives of the Fuel Security Code are to assist with the effective management of an event where primary fuel supplies for electricity generation are disrupted: a Fuel Security Event.

The Code enables Government to direct the electricity industry to provide information on power supplies and to take specific action to manage such disruption in a way to ensure as far as is reasonably practical.

### Monitoring balance of supply and demand

- Article 4

SONI prepare an annual Generation Capacity Statement which covers both demand predictions and the generation margins. The latest statement published in December 2014 shows:

- Current level of electricity peak demand is 1777 MW<sup>156</sup>. This has been forecasted to reach 1870 MW<sup>157</sup> by 2025. This forecasted peak is a decrease on previous estimates<sup>158</sup>;
- The large reduction in demand forecasts in NI and Ireland has led to an increase in generation adequacy. However, due to environmental constraints a number of generation plant are expected to be decommissioned by 2016 (loss of 260MW of capacity);
- During the period 2016 to 2020 there is sufficient generation capacity to achieve compliance with the generation security standard. The reduction in capacity at Ballylumford at the end of 2018 is likely to result in the surplus dropping to levels of under 300 MW;

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<sup>156</sup> Observed generation, excludes house load.

<sup>157</sup> Total Energy Requirement

<sup>158</sup> Further information available at:

<http://www.soni.ltd.uk/media/documents/Operations/CapacityStatements/All%20Island%20Generation%20Capacity%20Statement%202015%20-%202024.pdf>

- By 2021, more severe restrictions are placed on the Kilroot coal plant, and this could have the result of pushing Northern Ireland into deficit. This is based on the assumption that forecasts of demand, generation capacity and availability are achieved. It also relies on imports from GB and a reliance on generation in RoI. There remains however a risk of operational scenarios that could result in load shedding due to a generation capacity shortfall as generators unit sizes are large and there is a dependency on imports;
- There is currently 2427 MW of installed capacity, this figure excludes available capacity via imports on interconnector and tie lines. There is also 999 MW of Partially dispatchable or non dispatchable generation capacity (including 870 MW of Wind) installed on the NI system;
- Imports of 250 MW from GB and 100 MW from Ireland are expected to be available to support security of supply.

The most significant transmission project in NI is the second north-south interconnector. Preparatory work is ongoing for this; however the project is encountering significant opposition from residents along the route. Some delays are now expected due to other planning issues that have arisen in the Republic of Ireland. To view SONI's most recent Generation Adequacy Report (2015) see:

<http://www.soni.ltd.uk/media/documents/Operations/CapacityStatements/All%20Island%20Generation%20Capacity%20Statement%202015%20-%202024.pdf>

## Monitoring investment in generation capacities in relation to SoS

- Article 37(1)(r)

### *Operational network security*

- Article 7 2005/89/EC

### *Investment in interconnection capacity for the next 5 yrs or more*

- Article 7 2005/89/EC

### *Expected future demand and envisaged capacity for the next 5 years and 5-15 years*

### *Article 7 2005/89/EC*

In addition to the Generation Capacity Statement SONI are required by licence to publish an annual “Transmission System Capacity Statement” this details the statutory operational requirements, the existing network, its configuration and its planned development over the ten year period to 2023<sup>159</sup>.

## Measures to cover peak demand or shortfalls of suppliers

- Article 4

The Transmission System Capacity Statement analyses the potential for the system to meet peak demand.

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<sup>159</sup>

<http://www.soni.ltd.uk/AboutUs/News/TenYearTransmissionForecastStatement2013.html>

# The gas market

## Network regulation

### Unbundling

- Articles 10,11 2009/73/EC Article 3 Regulation (EC) 715/2009
- Article 26

*Report on TSO certification, DSO provisions regarding branding and resources and new developments regarding certification revisions. Report also on storage and LNG*

NI has three Distribution System Operators (DSOs). Phoenix Natural Gas Limited is solely a Network Operator, with no supply business and firmus energy (Distribution) Limited continues to have an integrated supply business (firmus energy (Supply) Limited). firmus energy (Distribution) Limited however does not have at present , more than 100,000 connected customers, therefore it remains an integrated Distribution and Supply business. SGN is developing the distribution network to the west of NI with first gas expected to flow in the second half of 2016.

