

# 2014 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)

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## Ofgem 2014 National Report to the European Commission

### Overview

The Directives on gas and electricity liberalisation stipulate a reporting obligation for national regulatory authorities. To that end, this report covers Ofgem's annual reporting requirements to the European Commission, in accordance with Directives 2009/72/EC (Electricity) and 2009/73/EC (Gas). 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 found in the second section of this UK response.

The Great Britain (GB) report covers:

- Developments in the GB energy markets in 2013 and Quarter I + II of 2014;
- The regulation and performance of the GB electricity and gas markets along the themes of Network Regulation, Promoting Competition, and Security of Supply; and
- 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 where relevant. It should be noted that some of the information in this report relates to matters which are outside of Ofgem's jurisdiction. Where external sources are used references are provided.

Finally, for further information on Ofgem's activities, please consult our Annual Reports. The 2013-14 Ofgem Annual Report is available at the link below.<sup>2</sup>

### Contact person:

Matthew Berry  
Ofgem, European Wholesale  
9 Millbank, London, SW1P 3GE  
Matthew.Berry@ofgem.gov.uk  
+44(0)203 263 9626

Daniel Tattersall  
Ofgem, European Wholesale  
9 Millbank, London, SW1P 3GE

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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%E2%80%99s-annual-report-and-accounts-2013-14>

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# 1. Chairman's Foreword

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The past year has been extremely busy for Ofgem. Energy has been high on the political and media agenda at both domestic and European level, reflecting public concern over energy prices, security of supply and the quality of service that energy companies provide. We have worked to address these issues, and continue to strive for a competitive and integrated energy market which serves consumers well.

Our assessment of the state of competition in the energy market, which we undertook in conjunction with the Office of Fair Trading and the Competition and Markets Authority (CMA), led us to propose an in-depth market investigation by the CMA. After public consultation we confirmed this proposal and have now referred the energy market to the CMA for an investigation to ensure that there are no barriers to effective competition.

We have also sought to increase and ease consumer engagement with the energy market through our Retail Market Review. Reforms that came fully into effect in April 2014 will ensure suppliers treat consumers fairly, reduce the complexity and number of tariffs, and improve the quality of information available to consumers.

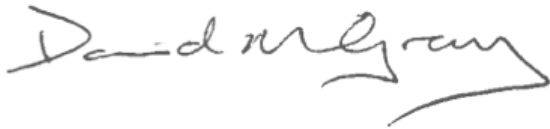
One of our principal functions is to regulate network companies and we are currently reviewing the price controls for the electricity distribution networks. This is the last of the first phase of price controls under our RIIO framework which has attracted a lot of interest across Europe and internationally. The RIIO framework encourages the companies to engage fully with local stakeholders and to address the challenges arising from new developments such as smart grids and the impact of smart meters.

We have maintained our positive engagement with Europe. Day-ahead market coupling, which began in North-West Europe in February 2014, is an important step towards an integrated European energy market. It will bring together prices in different markets and make more efficient use of interconnector capacity. It brings us closer to a sustainable and competitive Internal Energy Market – a market that will gain momentum in the next year and beyond.

Transparency is a growing area too. REMIT (the regulation on wholesale energy market integrity and transparency) helps to create transparency across Europe while stamping out market manipulation. In June 2013, the UK government gave us new powers to monitor, investigate and act against anyone who abuses – or attempts to abuse – the energy market.

As we look ahead, our strong relationship with Europe is as important as ever. Through the Council of European Energy Regulators and the Agency for the Cooperation of Energy Regulators we continue to develop infrastructure and markets which provide secure supplies and competitive prices to customers across Europe. One way we're working together is interconnection – and the recent conflict in Ukraine shows how important it is. To promote this kind of cooperation we're consulting on introducing a new regulatory regime that highlights the value of a flexible and coordinated European energy system.

The coming year will be just as challenging as the previous one, but I'm confident that our regulatory actions, in Britain and with our European counterparts, will let us deliver significant benefits to energy consumers throughout Britain and Europe.

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

David Gray, Chairman

## 2. Main Developments in the gas and electricity markets

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Ofgem's principal objective is to protect the interests of consumers. This summary focuses on two of the many ways in which we achieve this objective. That is: i) by acting as the guardian of the rules governing the wholesale and retail markets, improving those rules when we consider they are not working as well as they should or not promoting appropriate behaviours and taking enforcement action when the rules are breached; and ii) by facilitating the investment in network infrastructure which the energy sector needs and ensuring it is made in a timely and efficient manner.

### **Ensuring retail markets deliver for consumers**

Over time Ofgem has become increasingly concerned about the level of competition in the retail energy sector. During the period covered by this report we introduced significant changes to retail market arrangements which will benefit domestic and non-domestic consumers as part of our Retail Market Review package. We also presented our first 'State of the Market Report' which has resulted in us referring the energy market to the Competition and Markets Authority (CMA) for a competition investigation. The review provides an opportunity to ensure that competition is delivering effectively for consumers.

We also developed a programme and longer term vision for smarter markets. This work proactively identifies and implements market changes that have been made possible by the introduction of smart meters. This will enable the development of smarter markets that are more efficient, dynamic and competitive, which ultimately will deliver better outcomes for consumers.

#### *Improving the functioning of retail markets*

Our Retail Market Review reforms introduced new Standards of Conduct to help ensure fairer treatment of both domestic and non-domestic customers. In addition we have simplified domestic tariffs by limiting the different types of tariffs that suppliers can offer and we now require clearer communication by suppliers, including informing consumers of the cheapest tariff available for them. Non-domestic consumers will benefit from our proposals to simplify the terms under which these businesses can end their contracts.

We are confident that these reforms will help increase consumer engagement in the market. Nevertheless, we continue to see low levels of consumer trust and public concern over the sector, which may limit the ability of the Retail Market Review reforms to deliver improved competition at the pace that is needed. As such we decided to conduct a comprehensive assessment of the market.

#### *Assessing the State of the Market*

We published our first annual State of the Market report on 27 March 2014, in collaboration with the Office of Fair Trading and the Competition and Markets Authority.

Concerns identified in the report include weak customer response, continued evidence of incumbency advantages, further evidence of possible tacit coordination among suppliers, vertical integration and barriers to entry, and increased supplier profits. Taken together, these problems indicate a lack of effective competition in energy markets. The problems identified have been analysed in previous Ofgem reviews but have persisted, and in some cases worsened, over the last few years. They constitute clear evidence that consumers are not being well served by current levels of competition.

As a result, after consultation we have made a market investigation reference to the CMA. Their analysis should identify whether there are reforms, including those outside Ofgem's powers, which would benefit consumers by making competition in the market more effective.

#### *Acting decisively where rules are breached*

Ofgem monitors companies' compliance with their obligations under industry rules and uses its enforcement powers to protect the interests of consumers where these obligations are not met. During 2013 our enforcement activity led to energy companies paying £35.5 million in compensation and penalties. Our most notable investigations included:

- In May 2013 we penalised SSE £10.5 million for mis-selling. SSE had used misleading sales scripts providing inaccurate estimates and comparisons to customers and failed to adequately monitor its sales agents' activities.
- In June 2013 British Gas paid £10 million to customers in financial hardship. This was in response to the way it had been interpreting the regulations for calculating the amount of energy contained in gas.
- In December 2013 Scottish Power returned £8.5 million to customers after our investigation into mis-selling. It had failed to give customers accurate information about annual charges and about how much they would save if they switched supplier.

### **Ensuring efficient, competitive and secure wholesale markets**

Effective wholesale markets are key to ensuring competition in retail markets. Over the past year, we have worked to further improve their functioning and to promote the integration of the GB market with the markets of our European neighbours – to enhance transparency and to increase efficiency.

#### *Integrating GB and European markets*

Market coupling facilitates the integration of markets and more efficient use of available transmission capacity. A series of auctions bring together those willing to buy and sell energy across borders and allocate the capacity which exists between countries efficiently to those who value it most highly. Market coupling can lead to more robust day-ahead prices, greater liquidity, allow resources to be used more efficiently and potentially send a

signal about where future investment is needed. All of which benefits European consumers.

The 4<sup>th</sup> February 2014 marked an important step for Britain, as it joined the North-West Europe market coupling project. Following the subsequent joining of Iberia, this means Britain is now part of a market covering seventeen countries in the day-ahead timeframe. Efforts are ongoing to create similar projects for intraday trading and trading in the balancing timeframe.

#### *Increasing European wholesale market transparency*

As markets become ever more integrated and interconnected, it is vital to improve wholesale transparency at the European level. The EU regulation on wholesale energy market integrity and transparency (REMIT) prohibits insider trading and attempted or actual market manipulation in wholesale energy markets across the EU.

In June 2013, the UK government granted Ofgem new powers to monitor, investigate and take action against organisations or individuals who carry out or attempt to carry out energy market abuse. We are putting in place the arrangements to be able to start this process in line with its date of application in 2015.

#### *Improving the functioning of GB wholesale markets*

During 2013 Ofgem has also sought to increase the efficiency of the GB wholesale markets. In particular we have focussed on improving the efficiency of the arrangements for balancing and promoting liquidity. This should have beneficial impacts for market efficiency and security of supply.

Our electricity balancing reforms better the current balancing arrangements by improving the balancing market signals sent to flexible capacity (including providers of demand side response) in order to reduce cost and increase efficiency. Our gas balancing proposals reduce the likelihood, severity and duration of a potential gas supply emergency by ensuring arrangements send price signals about the need to import gas at times of system stress and support demand side response. Our liquidity reforms also enhance the functioning of wholesale markets, making it easier for new participants to enter the market, thereby increasing competition and driving down end prices for consumers.

### **Promoting efficient investments in infrastructure**

An effective and integrated wholesale market must be supported by robust infrastructure in GB and interconnection across borders. In 2013/2014 we introduced a new approach to promoting interconnection, as well as continuing with our innovative RIIO approach to regulate our grid companies.

#### *A new approach to promoting interconnection*

In May 2014 we published our decision to roll out a new regulatory regime, termed “cap and floor”, for interconnection projects which may be built in the near future. Prior to announcing this generic approach we consulted on the regulatory regime which would



apply to project NEMO (the proposed electricity interconnector between GB and Belgium). The regime has been developed together with the Belgian regulator Commission de Régulation de l'Electricité et du Gaz (CREG).

In order to stimulate investment in cross-border interconnection, we are willing to consider exemptions from certain legal conditions (for example use of revenues, third party access and unbundling). These exemptions are subject to agreement by the necessary parties, public consultation, and European Commission approval. One such example of this is Eleclink Limited, a proposed 1GW interconnector project between GB and France. Eleclink's exemption was approved, and published on the 9th April 2014.

### *RIIO price controls*

RIIO (Revenue = Incentives + Innovation + Outputs) price controls determine the outputs, allowed revenues and other elements of the regulatory frameworks for network companies for an eight-year period.

In early 2013 we completed the first price control reviews using the RIIO framework: RIIO-T1 (gas and electricity transmission) and RIIO-GD1 (gas distribution), which apply from 1 April 2013 to 31 March 2021. We are currently undertaking the first electricity distribution price control review (RIIO-ED1) which will be applicable to six electricity distribution network operators (DNOs) from 1 April 2015 to 31 March 2023.

Under RIIO-ED1 distribution companies will need to deliver outputs that we have set in relation to safety, network reliability, customer satisfaction, services for customers seeking a new connection and a range of different social issues. Distribution companies will also need to be able to accommodate uncertain levels of low carbon technologies onto their networks and respond to the increasing potential for demand side response. The RIIO-ED1 package will ensure they do this at an efficient cost, using smart grid tools and techniques whilst providing good service to new and existing customers.

The RIIO approach places emphasis on incentives to drive the innovation needed to deliver a sustainable energy network at value for money to existing and future consumers. As part of the innovation stimulus package, we run separate Network Innovation Competitions for both electricity and gas transmission. The competitions provide funding for the innovation projects which produce environmental benefits and security of supply at value for money, as GB moves to a low carbon economy.

### **Challenges ahead**

The next year will continue to be very busy for Ofgem. We will work with the CMA on the market investigation reference, to determine whether any remedies are needed to deliver improved competition in the GB energy markets.

We will continue to work closely with fellow national regulatory authorities, the Agency for the Cooperation of Energy Regulators and the European Commission towards the goal of completing the Internal Energy Market. Progression towards this target will be achieved

through the continued development and implementation of the technical rules (the European Network Codes and Guidelines) that facilitate more efficient cross-border trade of gas and electricity. We will also maintain our focus on wholesale market transparency and monitoring through REMIT. Facilitating the physical integration of European energy markets through interconnection and infrastructure projects will be a priority for us too.

We will also continue to work with other European energy regulators and the European Commission on the development of smart grids. Our engagement reflects the cross industry work in the Smart Grid Forum we co-chair with the government's Department of Energy and Climate Change and the incentives on innovation within our RIIO framework.

At both the European and national level we will continue to ensure that the consumer is at the forefront of the energy market.

## 3. The electricity market

The following chapter contains details of developments within Great Britain's (GB) electricity sector during 2013. This includes details on network regulation, competition, and developments in both the wholesale and retail markets along with security of supply.

### 3.1 Network regulation

#### 3.1.1 Unbundling

On 10 November 2011, the GB Electricity and Gas (Internal Markets) Regulations 2011 (the GB Regulations) came into force. The GB Regulations implement the Third Package into the GB domestic regulatory regime including legislation, licences and industry codes along with the ownership unbundling requirements in respect of Transmission System Operators (TSOs) and the unbundling requirements in respect of Distribution System Operators (DSOs). 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 pursuant to one of the grounds for certification set out in the Electricity Act.

The GB Regulations have amended the Utilities Act 2000 to designate the Authority as the National Regulatory Authority (NRA) for GB and have given it (through amendments to the Gas Act and the Electricity Act) the responsibility for administering the certification process. The Authority is also required 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 such applications in 2013.

#### **Transmission System Operators (TSOs)**

Under Article 10 2009/72/EC (Electricity 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 transmission system operator.

In 2013 the Authority published two final certification decisions (pursuant to sections 10D(6)-(8) of the Electricity Act and Article 3(2) of Regulation (EC) No. 714/2009 (the Electricity Regulation) in respect of;

- BritNed Development Limited (BritNed) – decision published 3 July 2013<sup>3,4,5</sup>
- Moyle Interconnector Limited (MIL) – decision published 4 September 2013<sup>6,7</sup>

<sup>3</sup> <https://www.ofgem.gov.uk/ofgem-publications/75780/certification-decision-britned-development-ltd.pdf>

<sup>4</sup> <http://eur-lex.europa.eu/legal-content/en/ALL/?i=2vtpTxWGFZYhWKfnn4rpytGXJGidL22rzzL0N0tYDLQ7K5nyTxcS!-1634048440?uri=CELEX:32003R1228>

<sup>5</sup> [http://ec.europa.eu/energy/gas\\_electricity/interpretative\\_notes/doc/certification/2013\\_062\\_uk\\_en.pdf](http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/certification/2013_062_uk_en.pdf)

<sup>6</sup> <https://www.ofgem.gov.uk/publications-and-updates/certification-decision-moyle-interconnector-limited>

<sup>7</sup> [http://ec.europa.eu/energy/gas\\_electricity/interpretative\\_notes/doc/certification/2013\\_070\\_072\\_uk\\_en.pdf](http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/certification/2013_070_072_uk_en.pdf)

Under Article 10 2009/72/EC (Electricity Directive) we also have an obligation to monitor the continuing compliance of TSOs with the requirements of Article 9. As such, in Q3 2013, the Authority reviewed the annual declarations submitted on behalf of the following TSOs and remained satisfied that the ground for their certifications remained valid:

- Scottish Hydro Electric Transmission (SHETL)
- Scottish Power Transmission Limited (SPTL)
- National Grid Electricity Transmission plc and National Grid Interconnectors Limited (NGET and NGIL)
- BritNed

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

There were no changes or additions to the population of electricity DSOs in GB during 2013.<sup>8</sup> There continue to be fourteen electricity distribution services providers (DSPs); Northern Powergrid (Northeast) Limited, Northern Powergrid (Yorkshire) plc, London Power Networks plc, South Eastern Power Networks plc, Eastern Power Networks plc, Electricity North West Ltd, Scottish Hydro Electric Power Distribution plc, Southern Electric Power Distribution plc, SP Distribution Ltd, SP Manweb plc, Western Power Distribution (East Midlands) plc, Western Power Distribution (West Midlands) plc, Western Power Distribution (South West) plc and Western Power Distribution (South Wales) plc.

There also continue to be six independent (embedded) electricity distribution system operators: Independent Power Networks Ltd, Energetics Electricity Ltd, The Electricity Network Company Ltd, ESP Electricity Ltd, UK Power Networks (IDNO) Ltd and Utility Assets Ltd. Each independent DSO owns and operates a number of relatively small networks at various geographical locations. During 2013, the electricity distribution assets of UK Power Networks (IDNO) Ltd, which constituted the electricity distribution network within the London 2012 Olympic Park, were transferred to London Power Networks plc, the DSO for the London area which is in the same ownership group. The UK Power Networks (IDNO) Ltd is remaining in place, however, pending the orderly transfer of meter point administration and supplier account details under the electricity settlement system.

During 2013 we reviewed the returns submitted by DSOs relating to business independence, financial reporting and output performance. In that context we are satisfied that the Electricity Directive requirements relating to unbundling are being properly observed.

We also dealt with one application for approval of a charging methodology for a licence-exempt private network and one determination of a dispute concerning which of two parties held licence exempt operator status in relation to a private network.

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<sup>8</sup> In relation to Article 26 of Directive 2009/72/EC.

## **Offshore Transmission Owners (OFTOs)**

In 2013 the Authority certified the following OFTOs as ownership unbundled:<sup>9</sup> Blue Transmission Walney 1 Limited, Blue Transmission Walney 2 Limited, Blue Transmission Sheringham Shoal Limited, Blue Transmission London Array Limited, and Greater Garbbard OFTO plc. In 2013, the Authority also certified two Preferred Bidders which are expected to be granted transmission licences in respect of offshore network operation in 2014, namely TC Lincs OFTO Limited and Thanet OFTO Limited.<sup>10</sup>

As with TSOs and DSOs, the Authority monitors, and will continue to monitor, whether the basis upon which it decided to certify OFTOs continues to apply following these Final Decisions.<sup>11</sup> In 2013 the Authority reviewed whether the certification basis in respect of the first four OFTOs mentioned above continued to apply in light of a change of the structure of the joint venture that owns these four OFTOs. Following this review, the Authority's Preliminary Decision stated that the certification of these four OFTOs should be continued.

### **3.1.2 Technical functioning**

#### **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 Great Britain (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<sup>12</sup> regarding the Balancing and Settlement Code (BSC) – the document which defines the rules and governance for the balancing mechanism and imbalance settlement – and regarding the procurement and use of balancing services. The BSC objectives are set out in NGET's licence and include the efficient, economic operation of the transmission system and compliance with European Commission decisions.

The current electricity balancing arrangements are designed to provide commercial incentives for generators to physically match the amount that they notify<sup>13</sup> with what they

<sup>9</sup> In relation to Article 10 and 11 of Directive 2009/72/EC and following procedures in Article 3 Regulation (EC) 714/2009

<sup>10</sup> All Final Decisions for OFTOs and Preferred Bidders can be found on our website.

<sup>11</sup> Following an application for certification, Preliminary Decisions are taken by the Authority and notified to the European Commission. The Authority then takes utmost account of the Commission's opinion in reaching its Final Decision.

<sup>12</sup> All licence conditions are enforceable by the Authority. We can make orders to ensure compliance and can impose a financial penalty of up to 10% of the licensee's turnover for failure to comply with a licence condition.

<sup>13</sup> In order to balance the network, NGET relies on generators to provide accurate Final Physical Notifications (FPNs) of how much energy they expect to produce in the next half hour.

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. Generators' imbalance relates to the difference between the amount they physically deliver and their contracted volume. Suppliers' imbalance relates to the difference between that notified and that which is offtaken. Where there is an imbalance either generator or supplier will incur cash-out charges.

Ofgem has proposed improvements to these balancing and cash-out arrangements as part of our Electricity Balancing Significant Code Review (EBSCR). We published an initial consultation document<sup>14</sup> in 2012 and following a consultation period and significant further stakeholder engagement we published our Draft Policy Decision document in July 2013. During this review we, and the industry, have considered ways to change the balancing arrangements in order to improve balancing efficiency and greater levels of security of supply. In particular sending the right signals for flexible capacity is becoming more important as we transition into an electricity system with an increasing share of intermittent generation. We concluded the EBSCR on 15 May 2014.<sup>15</sup>

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) and approved by Ofgem. Ofgem places financial and reputational incentives on the SO to ensure that it is encouraged to keep the costs of operating the system as low as possible for system users within the safety and security bounds which are set out under the codes and licences. In addition, Ofgem is required to approve any change to the charging methodology. Further details of how BSUoS charges are levied can be found below 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, regulators 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 Owners (TOs) 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.

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<sup>14</sup> Electricity Balancing Significant Code Review (SCR) – Initial Consultation. Available here: <http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/electricity-balancing-scr/Documents1/Electricity%20Balancing%20SCR%20initial%20consultation.pdf>.

<sup>15</sup> <https://www.ofgem.gov.uk/ofgem-publications/87782/electricitybalancingsignificantcodereview-finalpolicydecision.pdf>

NGET's licence requires NGET, in its role as SO, to submit a report providing details of system security and quality of service and supply to Ofgem each year. This report includes information on system availability, security and quality of service of the NETS during the previous financial year.<sup>16</sup>

### *System Reliability*

There is also a regulatory mechanism in place to incentivise TOs to maintain a reliable and secure system. Each onshore TO licensee is set a target for availability, reliability and for minimising loss of supply events as part of a price control. They are either rewarded or penalised according to their level of performance against targets set by us.

The electricity transmission price control model (RIIO-T1)<sup>17</sup> includes, among other outputs, a reliability output which from April 2013 until March 2021, will be based on performance of Energy Not Supplied (ENS). This incentivises network companies to ensure the reliability of their network. There are also a suite of network output measures that inform the safety and reliability of a TO's network and will directly affect the funding at the start of next price control, RIIO-T2, in 2021.

Strategic Wider Works (SWW) arrangements provide flexibility within the RIIO-T1 price control by allowing TOs to bring forward projects when more information is available (rather than only allowing TOs to develop projects that were agreed at the start of the price control). This helps to manage uncertainty and guarantee value for money for consumers by ensuring that network infrastructure projects are progressed at the most appropriate time.

In December 2013 we made a decision on an application for a transmission project between Kintyre-Hunterston to reinforce the transmission system around the Kintyre peninsula, in the South West of Scotland.<sup>18</sup> The increase in transmission capacity will accommodate future generation, including that from renewable generation projects. This project is designed to deliver a SWW output of 270MW of additional transmission capacity. It is expected to cost £197.4 million and is planned to be completed in 2016.

In 2013 we also received three full submissions to the electricity transmission Network Innovation Competition (NIC), introduced as part of the RIIO-T1 price control. Funding is provided for the innovation projects which provide environmental benefits and security of supply at value for money. Two of the three projects were selected for funding, a combined total of £17.8m.<sup>19</sup>

<sup>16</sup> The latest version of the report covers the period to 31 March 2013 and is available on National Grid's website: [http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&cad=rja&uact=8&ved=0CCwQFjAA&url=http%3A%2F%2Fwww2.nationalgrid.com%2FWorkArea%2FDownloadAsset.aspx%3Fid%3D24519&ei=A0dNU5WVEaQV7AbR\\_oCoBg&usq=AFQjCNF8et0ju2h4Aq8Kgk5Hyyp123Dn3A](http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&cad=rja&uact=8&ved=0CCwQFjAA&url=http%3A%2F%2Fwww2.nationalgrid.com%2FWorkArea%2FDownloadAsset.aspx%3Fid%3D24519&ei=A0dNU5WVEaQV7AbR_oCoBg&usq=AFQjCNF8et0ju2h4Aq8Kgk5Hyyp123Dn3A)

<sup>17</sup> RIIO-T1: <https://www.ofgem.gov.uk/network-regulation-%E2%80%93-riio-model/riio-t1-price-control>

<sup>18</sup> Decision on the proposed Kintyre-Hunterston reinforcement: <https://www.ofgem.gov.uk/electricity/transmission-networks/critical-investments/strategic-wider-works/kintyre-hunterston>

<sup>19</sup> <https://www.ofgem.gov.uk/ofgem-publications/84870/electricitynetworkinnovationcompetition-decisiononfirstyearcompetitiondoc.pdf>

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

### *Distribution*

In GB, licensed electricity Distribution Network Operators (DNOs) are required by their licence to design their networks to meet the requirements of engineering standards.<sup>20</sup> In the event that a licensee cannot comply with this licence condition it is able to apply to us for a derogation.

All DNOs are required by their licence to provide us with data on the performance of their networks.

In April 2010, the current price control for DNOs (Distribution Price Control Review 5 - DPCR5) took effect and will run until 2015. One of the key features of DPCR5 is an 'Interruptions Incentive Scheme' (IIS). This scheme incentivises DNOs to invest in and operate their networks to manage and reduce the frequency and duration of power cuts experienced by their customers.