The arrangements for unbundling at the transmission level are being examined as necessary as part of the certification process required under the third energy package.

In relation to GNI(UK)'s application for certification as a fully ownership unbundled, the UR notified its Preliminary Decision to the European Commission in relation to GNI(UK) on 4<sup>th</sup> December 2015.

We also continued to monitor the compliance of PTL and BGTL with their certification as fully ownership unbundled and no issues arose.

### Technical functioning

- Balancing services (Article 41(6)(b), Article 41(8))
- Security and reliability standards, quality of service and supply (Article 41(1)(h))

*Report relevant security and reliability regulation and data*

- Monitoring time taken to connect and repair (Article 41(1)(m))

*Clarify here at least if there is in your country a definition for “time to connect” for consumers and for producers*

- Monitoring access to storage, linepack and other ancillary services (Article 41(1)(n))
- Monitoring correct application of criteria that determine model of access to storage (Article 41(1)(s))
- Monitoring safeguard measures (Article 41(1)(t))

NI currently has no gas storage facilities; however Islandmagee Storage Limited is progressing plans to develop an underground natural gas storage facility in the Larne Lough area of Northern Ireland.

The project has been granted planning permission, a gas storage licence from us, and a Mineral Licence from DETI. During 2015 the developers continue to seek the further consents that are needed before the project can proceed to full construction and operation.

### **Network and LNG tariffs for connection and access**

- Article 41(1)(a), Article 41(6)(a), Article 41(8), Article 41(10) and Article 41(12)

Report on relevant new tariff regulation provisions

- Prevention of cross-subsidies (Article 41(1)(f))

*Specify the methodology used in tariff regulation (i.e. cost plus vs incentive regulation), the method of checking undertaking’s cost data and if benchmarking is used please describe methodology used by NRA*

- Regulated and negotiated access to storage 41(1)(s)

*Report on the decisions adopted by MS*

### **Distribution**

Information is collected in relation to volumes, revenues and costs, split across relevant customer categories, which are then used to calculate appropriate tariffs. A combination of incentive-based regulation, along with performance-based outputs is implemented for distribution companies. A price control is applied, alongside a performance-based system, which is adjusted, via the “Uncertainty Mechanism” based on actual performance, with incentives included to encourage efficiency and network growth. The next price control, referred to as GD17, will be for a 6 year duration, for the period, 1 January 2017 – 31 December 2022.

The distribution system operator proposes the tariff structure; we review and approves the structure, and then monitors execution. In terms of the regulatory period, the distribution system operators have licences extending 20 to 40 years. In terms of investment incentives, a higher RoR for the Distribution system operators (DSOs) is fixed until the end of 2016 to encourage investment. DSOs provide information on tariffs and connection charges to market participants and other interested parties; this information is available on the website of the individual DSOs.

## **Transmission**

At the transmission level, the tariff is set using an entry exit methodology by the us and tariff setting is overseen on an annual basis. The transmission tariffs are calculated by collecting forecast volumes, capacity bookings and revenue requirements from the power and distribution sectors at the beginning of the gas year. The individual submissions are then totalled and capacity and commodity tariffs are calculated for all sectors. A reconciliation process is applied at the end of the year when actual volumes, capacity and revenues are known.

The non-annual products required by the network code on CAM and a methodology for calculating their tariffs were both implemented for the 15/16 gas year commencing on 1 October 2015. In moving to a CAM compliant tariff regime we took account of the draft EU Network code on harmonised tariff structures for gas where sensible to do so. We continued to keep the development of the tariff code under review.

The TSOs are also price controlled in NI. The regulatory approach to the price control depends upon the financing model under which the TSO operates.

To improve the rate at which certain pipelines are financed, we have employed a mutualised financing model where the normal regulatory control over any allowed operational expenditure accrued by the TSO has been removed. The resulting transfer of risk onto consumers, through potential inefficient operating costs, can be limited through corporate governance licence conditions contained within the conveyance licence held by the TSO. One of which is a condition that, in the form of a shadow price control, allows us to review the level of operating expenditure forecast to be incurred by the TSO.

Where a more standard regulatory model is used, a 'pain-gain' mechanism is applied at the transmission level where TSOs can share in any CAPEX efficiencies gained.

## **LNG**

We have no LNG in NI.

### Cross-border issues

- Access to cross-border infrastructure including allocation and congestion management (Article 41(6)(c), Article 41(8), Article 41(9), Article 41(10) and Article 41(12))

*Report in particular on cases where specific cross-border cooperation between NRAs happened besides the general activity of the NRA in the frame of ACER/FG. Provide case study/data on standard contracts t.b.d by ACER (i.e. average cost/conditions of importing/exporting 1 MW). Only provide text explanations in the National Report as data are included in the data base.*

- Cooperation (Article 41(1)(c))

*Other relevant cooperation agreements/activities of the NRA besides the RI*

- Monitoring investment plans and assessment of consistency with Community-wide network development plan Article 41(1)(g)

Along with the Commission for Energy Regulation (CER) and Ofgem we worked together throughout 2015 to coordinate the joint implementation of the EU network codes on Capacity Allocation Mechanism (CAM), Interoperability, and Balancing at the Moffat entry point. All three NRAs continue to monitor the development of the EU network codes and to assess the potential impact to their networks.

### Compliance

- Compliance of regulatory authorities with binding decisions of the Agency and the Commission (Article 41(1)(d)) and with the Guidelines (Article 43))

*Which decisions/actions have been taken following binding decisions of the Agency or the Commission*

- Compliance of transmission and distribution companies, system owners and natural gas undertakings with relevant Community legislation, including cross-border issues (Article 41(1)(b), Article 41(1)(r), Article 41 (3) and Article 41(5)) + imposing penalties (Article 41(4)(d))

*Report in particular on monitoring systems for TSO certification compliance and in the next future NC compliance. Report on other compliance cases and existing active monitoring methods*

Compliance of transmission and distribution companies, system owners is through their licences. There are no issues to report.

## Promoting Competition

### Wholesale markets

*Please provide a brief illustration of the state of competition of wholesale market and the main changes in the recent year*

All gas for NI is purchased at the UK NBP.

### Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition

- Article 41(1)(i) , (j), (k) (l) (u) and Article 44(3)

*Report separately the three issues: prices, transparency and effectiveness of competition. In particular regarding prices report on fundamentals, price developments and liquidity. Regarding transparency report on the access to prices and on how robust prices are and if at national level transparency obligations regarding pricing exist.*

As above all gas for NI is purchased at the UK NBP.

### Retail market

*Please provide a brief illustration of the state of competition of retail market and the main changes in the recent year*

The gas market in the Greater Belfast area has been open to competition to domestic customers since 2007. However, there were no competing suppliers in the domestic market until 2010. In this distribution licensed area there has been six active gas suppliers in the non-domestic sector during 2015: SSE Airtricity Gas Supply (SSE Airtricity), firmus energy, Electric Ireland, VAYU, Go Power and Flogas Natural Gas. In the Greater Belfast licensed area there has been two active gas suppliers in the domestic sector in 2015. SSE Airtricity is subject to a price control over the domestic and small I&C (industrial and commercial) customers who consume less than 25,000 therms per annum in the Greater Belfast area. A maximum average tariff is employed in these sectors for customers of SSE Airtricity. Other suppliers are free to compete against this maximum average tariff. In the Greater Belfast area, during 2015 the total market share of the incumbent supplier (SSE Airtricity) remained at around 72% throughout the year (based on connection numbers). SSE Airtricity also retained about 72% of the domestic market shares throughout 2015 while their shares in the I&C market reduced marginally during 2015 from 66% at the start of the year to 63% at the end of the year.

The ten towns gas area opened to competition for large I&C (industrial and commercial) customers in October 2012. SSE Airtricity entered this market to compete against the incumbent firmus energy from 1 January 2013. The remainder of the market (small I&C customers and domestic customers) opened to competition from April 2015. Since April 2015 two other suppliers, Go Power and Flogas Natural Gas, have entered the Ten Towns market to compete in the I&C market. There are no competing suppliers in the domestic market in the Ten Towns area. firmus energy is the incumbent supplier in the Ten Towns area. During 2015 firmus energy's share of the total I&C market dropped from 99% at the start of the year to 87% by the end of the year based on connection numbers. Domestic customers were supplied exclusively by the incumbent supplier, firmus energy, during 2015.