We set the targets and incentive rates for the number of customer interruptions and customer minutes lost for each DNO as part of the price control process. The strength of these incentives reflects the value customers place on an uninterrupted supply of electricity (based on our research into customers' 'willingness to pay'). This incentive has led to a reduction in the amount of disruption caused by supply interruptions. DNOs were rewarded (through increased allowed revenue) £109 million in total for their performance in 2012-13.

As part of DPCR5 we also updated the "Electricity (Standards of Performance) Regulations 2010" (SI 2010/698). Under these Regulations, the Standards encourage DNOs to meet certain expected levels of service and to provide payments to end customers in the event of individual standards not being met. The standards cover a range of activities – including restoring supply during an unplanned interruption and providing notice periods for planned interruptions. The amounts paid vary depending on the activity involved. The major changes in this area have been in adjusting the payment levels to account for inflation, as well as the introduction of new standards.<sup>21</sup>

We have published annual reports on DNO IIS performance since 2001-02.<sup>22</sup> Recently this report<sup>23</sup> has moved beyond focussing exclusively on interruptions of performance and

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<sup>20</sup> Such as Engineering Recommendation P2/6

<sup>21</sup> The new standards are: a '5,000 customer standard' (payments are due to customers if 5,000 customers are interrupted as part of a single electricity incident on a DSO's network and they have not been restored to supply after 18 hours); and 'Supply restoration: rota disconnection' (this standard applies where a rota disconnection policy is employed to share out available load, where some customers are off for 24 hours or longer, in aggregate, across an entire event).

<sup>22</sup> The latest published IIS data was in the November ED1 fast track document and had data for 2010-11 to 2012-13, showing the DNOs' performance against their targets for these years.

<sup>23</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=702&refer=Networks/ElecDist/PriceCtrls/DPCR5>



looks at the performance of DNOs across a wider range of areas, including: reliability and availability, network investment, customer satisfaction, connections, social responsibility and the environment.

In 2013 we published our strategy decision<sup>24</sup> regarding the next electricity distribution price control (RIIO-ED1), which will run from 2015-2023. In July 2013 we received business plan proposals from each of the DNOs. We assessed these and in February 2014, following consultation, we published our decision to settle the price control early ('fast-tracked') for Western Power Distribution's (WPD) four licensees. In March 2014 we received revised business plans from the remaining DNOs and we are in the process of assessing these.

Innovation will play a key part in the DNOs delivering at an efficient cost and dealing with uncertainty. In the current price control - Distribution Price Control Review 5 (DPCR5)<sup>25</sup> - we established the Low Carbon Networks (LCN) Fund. The objective of the LCN Fund is 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. The Fund allows up to £500m support to projects sponsored by the DNOs to trial new technology, and operating and commercial arrangements. We expect to see the learning from the LCN Fund trials embedded in the DNOs' business plans.

There are two tiers of funding under the LCN Fund. The First Tier allows DNOs to recover a proportion of expenditure incurred on small scale projects. Under the Second Tier of the LCN Fund, we run an annual competition for an allocation of up to £64 million to help fund a small number of flagship projects. In the Second Tier 2013 competition, we received seven applications. From these, we selected four for funding and awarded £26.58m of the available £64m to these projects.<sup>26</sup>

### **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.

#### *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, i.e. spread across all generation and demand (levied 50:50) in GB, and are recovered through Balancing Services Use of System (BSUoS) charges.

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<sup>24</sup> <https://www.ofgem.gov.uk/publications-and-updates/strategy-decision-riio-ed1-overview>

<sup>25</sup> More information DPCR 5 can be found on our website:

<http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Pages/DPCR5.aspx>

<sup>26</sup> <https://www.ofgem.gov.uk/ofgem-publications/84868/lcnfdecisiononfourthcompetition.pdf>

We receive half-yearly 'Timely Connections' reports from onshore transmission licensees. These reports provide us with information on the factors affecting the connection dates offered to generators. This enables us to assess whether any changes to the existing framework are needed. A non-confidential version of the report is published on NGET's website.<sup>27</sup>

Each year we also publish an annual report which is submitted to the Secretary of State. The report monitors the impacts of the 'Connect and Manage' regime. The most recent report (December 2013)<sup>28</sup> noted that under the 'Connect and Manage' regime, connection dates have been brought forward by an average of five years compared with previous arrangements.

To date all OFTOs own and operate assets built by offshore generators. As such there have been no issues under the offshore transmission regime regarding the time taken to connect. OFTOs' licences require them to report, on a quarterly basis, offshore transmission system performance and whether that performance has fallen below target. All OFTOs, except one, have reported system availability at levels above the incentive target for 2013.

### *Distribution*

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 where 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 per cent of occasions in each quarter constitutes a breach of licence.

In our RIIO-ED1 (distribution price control) Strategy Decision, published in March 2013, we outlined a new 'time to connect' incentive we will be introducing in 2015. This will monitor and reward DNOs if they are able to issue quotes and complete connections (for smaller connection projects) quicker than the target timescales.

We also monitor the time taken to repair faults through the IIS. The time taken to repair has been incentivised as part of the customer minutes lost element of the IIS - this is dealt with more fully in the previous sub-section on "Security and reliability standards, quality of service and supply".

### **Monitoring safeguard measures**

In the event of a sudden crisis in the energy market and where the physical safety or security of persons, apparatus or installations of system integrity are threatened, a

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<sup>27</sup> Timely Connections Reports 2013: <http://www2.nationalgrid.com/UK/Services/Electricity-connections/Industry-products/timely-connections-report/>

<sup>28</sup> Monitoring the 'Connect and Manage' electricity grid access regime – Fourth report from Ofgem (December 2013) <https://www.ofgem.gov.uk/ofgem-publications/84982/connectandmanage2013final051213.pdf>

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 UK 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 set out in the Fuel Security Code (standard licence condition B11).<sup>29</sup> Transmission licensees are required to comply with the Code. Under the Fuel Security Code, in an emergency the Energy Emergencies Executive ('E3') Committee<sup>30</sup> will establish the Joint Response Team to liaise between industry and government and to develop the mechanism by which the practical management of an emergency can be achieved.

The principal objective of this Fuel Security Code is to provide an administrative structure during a fuel crisis enabling appropriate measures be taken by the government with the minimum of interference with normal market arrangements.

### **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.

DPCR5 introduced a number of measures to assist the development of competition. This included requiring DNOs to charge a regulated margin of four per cent on contestable connection activities. DNOs have also been required to demonstrate to us that there is effective competition in different segments of the market. Where we believe there is effective competition a DNO is allowed to charge an unregulated margin on contestable works. DNOs were able to submit applications up to the end of 2013 and we are currently reviewing the final Competition Tests submitted. Following this, we will review any segments of the market that did not pass the Competition Test and consider what further action to take. Progress on this process will be reported in more detail in forthcoming editions of the Electricity Distribution Annual Report (EDAR).

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

Under Article 37(1)(a) of the Electricity Directive national regulatory authorities (NRAs) are required to fix or approve transmission or distribution tariffs or their methodologies.

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<sup>29</sup> Standard Condition B11:

<http://epr.ofgem.gov.uk/EPRFiles/Electricity%20transmission%20full%20set%20of%20consolidated%20standard%20licence%20conditions%20-%20Current%20Version.pdf>, see page 87

<sup>30</sup> E3 includes representation from DECC, Ofgem and National Grid. Ofgem's role is to provide information and guidance on the operation of the gas and/or electricity markets during an emergency.

## **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 Balancing Services Use of System (BSUoS) charges;

### *Connection Charges*

Connection charges relate to the provision and maintenance of connection assets which are solely required to connect a particular user (for example, a generator) to the main transmission system. The costs are recovered under National Grid Electricity Transmission (NGET)'s connection charging methodology,<sup>31</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.

### *Transmission Network Use of System (TNUoS) Charges*

The TNUoS charging methodology<sup>32</sup> is applied by NGET in its role as System Operator (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>33</sup>

### *Balancing Services Use of System (BSUoS) Charges*

BSUoS charges relate to the costs of the day-to-day operation of the transmission system and include charges for the recovery of constraint costs.

Key to the calculation of BSUoS charges for each settlement day is the ability of NGET to access up to date volume information and appropriate balancing cost information. While some balancing service costs can be identified on a half hourly basis, some will be incurred over longer timescales and there is no simple method for NGET to allocate these costs to individual (half hourly) settlement periods.

<sup>31</sup> NGET's connection charging methodology: <http://www2.nationalgrid.com/uk/Industry-information/System-charges/Electricity-transmission/Transmission-Network-Use-of-System-Charges/Statement-of-Use-of-System-Charges/>

<sup>32</sup> TNUoS charging methodology: <http://www.nationalgrid.com/uk/Electricity/Charges/chargingstatementsapproval/index.htm>

<sup>33</sup> See 2010 National Report for a more detailed description of the components of the TNUoS charge:

[http://www.energy-regulators.eu/portal/page/portal/EER\\_HOME/EER\\_PUBLICATIONS/NATIONAL\\_REPORTS/National%20Reporting%202010/NR\\_En/E10\\_NR\\_UK-EN.pdf](http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/NATIONAL_REPORTS/National%20Reporting%202010/NR_En/E10_NR_UK-EN.pdf)

To address this issue, BSUoS charges are calculated, billed and reconciled at scheduled intervals for each settlement day. The process seeks to utilise the best estimate of costs and to refine the daily charge calculation over time through the use of reconciliations based on updated volume and cost information at each incremental settlement stage.

Section 14 of the Connection and Use of System Code (CUSC)<sup>34</sup> includes a detailed methodology for the calculation of daily BSUoS charges, some worked examples, and information on timing of BSUoS charges and financial settlement.

NGET raised modification proposal CMP201 in December 2011, with the aim of recovering all BSUoS costs from demand (currently costs are split 50:50 between demand and generation). The final modification report was submitted to us in May 2013<sup>35</sup> and we published an Impact Assessment consultation in November 2013. We are considering responses to this consultation and intend to make our final decision in 2014.

#### *Offshore Transmission Operators (OFTOs)*

Onshore, the price control process is designed to ensure that these three charges allow network owners to be remunerated for the efficient cost of network assets whilst protecting consumers. For offshore transmission, an OFTO's revenue is set through a competitive tender process and recovered through transmission charges over a 20 year period.

In terms of charging, the primary requirement of the transmission licence is that the various charging mechanisms should achieve the 'relevant objectives' of facilitating competition; reflecting costs incurred; and taking account of developments in the transmission businesses. The form of the methodologies must be approved by Ofgem, but we do not set or approve the level of individual charges.

Transmission charging methodologies form part of the Connection and Use of System Code (CUSC) and are subject to open governance arrangements. This means the wider industry, including generators and suppliers, can raise proposals to modify the charging methodologies. The CUSC governance arrangements ensure that proposals are subject to thorough review and consultation. The final decision of whether to approve changes rests with Ofgem, except where a proposed modification meets the self-governance criteria. Under the self-governance process, a modification proposal that would be unlikely to have material impacts on, for example, consumers, competition or sustainable development, can be determined by the CUSC Panel without reference to the Authority for decision.<sup>36</sup> There are also legislative arrangements in place to allow parties to appeal changes to the CUSC.

<sup>34</sup> CUSC – section 14 [http://www.nationalgrid.com/NR/rdonlyres/8FFA9408-9DC7-44C2-AF68-93E684A176D8/59890/CUSC\\_Section\\_14\\_v15combined\\_CMP20\\_3\\_1April2013.pdf](http://www.nationalgrid.com/NR/rdonlyres/8FFA9408-9DC7-44C2-AF68-93E684A176D8/59890/CUSC_Section_14_v15combined_CMP20_3_1April2013.pdf)

<sup>35</sup> This is a revised version of the Final Modification Report. We received the original version on 10 October 2012. We decided that we could not properly consult, or form an opinion, on the proposal as submitted. In particular, we identified deficiencies in the analysis, and the way the results of that analysis were used in the assessment of the proposal. The proposal was sent back to the industry for further work.

<sup>36</sup> The self-governance criteria are fully outlined in the CUSC.

Transmission Owners, including OFTOs are obliged to review their charging statements on an annual basis. Updated charging statements are subject to the approval of the Authority.

## **Distribution**

The electricity distribution licence requires Distribution Network Operators (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) that have been approved by Ofgem on the basis that they achieve the relevant objectives. These objectives include that compliance with the methodology facilitates competition in the generation and supply of electricity, does not restrict competition in the transmission and distribution of electricity and results in charges which reflect the costs incurred by the licensee in its distribution business.

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 licence gives us powers to determine in cases in which customers do not consider that a DNO's charges reflect those set out in their Charging Methodology. We also have powers to determine these disputes, and powers to enforce DNOs' compliance with the licence. For use of system charges there are two charging methodologies:

- Common Distribution Charging Methodology (CDCM) for normal and high voltage connectees to the distribution network
- Extra – high voltage Distribution Charging Methodology (EDCM) for those defined as
  - Distribution Systems connected to the licensee's distribution system at 22 kilovolts or more.
  - Premises connected to the licensee's Distribution System at 22 kilovolts or more.
  - Distribution Systems connected directly to substation assets that form part of the licensee's Distribution System at 1 kilovolt or more and less than 22 kilovolts where the primary voltage of the substation is 22 kilovolts or more and where the Metering Point is located at the same substation.
  - Premises connected directly to substation assets that form part of the licensee's Distribution System at 1 kilovolt or more and less than 22 kilovolts where the primary voltage of the substation is 22 kilovolts or more and where the Metering Point is located at the same substation.

The Codes relevant to electricity contain provisions for affected stakeholders to provide inputs to proposed changes to the methodologies or tariffs. 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. Whilst we have the power to make a decision on proposed

changes to the methodologies, we do not have the power to review these decisions.

Stakeholders have the right to apply for judicial review in respect of any such decision. There has not been any application for judicial review of any decision regarding the methodologies or tariffs during 2013.

### **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. 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>37</sup>

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-subsidisation.

We are satisfied that there were no material cross-subsidisation issues during 2013. We are satisfied that the particular guidance we issued to TSOs and DSOs (noted in last year's report) has been followed. 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 licensee. We do not have any unresolved concerns at present, but arrangements need to be monitored in the context of refinancing, restructuring and corporate transaction events.

On 1 April 2013 we modified all network licences (except those for independent DSOs and Offshore Transmission Owners) to include a requirement for each licensee to have at least two sufficiently independent directors. The requirement became effective on 1 April 2014 and we consider that this measure will be supportive of good governance at licensee level, including compliance with licence conditions relating to the prevention of cross-subsidisation and discrimination.

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<sup>37</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).

### 3.1.4 Cross-border issues

#### **Existing interconnection**

The completion of the 500MW EirGrid East-West Interconnector (EWIC) in 2012 increased interconnection between Great Britain (GB) and neighbouring countries from 3.5GW to 4GW. Existing interconnection includes the 1000MW BritNed interconnector with the Netherlands (BritNed), the 2000MW IFA interconnector with France (IFA), and the 450MW Moyle interconnector with Northern Ireland.

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

The Third Package introduced new responsibilities for NRAs regarding the rules for granting access to cross-border electricity infrastructures. Amendments have been made to the standard licence conditions of the electricity interconnector licence in GB to take account of these new responsibilities.<sup>38</sup>

Licensees are required to submit to Ofgem any new or amended access rules (including capacity allocation and congestion management). The interconnector licence also gives us the power to request licensees to review and amend these access rules.

The GB interconnector standard licence conditions place a responsibility on both Ofgem and the interconnector operator to ensure that tariff methodologies and access rules, and any modifications to these, comply with certain objectives. The objectives are objectivity, transparency, non-discrimination and compliance with the Electricity Regulation or any decision of the European Commission and ACER.

Interconnector operators are required to review and consult on their access rules at least once each calendar year, or at our request, and to provide us with a report. This report should highlight what amendments, if any, will be made to better facilitate the objectives outlined above. The review must take into account the consultation.

Ofgem maintains and regularly updates a database of interconnector statistics, including information on auctions, capacity, flows and nominations.

The following paragraphs give an overview of the arrangements on each of our interconnectors, and also highlight any recent and upcoming developments in relation to the approval of tariff methodologies and access rules.

#### *England-France Interconnector (IFA)*

The England-France Interconnector is jointly operated by National Grid Interconnectors Limited (NGIC) and Réseau de Transport d'Électricité (RTE), the French TSO. IFA is a high voltage direct current (HVDC) line with a nominated capacity of 2000MW.

During 2013, NGIC and RTE consulted with stakeholders on the necessary amendments to IFA access rules in order to implement market coupling. We approved IFA access rules in

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<sup>38</sup> See standard conditions 10, 11 and 11A of the Electricity Interconnectors Licence: [http://epr.ofgem.gov.uk/EPRFiles/Electricity\\_Interconnector\\_Standard%20Licence%20Conditions%20Consolidated%20-%20Current%20Version.pdf](http://epr.ofgem.gov.uk/EPRFiles/Electricity_Interconnector_Standard%20Licence%20Conditions%20Consolidated%20-%20Current%20Version.pdf)



November 2013<sup>39</sup> and in February 2014, day-ahead market coupling (implicit auctions) went live on IFA as part of the North West Europe (NWE) project.

Capacity is allocated explicitly in the long-term, using a single coordinated capacity platform. Netting<sup>40</sup> and Use-it-or-sell-it (UIOSI) 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, explicit auctions are used.

### *BritNed*

The 1000MW BritNed HVDC cable between GB and The Netherlands commenced operation in April 2011. BritNed allocates capacity on its cable through a blend of implicit and explicit auctions. It holds medium term (monthly and annual) and intra-day explicit auctions and day-ahead implicit auctions.

In October 2013 BritNed submitted a set of modified access rules to Ofgem for approval. In January 2014 Ofgem took the decision not to approve the proposed modifications, on the grounds that we did not receive adequate evidence to justify BritNed's proposal.<sup>41</sup>

BritNed has a 25-year exemption from rules relating to the use of interconnector revenues and charging methodologies and certain licence conditions are switched off and are not in operation in its licence.<sup>42</sup> However, it must still comply with the interconnector licence condition relating to access rules, introduced as a result of the Third Package.<sup>43</sup>

BritNed also became part of the NWE market coupling project in February 2014<sup>44</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<sup>45</sup> auctions. One cable on the Moyle interconnector is on a forced outage reducing its available capacity to 250MW.<sup>46</sup> It offers a range of long-term products from one month to one year. To maximise the availability of capacity, UIOSI applies to all long-term capacity.

In our approval letter of Moyle's access rules in September 2012<sup>47</sup> we requested Moyle to undertake a consultation and review how capacity is curtailed in the event of an outage, a

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<sup>39</sup> <https://www.ofgem.gov.uk/publications-and-updates/approval-england-france-interconnector-ifa-access-rules>

<sup>40</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>41</sup> <https://www.ofgem.gov.uk/publications-and-updates/decision-proposed-modified-britned-interconnector-access-rules>

<sup>42</sup> Standard conditions 9 and 10 of the Electricity Interconnector Licence

<sup>43</sup> Standard condition 11A of the Electricity Interconnector Licence

<sup>44</sup> BritNed already had implicit auctions on day-ahead, however it operated an interim embedded solution. On 4 February 2014 when NWE project went live, BritNed switched from its embedded solution to the NWE market coupling solution.

<sup>45</sup> On 4 September 2012, Ofgem approved access rules for Moyle to facilitate the introduction of intraday trading - <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=117&refer=Europe>

<sup>46</sup> <http://www.eirgrid.com/media/Generation%20Capacity%20Statement%202014.pdf>

<sup>47</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=117&refer=Europe>

matter stakeholders had previously expressed concern about. On 15 January 2014, Ofgem approved the modified access rules for Moyle<sup>48</sup> which included clarification of this issue.

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

The EirGrid East-West Interconnector (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 UIOSI to long-term capacity.

The EirGrid EWIC is not exempt from any requirements relating to access rules and charging methodologies. On 15 January 2014, Ofgem approved the amended access rules<sup>49</sup> and charging methodology<sup>50</sup> for EirGrid EWIC. Similarly to Moyle, the modified access rules included also a clarification on how capacity is curtailed in the event of an outage. This was a concern that had been raised by stakeholders and therefore in our approval of EWIC's access rules in September 2012<sup>51</sup> we requested EWIC to undertake a consultation and a review of this matter.

#### **Monitoring TSO investment plans in view of Ten Year Network Development Plan (TYNDP)**

We set price controls for the electricity transmission system operator. 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 across a longer period). Under the price control we require the transmission companies to report on their performance against these plans on a regular basis.

The GB System Operator (SO) produces, on an annual basis, the Electricity Ten Year Statement (ETYS). This publication describes the GB National Electricity Transmission System (NETS), the Transmission Operators' (TO) 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. We are in the process of implementing a new licence condition to make the production of this statement by National Grid Electricity Transmission (NGET) a requirement under the licence, including the requirement to consider potential development of interconnection with the rest of Europe. The licence condition will also require an explanation of any differences between the data used in the ETYS and the EU-wide ten year network development plan.

#### **Cooperation**

Article 37(1)(c) of the Electricity Directive imposes duties on us to consult and cooperate with ACER and the NRAs of other member states on cross-border issues. Changes have

<sup>48</sup> <https://www.ofgem.gov.uk/publications-and-updates/approval-modified-access-rules-moyle-interconnector>

<sup>49</sup> <https://www.ofgem.gov.uk/publications-and-updates/approval-modified-access-rules-eirgrid-east-west-interconnector>

<sup>50</sup> <https://www.ofgem.gov.uk/publications-and-updates/approval-modified-charging-methodology-eirgrid-east-west-interconnector>

<sup>51</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=119&refer=Europe>

been made to the Electricity Act to reflect this.<sup>52</sup> 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 to the Electricity Act also place a responsibility on us to cooperate with the NRAs of other member states 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*

We have been cooperating with the NRAs of adjacent member states over a number of issues around interconnectors. For example, we have worked closely with the Irish and Northern Irish regulators to develop and approve common trading arrangements for the Moyle and Eirgrid EWIC and on the Single Electricity Market (SEM) European market integration project.<sup>53</sup>

In addition, we have been cooperating closely with the Belgian regulator (CREG) as part of project NEMO, the proposed interconnector between GB and Belgium. After agreeing on high-level principles, Ofgem and CREG developed a proposed approach on the regime and the methodology for setting the cap and floor on returns for NEMO. In March 2013 we published a consultation outlining our proposals and seeking views on the proposed design and methodology.

Under the Electricity Directive, NRAs are required to certify TSOs, including interconnector operators, as compliant with the ownership unbundling requirements. This has required cooperation between us and the Irish, French and Dutch NRAs. In addition to this, we have been consulting with many other NRAs through our role as the lead regulator for the North West Europe (NWE) intraday project.

In September 2013 we received an exemption request from Eleclink Limited, a proposed 1000MW interconnector project between GB and France. The project developer requested an exemption from use of revenues, third party access and unbundling under Article 17 of the Regulation. After a joint public consultation process with the Commission de Regulation de l'Énergie (CRE), we made a joint decision<sup>54</sup> to approve partial exemption with CRE on Eleclink's exemption in March 2014 and submitted it to the European Commission for its approval.

We have also contributed to ACER's work in the development of Network Codes and Guidelines for the European electricity market. We are chairing the Electricity Working Group and we are leading the project team on the grid connection codes. We are also actively involved at Council of European Energy Regulators (CEER), holding the chair position of the Electricity Working Group and co-chair of the Sustainable Development Task Force and actively contributing to work on smart grids.

<sup>52</sup> See Regulation 35 of the Electricity and Gas (Internal Market) Regulations 2011, which inserts section 3F into the Electricity Act 1989: <http://www.legislation.gov.uk/uksi/2011/2704/regulation/35/made>

<sup>53</sup> [http://www.allislandproject.org/en/TS\\_Current\\_Consultations.aspx?article=ebc174b6-7ec5-44fa-b1fe-72a665e6966f](http://www.allislandproject.org/en/TS_Current_Consultations.aspx?article=ebc174b6-7ec5-44fa-b1fe-72a665e6966f)

<sup>54</sup> <https://www.ofgem.gov.uk/ofgem-publications/87163/eleclinkdecisioncoverletter.pdf>

### 3.1.5 Compliance

#### **Ensuring compliance with binding decisions of the Agency and the Commission, and with the Guidelines**<sup>55</sup>

Under the Third Package NRAs are required to ensure compliance 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 an event 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) 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.

Ofgem, in close cooperation with other relevant NRAs, will ensure TSOs are compliant with Network Codes and Guidelines and by monitoring GB TSO business rules, standard transportation agreements and any and all other relevant operational rules and agreements. Ofgem will require TSOs 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 compliance with the Ofgem approved network code compliance regime.

#### **Update on Ofgem's enforcement investigations**

We have set out below investigations which were concluded in 2013 relating to electricity and cross-cutting (electricity and gas) undertakings.

#### **Investigations concluded**

##### *Electricity*

##### Compliance with Industry Codes

- In May 2013 we closed an investigation on administrative priority grounds into MA Energy's compliance with Standard Condition 11 (SLC 11) of the Electricity Supply Licence (Compliance with Industry Codes). This decision was made taking into account MA Energy's change of ownership, the fact that the breach was no longer ongoing, and the fact that compliance with SLC 11 had been sustained for a significant period.

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<sup>55</sup> The Guidelines being those Guidelines referred to in the Gas and Electricity Directives and Regulations under the Third Package.

*Cross-cutting (electricity and gas)*

Mis-selling

- In May 2013, we found that Scottish and Southern Electric had acted in breach of licence conditions 23 and 25 of the Standard Conditions of the Electricity and Gas Supply Licences relating to notification of terms and marketing. We fined them £10.5m for this. The contraventions included using misleading sales scripts, providing inaccurate estimates and comparisons to customers and failing to adequately monitor its sales agents' activities. By imposing such a fine we sent out a strong signal that poor behaviour from energy companies will not be tolerated.
- In December 2013 we completed one of our investigations into Scottish Power, which resulted in them making payments of £8.5m to consumers. Scottish Power was also found to be in contravention of the licence condition relating to marketing, specifically condition 25 of the Standard Conditions of the Electricity and Gas Supply Licences, by failing to provide accurate information to customers about energy consumption and annual charges. Vulnerable customers identified through Scottish Power's Warm Homes Discount Scheme will benefit from £7.5m of these payments, with a further £1.0m to be paid in compensation to consumers affected by mis-selling activities.
- In February 2014 we confirmed our decision from December 2013 that npower had acted in breach of licence conditions including those relating to telephone and face-to-face sales activities, specifically 25 and 27 of the Standard Conditions of the Electricity and Gas Supply Licences. We agreed on an outcome to this investigation whereby npower must make payments amounting to £3.5m to consumers in fuel poverty. npower will also contact and refund customers who have suffered financial detriment. npower's specific shortcomings related to their obligations to provide customers with accurate estimates of consumption and charges when carrying out their marketing activities, and to set the correct levels of direct debit payments for their customers.

Inaccurate reporting

- In August 2013 E.ON agreed to make payments totalling £3.0m for incorrectly reporting the number of energy saving light bulbs they had distributed under the government's Carbon Emissions Reduction Target (CERT) energy efficiency programme. The agreed settlement amount of £3.0m comprised of £2.5m in payments for the benefit of persons in fuel poverty, and a penalty of £500,000.

Competition

- In June 2013 our investigation into two trade associations and six suppliers led to an amendment to a code of practice. This clarified that the code didn't apply to the activities of third-party intermediaries. The organisations investigated in this case were the Association of Energy Suppliers, British Gas, EDF Energy, the Energy Retail Association, E.ON, npower, Scottish Power and SSE.

Consumer Protection

- In October 2013 we closed an investigation on administrative priority grounds into Scottish Power's compliance with the Consumer Protection Regulations 2008 in relation to the tariff "ScottishPower Direct – Oct 2012 Offer". This decision was made taking into account Scottish Power's swift removal of the tariff from sale, and the assurances given by the company in relation to setting new tariffs in the future.

## 3.2 Promoting Competition

### 3.2.1 Wholesale markets

#### Key Summary

The following chapter provides an overview of the developments in the wholesale electricity market in Great Britain (GB) during 2013. Detailed information can be found in the concurrent sections, a summary of which is presented below;

- In 2013, a total of a total of 939.7 TWh of wholesale electricity was traded in GB, a relatively small year-on-year decline from 2012. Total over the counter (OTC) trading also fell in 2013
- Volumes traded on the exchanges increased in 2013, driven by additional volumes on the exchanges N2EX and APX
- Total installed capacity on the GB system fell slightly by 0.9 GW which has resulted in deterioration in the supply-side outlook. Peak electricity demand also fell in 2013 by 2.5 GW to 56.5 GW
- EDF again contributed the largest proportion of power generation in GB. Centrica, Dax, E.ON, RWE, Scottish Power and SSE all produced more than 5 per cent of total GB generation
- Monthly averaged OTC Day-Ahead baseload and peakload electricity prices in 2013 were higher than in previous years
- Elevated gas prices fed through to electricity prices following high gas demand and low gas storage stocks at the beginning of the year. Intensification of these factors in the gas market led to electricity price spikes in March.

Policy developments in several areas of GB's wholesale electricity market have continued throughout 2013. Some notable policy areas include:

- Electricity Market Reform
- Electricity Cash-out Significant Code Review
- Cross-border electricity market developments
- Wholesale Liquidity developments
- REMIT implementation

## Description of the Wholesale Market

The wholesale electricity market in GB has been open to competition since 1990, with the creation of the Electricity Pool. This allowed electricity to be traded in bulk through a centrally managed trading system. In 2001, the Pool was replaced with the New Electricity Trading Arrangements (NETA) in England and Wales. The British Electricity Trading Transmission Arrangements (BETTA) replaced NETA in 2005, extending the previous arrangements to Scotland. This created the current single wholesale electricity trading market in GB which is predominantly based on bilateral trading between generators, suppliers, traders and customers across a series of markets.

GB also has a number of interconnections to external markets which facilitate cross-border trading of electricity. The newest addition is the East-West interconnector (500 MW) between GB and Ireland which began full commercial operation in 2013 after experiencing delays.

### *Wholesale Market Trading*

The GB wholesale market is mostly based on bilateral trading between generators, suppliers, traders and customers across a series of markets. The wholesale market can mainly be divided into bilateral OTC trading and power exchange trading, followed by Balancing Mechanism (BM) activity and imbalance settlement.<sup>56</sup> In 2013, a total of 939.7 TWh of wholesale electricity was traded in GB. This is a relatively small fall from 942.6 TWh in 2012.

#### (i) Over the counter trading<sup>57</sup>

Total OTC trading in 2013 fell by over 10 TWh to 768.3 TWh, from 778.8 TWh in 2012. The proportion of the total electricity volumes which were OTC traded was broadly stable year-on-year. Around 82 percent of all power traded in GB was OTC traded, marginally down from 83 per cent in 2012.<sup>58</sup>

#### (ii) Exchange Trading

Volumes traded on the exchanges increased in 2013 to 171.4 TWh, driven by additional volumes on the exchanges N2EX and APX. The APX exchange is usually associated with intraday trading, while the N2EX exchange sees the bulk of Day-Ahead and future trading.

Total traded volume on the APX Power UK exchange in 2013 rose to around 22.4 TWh, an increase of around 22 per cent (or 4 TWh) on the calendar year for 2012.<sup>59</sup>

N2EX saw traded volumes rise to 138.9 TWh for its Day-Ahead auction in 2013, up 47 per

<sup>56</sup> Further detail on the structure of the wholesale electricity market was provided in our 2008 National Report and has broadly remained unchanged. See National Report here: [http://www.energy-regulators.eu/portal/page/portal/EER\\_HOME/EER\\_PUBLICATIONS/NATIONAL\\_REPORTS/National%20reporting%202008/NR\\_En/OfgemNationalReport2008%20-%20FINAL%20V2.pdf](http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/NATIONAL_REPORTS/National%20reporting%202008/NR_En/OfgemNationalReport2008%20-%20FINAL%20V2.pdf)

<sup>57</sup> Bilateral trading between two market participants or where an intermediary (the broker) brings together a buyer and seller

<sup>58</sup> Please note, the values for 2012 have been revised compared to those published in the 2013 National Report.

<sup>59</sup> Includes both APX Continuous and Day Ahead auctions Data available from: <http://www.apxgroup.com/>

cent from 94.6 TWh in 2012. N2EX also operates a near-term continuous market which saw traded volumes fall by over 90 per cent in 2013, from 38.1 TWh to 3.5 TWh.<sup>60</sup> However, the continuous volumes do not originate on the platform – they are OTC trades which have been given up for clearing on the N2EX exchange. UK power futures exchange traded contracts are also available on the Intercontinental Exchange (ICE). Traded volumes on the ICE fell in 2013 to 6.6 TWh, from 12.7 TWh in 2012.

### *Liquidity*

We have been concerned that poor liquidity in the wholesale electricity market may be a barrier to competition in both generation and supply. By limiting the ability of firms to enter and grow, this may be imposing costs on consumers. We have particular concerns in relation to poor liquidity in longer-dated products.

We have regularly assessed liquidity against a number of quantitative and qualitative indicators. These have indicated that our liquidity objectives for the wholesale market remain unmet. For example, churn<sup>61</sup> remained low (at around 3) throughout 2013 and there is very limited trading along the curve.

After a consultation<sup>62</sup> in 2013, the Secure and Promote licence condition came into effect on the 31 March 2014. This aims to secure some positive industry-led initiatives, and promote progress along the curve. This includes a set of Supplier Market Access rules to improve access to the wholesale market for small suppliers and a market-making obligation, which obliges firms to post prices at which they would be prepared to buy and sell electricity.

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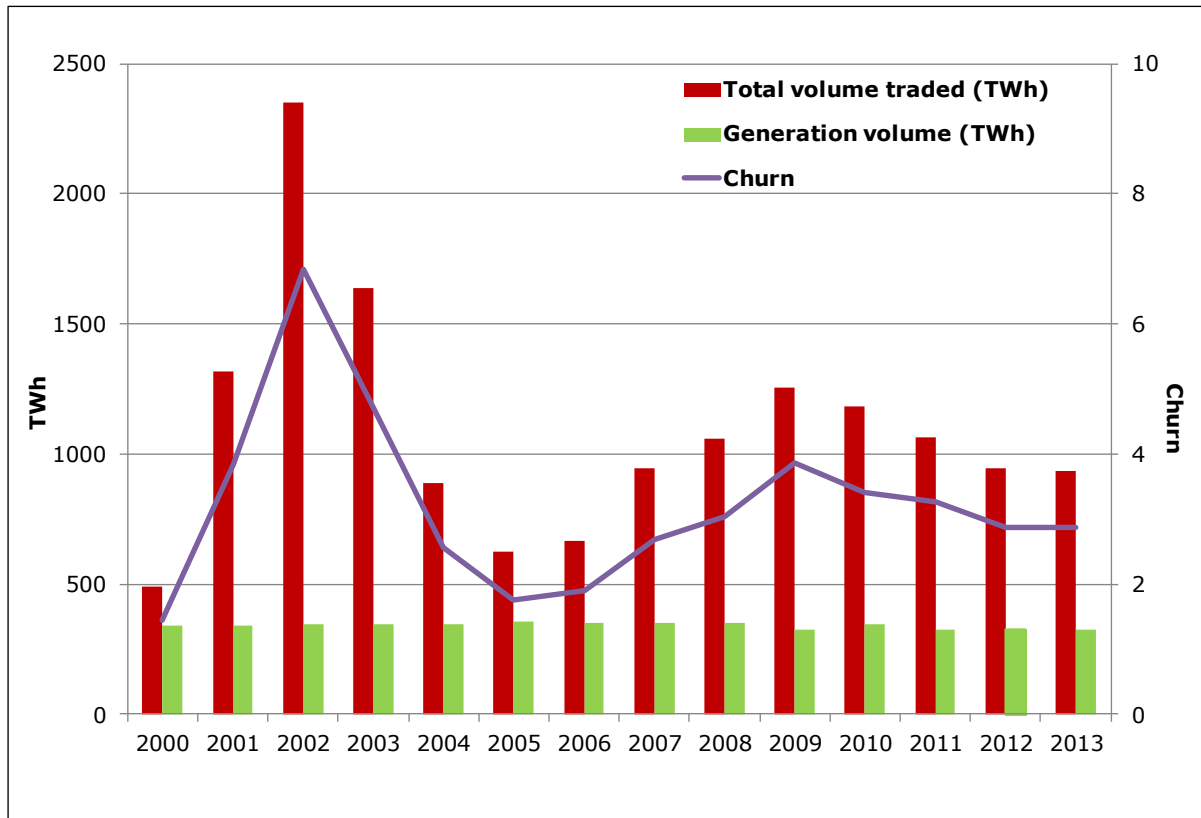
<sup>60</sup> Includes Prompt and Day Ahead auctions. Data available from: <https://www.n2ex.com/>.

<sup>61</sup> Churn, or churn ratio, is a high level indicator of liquidity, particularly in commodity markets. In this case, it is a measure of the number of times electricity which is generated in the market is subsequently traded.

<sup>62</sup> Wholesale power market liquidity: statutory consultation on the 'Secure and Promote' licence condition.

Available here: <https://www.ofgem.gov.uk/ofgem-publications/84508/wholesalepowermarketliquiditystatutoryconsultationonthesecureandpromotelicencecondition.pdf>.



**Figure 1: GB traded volume, generation output and churn ratios from 2000 to 2013**

Source: APX, DUKES, ICE, N2EX.

### *Balancing mechanism (BM)*

In the GB electricity market, Gate Closure occurs one hour ahead of a Settlement Period. After gate closure market participants cannot adjust contracted positions against what they are expecting to physically deliver or consume but may provide balancing services to National Grid Electricity Transmission (NGET). Note that NGET is the system operator in GB, responsible for balancing supply and demand in real time. The BM is the mechanism where NGET may accept bids and offers to increase or decrease electricity to assist it in balancing the system.

Around 9.3 TWh of bids and 8.1 TWh of offers were accepted in 2013, an increase compared to 8.8 TWh of bids and 7.9 TWh of offers in 2012.<sup>63</sup>

<sup>63</sup> Please note that the figures for 2012 have been revised, and do not match those published in the 2013 National Report.

### *Generation capacity*

Total installed capacity on the GB system at the end of 2013 was 79.4 GW, down by 0.9 GW from 2012.<sup>64</sup> This fall was mainly due to oil- and coal-fired power stations closing as a result of European environmental legislation on emissions. Additional related closures are anticipated. Some of this decline was off-set by new generation capacity coming online. This was mainly driven by an increase in wind and biomass generation (1.8 GW) and gas-fired generation (1.1 GW). However, total capacity is anticipated to continue falling until 2015.

This decrease in installed generation capacity in 2013 has caused a deterioration in the supply-side outlook, which is set to impact de-rated generation margins despite falling peak demand. The 2013 Capacity Assessment Report<sup>65</sup> presented a Reference Scenario which showed de-rated capacity margins<sup>66</sup> decreasing faster in the next few years than expected in our 2012 report. However, they still bottom out in 2015/16 at around 4 per cent, before recovering thereafter (see Figure 2) as new gas and wind generation comes online. While de-rated margins illustrate trends in the market, they are not a measure of the risk to security of supply. Instead, we present risk using Loss of Load Expectation (LOLE).<sup>67</sup> In the Reference Scenario, we estimated an increase in the LOLE from less than 1 hour per year in winter 2013/14 to just under 3 hours per year in 2015/16 as de-rated margins decrease.

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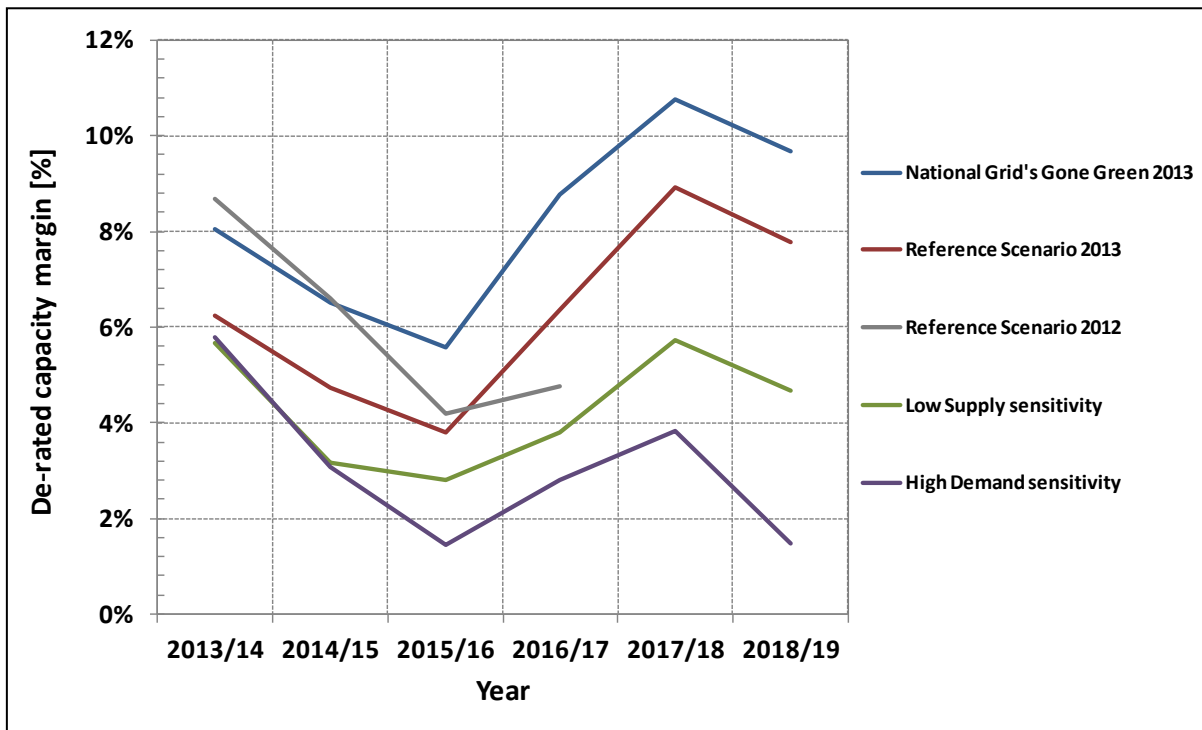
<sup>64</sup> This is based on transmission connected generation in the Gone Green scenario of National Grid's 2013 UK Future Energy Scenarios. Please note that the 2012 installed capacity figure is lower than that published in the 2013 National Report as it has been revised downwards by National Grid. Available here: <http://www2.nationalgrid.com/uk/industry-information/future-of-energy/future-energy-scenarios/>.

<sup>65</sup> The Reference Scenario provides a view of the outlook for security of supply, based on the information available to us at the time of publication. Please see the Electricity Capacity Assessment Report 2013 for more details. Available here: <https://www.ofgem.gov.uk/ofgem-publications/75232/electricity-capacity-assessment-report-2013.pdf>

<sup>66</sup> The de-rated capacity margin is defined as the average excess of available generation capacity over peak demand, expressed in percentage terms. Available generation capacity takes into account the contribution of installed capacity at peak demand by adjusting it by the appropriate de-rating (or availability) factors which take into account the fact that plants are sometimes unavailable due to outages.

<sup>67</sup> This represents the number of hours per year in which supply is expected to be lower than demand under normal operation of the system. Importantly, this is before any intervention by the System Operator, so does not represent the likelihood of customer disconnections.

**Figure 2: De-rated capacity margins in the Reference Scenario 2013 and the other major sensitivities.**



Source: Electricity Capacity Assessment Report 2013, Ofgem

### *Demand*

Peak demand has fallen by around 5 GW over the last seven years due mainly to the economic downturn and improvements in energy efficiency. Actual peak electricity demand<sup>68</sup> fell by almost 2.5 GW in 2013 to 56.5 GW. This was mainly due to the IFA interconnector importing to GB when peak demand was reached, as opposed to exporting at near-maximum levels in 2012. This is reflected in demand data which excludes own use demand at power stations and interconnector exports as this only fell by 0.3 GW to 55.5 GW in 2013.

### **Market integration**

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

The GB market is broadly integrated with neighbouring markets to the extent that market parties are able to trade between them, with prices for such trade 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). Full commercial operation of the East-West interconnector (EWIC) was delayed

<sup>68</sup> Total Gross System Demand. This includes station load, pump storage pumping and interconnector exports.

until the start of Q2 2013 due to technical problems. When fully operational, this increased the level of physical integration in 2013 to almost 4 GW.<sup>69</sup> However, in June 2013 it was announced that Moyle's capacity would remain at 250 MW (half of the designed capacity) for a minimum of 18 months. Flows were initially cut to this level in June 2012.

Both gross imports to, and exports from, GB have increased year-on-year. However, there was a larger increase in imports to GB which resulted in net imports increasing by over 30 per cent in 2013 to 12.9 TWh. This trend was mainly driven by increased imports over IFA and exports along the newly operational EWIC. In its first year of commercial operation, EWIC exported 2.2 TWh of electricity while imports to GB were minimal.

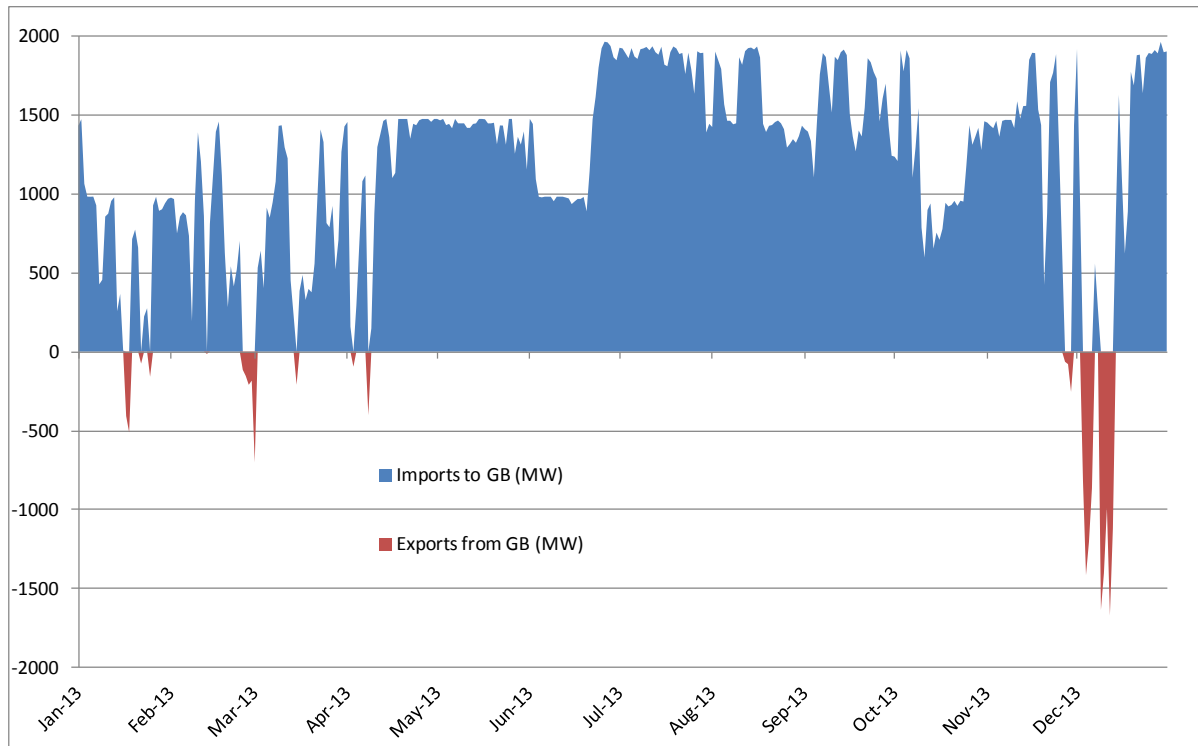
In periods of high electricity demand in both GB and France during winter, IFA often exports from GB to France. However, in 2013 the number of occasions with net exports fell and so did the total exported volume. December 2013 had the highest monthly export volume at 0.3 TWh. This was driven by a combination of unplanned nuclear generation outages in France, and falling temperatures.

Figure 3 shows average daily flows across the GB-France interconnector for the whole of 2013. Total flows (imports and exports) increased in 2013 by over 30 per cent compared to the previous year as IFA underwent less maintenance. Gross imports to GB increased in 2013, whilst exports from GB decreased. This resulted in a 3.3 TWh increase to 10.7 TWh in the net volume of electricity imported to GB. This represents absolute import and export flows<sup>70</sup> of 97 per cent and 3 per cent, respectively, across the interconnector over 2013.

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<sup>69</sup> This figure does not account for the fault with Moyle.

<sup>70</sup> Imports are to GB, exports from GB.

**Figure 3: Average daily flows along IFA during 2013 (MW)**

Source: National Grid<sup>71</sup>

As of the end of 2013, GB only had 1 GW of market coupled interconnector capacity via BritNed's link to the Central Western Europe (CWE) region. This figure increased to 3 GW when NWE Day-Ahead market coupling was launched in February 2014 as IFA (2 GW) was added. The Moyle (0.45 GW)<sup>72</sup> and East-West (0.5 GW) interconnectors will not be included as part of the NWE market coupling project. Looking forward, there is currently a total of 5.8 GW<sup>73</sup> of contracted interconnector capacity planned by 2021.

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

#### **Monitoring: Prices**

Under Article 37(1)(i) we have an obligation to monitor the level of transparency of wholesale prices. In GB wholesale prices are compiled and made available to market participants by a number of independent pricing agencies, energy market brokers and via

<sup>71</sup> Data available from National Grid: <http://www.nationalgrid.com/uk/Electricity/Data/Demand+Data/>

<sup>72</sup> This figure relates to export capacity. Import capacity is 0.08 GW. Note these figures do not take into account the current outage. See National Grid's Electricity Ten Year Statement for more details: <http://www2.nationalgrid.com/UK/Industry-information/Future-of-Energy/Electricity-ten-year-statement/Current-statement/>.