### **Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition**

- Article 41(1)(i),(j) (k), (l) (u) and Article 44 (3)

*Report separately the three issues: prices, transparency and effectiveness of competition. In particular regarding prices report on fundamentals, price developments and liquidity. Regarding transparency report on the access to prices and on how robust prices are and if at national level transparency obligations regarding pricing exist. Make reference to dual fuel if necessary.*

SSE Airtricity Gas Supply (Northern Ireland) Limited (SSE Airtricity) has a regulated tariff for domestic and small industrial and commercial customers (using less than 25,000 therms per annum) in the Greater Belfast distribution network area. In April 2015, we also introduced a regulated tariff for firmus energy's domestic and small industrial and commercial customers (using less than 25,000 therms per annum) in the Ten Towns distribution network area.

We enter into a formal tariff review process with SSE Airtricity and firmus energy twice per year with a view to tariff changes being effective from 1st April and 1st October each year. We also monitor gas prices on an ongoing basis and an ad-hoc tariff review for SSE Airtricity and firmus energy may be initiated at any stage if the Utility Regulator considers that gas prices have increased or decreased enough to warrant a tariff review. We monitor the SSE Airtricity and firmus energy regulated tariff against the standard tariffs of other supply companies in NI, the UK and ROI. Transparency reports are published by us every quarter which provides comparisons of the gas tariffs in NI, GB and ROI: [http://www.uregni.gov.uk/publications/transparency\\_reports\\_2015](http://www.uregni.gov.uk/publications/transparency_reports_2015).

During 2015 the SSE Airtricity and firmus energy regulated tariffs for domestic customers were consistently lower than the standard domestic tariff of the incumbent supplier, Bord Gais, in ROI and lower than the average of the big six suppliers in GB (based on their standard domestic tariffs). Supply companies in NI have a licence obligation to inform customers at least 21 days in advance of any change (increase or decrease) in the tariff. Suppliers are also required to provide advanced notification of when customer is coming to the end of a fixed term or discounted tariff period (no less than 28 days but no more than 42 days before).

We review the SSE Airtricity and firmus energy gas purchasing strategies each year and also receives regular gas purchasing reports from SSE Airtricity and firmus energy showing the volumes and cost of gas purchased for the short and long term future.

We also monitor the effectiveness of competition in the retail gas markets in NI. There are two retail markets in NI: the Greater Belfast market and the Ten Towns market. Competition in these markets is monitored by us on a quarterly basis and an analysis of the competition is published in our transparency reports:

[http://www.uregni.gov.uk/publications/transparency\\_reports\\_2015](http://www.uregni.gov.uk/publications/transparency_reports_2015).

In the Greater Belfast market, during 2015, there were two active gas suppliers for domestic customers. The domestic market share of the incumbent gas supplier (SSE Airtricity) remained relatively stable at 72% during 2015 (based on number of domestic connections). During 2015 there were six active suppliers for non-domestic customers in Greater Belfast. The total I&C market share of the incumbent gas supplier (SSE Airtricity) remained dropped from around 66% at the start of 2015 to 63% by the end of 2015 (based on number of I&C connections). In the Ten Towns market, the large I&C market (customers using more than 732,500kWh per annum) has been open to competition since October 2012. The remainder of the market (domestic and small I&C customers) opened to competition from April 2015. One competing supplier entered the large I&C market in 2013 and two additional suppliers entered the I&C market during 2015. During 2015 the I&C market share of the incumbent supplier, firmus energy, fell from 99% to 87% (based on number of I&C connections). There are no competing suppliers in the domestic market in the Ten Towns area. Recommendations on supply prices, investigations and measures to promote effective competition.

- Article 41(1)(p)

*Report on recommendations at national level on supply prices and competition*

- Article 41(4)(b)

*Report on main investigations, results and possible measures adopted*

*Report on tariff deficit if it exists*

In the Greater Belfast distribution network area SSE Airtricity Gas Supply (Northern Ireland) Limited (SSE Airtricity) is price regulated for customers using less than 25,000 therms per annum. In the Ten Towns distribution network area firmus energy is price regulated for customers using less than 25,000 therms per annum. We determined, and published, price controls for SSE Airtricity and firmus energy which set out procedures which SSE Airtricity and firmus energy must comply with in setting tariffs. The price controls also set out a level of operating expenditure for each company for each year of the control which is then used when compiling the supply opex costs for the tariff. At each tariff change we publish a paper which provides detail on the various elements of the tariff, details of any over/under recovery which has been built up or lost in previous tariff periods and therefore incorporated into the new tariff and comparisons with tariffs in GB and ROI.

## Security of supply (Article 5) (if and insofar as NRA is competent authority)

The Department of Energy and Climate Change (DECC) is the designated Competent Authority with respect to the security of supply for the UK Member State (as notified to the Commission under Regulation 994). As such a number of the requirements of Article 5 of Directive 2009/73/EC are carried out by DECC. However we do contribute to some of the elements identified below.

### Monitoring balance of supply and demand

100% of Northern Ireland gas supplies are currently provided from Great Britain via the National Transmission System Exit Point at Moffat. As such the wider monitoring of UK demand and supply is largely carried out by DECC and National Grid. However the Transmission System Operators in Northern Ireland and the Republic of Ireland regularly engage with National Grid on demand and supply issues downstream of Moffat.

There are also a number of government and TSO groups that have been established between the UK and Ireland to facilitate communication on emergencies and security of supply. These groups also co-ordinate the work required under Regulation 994.

### Expected future demand and available supplies as well as envisaged additional capacity

Forecast Total Volumes (mscm)									
2015/2016	2016/2017	2017/2018	2018/2019	2019/2020	2020/2021	2021/2022	2022/2023	2023/2024	2024/2025
1,310	1,178	1,218	1,245	1,276	1,300	1,308	1,274	1,315	1,309

All of NI gas supplies are currently provided from Great Britain via the NTS Exit Point at Moffat. As noted previously there is significant industry interest in developing gas storage facilities in the Larne area of NI which could strengthen security of supply within the region.

Along with the NI TSOs we annually produce a gas capacity statement which examines the ability of the gas network to meet future supply and demand

scenarios over a ten year period. This assessment included the proposed Islandmagee storage project and network extension to the West and North West as discussed above.

This approach ensures that any areas requiring investment are identified and addressed so that future demands on the system can be met. The capacity statement is published on our website.

### **Measures to cover peak demand or shortfalls of suppliers**

- Art 41(1)(t): implementation of safeguard measures

The transmission companies in Northern Ireland have emergency arrangements in place to deal with either a physical disruption to the network or a restriction in gas supplies. The arrangements are a legal requirement and are contained within each TSO's Safety Case. The safety case outlines the emergency stages and the actions that are to be undertaken at each stage.

Additionally power stations are required to hold reserves of alternative fuels to enable fuel switching in the event of a restriction to gas supplies. The emergency measures are tested annually alongside the Republic of Ireland and Great Britain exercises.

Gas Supply licenses in NI also require that suppliers have access to gas supplies to meet peak demand during severe winter conditions.

# Consumer protection and dispute settlement in electricity and gas

## Consumer protection

- Compliance with Annex 1 (Article 37(1)(n)) and (Article 41(1)(o))
- Ensuring access to consumption data (Article 37(1)(p)) and (Article 41(1)(q))

Article 11A of the Electricity Order and Article 10A of the Gas Order provides the Authority with powers to impose conditions on licensees to give effect to this obligation. Part VI of the Energy Order provides the Authority with such enforcement powers as are necessary to compel compliance. The conditions which ensure that these consumer protection measures are adhered to are set out in part II of the electricity supply licences, Customer Related Conditions and Part 2 of the Gas Supply licences, Conditions Applicable to the Supply of Gas by the License Holder. The implementation of the third package has seen these conditions further enhanced.