<sup>73</sup> This was correct as of November 2013. For more information on planned interconnector projects, please see National Grid's Ten Electricity Year Statement: <http://www2.nationalgrid.com/UK/Industry-information/Future-of-Energy/Electricity-ten-year-statement/Current-statement/>.

exchanges. Argus Media, ICIS Heren and Platts provide pricing based on reported over the counter (OTC) trades, and made available to the market via subscription services. Data providers produce pricing data for a wide variety of peak and baseload contracts up to three years ahead of delivery. Financial data providers (such as Bloomberg PROFESSIONAL service) also provide close to real time energy broker pricing based on OTC trades.

Through our price benchmark consultation,<sup>74</sup> we are considering a range of issues around the role of reference prices and the key factors that determine the ability of price reporting agencies to make price assessments that represent a fair reflection of the market. This is a good example of the steps we are taking to ensure the robustness of prices within the GB market.

In addition to a wide range of OTC pricing data, the three power exchanges in the GB electricity market<sup>75</sup> all provide pricing data to the market.

As noted in the previous section, the bulk of contract trading in the GB wholesale market is bilateral between generators, suppliers, traders and customers across a series of markets. The majority of wholesale market trading is divided into over the counter (OTC) trading and power exchange trading. Balancing Market activity and imbalance settlement also takes place.

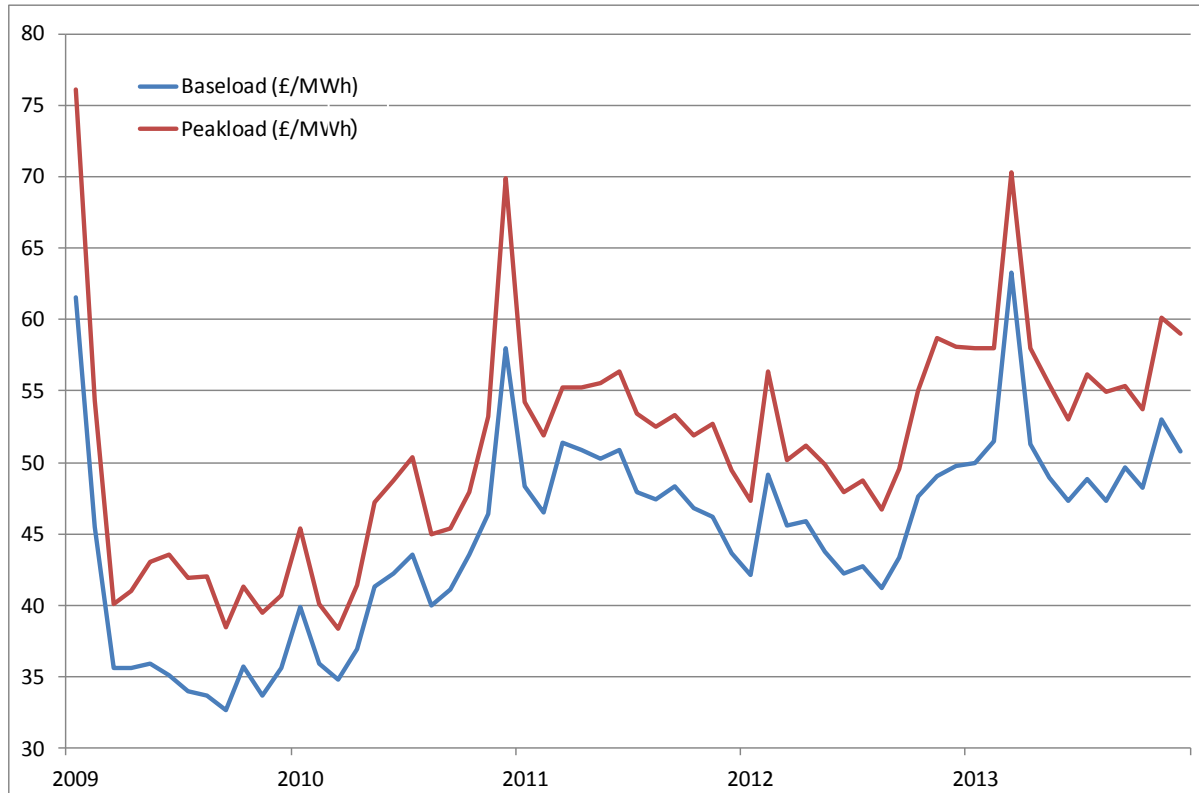
Figure 4 below shows monthly averaged OTC Day-Ahead baseload and peakload electricity prices in GB since the beginning of 2009. The average baseload and peakload prices in 2013 were the highest in the 2009-2013 series below. This was a result of elevated gas prices feeding through<sup>76</sup> to electricity prices following high gas demand and low gas storage stocks at the beginning of 2013. Further, the intensification of these factors in the gas market led to electricity price spikes March. Please see section 4.2.1 for more information on the trends in the GB gas market 2013.

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<sup>74</sup> Pricing benchmarks in gas and electricity markets – a call for evidence (<https://www.ofgem.gov.uk/ofgem-publications/40363/pricing-benchmarks-gas-and-electricity-markets.pdf>)

<sup>75</sup> The APX Group, N2EX (a Nord pool Spot and Nasdaq OMX commodities joint venture) and the Intercontinental Exchange (ICE).

<sup>76</sup> Gas-fired electricity generation was the marginal source of electricity supply in GB during 2013.

**Figure 4: GB monthly averaged Day-Ahead baseload and peakload electricity**

Source: Heren

### **Monitoring: Competition**

We actively monitor competition in the market for wholesale electricity. Competition indicators such as market concentration levels are assessed across different areas of the market, including physical capacity and generation, and trading.

For electricity generation, seven companies had market shares exceeding five per cent, the same figure as 2012. Metered volumes in 2013 indicate that EDF again contributed the largest proportion of generation in GB.

We have concurrent powers, together with the Competition and Markets Authority (CMA), to enforce Chapter I of the Competition Act 1998 (CA98) / Article 101 Treaty on the Functioning of the European Union (TFEU) and Chapter II / Article 102 TFEU in the energy sector which relate to anti-competitive agreements and abuse of dominant market position. We may undertake an investigation where we have reasonable grounds to suspect a breach of these provisions.

We may also be asked to assist relevant competition authorities (such as the CMA or European Commission) during their assessment of mergers affecting the GB energy market. In the past, we have conducted various assessments into proposed mergers and acquisitions.

## **Market concentration**

As illustrated in Figure 5 below, seven companies once again had market shares exceeding five per cent and, of these, the largest three companies generated approximately half of the electricity consumed in GB in 2013.<sup>77</sup>

Metered volumes in 2013 indicate that EDF again contributed the largest proportion of power generation in GB. Based on this data, EDF now has a market share of 26 per cent, up by 1 percentage point from 2012. 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 per cent of total GB generation. The market share of the 'Other' generators also increased by 3 percentage points compared to 2012. This partly reflects the higher output of independently-owned renewable generation in 2013.<sup>78</sup>

**Figure 5: 2013 electricity market share in GB based on metered volume<sup>79</sup>**

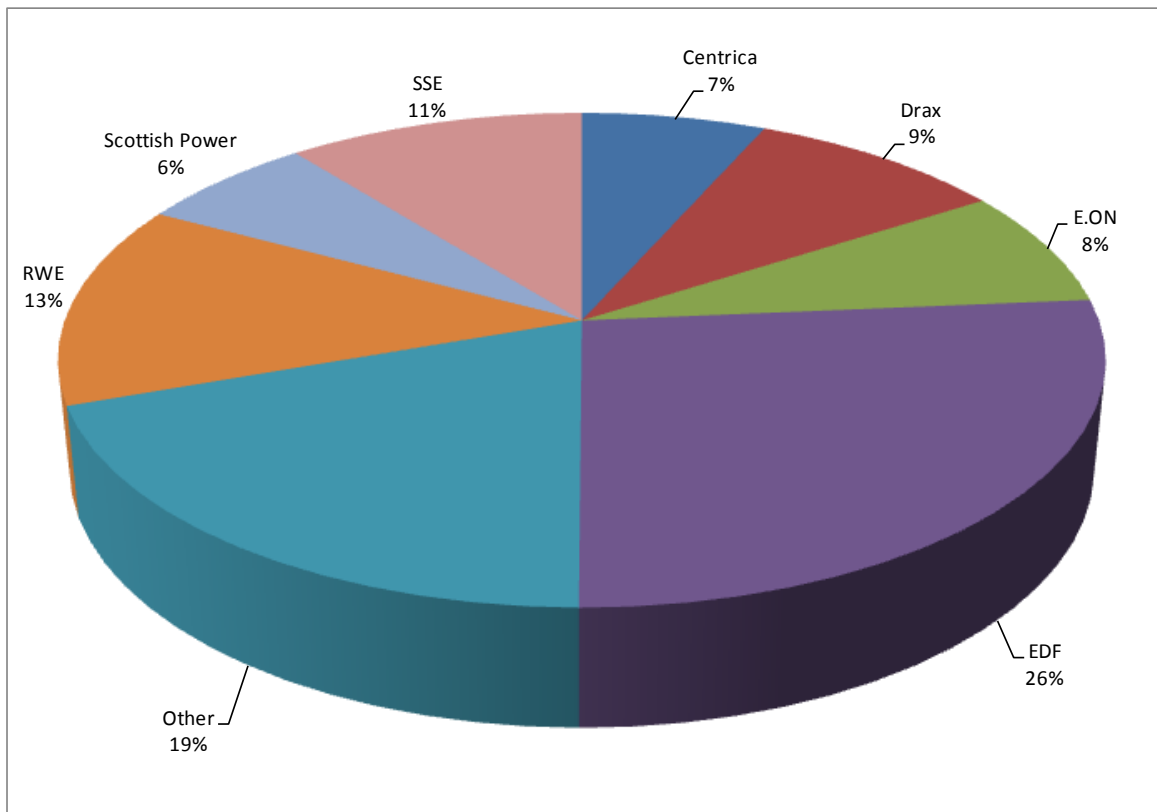


Table 1 provides Herfindahl-Hirschman Index (HHI) analysis based on metered volume by different companies in GB in 2013. The HHI is an indicator for the level of competition in a specific market. The largest individual HHI by capacity is EDF (HHI of 687) which owns and

<sup>77</sup> Produced from proprietary data.

<sup>78</sup> Renewables' share of electricity generation reached a record high of 14.8% on 2013. DECC Energy Trends section 6: Renewables:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/295356/6\\_Renewables.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/295356/6_Renewables.pdf).



operates the majority of nuclear plants in GB. The total HHI increased to 1,593 from 1,483 in 2012.

**Table 1: Herfindahl-Hirschman Index (HHI) based upon 2013 metered volume<sup>80</sup>**

Company	Capacity (HHI)
Centrica	44
Drax	86
E.ON	63
EDF	687
Other	379
RWE	177
Scottish Power	41
SSE	115
Total	1,593

### **Measures to avoid abuses of dominance**

Information provision is a key component of the effective and efficient operation of the GB electricity markets. Information relating to the operation of the electricity BM is provided through the Balancing Mechanism Reporting Service (BMRS) website by the Balancing Mechanism Reporting Agent (BMRA).<sup>81</sup>

Parties that hold electricity licences are also able to propose further improvements to the type of information to be made available to the BMRA and publically.

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

The Transmission Constraint Licence Condition (TCLC) came into force on 29th October 2012. It is complementary to powers under competition law to tackle abuse of dominance. We published guidance on our intended approach to the interpretation and enforcement of the TCLC on the same date.

The 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 for the System Operator in return for reducing their generation. These behaviours can significantly increase the costs of balancing the electricity system during periods of transmission constraint.

Throughout 2013, we continued to monitor the bids and offers submitted in the balancing mechanism and generator's compliance with the TCLC. In 2013, the average price paid to onshore wind farms to reduce generation was £88/MWh compared to £133/MWh in the previous year.

<sup>80</sup> Produced from proprietary data.

<sup>81</sup> Further information relating to the operation of the BMRS and the information available on this website can be found in our 2008 National Report and at the following link: [www.elexon.co.uk](http://www.elexon.co.uk)

The TCLC will cease to have effect 5 years after Section 18 of the Energy Act 2010 came into force on 16 July 2012. There is the possibility of a 2 year extension which would be granted by the Secretary of State.

### **Monitoring price transparency**

#### *REMIT*

EU Regulation on Wholesale Energy Market Integrity and Transparency (REMIT) legislation is a key tool in ensuring the transparency of prices within the wholesale energy market. It came into force in December 2011 and prohibits insider trading and attempted or actual market manipulation in wholesale energy markets across the EU.

In June 2013, the UK government introduced legislation which provided us with new powers to monitor, investigate and take action against organisations or individuals who carry out or attempt to carry out energy market abuse. After a public consultation, in November we published our REMIT penalties statement and guidelines setting out how we will use our REMIT investigations and enforcement powers.

In November 2013, Ofgem and the Financial Conduct Authority (FCA) concluded a detailed review of allegations of manipulation of the gas market in Great Britain. We determined that no evidence of the alleged market manipulation could be found and therefore that the interests of consumers have not been harmed. Ofgem continues to monitor the wholesale energy markets and will consider carefully any evidence of potential abuse that is brought to our attention.

We regularly discuss REMIT issues with ACER, other NRAs and financial authorities (such as the FCA), including how best to co-operate. This will help us deal effectively with any cases that have a negative impact on wholesale energy markets in more than one EU country or which affect financial markets.

### **Market surveillance**

Our market surveillance team monitors the gas and electricity markets, including the wholesale electricity market and the BM. They routinely assess whether there is any evidence of anti-competitive behaviour or breaches of statutory provisions or licence conditions which may be investigated by us. On the basis of active surveillance and monitoring of the markets, we can investigate the behaviour of market participants if anti-competitive conduct is suspected and, where necessary, enforce domestic and European competition law.

Additionally, the FCA has responsibilities for the operation of financial markets in the UK. The FCA works to prevent abuse or distortion of financial markets. The FCA has the power to fine persons who have abused the market, where "market abuse" is defined under the Financial Services Market Act 2000.

## 3.2.2 Retail market

### Gas and Electricity retail market overview

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. These areas of our work are covered below. Where Ofgem *does* engage with the electricity and gas retail sectors separately, the information has been documented in this section and 4.2.2 respectively.

The energy supply market in Great Britain (GB) has been open to competition since the late 1990s. Initially this applied to large industrial consumers and was then rolled out across all consumers, including at the household level. Although regulations exist to protect consumers and to facilitate competition, price controls on domestic retail energy prices were removed by April 2002.

#### **Price Monitoring: Transparency**

Ofgem is committed to ensuring the energy market is transparent. In this section, we set out the rules in place regarding transparency of suppliers' activities. We also set out our proposals to enhance transparency further and benefit the interests of consumers.

##### *Financial transparency*

Over the last four years, we have taken measures that have significantly improved the transparency of revenues, costs and profits.

Since 2009 we have required large, vertically-integrated suppliers to publish annual Consolidated Segmental Statements (the Statements) on their websites. These Statements provide a breakdown of suppliers' revenues, costs and profits and are reconcilable to audited accounts. The information is required for five business segments: electricity generation and four supply segments (domestic and non-domestic, electricity and gas). Ofgem produces an annual summary of the Statements, the archive of which can be found on our website.<sup>82</sup>

Since 2009 we have published the Supply Market Indicator (SMI) on a regular basis (currently every month). The SMI provides a near term outlook on trends in domestic energy bills relative to suppliers' costs, and to estimate an indicative pre-tax net margin that a large supplier might make on an average domestic consumer over the next 12 month period. This helps make trends in costs and bills clearer to consumers. We periodically review the SMI and update our assumptions as circumstances change, including for example, our assumptions on domestic consumption.

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<sup>82</sup> Available on our website at:

<https://www.ofgem.gov.uk/search/?keyword=consolidated%20segmental%20statements>

In 2013 we concluded a consultation on changes to the reporting requirements for the Statements and published an open letter in February 2014 setting out improvements we propose companies are required to make to their 2014 statements. These improvements include requirements on companies to audit their statements, to publish them sooner, to provide greater cost breakdown, and to provide greater insight into their trading activities.

In addition, we aim to carry out an in-depth review of the large companies' transfer pricing policies. The aim is to provide further clarity on the allocation of revenues, costs and profits between the companies' generation and supply activities.

#### *Transparency for domestic consumers*

Clear and relevant information is essential to facilitate effective consumer engagement in the retail market. Our research has repeatedly shown that consumers often do not have key information needed to make informed decisions about their energy suppliers. To improve the quality of the information consumers receive we have introduced a series of new measures from March 2014, as part of our Retail Market Review (RMR) reform package. Please see the *Main Developments* for a description of the changes we have introduced since the beginning of 2014.

Third party intermediaries such as price comparison websites are playing an increasingly important role in the retail energy market. Our aim is to ensure that consumers using these services can have confidence that the information provided to them is independent, reliable and transparent. Ofgem administers a code of practice, the "Confidence Code", which currently covers 12 accredited online energy price comparison websites.<sup>83</sup> Each of these websites enables consumers to compare a wide range of suppliers' tariff prices and service offerings and determine which deal best suits their needs. Ofgem assumed responsibility for the code in March 2013. Each site must meet a range of requirements to become, and remain, accredited to this voluntary scheme.

Ofgem is currently reviewing the terms of the code to assess whether it can offer enhanced protection to consumers. The review will also explore whether it is possible to allow other types of comparison service (e.g. collective switching, "next generation" comparison services<sup>84</sup>) to become accredited, thus providing reassurance to consumers using different types of comparison tools.

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

Ofgem is also working to increase transparency for consumers in the non-domestic market. Our research has shown that some businesses experienced a lack of transparency and clarity in the information provided on bills by their supplier.<sup>85</sup>

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<sup>83</sup> As of 17<sup>th</sup> July 2014 there were 12 websites accredited under Ofgem's Confidence Code. A list of these can be found here: <https://www.ofgem.gov.uk/information-consumers/domestic-consumers/switching-your-energy-supplier/confidence-code>

<sup>84</sup> "Next generation" comparison could include mobile app switching services, or services that perform the comparison process on the consumer's behalf, presenting them with cheaper offers.

<sup>85</sup> Research Findings on the Experiences of Non-domestic Customers, Opinion Leader,

Our non-domestic RMR policies published in 2013 include measures to increase transparency for non-domestic consumers. In particular, we established simpler processes for the end of contracts for smaller businesses. From 31 March 2014, suppliers have to make sure all their bills and statements clearly show the contract end date and the deadline for giving notice. We've also stopped suppliers setting narrow periods for allowing customers to end contracts. Micro-businesses can now give notice at any time.

We are also reviewing the rules on automatic rollovers which apply when a business reaches the end of a fixed-term contract and is moved to a new tariff. We have consulted on proposals to make contract renewal more clear and consistent, to help business customers make better decisions about their next energy contract. This will help them decide whether they want to be rolled over onto another contract or shop around for a better deal. We intend to publish our final proposals later in 2014.

We are also working on how best to increase the transparency of non-domestic Third Party Intermediaries' (TPIs) activities.<sup>86</sup> TPIs act as brokers between non-domestic customers and suppliers, assisting customers in finding the most appropriate energy deal for their needs. However, our research from the 2008 Energy Supply Probe and RMR found evidence that TPIs are not always delivering the best outcomes for consumers.

TPIs are particularly important for the non-domestic sector, where consumers rely on them more to help meet their energy needs. To enhance safeguards for these consumers, we've developed a code of practice for non-domestic TPIs. We propose to prevent suppliers from contracting with any TPI that doesn't comply with this code. We published a consultation on the code's regulatory framework in February 2014.<sup>87</sup> This was informed by a June 2013 consultation and a series of workshops held throughout 2013.

### **Charges for and the execution of maintenance services**

To assess performance, the electricity and gas distribution networks are required to submit regulatory returns on an annual basis providing relevant cost and volume information to Ofgem. A component of the Distribution Use of System charges that all customers pay as part of their energy bills reflect the costs associated with the volume of maintenance work undertaken.

This information allows us to monitor the Distribution System Operators' performance over the price control which is funded via the Use of System charges. The company's investment and maintenance choices made today affect both their current and future customers' experience of the networks.

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[http://www.ofgem.gov.uk/MARKETS/RETMKTS/RMR/Documents1/Ofgem\\_Non%20Doms%20Research.pdf](http://www.ofgem.gov.uk/MARKETS/RETMKTS/RMR/Documents1/Ofgem_Non%20Doms%20Research.pdf)

<sup>86</sup><https://www.ofgem.gov.uk/publications-and-updates/retail-market-review-application-rules-tpi-sector>

<sup>87</sup> <https://www.ofgem.gov.uk/ofgem-publications/86072/tpinon-domcondocfinal.pdf>

### **Complaints by household consumers**

Ofgem does not directly investigate domestic customer complaints. Instead, we set the standards to which suppliers must adhere to when dealing with and processing customer complaints.<sup>88</sup> If a consumer wishes to make a complaint about an energy supplier or network operator, they should contact the relevant company in the first instance. The energy company then has up to eight weeks to resolve the complaint. If a vulnerable consumer requires assistance with their complaint or a consumer has been disconnected or has been threatened with disconnection, they can go to Citizen's Advice Extra Help Unit which is able to deal with that complaint on their behalf.

If, at any point before the eight week time period, the energy company says it can do no more to resolve a customer's complaint or the eight week time limit has expired, it must advise the customer that they can seek redress through the Ombudsman. *Ombudsman Services: Energy*, approved by Ofgem, is independent and free of charge to the consumer. It will settle disputes between the energy company and the customer and has a range of remedies at its disposal including the power to make a financial award to the customer of up to £10,000. Its decisions are binding on the energy company but not the customer.

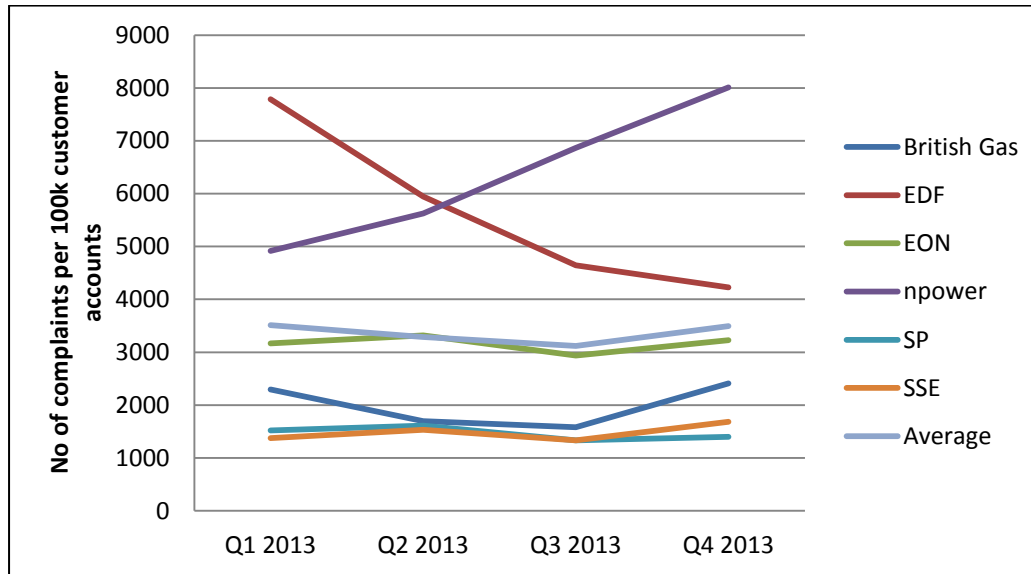
In 2013, following work undertaken by Ofgem, the former incumbent suppliers began to publish their direct complaints data. Smaller suppliers have also started to publish this information from the second half of 2013.

Figure 6 below shows the number of complaints received directly by the former incumbent suppliers per 100,000 customers in 2013. The graph shows that the complaints average remained relatively stable in 2013, but npower showed a steady increase in complaints whilst EDF Energy had a steady decrease.

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<sup>88</sup>The complaint standards are prescribed by "The Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008" which came into force on 1 October 2008 and are published at: [http://www.opsi.gov.uk/si/si2008/uksi\\_20081898\\_en\\_2#pt2-l1g3](http://www.opsi.gov.uk/si/si2008/uksi_20081898_en_2#pt2-l1g3)

**Figure 6: Domestic suppliers' performance in electricity and gas based on complaints received directly from suppliers**



Source: Suppliers

Ofgem commissioned research in 2013 to find out why so few consumers ask the Ombudsman to investigate their unresolved complaints. As a result of the findings, energy suppliers have redesigned their letters to customers telling them about their right to take their complaint to the Ombudsman, and some suppliers will be trialling giving this information at a different point and allowing the customer to go to the Ombudsman after six rather than eight weeks. Later in 2014, we expect the Ombudsman to start to publish complaints information by supplier.

### **Monitoring restrictive contractual practices**

Ofgem recognises the importance of monitoring restrictive contractual practices in the retail energy market. We have dedicated Retail Markets and Enforcement teams that engage with a variety of stakeholders and suppliers, ensuring that we are both proactively monitoring the market, and that we are open and receptive to any issues that may be brought to our attention.

Whilst it is challenging to actively monitor all bilateral contractual interactions in the entire domestic and non-domestic energy markets, we have a range of data and information that we regularly analyse and assess to help us understand trends and identify issues. Furthermore, we may seek additional information where needed and have a legal power to investigate further in instances where we receive information that suggests restrictive practices are occurring. Ofgem is able to compel the provision of information and documents from regulated persons for the purposes of monitoring the matters referred to in Article 37(1)(k) of the electricity directive and Article 41(1)(k) of the gas directive.

### **Respecting contractual freedom**

Ofgem issues licences which prescribe the regulatory requirements with which energy suppliers must comply. Where licence conditions are not being complied with, we have the power to investigate and ultimately take action, ranging from fines to revocation of the supplier's licence.

The supply licence contains some conditions relating to supply contracts to help ensure the provision of clear contractual information to household and small business consumers. As part of our RMR reforms, we have put in place stronger rules to ensure the transparency of contractual information, particularly for fixed term contracts, for domestic customers.

The Standards of Conduct were introduced on 26 August 2013 and seek to regulate the fairness of terms expressly agreed between a supplier and customer. Household customers are also protected by the general national rules which transpose Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. These rules are set out in the Unfair Terms in Consumer Contracts Regulations 1999 and Ofgem is one of the public bodies with enforcement powers. In addition, in respect of special types of contract that are deemed by national law to exist between a supplier and customer, there are bespoke rules in place which protect both household and business customers from unduly onerous terms.

### **Contributing to the compatibility of data exchange processes**

The previous sections have shown the range of information that Ofgem makes publicly available. In 2013, this included regular updates such as the SMI (currently published on a monthly basis), which estimates supplier costs and the retail energy bills for the year ahead. It also included quarterly disconnection data. We have published our work to refine and update the Consolidated Segmental Statements, which will make these annual reports more consistent and informative. Finally, it included the State of the Market Assessment and the RMR policies, both of which built on and developed a significant amount of supporting market data and consumer research. The sections have also shown the information that is available from other parties such as Consumer Futures. Market participants are free to access this information if they wish.

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

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 associated with environmental and social programmes such as Renewable Obligation Certificates<sup>89</sup> and the Warm Home Discount<sup>90</sup>, and transmission and distribution costs.

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<sup>89</sup> <http://www.ofgem.gov.uk/Sustainability/Environment/RenewablObl/Pages/RenewablObl.aspx>

<sup>90</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 role we aim to ensure the electricity and gas markets deliver the best outcomes for consumers. Through our licence conditions, our market monitoring activities 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, namely:<sup>91</sup>

### **Clearly comparable prices:**

- Consumers can compare suppliers' gas and electricity prices using a wide range of online energy price comparison websites. To ensure they can use a site they can trust to provide accurate and reliable pricing information, Ofgem currently administers a code of practice, the "Confidence Code", as described earlier.
- Our RMR policies aim to facilitate consumer engagement and enhance consumers' ability to compare suppliers' tariff terms and prices. As explained above, we have introduced a range of 'Information Remedies', including a standard Tariff Information Label, to increase the transparency of prices and enable consumers to more easily compare tariffs.

### **Transparent prices:**

- Ofgem regularly publishes a Factsheet that shows consumers the components of their household energy bill. The Factsheet<sup>92</sup> provides clear information on energy bills and the charges that comprise them; and
- Throughout 2013, as in previous years, we published the SMI, which shows the relationship between wholesale costs, other costs, and energy retail bills.<sup>93</sup>

### **Price Monitoring: Market opening and competition**

In 2013 we brought key retail market reforms into force<sup>94</sup> in the domestic and non-domestic retail markets.

<sup>91</sup> Our interpretation of Article 3 is that paragraph 3 has the most relevance for both electricity and gas supply prices (on the basis the gas supply prices will form part of terms and conditions as in the gas directive stated below).

Article 3(3) of the electricity directive states that "*Member States shall ensure that all household customers, and, where Member States deem it appropriate, small enterprises...enjoy universal service, that is the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable, non-discriminatory prices.*"

Article 3(3) of the gas directive states that "*Member States shall ensure high levels of consumer protection, particularly with respect to transparency regarding contractual terms and conditions, general information and dispute settlement mechanisms*"

<sup>92</sup> <https://www.ofgem.gov.uk/publications-and-updates/charts-outlook-costs-make-energy-bills>

<sup>93</sup> Ofgem's Electricity and Gas Supply Market Indicators webpage, which has a full archive of the updates, can be found at <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Pages/indicators.aspx>

<sup>94</sup> <https://www.ofgem.gov.uk/electricity/retail-market/market-review-and-reform/retail-market-review>

The Retail Market Review found that more could be done to facilitate consumer engagement in the retail energy market. The evidence suggested that consumers found the retail market to be complex and challenging to navigate effectively. The Review also found that a large proportion of consumers were disengaged from the energy market completely, potentially weakening competitive pressure on suppliers.

Our policies to address the lack of consumer engagement in the energy market, as outlined in the *Main Developments* section, aim to make the market simpler, clearer and fairer, generating increased consumer engagement. This should lead to greater competitive pressure between suppliers and more beneficial outcomes for consumers. The majority of these policies entered into force between 31 December 2013 and 31 March 2014. The final set of measures requiring suppliers to move consumers off expensive 'dead' tariffs came into force on 30 June 2014, which is the deadline for suppliers to move consumers off expensive dead tariffs.

### *Monitoring competition*

During 2013, we undertook work that led to the publication of our first annual State of the Market report in March 2014, in collaboration with the Office of Fair Trading (OFT) and the Competition and Markets Authority (CMA).<sup>95</sup> As a result, we made a market investigation reference to the CMA after a public consultation process.<sup>96</sup> The aim of the reference is to establish if there are market features which are having an adverse effect on competition and, if so, whether there are reforms, including those outside Ofgem's powers, which would make competition in the market more effective.

The main areas of concern identified in the State of the Market report included weak customer response, continued evidence of incumbency advantages, further evidence of possible tacit coordination among suppliers, vertical integration and barriers to entry as well as increased supplier profits. Taken together, these problems indicate a lack of effective competition in energy markets. The problems identified have been analysed in previous Ofgem reviews but have persisted, and in some cases worsened, over the last few years. They constitute clear evidence that consumers are not being well served by current levels of competition.

Ofgem has put in place a number of remedies to improve competition in the market, as described above. Nevertheless, there continue to be low levels of consumer trust and public concern over the sector, which may limit the ability of RMR to deliver increased consumer engagement at the pace that is needed. There is also continuing uncertainty over whether vertical integration is in consumers' interests. The CMA is well placed to analyse all of these issues using its experience to draw on evidence from other sectors and given the broader powers it can draw on should it conclude structural change is needed. A

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<sup>95</sup> Ofgem "State of the Market Assessment" (March 2014) available at: <https://www.ofgem.gov.uk/ofgem-publications/86804/assessmentdocumentpublished.pdf>

<sup>96</sup> Ofgem "Consultation on a proposal to make a market investigation reference in respect of the supply and acquisition of energy in Great Britain" available at <https://www.ofgem.gov.uk/ofgem-publications/86807/consultationpublish.pdf>

comprehensive review of these complex and inter-related issues should help restore consumer confidence in the working of the market.

Ofgem also monitors competition on an on-going basis. For example, we collect data from suppliers and network operators monthly. We also regularly commission consumer research and have regard to a wide range of data and information from other sources which also serve to inform our view of the market and levels of competition within it.

### **Investigations**

The Authority has concurrent competition and consumer protection powers with the new Competition and Markets Authority (CMA), which has taken over the work of the Office of Fair Trading and Competition Commission. We will work with the CMA going forward, including as members of the newly-established United Kingdom Competition Network which aims to promote best practice and co-ordination between the sectoral regulators in the use of their concurrent competition powers.

Please see section 3.1.5 and 4.1.5 for details of our electricity and gas enforcement cases.

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

The majority of the domestic electricity supply market is accounted for by six large vertically integrated suppliers (integrated generation and supply businesses), which evolved between 1998 and 2003 from the 15 former incumbent electricity and gas suppliers.<sup>97</sup> There were also 14 smaller domestic electricity suppliers at the end of 2013. We have witnessed a growth in small supplier numbers during 2013, with two suppliers entering the market. Within the non-domestic market, there were 25 active suppliers at the end of 2013, one more compared to the total number of companies active at the end of 2012.

#### *Monitoring competition – domestic market share*

We regularly analyse suppliers' market shares in the domestic market segment, based on monthly domestic customer numbers. In December 2013 there were 27.7m domestic electricity consumers in GB. As Figure 7 shows, the 'Big six' suppliers supplied 95 per cent of these customers.

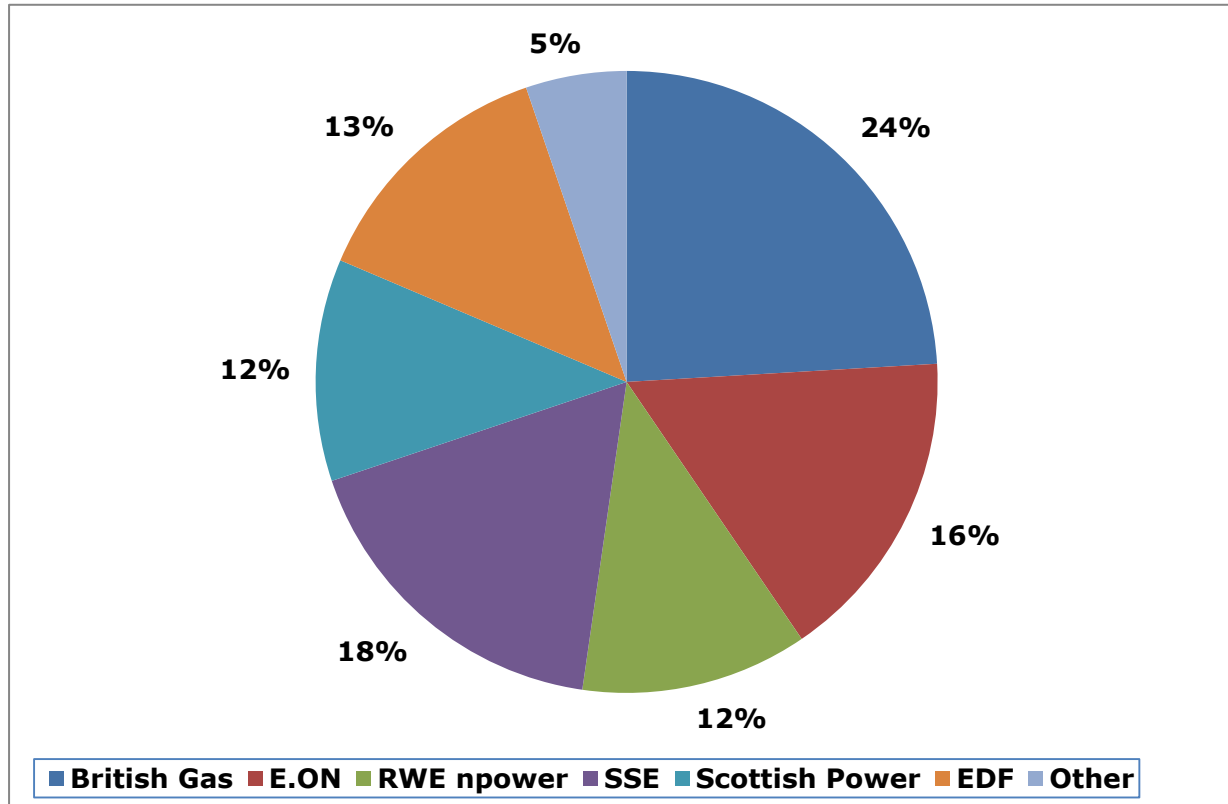
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<sup>97</sup> These companies are (i) Centrica plc: Centrica plc owns British Gas Trading, which operates three retail brands: British Gas (in England), NwyPrydain (in Wales) and Scottish Gas (in Scotland). (ii) E.ON UK: A wholly-owned subsidiary of the German energy group, which operates under the E.on brand. (iii) EDF Energy: A wholly-owned subsidiary of the French energy group. It operates under the EDF Energy brand. (iv) RWE npower: Part of the German energy group, RWE Group. The supply business operates under the npower brand. (v) Scottish and Southern Energy (SSE): It maintains and promotes separate and distinct energy retail brands in England, Scotland and Wales. (vi) Scottish Power: A wholly-owned subsidiary of the Spanish energy group, Iberdrola.

There were 14 small suppliers active in the market at the end of 2013, with a combined market share of five per cent.<sup>98</sup> These are Co-Operative Energy; Economy Energy; Ecotricity; First Utility; Flow Energy; Good Energy; Green Energy; Green Star Energy; iSupply Energy; Axis Telecom; OVO Energy; Spark Energy; Utilita and Utility Warehouse. The recent growth of smaller suppliers is an encouraging development. As a group, their market shares increased by more than two percentage points between December 2012 and December 2013.

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 have an aggregate market share of 37 per cent in their home regions.

**Figure 7: GB Domestic Electricity Suppliers’ Market Share, December 2013**



Source: Ofgem analysis based on Meter Point Administration Number (MPAN) data from Distribution Network Operators (DNOs)

*Monitoring competition – non-domestic market share*

Ofgem also monitors non-domestic suppliers’ market shares. We gather some data directly from suppliers, but also contract with Datamonitor, an independent consultancy, to provide non-domestic customer numbers.

<sup>98</sup> This includes the acquisition by Telecom Plus of 770,000 customer accounts from npower

The non-domestic electricity market is supplied by the five former incumbent electricity suppliers, British Gas, and a group of independent new entrants. The individual segments of the non-domestic market are dominated by the former incumbent suppliers and British Gas, as shown in Table 2. As a group, they supply between 78 per cent and 92 per cent of the Half Hourly (HH) and non-HH segments respectively.<sup>99</sup> We also notice that independent suppliers continue to grow in the non-domestic market, and in 2013 supplied eight per cent of non HH sites and 22 per cent of HH sites. This corresponds to an increase of one and three percentage points respectively over 2013.

In 2013, the three suppliers with the highest market shares in the non HH segment were British Gas, E.ON Energy and SSE, which together had a 61 per cent share of the segment. The HH segment is dominated by RWE npower, EDF Energy and E.ON Energy, which together had a 52 per cent share, down two percentage points from November 2012.

**Table 2: Electricity suppliers' non-domestic market share in November 2013**

Electricity supplier	Non Domestic Sites		
	Non HH	HH	All Non Domestic
British Gas	23.4%	6.0%	22.6%
E.ON Energy	22.8%	15.4%	22.4%
EDF Energy	14.3%	17.6%	14.5%
Gazprom	0.1%	1.4%	0.2%
GDF	0.0%	3.5%	0.2%
Good Energy	0.1%	0.2%	0.1%
Haven Power	1.6%	4.0%	1.8%
Opus Energy	6.0%	1.8%	5.8%
RWE npower	8.6%	19.4%	9.1%
ScottishPower	8.1%	5.7%	8.0%
Smartest Energy	0.0%	2.5%	0.1%
SSE	14.6%	13.8%	14.6%
Total Gas and Power	0.0%	1.9%	0.1%
Others	0.5%	6.8%	0.7%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Datamonitor

### *Monitoring competition – HHIs*

Herfindal-Hirschman Indices (HHI)<sup>100</sup> are often used to gauge market concentration. Though HHI does not provide conclusive evidence on the level of competition, it offers

<sup>99</sup> HH customers have their electricity meters read every half-hour. A HH meter is required if the average of maximum demand in the 3 months of highest demand exceeds 100KW. Non HH customers tend to be smaller organisations that do not consume large volumes of electricity and therefore do not need their meters read at short intervals.

<sup>100</sup> HHI is commonly used to assess market concentration, ranging from 10,000 for a monopoly to just above zero

pointers as to whether a market has the potential to deliver competitive outcomes. The relevant HHIs<sup>101</sup> for electricity are:

- domestic (Dec 2013) –1,636
- non-domestic, non-half hourly metered sites (Nov 2013) –1,660
- non-domestic, half-hourly metered sites (Nov 2013) –1,273

All three electricity markets are judged to be 'concentrated' according to the threshold HHI levels (1,000) used by the Competition and Markets Authority.

### **Distortion or restriction of competition**

The previous sections have outlined both our State of the Market Assessment and our regular ongoing monitoring activities in respect of assessing distortions and/or restrictions of competition. These work streams are helping us to identify where further intervention in the market is needed to enhance competition and improve outcomes for consumers.

Please see section 3.1.5 for details of our electricity and cross-cutting (gas and electricity) enforcement cases.

### **Prices for household consumers including prepayment systems**

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 actively monitors domestic suppliers' electricity prices across GB. We receive price change notifications from suppliers but also contract with Energylinx, an independent data provider and one of the comparison sites accredited by the Confidence Code run by Ofgem. Ofgem uses this information to calculate the implications for domestic customers' retail bills based on characteristics such as their consumption level, payment type, and region.

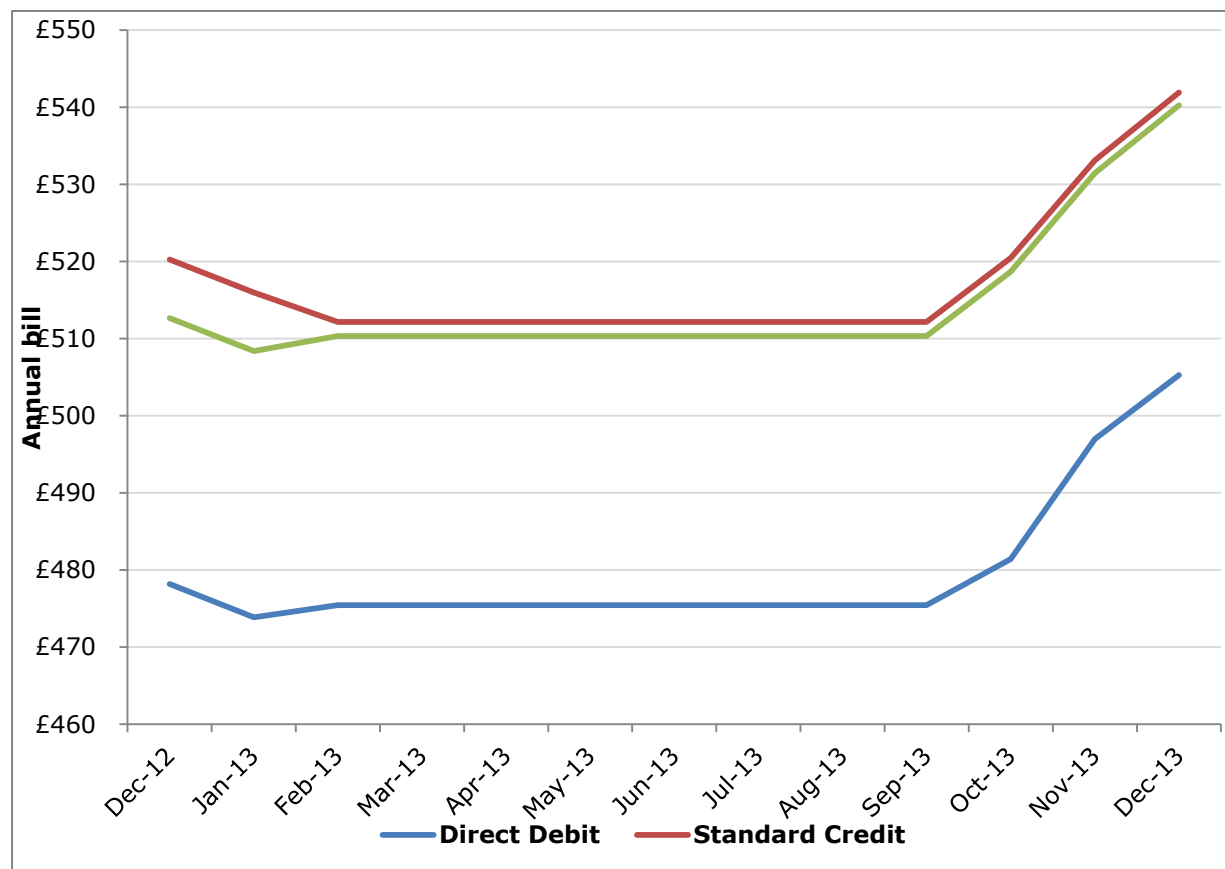
Figure 8 shows the change in typical domestic electricity bills in GB's electricity market for direct debit, prepayment and standard credit customers between January and December 2013. Overall, average electricity bills increased by six per cent (£30) over the year.<sup>102</sup> Standard credit prices fell slightly from January to February and prices rose for all payment methods in the last quarter of 2013.

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for perfect competition. Office of Fair Trading Guidelines categorise a market as 'concentrated' if its HHI exceeds 1,000 and 'highly concentrated' if its HHI exceeds 1,800.

<sup>101</sup> Domestic HHIs have been calculated using suppliers' monthly customer numbers and non-domestic HHIs have been calculated using market shares information provided to us by Datamonitor.

<sup>102</sup> Change for the three payment methods were: direct debit 6% (£30); prepayment 5.7% (£31); standard credit 5.7% (£31).

**Figure 8: Typical domestic electricity bills by payment method, Jan – Dec 2013**

Source: Ofgem analysis of Energylinx data

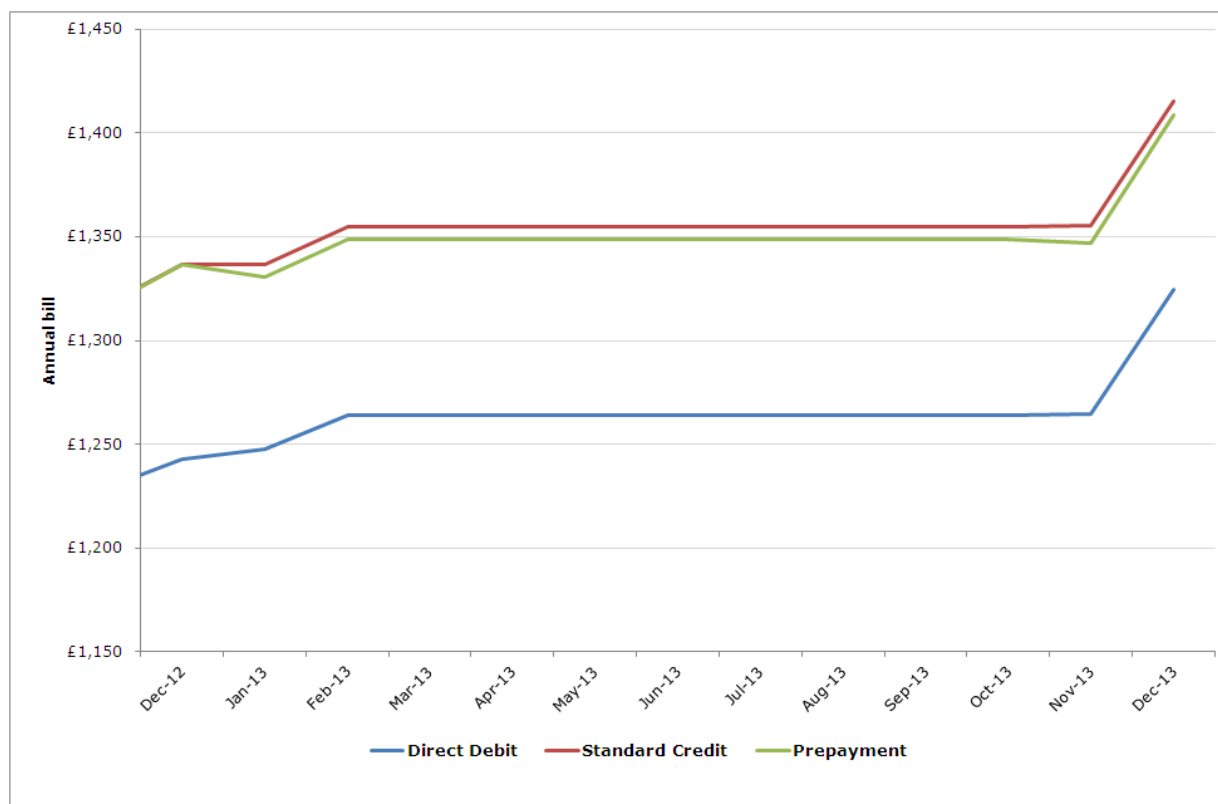
Notes: 1) Average of Big six's standard tariffs, 2) Typical consumption level: 3,300 kWh per year

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 UK Government environmental and social policies such as the Renewable Obligation and the Warm Home Discount, and transmission and distribution costs. We use our SMI to explore the relationship between retail bills and these costs.<sup>103</sup>

Figure 9 shows the change in typical domestic dual fuel bills in GB's dual fuel market for direct debit, prepayment and standard credit customers between January and December 2013. Overall, average dual fuel bills increased by six per cent (£80) over the year.<sup>104</sup> Prices for all payment methods increased in the first and last quarters of the year at the same rate.