We ensure customer access to consumption data via conditions in the gas and electricity supply licences. Licence Condition 38 and 44 in electricity supply licences and 2.19 and 2.28 in gas supply licences ensures that customers have access to, and are informed of their consumption and that information is provided in such detail and format as is approved by the Utility Regulator and the consumer representative body. Licence conditions were updated as a result of the third package to ensure that consumers are entitled to further detailed information on their electricity and gas consumption.

We have consulted on and implemented licence modifications under the EU Third Internal Energy Package. The licence modifications implemented under the EU Third Internal Energy Package also required Gas and Electricity suppliers to develop and publish Codes of Practice to enhance the consumer protection measures. During 2015, we further extended the consumer protection under the Codes of Practice by developing minimum standards for the Codes of Practice. This strengthened the consumer protection covered by all supplier Codes of Practice. The licence conditions ensure that customers are provided with access to their consumption data and transparent information in relation to tariffs, terms and conditions and complaints handling procedures. It also requires suppliers to offer customers a range of payment methods, to facilitate supplier transfers within 15 working days, and to provide a code of practice on provision of services for vulnerable customers. Licence conditions also set out timeframes for suppliers

providing terms and conditions to new customers and for suppliers to give notice to customers at least 21 days prior to any changes to the terms (including price) being made. Suppliers must also inform customers of their right to withdraw prior to when the terms of their contract are changing. Suppliers also have a licence condition requiring final bills to be issued to customers within six weeks from the date the change of supplier takes place.

## Dispute settlement

- Article 37(11), 37(5)(c), Article 37(4)(e)
- Article 41(11) and Article 41(4)(e)

*Report on cases, in particular on major issues concerning network users (access tariffs, connection disputes/refusals...), including producers and consumers*

As a direct result of Directive 2009/72/EC we were given the legal authority to act as a dispute resolution authority for certain matters in relation to electricity.

Prior to the implementation of the Directive into national law, we had been, and still are, able to determine certain complaints or disputes, such as disputes arising between an electricity distributor and any person requiring a connection to that distributor's distribution system.

On the implementation of the Directives, our dispute resolution remit was extended further, as now individuals and companies are able to refer certain disputes or complaints regarding the transmission and distribution of electricity in Northern Ireland to us for resolution.

In June 2011 we published its "Policy on the Resolution of Complaints, Disputes and Appeals". This sets out procedures which the Utility Regulator will generally follow when dealing with a complaint or dispute which it has been requested to determine. This policy was amended in June 2013<sup>160</sup>.

Under the Gas (NI) Order 1996 billing disputes must in the first instance be referred to the Consumer Council for Northern Ireland. The Consumer Council has 3 months in which to resolve the matter to the customers' satisfaction or the matter is referred to us. We have had no referrals during this period.

The Gas Market Opening Group (GMOG) was established by us to address any operational barriers to entry into the Greater Belfast gas market. The group was extended several years ago to cover the Greater Belfast gas market and the Ten Towns gas market. During 2015 the group was extended again to cover any retail related issues in relation to the gas market that is being developed for the West area. The group includes active representation from supply and distribution license holders, the DETI in NI, the Consumer Council in NI and the Utility Regulator. The GMOG identifies barriers to entry into the gas market in NI; these

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[http://www.uregni.gov.uk/publications/appeals\\_complaints\\_and\\_disputes\\_policy\\_updated\\_june\\_2013](http://www.uregni.gov.uk/publications/appeals_complaints_and_disputes_policy_updated_june_2013)

issues are then discussed with the group with a view to making a decision on the best way to address each issue.

We also initiated the set-up of a Gas Supplier Forum group. This group identifies any requirements for supplier to supplier agreements in relation to customer switching and overcoming supplier barriers to competition. Agreements are then drawn up to be included in the Supply Meter Point Agreement. This group includes active representation from gas supply licence holders, the Consumer Council NI and us; however the Distribution licence holders also attend to ensure all decisions made for supplier agreements will work in accordance with the distribution market rules.

In 2015, we did not receive any formal disputes relating to billing issues. We received 5 formal complaints within 2015 in relation to network issues. Two disputes were completed while two were officially withdrawn after reaching the draft Determination stage. The remaining complaint is due for completion in 2016.