<sup>103</sup> Available on the Ofgem website at: <https://www.ofgem.gov.uk/gas/retail-market/monitoring-data-and-statistics/understanding-energy-prices-great-britain/supply-market-indicator>

<sup>104</sup> Change for the three payment methods was: direct debit, 3.9% (£47); prepayment, 4.6% (£59); standard credit, 3.3% (£43).

**Figure 9: Typical domestic dual fuel bills by payment method, Jan – Dec 2013**

Source: Ofgem analysis of Energylinx data

Notes: 1) Average of Big six's standard tariffs, 2) Medium consumption levels: 3,300 kWh per year for electricity and 16,500 kWh for gas

## **Switching rates**

### *Domestic*

Consumers' ability to switch their energy supplier is important for a well-functioning, competitive energy market. Ofgem monitors switching rates on an ongoing basis. In 2013, 3.4m domestic consumers switched their electricity supplier, equivalent to an average of approximately 285,000 per month. This represents a switching rate of 12 per cent, almost identical to that observed in 2012. We also saw an increase in switching away from the six largest suppliers, with 25-30 per cent of customers that switched at the end of 2013 moving to smaller suppliers. We think this is due to extensive publicity and media interest surrounding the latest round of price rises. It is not clear whether these trends will be sustained.

Rates of switching are only one indicator of the extent of competition in a market. However, the figures should not be viewed in isolation. The speed and reliability of switching is important (see chapter 5.1 for our change of supplier project within our smarter markets programme of reforms), as is the quality of the outcome, such as the new tariff being better value than the old one. Switching rates have steadily fallen since



2008 despite persistent price differentials and potentially large savings from switching. This may be explained, at least in part, by the gradual withdrawal from doorstep selling of the six largest suppliers. We also noted an increase in customers switching to different tariffs or payment methods from their existing supplier. While this may be evidence of customer engagement, we cannot yet determine the extent of this.

We also noted that large numbers of people don't switch, or switch very rarely. Surveys<sup>105</sup> have revealed that 62 per cent of customers could not recall ever having switched supplier. We also noted that 37 per cent of electricity customers were still being supplied by their regional incumbent, more than 15 years after the market was liberalised.

The evidence gathered through the Ipsos Mori Tracking Survey 2013, used for our State of the Market Assessment, confirms the previous findings from our Retail Market Review. Many consumers continue to lack the ability to access, assess and act on information on offerings in the market, and therefore cannot exercise effective consumer choice. The main barriers are a combination of the complexity of tariffs, unclear and incomplete information, and continued lack of trust and confidence in suppliers and the market. These all contribute to an overall lack of engagement in the market. This is likely to cause consumer detriment by failing to put competitive pressure on suppliers to offer the products and services consumers want.

#### *Non-domestic*

Our quantitative survey<sup>106</sup> on non-domestic consumer engagement, published in December 2013, showed that around one in seven business customers (14 per cent) had switched suppliers in the last year, rising to nearly two in five (37 per cent) over the last five years. Businesses appear to be making informed switching decisions. Respondents who had switched reported that, on average, they had contacted more than three suppliers and also that more than three suppliers had provided offers in return.

On the other hand, this research has also shown that smaller businesses are more likely to have never considered switching than larger businesses. For example, 41 per cent of micro businesses (<10 employees) surveyed said they had not switched supplier in the last five years, compared to 19 per cent of large businesses (≥250 employees).

Non-domestic switching is primarily price-driven. Some customers reported they had not switched in the past 12 months due to perceptions that it was too complex and time-consuming.

Consumers and suppliers have also expressed concerns that transfer blocking ('objections') rules set out in licences and industry codes are not adhered to in some circumstances. The impact of objections can be significant for consumers. Those that have

<sup>105</sup> We annually commission IPSOS MORI, an independent research company, to explore switching with consumers. See Ipsos MORI, *Customer Engagement with the Energy Market - Tracking Survey 2013*, p.35-36 <https://www.ofgem.gov.uk/ofgem-publications/74756/customer-engagement-energy-market-tracking-survey-2013.pdf>

<sup>106</sup> Element Energy and The Research Perspective (Dec 2013) <https://www.ofgem.gov.uk/ofgem-publications/85187/non-domquantfinalforpublication181213.pdf>

a transfer blocked incorrectly may incur high out-of-contract prices and be persuaded to enter a new contract with their current supplier. We are therefore looking to increase our monitoring of supplier behaviour in this area as well as consulting on wider reforms to the switching process as part of our Smarter Markets Programme described in Section 5.1.

### **Disconnections for debt**

Suppliers' licences require that they only disconnect domestic customers for debt as a last resort and avoid disconnecting consumers who are of pensionable age, disabled or chronically sick in the winter months. In addition to this, the six largest suppliers have committed through their self-regulatory 'Safety Net' not to disconnect any consumer in a vulnerable position at any time of the year. We require suppliers to provide us with information about disconnections for debt 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.

Latest published data shows that there were 234 electricity disconnections in the first six months of 2013, 83 more electricity disconnections than in the same period the previous year. While disconnection levels remain well below previous highs (for example 30,000 energy customers were disconnected in 1998) we have made public our concern that some suppliers' disconnection rates are much higher than others. We have reminded suppliers that disconnection should only be used as a last resort and that we expect them to actively seek out alternative solutions to disconnection wherever possible.

In 2013 we introduced further monitoring to increase our oversight of the reasons customers are disconnected for debt. Responses showed that in most cases disconnections had occurred where it was not possible to agree a debt repayment arrangement with the customer and it was not safe or practicable for the supplier to fit a pre-payment meter.

Our latest data related to domestic energy debt and disconnection can be found at our Social Obligations Monitoring webpage.<sup>107</sup>

### **3.2.2.2. 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 section (3.2.2).

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<sup>107</sup> <https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/supplier-performance-social-obligations>

### 3.3 Security of supply

No single body is responsible for ensuring security of supply as we rely on the market to provide us with this. However Government sets overall energy policy on energy security. Ofgem is responsible for regulating the market and National Grid, as operator of GB electricity system has responsibility for ensuring that supply meets demand on a minute-by-minute basis each day.

The Third Package does however put an obligation on NRAs to monitor investment in generation capacities in relation to security of supply. We therefore review National Grid Electricity Transmission (NGET)'s annual Electricity Ten Year Statement (ETYS)<sup>108</sup> and UK Future Energy Scenarios (FES) documents<sup>109</sup>, which outline detailed electricity demand and generation (closure and investment) projections, and other relevant publications by NGET.

We also publish an annual Statutory Security of Supply Report<sup>110</sup> jointly with DECC, which analyses the availability of electricity and gas for meeting the reasonable demands for energy of consumers in GB.

#### *Electricity Market Reform (EMR)*

The Energy Act 2013 entered into force in December 2013.<sup>111</sup> It contains the main pillars of the Government's Electricity Market Reform (EMR) programme.<sup>112</sup> EMR is intended to incentivise investment in secure, low-carbon electricity, improve security of supply and affordability for consumers. It will have significant implications for industry and we have been considering these implications for some of our existing roles. In addition the UK's Department for Energy and Climate Change (DECC) are proposing new roles for Ofgem, including:

- Owning and managing the Capacity Market (CM) rules
- Overseeing the performance of National Grid Electricity Transmission plc (NGET)
- Enforcing the CM rules and Contracts for Difference (CfD) regulations against NGET, generators and suppliers
- Adjudicating certain disputes between NGET in its role as delivery body and a CM participant or an application for CfDs eligibility

We have been working with DECC to ensure that the necessary arrangements are in place to enable us to fulfil our roles successfully. We have also continued to work closely with DECC to inform their policy development and legislative framework.

<sup>108</sup> <http://www.nationalgrid.com/uk/Electricity/ten-year-statement/current-elec-tys/>

<sup>109</sup> <http://www2.nationalgrid.com/uk/industry-information/future-of-energy/future-energy-scenarios/>

<sup>110</sup> For more information see:

[http://www.decc.gov.uk/en/content/cms/meeting\\_energy/en\\_security/sec\\_supply\\_rep/sec\\_supply\\_rep.aspx#](http://www.decc.gov.uk/en/content/cms/meeting_energy/en_security/sec_supply_rep/sec_supply_rep.aspx#)

<sup>111</sup> <http://www.legislation.gov.uk/ukpga/2013/32/contents/enacted/data.htm>

<sup>112</sup> <https://www.gov.uk/government/policies/maintaining-uk-energy-security--2/supporting-pages/electricity-market-reform>

### *Capacity Assessment*

The Energy Act 2011 amended the Electricity Act 1989 (by inserting a new section (47ZA) into it) and introduced an obligation on Ofgem to provide the Secretary of State with a report assessing plausible electricity capacity margins and the risk to security of supply associated with each alternative. This report is to be delivered to the Secretary of State by 1 September every year.

The 2013 Electricity Capacity Assessment<sup>113</sup> gave an evaluation of the outlook for security of electricity supply out to winter 2018/19. It focused on the de-rated capacity margins (the average excess of available supply over winter peak demand) that could be delivered by the market over these winters and the associated risks to security of supply.

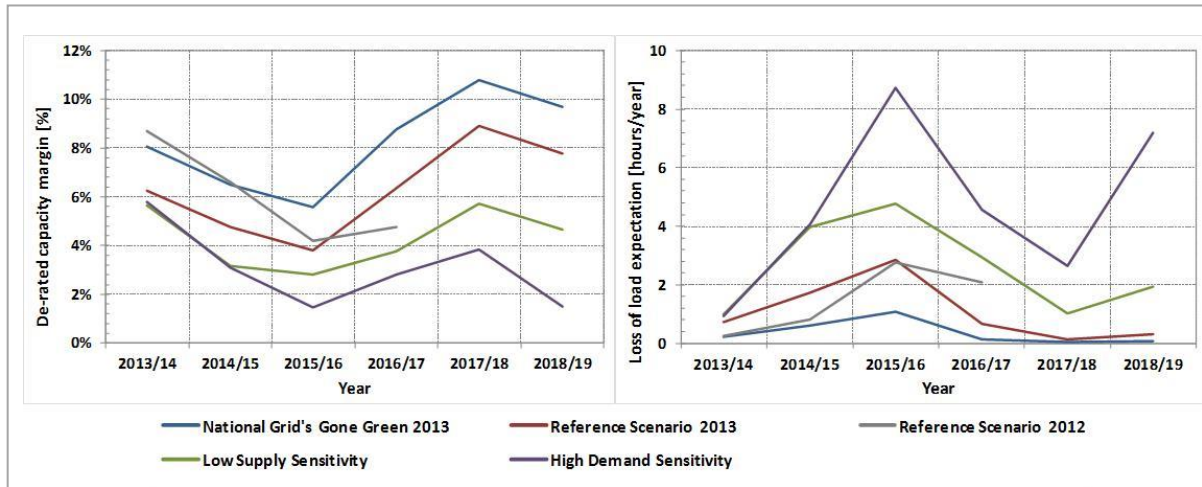
The Reference Scenario presented in the assessment suggests that the risks to security of supply are expected to increase faster than anticipated in the previous assessment published in Autumn 2012. This is primarily due to deterioration on the supply side outlook with a drop in the available capacity. De-rated margins are expected to decrease from 6 per cent in 2013/14 to just under 4 per cent in 2015/16, before recovering thereafter, primarily due to a projected drop in peak demand.

We also modelled a range of sensitivities around the risks associated with uncertainties to the future level of peak demand, the commercial decisions of generators and the level of interconnector flows with mainland Europe, among other factors. Considering the significant uncertainties around both the supply and demand outlook, the Reference Scenario alone should not be relied upon to assess the risks to electricity security of supply in the coming years.

While de-rated margins illustrate trends in the market, they are not a measure of the risk to security of supply. Instead, our assessment presents the risks to security of supply using the "Loss of Load Expectation" or LOLE - this represents the number of hours per year in which supply is expected to be lower than demand before any intervention (eg. voltage reduction) by the System Operator. In the Reference Scenario, we estimated an increase in LOLE from less than one hour per year in winter 2013/14 to just under three hours per year in 2015/16 as de-rated margins decrease. The change in LOLE illustrates that small reductions in margins from current levels would result in a significant increase in the risks to security of supply.

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<sup>113</sup> <https://www.ofgem.gov.uk/ofgem-publications/75232/electricity-capacity-assessment-report-2013.pdf>

**Figure 10: De-rated Capacity Margins and LOLE**

Source: Electricity Capacity Assessment Report 2013

We also estimate the risk to customer disconnections. Controlled disconnections of customers - involving industrial and commercial sites before households - would only happen after all mitigation actions available to the System Operator have been exhausted, including voltage control and emergency interconnection services (2 GW in the Reference Scenario). These services are not taken into account in the de-rated margins and LOLE estimations. The chance of an event requiring the temporary controlled disconnection of customers in the Reference Scenario increases from around 1 in 47 years in 2013/14 to 1 in 12 years in 2015/16.

In light of the uncertain outlook to electricity security of supply during the middle of the decade, DECC, NGET and Ofgem have been working together to explore options for additional safeguards for consumers in the form of new balancing services, aimed at enabling NGET to maintain system balance.

We published an open letter<sup>114</sup>, alongside the Electricity Capacity Assessment 2013, seeking stakeholders' views on whether it is prudent to consider introducing new balancing services given the uncertain mid-decade outlook. These services<sup>115</sup> will assist NGET to balance the system and provide consumers with an extra layer of protection from potential disruptions to supply. In December 2013 the Authority approved NGET's application to introduce the two new balancing services.

We also continued with our Electricity Balancing Significant Code Review (EBSCR) in 2013, details of which can be found in section 3.1.2.

<sup>114</sup> <https://www.ofgem.gov.uk/ofgem-publications/75221/consultation-potential-requirement-new-balancing-services-support-uncertain-mid.pdf>

<sup>115</sup> National Grid has informally consulted on two options for these services. Demand Side Balancing Reserve is a proposed new balancing service for demand side response. Supplementary Balancing Reserve would enable some generators and large users to participate in the provision of additional generation capacity or demand reduction.

## 4. The gas market

The following chapter contains details of developments within the GB gas sector during 2013. This includes details on network regulation, competition, developments in both the wholesale and retail markets and security of supply.

### 4.1 Network regulation

#### 4.1.1 Unbundling

On 10 November 2011, the Electricity and Gas (Internal Markets) Regulations 2011 (“the GB Regulations”) came into force. The Great Britain (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 Transmission System Operators (TSOs), storage and Liquefied Natural Gas (LNG) system operators, and the unbundling requirements for Distribution System Operators (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 National Regulatory Authority (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 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 such applications in 2013.

#### **Transmission System Operators (TSOs)**

Under Article 10 2009/73/EC (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 transmission system operator.

In 2013, the Authority published three final certification decisions (pursuant to sections 8F of the Gas Act and Article 3(2) of Regulation (EC) No. 715/2009 (‘the Gas Regulation’)) in respect of;

- BBL Company VOF (BBL) – decision published 8 May 2013 <sup>116,117</sup>
- Interconnector UK (IUK) – decision published 22 May 2013 <sup>118,119</sup>
- Premier Transmission Limited (PTL) – decision published 12 September 2013 <sup>120,121</sup>

<sup>116</sup> <https://www.ofgem.gov.uk/publications-and-updates/certification-decision-bbl-company-vof>

<sup>117</sup> [http://ec.europa.eu/energy/gas\\_electricity/interpretative\\_notes/doc/certification/certifications\\_decisions.pdf](http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/certification/certifications_decisions.pdf)

<sup>118</sup> <https://www.ofgem.gov.uk/publications-and-updates/certification-decision-interconnector-uk-limited-iuk>

<sup>119</sup> [http://ec.europa.eu/energy/gas\\_electricity/interpretative\\_notes/doc/certification/certifications\\_decisions.pdf](http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/certification/certifications_decisions.pdf)

<sup>120</sup> <https://www.ofgem.gov.uk/publications-and-updates/certification-decision-premier-transmission-limited>

<sup>121</sup> [http://ec.europa.eu/energy/gas\\_electricity/interpretative\\_notes/doc/certification/2013\\_073\\_uk\\_en.pdf](http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/certification/2013_073_uk_en.pdf)

In Q3 2013, the Authority reviewed the annual declaration submitted on behalf of the following TSOs and remained satisfied that the grounds for their certifications remain valid:

- BBL
- IUK
- National Grid Gas (plc)

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

There were no changes or additions to the number of gas DSOs in GB during 2013.<sup>122</sup> There continue to be eight gas distribution services providers (DSPs); four network areas for National Grid Gas plc, Northern Gas Networks Ltd, Scotland Gas Networks plc, Southern Gas Networks plc and Wales and West Utilities Ltd. As in 2012, there continue to be fourteen 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, SSE Pipelines Ltd, Severn Gas Transportation Ltd, Greenpark Energy Transportation Ltd, SP Gas Transportation Cockenzie Ltd and SP Gas Transportation Hatfield Limited.

Each independent DSO owns and operates a number of relatively small networks at various geographical locations. There was some further consolidation of asset ownership in the independent sector reflecting the focus of some businesses on providing initial connections and/or in operating commercial (as opposed to domestic) network assets. These developments have not given rise to any competition concerns, but have highlighted some operational issues, which are being addressed, with regard to updating asset ownership records within settlement systems.

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

### **Storage and LNG System Operators**

The GB Regulations have also introduced in the Gas Act a number of unbundling requirements applicable to storage and LNG system operators.

Specifically, storage facilities which are technically and/or economically necessary and are part of vertically integrated undertakings shall be independent from activities relating to the production and supply of natural gas. These provisions contained in Articles 15-16<sup>123</sup> of the Gas Directive, have been transposed in the Gas Act in Section 8 (R).

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<sup>122</sup> In relation to Article 26 of Directive 2003/55/EC

<sup>123</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.



In GB, only two storage facilities (all the others hold a minor facility exemption) are subject to these provisions: Rough and Hornsea. Rough is owned and operated by Centrica Storage Limited (CSL) while Hornsea by SSE Hornsea Limited (SSEHL). Under these new provisions both facilities are required, amongst other things, to publish an annual report, which states how they comply with these requirements. Ofgem provided guidance on compliance with these new requirements in its negotiated third party access (nTPA) guidance in December 2011.<sup>124</sup>

For LNG facilities, the Gas Directive (Article 31) and the Gas Act (Section 19E(2)-(4)) only require LNG system operators to keep their (financial) accounts separate from any other business. In GB, all the existing LNG import facilities are owned by separate legal entities and are therefore compliant with these requirements.

## 4.1.2 Technical functioning

### **Balancing services**

Under Article 41(6)(b), 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 performed in the most economic manner and incentivise network users to balance their input and off-takes.

In Great Britain (GB), the primary responsibility for balancing lies with gas shippers. The current gas balancing arrangements are designed to provide shippers with commercial incentives to balance their inputs to, and off-takes from, the GB high-pressure national gas transmission system (NTS) over the course of each daily balancing period, which corresponds to a gas day. As such, parties who are not in balance incur charges that reflect the costs incurred by the System Operator (SO) in addressing the imbalance. These charges are known as cash out prices and they provide the commercial incentives for shippers to balance their positions.

National Grid Gas (NGG), in its role as SO for the NTS, has a role as residual balancer and, as such, it can buy and sell gas to correct residual imbalances and thus ensure that the system remains in balance at all times. The primary tool that NGG uses to balance the system is the on-the-day commodity market (OCM). Ofgem has oversight through licensing arrangements over the types of balancing tools that NGG can use and their tendering processes.

In addition, the Gas Directive requires regulators to ensure that transmission system operators are given appropriate incentives to increase efficiencies, foster market integration and security of supply. Within GB, financial incentives provide information to the market allowing it to better self-balance in each gas day, hence reducing the need for NGG to act in its role as residual balancer. These incentives help ensure security of supply

<sup>124</sup> Guidance is published on the Ofgem website- see chapter 3:  
<http://www.ofgem.gov.uk/Markets/WhIMkts/CompanEff/Documents1/Guidance%20on%20the%20regulatory%20regime%20for%20gas%20storage%20facilities%20in%20GB.pdf>



by ensuring that shippers are incentivised to contract for enough gas to meet their demand.

A price measure incentivises NGG to trade at a price close to the market price, thereby minimising the impact of NGG's balancing actions in the market on a daily basis, whilst the linepack measure incentivises NGG to ensure that the linepack at the end of each gas day is similar to that at the start of the same day, so that the costs of resolving imbalances are accurately targeted on those shippers who caused them. Ofgem also financially incentivises NGG to provide the market with accurate demand forecasts up to five days ahead.

In 2013 we implemented our revised incentives on NGG and added a new incentive on demand forecasting (on the D-2 to D-5 forecasts). Our incentive period is set at 8 years, in alignment with RIIO-T1. As such, with the exception of a few incentives that will be reviewed earlier, NGG is incentivised under this scheme until March 2021.

### **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.

#### *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; and
- 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 distribution licence 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 per cent 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 contained in the Gas (Standards of Performance) Regulations 2005 (SI No. 1135), standard special licence condition D10.

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

#### *Transmission*

Connections to the NTS are governed by the UNC. Connections to the NTS are infrequent and for major pipeline developments 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 2013 quarterly reporting periods. The data can be found in "Gas Connections Quarterly Reporting".<sup>125</sup>

#### *Distribution*

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.

We did not monitor the end to end time taken by GDNs to make connections in 2012-13 but standard licence condition 24.1 of the gas transporter licence has been amended to enable the Authority to perform its functions under the Directive as well as domestic legislation.

Article 41(1)(m) requires GDNs to report information on the time taken to make connections and repairs. In 2011, we wrote to all GDNs to notify them of this requirement and since then, the GDNs have developed systems to record this data and report it on an ad hoc basis. We are currently developing the associated reporting instructions to ensure that the GDNs report this data on a consistent basis.

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

Regulators are required under the Third Package to monitor and review the access conditions to storage, linepack and other ancillary services. In the GB gas market, the

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<sup>125</sup> <http://www2.nationalgrid.com/UK/Services/Electricity-connections/Industry-products/transmission-networks-quarterly-connections-updates/>

default regime is for all storage facilities to offer negotiated third-party access 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).
- To offer access to third-parties on non-discriminatory terms.

Ofgem published a guidance document in December 2011 in respect of the new regulatory regime.<sup>126</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 (eg, national or locational balancing actions). Ofgem assesses the tender process and carries out a test to ensure the tender is competitive. In 2013 we were satisfied that competition was effective for the provision of Orderly Rundown and Non Locational requirements.

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

Under the Third Package, 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 negotiated third-party access unless the facility has been granted an exemption.

Ofgem grants a 'minor facility exemption' 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>127</sup>

Ofgem has not granted any new minor facility exemptions in 2013.

### **Monitoring safeguard measures**

Under Article 41(1)(t) we are also required to monitor the implementation of safeguard measures. These safeguard measures 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 (No 994/2010). As such, under Article 10 of the Gas Security of Supply Regulation, the competent authority is required to prepare an Emergency Plan that outlines the action that it intends to take in an emergency. In GB, the competent authority

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<sup>126</sup> Guidance on the regulatory regime for gas storage facilities in Great Britain:  
<http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/Documents1/Guidance%20on%20the%20regulatory%20regime%20for%20gas%20storage%20facilities%20in%20GB.pdf>

<sup>127</sup> Gas storage third party access (TPA) exemptions – minor facilities:  
[http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/TPAccess/Documents1/Storage%20Exemptions%20Open%20Letter%2009%20For%20publication\\_.pdf](http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/TPAccess/Documents1/Storage%20Exemptions%20Open%20Letter%2009%20For%20publication_.pdf)

is the Department for Energy and Climate Change (DECC) which has previously published the National Emergency Plan - Gas (NEP - G)<sup>128</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 Emergency Plan throughout the drafting process and as such we are comfortable that the appropriate safeguard measures have been implemented.

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

National Grid Gas Transmission (NGGT) is the sole owner and operator of the Great Britain (GB) gas National Transmission System (NTS), whilst there are eight GB Gas Distribution Networks (GDNs). The revenues that both NGGT and the GDNs can collect from users of the NTS and GDN via network charges is 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>129</sup> and RIIO-GD1<sup>130</sup>) and began on 1 April 2013, running until 31 March 2021.

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, and both are required by the regulatory regime to set charges for use of their networks such that it complies with the limits on allowed revenue that have been set. Should more or less than the maximum permitted revenue be earned in any formula year, then a compensating adjustment is made in the following year.

#### *Transmission*

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

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

TO charges are for the provision and maintenance of transmission network assets. NGGT aims to recover all of its TO allowed revenue on the basis of TO entry and exit capacity charges, but TO entry and exit commodity charges (charges based on actual gas flows) are levied where NGGT forecasts 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. System Operator 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.

<sup>128</sup> National emergency plan: gas: <https://www.gov.uk/government/publications/national-emergency-plan-gas>

<sup>129</sup> <https://www.ofgem.gov.uk/network-regulation-%E2%80%93-riio-model/riio-t1-price-control>

<sup>130</sup> <https://www.ofgem.gov.uk/network-regulation-%E2%80%93-riio-model/riio-gd1-price-control>

Under its licence, NGGT is obliged to develop and maintain a methodology which sets out how NTS charges are determined and which complies with certain charging methodology objectives; that the methodology results in charges that are reflective of the costs incurred by NGGT in its transportation business; that facilitates effective competition between gas shippers and between gas suppliers; that takes account of developments in the gas transportation business; and that is in compliance with the regulation 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 Uniform Network Code (UNC). This means that modification proposals to the charging methodology are subject to the governance procedures of the UNC and that, consequently, such 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 number of criteria are set out in the licence; a proposal must meet these criteria in order to be classified as self-governance.

We do not approve the network charges levied, only the charging methodology used to determine them. NGGT is obliged to provide 150 days' indicative notice of proposed changes to the level of charges, and 60 days' 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>131</sup>

Although the new transmission price control, based on the RIIO model, began on 1 April 2013, no significant changes were made to the gas transmission charging methodology during 2013. In June 2013 we launched the Gas Transmission Charging Review (GTCR).<sup>132</sup> This review is looking at the way in which charges are set on the NTS and in particular, the volatility and magnitude of commodity charges (including their potential impact on cross-border flows). It is also timely to consider the GB charging regime in the context of changes to tariffs that will be affected by forthcoming European law.

### *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

<sup>131</sup> <http://www2.nationalgrid.com/uk/Industry-information/System-charges/Gas-transmission/Forecasts/>

<sup>132</sup> <https://www.ofgem.gov.uk/publications-and-updates/gas-transmission-charging-review-%E2%80%93-call-evidence>

obliged to provide 150 days' indicative notice of proposed changes to the level of these charges, and 60 days final notice of 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 pipeline system in relation to the connection of that system to the pipeline system to which the licence relates. These charging methodology objectives also apply to the GDN's connection charging methodology which the GDNs are also obliged to maintain under 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 contractual framework between GB gas network users and operators, the UNC. This means that modification proposals to the charging methodologies are subject to the governance procedures of the UNC and that, consequently, such 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.

The Codes relevant to gas contain provisions for affected stakeholders to provide inputs to proposed changes to the methodologies or tariffs. 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. While we have the power to make a decision on proposed changes to the methodologies, we do not have the power to review these decisions. Stakeholders have the right to request a judicial review of any such decision.

There were no requests for judicial review on any decision regarding the methodologies or tariffs during 2013.

### *LNG facilities*

The three<sup>133</sup> Liquefied Natural Gas (LNG) facilities currently operating in GB have an exemption<sup>134</sup> from third party access and therefore the provisions of Articles 41(10) and 41(6) 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

<sup>133</sup> Isle of Grain, South Hook and Dragon LNG.

<sup>134</sup> Ofgem published its final decision to grant an exemption to the Isle of Grain LNG terminal for an expansion ('phase 4') of approximately 8.4 billion cubic meter/year (bcm/y) of capacity on 8 March 2013. The European Commission approved this decision on 4 June 2013. Ofgem's decision can be found at the following link: <http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/TPAccess/Documents1/Isle%20of%20Grain%20-phase%204%20final%20views%20document.pdf>

published<sup>135</sup> by LNG operators are discriminatory we are able take actions under the enforcement provisions contained in the Gas Act - in particular section 28.

We published guidance on regulated third party access to LNG facilities in 2012 No investment under this route took place in 2013.<sup>136</sup>

### **Prevention of cross-subsidies**

In GB, licensed gas transmission and distribution network operators 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>137</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 raises supplementary questions as appropriate.

We are satisfied that there were no material cross-subsidy issues during 2013.

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

Under the Third Package, 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 negotiated third-party access 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) and,
- to offer access to third-parties on non-discriminatory terms.

Ofgem grants a 'minor facility exemption' 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>138</sup>

Ofgem has not granted any new minor facility exemptions in 2013.

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<sup>135</sup> Under section 19D Gas Act 1986

<sup>136</sup> Please follow this link for more information on the regulation of LNG facilities in GB:

<http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/TPAccess/Pages/TPAccess.aspx>

<sup>137</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).

<sup>138</sup> Gas storage third party access (TPA) exemptions – minor facilities:

[http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/TPAccess/Documents1/Storage%20Exemptions%20Open%20Letter%2009%20\\_For%20publication\\_.pdf](http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/TPAccess/Documents1/Storage%20Exemptions%20Open%20Letter%2009%20_For%20publication_.pdf)

#### 4.1.4 Cross-border issues

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

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 more a more integrated European gas market.

The paragraphs below give an overview of the arrangements on each of the interconnectors.

##### *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.

To secure financing for the interconnector, original IUK customers agreed to book and pay for primary capacity on a 20 year term. Subsequent capacity expansions have also been funded on the basis of primary capacity charges. Primary capacity gives holders ('IUK Shippers') the right to flow a certain volume of gas in Forward Flow and/or Reverse Flow. Primary Interruptible Capacity is also available to IUK shippers to account for the fact that the physical capacity of IUK may vary depending on operating conditions. Secondary capacity can be made available to non-IUK Shippers through subletting or capacity transfers. IUK has sold all of its capacity in long-term contracts until 2018.

##### *BBL*

BBL (Balgzand Bacton Leiding) Company (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.

BBL offers forward flow capacity, on a first-come first-served basis, to any shipper that signs an agreement to become a BBL Shipper. The first of the existing long term contracts with BBL expire in 2016, with further capacity becoming available in 2022. As not all capacity offered in the open season in 2007 has been contracted, a limited amount of firm capacity is available for sale. An unlimited amount of interruptible forward flow capacity is also available. Interruptible reverse flow capacity, from the UK to the Netherlands, is sold through daily, monthly and quarterly auctions at a zero reserve price.



BBL has an exemption and has certain licence conditions switched off relating to third party access and approval of charging methodologies for 80 per cent of its forward capacity.<sup>139</sup>

### *Moffat*

The Moffat interconnector with the Republic of Ireland became operational in 1993. The capacity available to exit the system 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 Great Britain (GB) on an interruptible basis. The maximum entry capacity at Moffat is 31.1 mcm/day.

From 1996 a branch off 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 (SNIP). In February 2013, a virtual reverse flow service was introduced to nominate flows from Northern Ireland to GB.

Until 30 September 2012 existing exit capacity was released on a first come first served basis. Since October 2012 users have been able to purchase long-term exit capacity (from GB to Ireland) at the Moffat interconnection point in an annual window. Short-term exit capacity and interruptible entry capacity (for virtual reverse flow) on the GB side is also available through daily auctions with a zero reserve price.

In addition, incremental exit capacity can be allocated if the interconnector capacity is sold out via the long-term booking process. National Grid can also apply oversubscription and Use It Or Lose It (UIOLI) to ensure the maximum amount of capacity is available.

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

The Third Package gives regulators the power to modify the tariffs or charging methodologies applied by LNG System Operators and Storage System Operators (SSOs), to ensure that they are proportionate and applied in a non-discriminatory manner.<sup>140</sup>

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. 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 negotiated Third Party Access (nTPA) regime. 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 SSOs to ensure that their tariffs meet the requirements of

<sup>139</sup> Standard conditions 10,11 and 11A of the Gas Interconnector Licence

<sup>140</sup> See Article 41(10) of the Gas Directive 2009/73/EC

the Gas Regulation. We have the power to proactively monitor SSOs' compliance with the Gas Regulation and can take enforcement action if we believe any conditions relating to a grant of storage rights published<sup>141</sup> by owners of a gas storage facility discriminatory.<sup>142</sup>

The Gas Directive gives the right to any party affected to submit a complaint for review regarding a decision on methodologies taken 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>143</sup> We did not receive any complaints in 2013.

### **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>144</sup> In GB, changes have been made to the standard conditions of the Gas Interconnectors Licence<sup>145</sup> to take full account of these new responsibilities.

In August 2012, the European Commission adopted the Congestion Management Procedures (CMP) Guidelines<sup>146</sup>, which set a deadline of 1 October 2013 for the implementation of three procedures, and 1 July 2016 for the implementation of a fourth. The main requirements of the Guidelines are incentives for Transmission System Operators (TSOs) to offer capacity in addition to their technical levels and to allow users to surrender their unused capacity for resale. We have been working closely with all relevant TSOs and NRAs to introduce the CMP Guidelines. We published an open letter in March 2013 setting out our views on the minimum steps we expect relevant parties to take in order to comply with these Guidelines.<sup>147</sup> In September 2013, a modification to National Grid Gas' (NGG) industry code was approved, introducing the concept of Interconnection Points to GB and facilitating compliance with CMP. NGG has now raised a further modification, which will introduce the Long-term Use It Or Lose It mechanism by October 2014, as required.

Both BBL's and IUK's implementation of CMP was put on hold in late 2013 pending agreement with neighbouring NRAs on the interpretation and application of the CMP Guidelines. IUK conducted two consultations in 2013 and is expected to submit its proposal for approval in 2014. BBL is currently working up detailed proposals.

<sup>141</sup> See section 19B of the Gas Act 1986

<sup>142</sup> See sections 28 and following of the Gas Act 1986

<sup>143</sup> Regulation 28 amends sections 27B-27D of the Gas Act:

<http://www.legislation.gov.uk/ukxi/2011/2704/regulation/28/made>

<sup>144</sup> See Articles 41(6)(c), 41(8), 41(9) and 41(10) of the Gas Directive 2009/73/EC

<sup>145</sup> See standard conditions 10, 11 and 11A of the Gas Interconnector Licence:

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

<sup>146</sup> Commission Decision of 24 August 2012 on amending Annex I to Regulation (EC) No. 715/2009 of the European Parliament and of the Council on conditions for access to the natural gas transmission networks (2012/490/EU) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:231:0016:0020:EN:PDF>

<sup>147</sup> <http://www.ofgem.gov.uk/Europe/Documents1/Ofgem%20CMP%20Implementation%20Open%20Letter.pdf>

In October 2013, the European Commission adopted the Capacity Allocation Mechanism (CAM) Regulation, which applies from 1 November 2015 and to the extent any implementation is required this must be completed by 1 November 2015.<sup>148</sup> The main requirement of the CAM Regulation is for capacity at interconnection points to be auctioned as a bundled product with standard durations.

We have agreed a two-stage process with relevant TSOs and NRAs of GB, Belgium and the Netherlands to implement the auction of bundled products. During the first stage the relevant TSOs will jointly consult with stakeholders on proposals to implement bundled capacity auctions and seek an opinion from relevant NRAs on these proposals. In April and October 2013 IUK consulted on its proposal for implementing the CAM Regulation.

In the second phase the TSOs will make the necessary changes to their industry documents and contracts.

We also published an open letter in October 2013 setting out our views at the time on two specific issues relating to options on how the CAM Regulation could be implemented at the Bacton interconnection point and some wider issues on CAM implementation.

### **Cooperation**

Article 41 (1)(c) of the Gas Directive requires us to consult and cooperate with ACER and the regulatory authorities of other member states over cross-border gas issues. Changes have been made to the Gas Act 1986 to reflect this.<sup>149</sup>

The changes to the Gas Act also place a responsibility on us to cooperate with the regulatory authorities of other member states to promote certain objectives. This includes promoting the integration of national gas markets and supporting jointly managed cross-border trade in gas and the allocation of cross-border capacity.

#### *Examples of cooperation*

We have been cooperating with the regulators of neighbouring member states over a number of issues concerning interconnectors. For example, we have worked closely during 2013 with the Northern Irish regulator (UREGNI) and the Republic of Ireland regulator (CER) to develop and approve a virtual reverse flow service from Northern Ireland to GB. In February 2013, we published the decision letter approving the bilateral agreements between Bord Gais Eireann (BGE) (UK) and Premier Transmission Limited (PTL) to allow for virtual reverse flow service from Northern Ireland to GB.<sup>150</sup>

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<sup>148</sup> Commission Regulation No. 984/213 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, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:273:0005:0017:EN:PDF>

<sup>149</sup> See Regulation 34 of the Electricity and Gas (Internal Market) Regulations 2011, which inserts section 4D into the Gas Act 1986: <http://www.legislation.gov.uk/ukxi/2011/2704/regulation/34/made>

<sup>150</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=166&refer=Europe> and <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=167&refer=Europe>

In addition, we have closely collaborated with our Belgian and Dutch counterparts throughout 2013 on cross-border gas issues. The GB, Belgian and Dutch gas markets are interconnected by IUK (between GB and Belgium), BBL (between the Netherlands and GB) and several Interconnection Points (IPs) between Belgium and the Netherlands.

In 2013 we undertook a substantial amount of analysis on the price responsiveness of flows through our gas interconnectors to continental Europe. This explored whether gas flows to the UK from either Belgium or the Netherlands when our price is higher than on the continent and vice versa. In July 2013 we published an open letter jointly with the Dutch and Belgian regulators on our findings.<sup>151</sup> The findings indicated that our interconnector with Belgium (IUK) does respond to price signals, but that there are barriers to flows of gas in part due to GB transmission charges. On the contrary we found that our interconnector with the Netherlands (BBL) does not respond to price signals as one would expect. We continue to work with the Belgian and Dutch NRAs on this.

Ofgem is also working with the Dutch and Belgian regulators to facilitate the implementation of the Guidelines / European Network Codes on congestion management policy, capacity allocation and transmission tariffs that should help interconnector flows better respond to price signals.

We have also contributed to ACER's work to develop Framework Guidelines for the network codes of the European gas market. We led the drafting process, on behalf of ACER, on the gas Balancing Framework Guidelines (where we continue to chair the task force) and on ACER's opinion of both the Balancing and Capacity Allocation Mechanism Network Codes. We have also been actively involved in the development of the Harmonised Tariff Structures Framework Guidelines.

Ofgem has also been actively involved at the Council of European Energy Regulators (CEER). We are co-chairing, alongside two other regulators, CEER's incremental capacity work stream which focuses on developing a market-based approach for cross-border investment. We co-chair the Gas Storage Task Force and continue to contribute to CEER's projects around sharing experiences on regulatory matters, including on storage and LNG issues.

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

We set price controls for the gas transmission system operator (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

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<sup>151</sup> <https://www.ofgem.gov.uk/publications-and-updates/further-analysis-and-next-steps-review-gas-interconnectors-between-great-britain-and-belgian-and-dutch-markets>

development e.g. setting revenue drivers to make sure that National Grid receives an appropriate revenue adjustment. We will therefore have sufficient information to inform our duty under Article 41(1)(g).

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

##### **Compliance of regulatory authorities with binding decisions of the Agency and the 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, will ensure 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 Ofgem approved network code compliance regime.

### **Update on Ofgem's enforcement investigations**

We have set out below the investigation which we concluded in 2013 relating to gas undertakings. Please see section 3.1.5 for an update on Ofgem's cross-cutting (electricity and gas) enforcement actions for 2013.

#### Miscalculation of thermal energy

- In June 2013, we welcomed news of a £10m payment by British Gas to energy consumers in financial hardship. This payment was made in response to the interpretation that British Gas had taken to the regulations which cover the way thermal energy in gas, known as calorific value, is calculated. British Gas has confirmed all its processes and procedures have now been updated to be fully consistent with the appropriate regulations.

## **4.2 Promoting Competition**

### **4.2.1 Wholesale markets**

#### **Key Summary**

The following chapter provides an overview of the developments in the wholesale gas market in Great Britain (GB) during 2013. Detailed information can be found in the following sections, a summary of which is presented below;

- There are a total of 224 holders of Shipper Licenses in GB. 13 Shippers hold primary capacity rights on the Interconnector to Belgium (IUK) and 14 shippers for the interconnector to the Netherlands (BBL), three of which have primary capacity rights
- Concentration is low in the wholesale market. Largest market share in terms of traded volume stood at 6.9 per cent. Largest share of physical throughput was 14.9 per cent and six shippers had a market share greater than five per cent
- In 2013, LNG represented 12 per cent of total gas supplies in GB down from 17 per cent in 2012
- Gas storage levels remained unchanged from 2012 at 4.6 bcm
- Gas demand for 2013 was 77.7 bcm, down slightly by 0.8 per cent on 2012. Demand from electricity continued to fall, whilst a cooler first quarter provided some upward pressure on demand
- In March 2013, a combination of high demand, low storage levels and a brief outage on IUK drove the monthly average day ahead price to 86.5 p/therm, the highest levels since 2006. However, the market responded and strong injections throughout the summer and the winter 2013 saw total gas in store recover to above the six-year average by year end.

Policy developments in several areas of GB's wholesale gas market have continued throughout 2013. Some notable policy areas include:

- Gas significant code review
- Gas transmission charges for interconnectors
- Development of European Network Codes and Guidelines
- DECC Gas Security Framework<sup>152</sup>

### **Description of the wholesale market**

The privatisation of the gas market in GB as a whole began with the Gas Act 1986. The GB wholesale market today is based mostly on trading between gas producers, shippers, suppliers, traders and customers across a series of markets.

#### *Wholesale Market Trading*

Trade on the wholesale market consists of over the counter (OTC) trading (through brokers and off-market) and exchange trading. There are three price reporting agencies which provide prices based on reported OTC trades, as well as two exchanges which offer pricing information to the market. In addition to these, in early 2013, three of the large brokerages which facilitate the OTC market have joined together to launch a new pricing index called Tankard based on trades that they broker.<sup>153</sup>

#### (i) Over the counter trading<sup>154</sup>

OTC trading<sup>155</sup> typically operates from a year or more ahead of real time up until 24 hours ahead of real-time.<sup>156</sup>

According to the London Energy Brokers' Association (LEBA), total OTC volumes at the National Balancing Point (NBP) (UK's virtual trading platform for natural gas) in 2013 were

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<sup>152</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/236756/Gas\\_Security\\_Policy\\_Announcement\\_-\\_Final\\_3\\_.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/236756/Gas_Security_Policy_Announcement_-_Final_3_.pdf)

<sup>153</sup> Please see the Tankard website for further information. Available from: <http://www.tankardindex.com/>.

<sup>154</sup> Bilateral trading between two market participants or where an intermediary (the broker) brings together a buyer and seller

<sup>155</sup> Bilateral trading between two market participants or where an intermediary (the broker) brings together a buyer and seller

<sup>156</sup> Examples of typical contracts include annual contracts (contracts for the delivery of a given volume of gas at a specified price throughout a year), seasonal contracts (summer/winter), quarterly contracts and monthly contracts. However, this market is also used for non-standard contracts designed to match a consumer's anticipated demand profile.

down 14.51 per cent year-on-year. This is in contrast to activity on the Continental European hubs, where volumes rose across the board.<sup>157</sup>

(ii) Exchange Trading

Although trading on exchanges can extend out as far as the contract OTC market, trading on GB exchange tends to be concentrated towards real-time. Shippers trade short term on the exchanges to keep in balance as their demand and supply forecasts become more accurate in the run-up to real time.

In September 2012, the Intercontinental Exchange (ICE) bought a majority share of APX-Endex's (APX) derivatives and spot natural gas business. Gasunie, the Dutch gas grid operator, holds the remaining share of the business.<sup>158</sup> Following a demerger, ICE Endex was launched in March 2013, based on the derivatives and spot gas trading business of the former APX-ENDEX. These services were migrated to the ICE Clear Platform in September 2013.

Traded volumes on the ICE UK Gas Futures exchange totalled 506 bcm in 2013, down by around 15 per cent from 595 bcm in 2012, in line with similar drops in OTC volumes.<sup>159</sup> On the ICE Endex, combined volumes for OCM (On-the-day-commodity market) and NBP totalled 13.75 bcm in 2013, up slightly on 2012's figure of 13.1 bcm.

*Demand*

Figures from the Department for Energy and Climate Change (DECC) show that GB gas demand for the year 2013 was 77.7 bcm, a slight decrease of 0.8 per cent on the previous year. This is driven by falling demand from electricity, offset to an extent by an increase in domestic/final users' consumption due to a cooler first quarter.<sup>160</sup>

**Market integration**

The GB market is becoming more integrated due in part to the decline in domestic production and increased interconnection with our neighbours.

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<sup>157</sup> Source: <http://www.leba.org.uk/assets/LEBA%20December%202013.pdf>

<sup>158</sup> It has been reported that ICE and Gasunie will have shares of 79.12% and 20.88%, respectively. Source: <http://www.platts.com/RSSFeedDetailedNews/RSSFeed/ElectricPower/6632541>.

<sup>159</sup> Source: ICE. Represents total volumes traded in monthly, seasonal and quarterly products from 1<sup>st</sup> Jan 2013 to 31<sup>st</sup> Dec 2013. Available from: [www.theice.com](http://www.theice.com).

<sup>160</sup> Source: DECC Energy Trends – Gas. Available from: <https://www.gov.uk/government/publications/gas-section-4-energy-trends>.



*UK Continental Shelf Production***Table 3 – GB forecasts for demand, UK continental shelf production and import requirements (Gone Green Scenario)**

	2013	2014	2015	2016	2017	2018	2019	2020
Demand (inc. exports) (bcm)	79.2	79.6	77.8	75.9	75.5	74.3	72.7	71.2
UKCS production (bcm)	32.5	35.1	36.1	37.0	36.1	35.1	34.5	32.1
Import Requirement	59%	56%	53%	51%	52%	52%	51%	53%

Source: Gas Ten Year Statement 2013, National Grid<sup>161</sup>

Table 3 shows the forecast production from the UK Continental Shelf (UKCS) and the associated import requirements for the years ahead. The table shows a forecast rise in UKCS supplies over the short/mid-term, with year-on-year increases expected until 2016. In the longer term, it is anticipated that annual production will decrease. However, this is not expected to have a significant impact on GB import requirements before the end of the decade, since demand is also forecast to fall over this period.

*Interconnectors*

In terms of IUK (the gas interconnector between GB and Belgium), each shipper has a share of the Forward Flow and Reverse Flow Standard Capacity. Originally, nine shippers acquired Capacity Rights in IUK for a period of 20 years from 1 October 1998 through to 30<sup>th</sup> September 2018. Currently, 13 Shippers hold primary capacity rights.<sup>162</sup> Historical analysis<sup>163</sup> indicates that IUK's price responsiveness is reasonable, which is consistent with the record levels of imports seen in 2013<sup>164</sup>, as NBP/continental hub spreads widened during periods of high demand and low levels of storage were experienced in GB towards the end of the first quarter of 2013 (see figure 11). On 22<sup>nd</sup> March 2013, IUK briefly dropped to zero following a pump failure– see further discussion in *GB Market Trends in 2013*.

Since the installation of a fourth compressor at BBL, in April 2011, no further forward flow interconnector capacity expansion has occurred, and some long-term firm forward flow capacity remains unsold on the interconnector. Interruptible virtual reverse flows have been in use on BBL since the beginning of 2011. There are currently 14 shippers on BBL,

<sup>161</sup> Source: Gas Ten Year Statement 2013. Available from: <http://www2.nationalgrid.com/UK/Industry-information/Future-of-Energy/Gas-ten-year-statement/Current-statement/>

<sup>162</sup> Information correct as at Q1 2014. Shippers are listed on IUK's website:

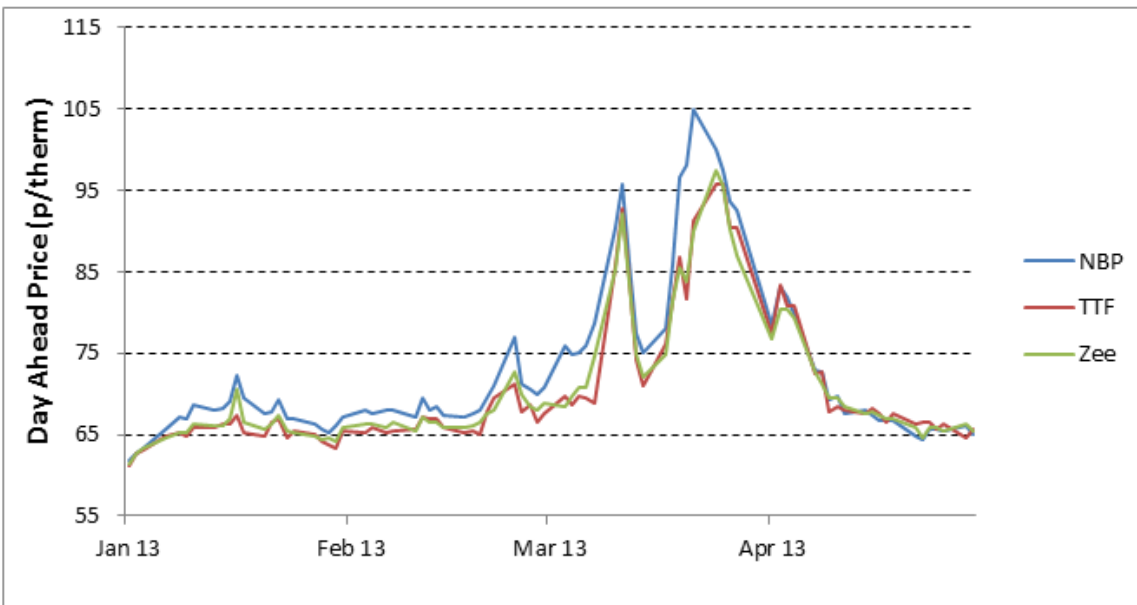
<http://www.interconnector.com/access-services/the-service/current-shippers/>.

<sup>163</sup> Detailed analysis available at <https://www.ofgem.gov.uk/ofgem-publications/75776/interconnector-flows-further-analysis-next-steps-final.pdf>

<sup>164</sup> Flow data available from National Grid: <http://marketinformation.natgrid.co.uk/gas/DataItemExplorer.aspx>.

three of which have primary capacity rights.<sup>165</sup> Experience so far<sup>166</sup> shows that interruptible virtual reverse flows do not always reflect price signals, e.g. they are utilised even when NBP prices are higher than TTF (the virtual trading point for natural gas in the Netherlands)<sup>167</sup> prices while during other times they are underutilised despite TTF prices exceeding NBP prices.

**Figure 11: Day ahead NBP (GB, blue), TTF (Netherlands, red) and Zeebrugge (Belgium, green) hub prices for the period 1<sup>st</sup> January to 30<sup>th</sup> April 2013**



Source: Bloomberg/Ofgem

#### *Interactions with Global LNG markets*

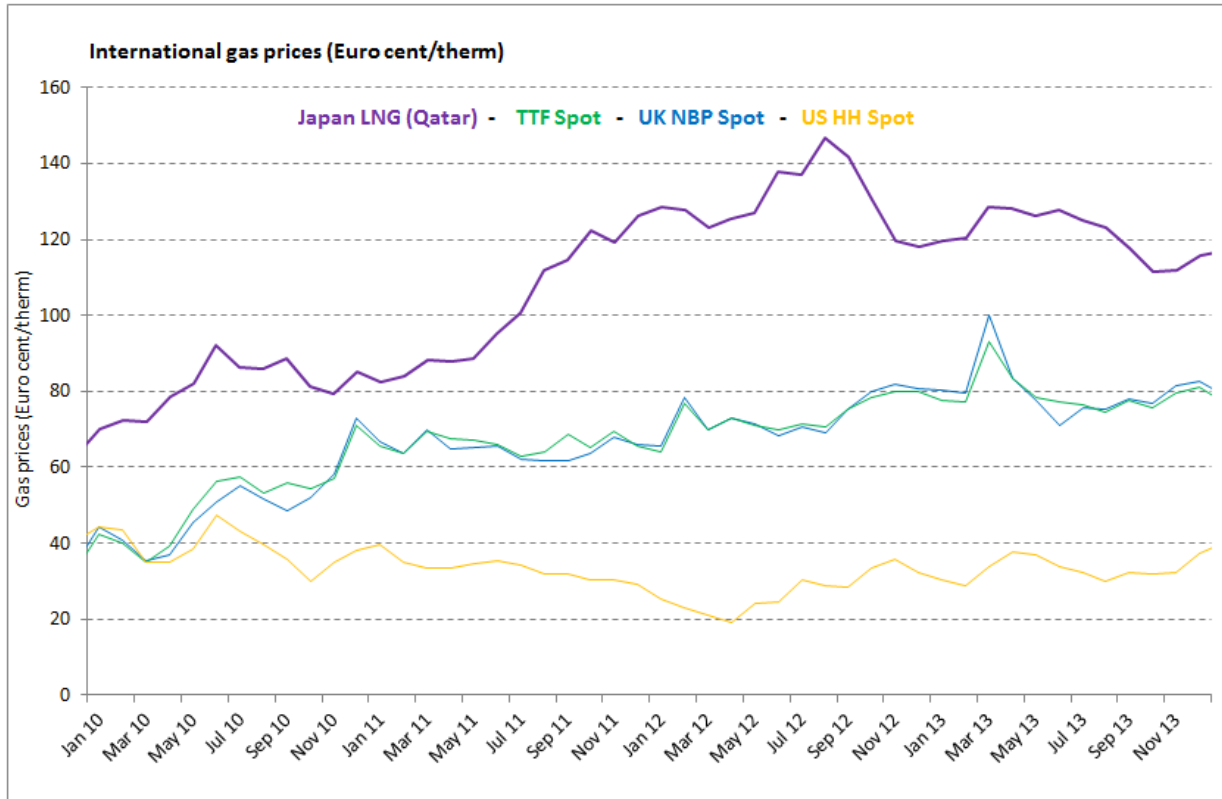
In 2013, LNG comprised 12 per cent of total gas supplies in GB<sup>168</sup>, down from 17 per cent and 30 per cent in 2012 and 2011 respectively, in line with similar decreases seen across Europe. This represented a continuation of the global trends seen since the Fukushima Daiichi nuclear accident, with Japan's nuclear shutdown bringing about increased demand for LNG in Asia, and Asian prices at a significant premium to the European hubs such as the NBP. In the US, Henry Hub's significant discount to Europe and Asia persists, due to sustained shale gas production. Whilst the LNG market continues to be dominated by long term supply contracts, there are increasing volumes of short term/spot trading.

<sup>165</sup> Shippers are listed on BBL's website: <http://www.bblcompany.com/commerce/shippers-list>.. Information correct as April 2014.

<sup>166</sup> Detailed analysis available at <https://www.ofgem.gov.uk/ofgem-publications/75776/interconnector-flows-further-analysis-next-steps-final.pdf>

<sup>167</sup> TTF - Title Transfer Facility

<sup>168</sup> Source: DECC Energy Trends – Gas. Available from: <https://www.gov.uk/government/publications/gas-section-4-energy-trends>.

**Figure 12: Monthly averaged GB, Dutch, US and Japanese gas prices from 2010**

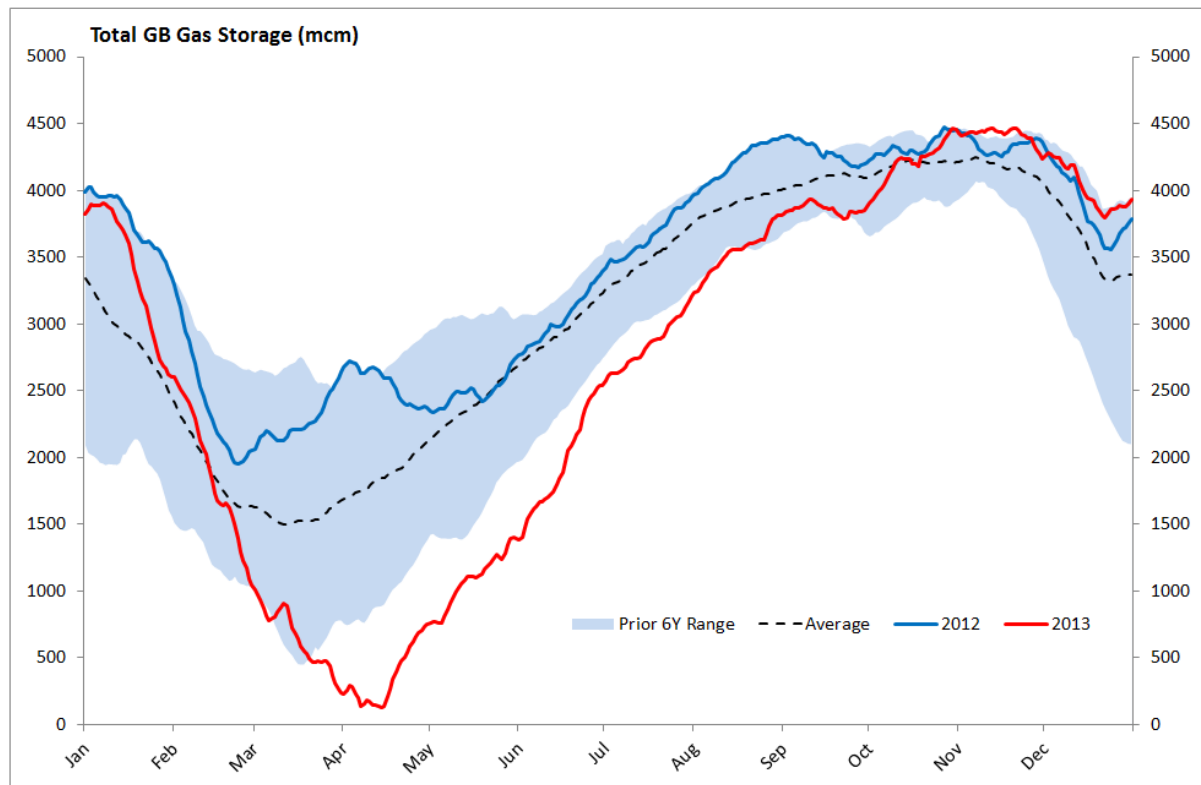
Source: Bloomberg/Ofgem

### GB Market Trends in 2013

In March/April 2013, the GB gas system was tested when IUK interconnector flows dropped to zero following a pump failure at Bacton, down from an average flow of 73.5 mcm on the previous two days. The outage occurred against the backdrop of the coldest March since 1962, with gas demand over the month averaging 325.5 mcm/day, 51.5 mcm/day above seasonal norms. Resulting day ahead prices averaged 86.5p/therm in March, the highest levels since 2006.

Over subsequent weeks, GB gas stocks reached an all-time low of four per cent. However, the market responded, and strong injections throughout summer and winter 2013 saw total gas in store recover to above the six-year average by year end (figure 13).

**Figure 13: Total GB gas in storage during 2013 (red line), as compared with 2012 (blue line), 6Y average (dotted) and prior 6 year range (blue bands)**



Source: National Grid/Bloomberg/Ofgem

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

##### **Wholesale price transparency**

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 over-the-counter (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. Following a demerger, ICE Endex was launched in March 2013, based on the derivatives and spot gas trading business of the former APX-ENDEX. These services were migrated to the ICE Clear Platform in September 2013; consequently, there is now one common platform for GB gas exchange trading.

As noted in the electricity section of this report, we are considering a range of issues around the role of reference prices and the key factors that determine the ability of price reporting agencies to make price assessments that represent a fair reflection of the market.

### *REMIT*

EU Regulation on Wholesale Energy Market Integrity and Transparency (REMIT) legislation is a key tool in ensuring the transparency of prices within the wholesale energy market. It came into force in December 2011 and prohibits insider trading and attempted or actual market manipulation in wholesale energy markets across the EU.

In June 2013, the UK government introduced legislation which provided us with new powers to monitor, investigate and take action against organisations or individuals who carry out or attempt to carry out energy market abuse. After a public consultation, in November we published our REMIT penalties statement and guidelines setting out how we will use our REMIT investigations and enforcement powers.

In November 2013, Ofgem and the Financial Conduct Authority (FCA) concluded a detailed review of allegations of manipulation of the gas market in Great Britain. We determined that no evidence of the alleged market manipulation could be found and therefore that the interests of consumers have not been harmed. Ofgem continues to monitor the wholesale energy markets and will consider carefully any evidence of potential abuse that is brought to our attention.

We regularly discuss REMIT issues with ACER, other NRAs and financial authorities (such as the FCA), including how best to co-operate. This will help us deal effectively with any cases that have a negative impact on wholesale energy markets in more than one EU country or which affect financial markets.

### **Price Monitoring: Market opening and competition**

As noted, the bulk of contract trading in the GB wholesale market is bilateral between gas producers, shippers, suppliers, traders and customers across a series of markets. The majority of wholesale market trading is divided into OTC trading and power exchange trading. The market underwent the first stages of privatisation in the late 1980s, and is now open to competition.

The rules and regulations that were put in place, following market opening, have been removed and replaced with legislation aimed at facilitating competition and protecting consumers. We are bound by our statutory duties to protect the interests of consumers, both existing and future. Wherever appropriate, we perform our functions in a manner which we consider would further this principal objective by promoting effective competition. However, before exercising our functions in this manner, we must consider whether the interests of consumers would be better protected by exercising our functions in other ways.

## **Monitoring competition**

We actively monitor competition in the market for wholesale gas. Competition indicators such as market concentration levels are assessed across different areas of the market.

We have concurrent powers, together with the Competition and Markets Authority (CMA), to enforce Chapter I of the Competition Act 1998 (CA98) / Article 101 Treaty on the Functioning of the European Union (TFEU) and Chapter II / Article 102 TFEU in the energy sector relating to competition, cartels and abuse of dominant market position. We may undertake an investigation where we have reasonable grounds to suspect a breach of these provisions.

We may also be asked to assist relevant competition authorities (such as the CMA or the European Commission) during their assessment of mergers affecting the GB energy market. In the past, we have conducted various assessments into proposed mergers and acquisitions.

## **Market Concentration**

The GB market receives its gas supplies from a variety of different sources encompassing indigenous supplies from the UK continental shelf (UKCS), imports from Norway (via the Vesterled, Langeled and Tampen Link pipelines), imports from Continental Europe (via the Interconnector UK and BBL pipelines) and from the LNG market through the Isle of Grain, South Hook and Dragon LNG terminals and the Teeside GasPort facility for energy bridge regasification vessels (EBRV).

In 2013, there were six companies whose market share of production exceeded five per cent for UKCS.<sup>169</sup> Market share relating to import pipelines is more difficult to assess, as shippers trade their capacity on secondary markets making individual imports by companies harder to trace.

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

Rough remains the largest GB storage facility, with no change projected in the near term. There are approximately 20 capacity holders at Rough, with the three largest shippers holding approximately 44 per cent of the capacity.<sup>170</sup>

In addition, it is also possible to assess the market share of gas shippers<sup>171</sup> in the GB gas market. There are a total of 224 holders of Shipper Licences in GB.<sup>172</sup> Market

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<sup>169</sup> Source: from DECC Exploration and production - Oil and gas: field data <https://www.gov.uk/oil-and-gas-uk-field-data> .  
<sup>170</sup> Capacity shares based on when the facility was last fullest, in October 2013.

concentration is also low; in terms of physical throughput, six shippers have a share greater than five per cent, with the largest share on physical throughput standing at 14.9 per cent. Similarly, five shippers have greater than five per cent of traded volumes, with the largest share of trading volumes at 6.9 per cent.<sup>173</sup>

### **Storage services**

Broadly speaking gas from storage does not make a net contribution to annual gas demand as inputs into storage in summer months are generally equal to withdrawals in winter.

The Rough and Hornsea storage facilities are required to offer Third Party Access (TPA), whilst the other facilities are exempt from this requirement. Table 4 below provides details of the technical characteristics and the TPA status of existing UK storage facilities.

**Table 4: Existing UK storage and TPA status**

Facility	Space (bcm)	Deliverability (mcm/d)	Owner	TPA Status
Rough	3.3	41	Centrica Storage	Operated under nTPA + (varied) Rough Undertakings
Hornsea	0.3	18	SSE	Operated under nTPA
Avonmouth	0.08	13	National Grid LNGS	TPA offered under section Z of the Uniform Network Code
Aldbrough	0.3	40	SSE & Statoil	Exempt
Humbly Grove	0.3	7	Humbly Grove Energy	Exempt
Holford	0.2	22	EON	Exempt
Hatfield Moor	0.07	2	Scottish Power	Exempt
Holehouse Farm	0.05	11	EDF Trading	Exempt
<b>Total</b>	<b>4.6</b>	<b>154</b>		

Source: Gas Ten Year Statement 2013, National Grid<sup>174</sup>

<sup>171</sup> A Shipper Licence allows the licensee to arrange with a GT for gas to be introduced into, conveyed through, or taken out of a pipeline system operated by that GT. In all instances, the purpose of the gas movement should be general or for purposes connected with the supply of gas to premises. It cannot be held in conjunction with a Gas Transporter Licence or a Gas Interconnector Licence.

<http://www.ofgem.gov.uk/Licensing/Work/LicensAct/Pages/LicensAct.aspx>.

<sup>172</sup> Correct as of Q1 2013. A full list of licence holders is available from:

[http://www.ofgem.gov.uk/Licensing/Work/Documents1/external\\_gas\\_list.pdf](http://www.ofgem.gov.uk/Licensing/Work/Documents1/external_gas_list.pdf).

<sup>173</sup> Based on market sensitive data for the gas year 2012/13.

<sup>174</sup> Space is working gas capacity and deliverability is withdrawal capacity.

In 2013, total gas storage capacity remained unchanged at 4.6 bcm.<sup>175</sup> In total, an additional 0.3 bcm of capacity is expected to start-up in 2014, with 0.1 bcm at Hill Top Farm (owned by EDF Energy) and 0.2 bcm at Stublach (owned by Storengy UK, a subsidiary of GDF SUEZ).

The Rough and Aldbrough facilities account for around 80 per cent of total storage space and 50 per cent of total daily deliverability. Rough has a standard working gas capacity of about 3.3 bcm although depending on the injection profile over the course of the year it can store large quantities. The only LNG storage facility (Avonmouth) accounts for 1.7 per cent of space and approximately 10 percent of total daily deliverability.<sup>176</sup>

The storage sites offering TPA provide storage services on the basis of a standard bundled unit (SBU) of space, deliverability, and injection. Firm and interruptible products are offered. In addition, unbundled rights may be traded on the secondary market.

National Grid LNG Storage holds annual auctions for the sale of storage capacity on a pay-as-bid basis and publishes the weighted average price paid to the wider market. Scottish and Southern Energy auctions annual capacity at Hornsea ahead of each storage year. Annual average prices are published on its website. We have no information on rejected applications for storage capacity. Furthermore, we have not received complaints regarding the allocation mechanism, and currently all capacity has been sold.

## **Measures to avoid abuses of dominance**

### *Transparency*

Transparency is a key component in the effective and efficient operation of the GB gas market. National Grid has an obligation to ensure information required by Article 18 and the revised Chapter 3 Annex to Gas Regulation (EC) No 715/2009 is available on its website.<sup>177</sup>

As mentioned in the *Wholesale price* transparency section above, the EU Regulation on Wholesale Energy Market Integrity and Transparency (REMIT) legislation is a key tool in ensuring the transparency of prices within the wholesale energy market.

### *Market surveillance*

Our market surveillance team monitors the gas and electricity markets, including the wholesale gas market and the Balancing Market (BM). They routinely assess whether there is any evidence of anti-competitive behaviour or breaches of statutory provisions or licence conditions which may be investigated by us.

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<sup>175</sup> Source: National Grid Gas Ten Year Statement

<sup>176</sup> The LNG storage facilities are required to offer TPA under sections Z of the Uniform Network Code.

<sup>177</sup> For more information, see: <http://www.nationalgrid.com/uk/Gas/Data/>.



Additionally, the FCA<sup>178</sup> has responsibilities for the operation of financial markets in the UK. The FCA works to prevent abuse or distortion of financial markets. The FCA has the power to fine persons who have abused the market, where “market abuse” is defined under the Financial Services Market Act 2000.

## 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. These areas of our work are covered in section 3.2.2. Where Ofgem *does* engage with the electricity and gas retail markets separately, the information has been documented in 3.2.2 and 4.2.2 respectively.

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 5 large vertically integrated electricity suppliers (which evolved from the PESs through mergers and acquisitions). There were also 16 small domestic gas suppliers at the end of 2013. We have seen growth in small supplier numbers during 2013, with 5 new companies entering the market. Within the non-domestic market, there were 35 active suppliers at the end of 2013, 5 more than the total number of active suppliers at the end of 2012.

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

#### **Price Monitoring: Market opening and competition**

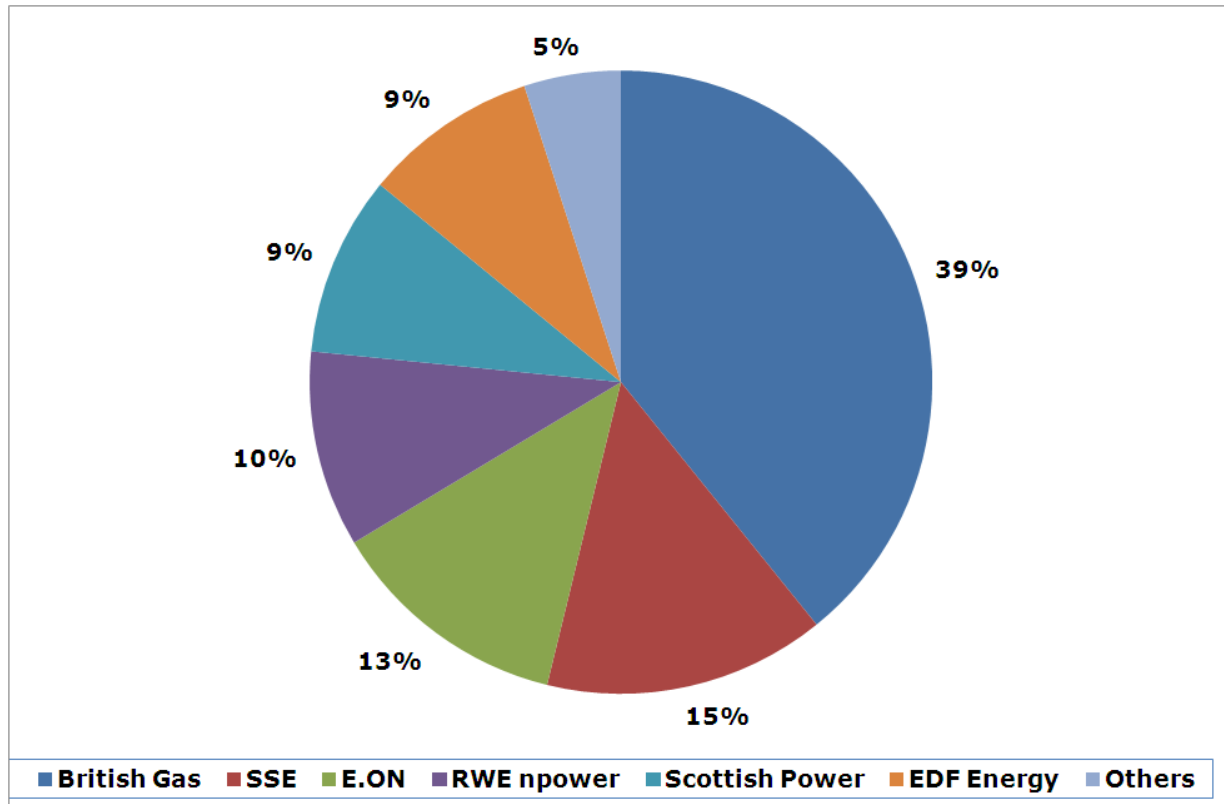
##### *Monitoring competition – domestic market share*

In December 2013 there were 21m domestic gas consumers in GB.<sup>179</sup> As Figure 14 shows, the former incumbent suppliers accounted for 95 per cent of gas supply to these customers, down from 98 per cent in 2012.

There were 16 small gas suppliers active in the domestic market at the end of 2013, with a combined market share of five per cent. Small suppliers operating in the market are Axis Telecom; Better Energy; Co-Operative Energy; Dali Gas; Economy Energy; Ecotricity; First Utility; Flow Energy; Gnergy; Good Energy; Green Star Energy; OVO Energy; Spark Energy; Utility Warehouse; Utilita; Zog Energy. As a group, small suppliers market share increased by three percentage points in the period December 2012-2013.

<sup>178</sup> <http://www.fca.org.uk/>.

<sup>179</sup> Please note that the 2013 figure is not directly comparable with 2012 figure given that they are taken from a different source, i.e. Xoserve.

**Figure 14: GB Domestic Gas Suppliers' Market Share, December 2013**

Source: Ofgem

#### *Monitoring competition – non-domestic market share*

Ofgem also monitors non-domestic suppliers' market shares.<sup>180</sup> We gather some data from suppliers but also contract with Datamonitor, an independent consultancy, to provide non-domestic customer numbers.

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 29 independent suppliers, with varying focus and market share across the non-Daily Metered sites (Non-DM) and Daily Metered sites (DM) sectors.<sup>181</sup>

The DM segment is by far the least concentrated, and the three suppliers with highest market shares hold 47 per cent of the market share. As in the domestic sector, suppliers other than the former incumbents have been expanding in the market in 2013. This was

<sup>180</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.

<sup>181</sup> Daily Metered sites are fitted with a meter that records gas consumption on a daily basis, where annual consumption is of 58,600,000 kWh or greater. Non-Daily Metered sites do not have this type of meter and usage is recorded on a monthly or quarterly basis.

especially the case for Opus Energy and Gazprom. The three suppliers with the highest market shares in the Non-DM segment are British Gas, E.ON Energy and Corona Energy.

**Table 5: Gas suppliers' non-domestic market share November 2013**

Gas supplier	Non Domestic Sites		
	nDM	DM	All Domestic Non
British Gas	33.8%	3.5%	33.7%
Corona Energy	11.8%	4.9%	11.8%
EDF Energy	0.3%	0.0%	0.3%
E.ON Energy	25.3%	9.1%	25.2%
ENI	0.1%	11.2%	0.1%
Gazprom	6.9%	11.9%	6.9%
GDF Suez	1.3%	14.7%	1.4%
Opus Energy	3.3%	0.0%	3.3%
RWE npower	0.8%	4.2%	0.8%
ScottishPower	1.2%	0.0%	1.2%
Dong Energy Sales	1.9%	19.6%	1.9%
SSE	6.4%	0.0%	6.4%
Total Gas and Power	6.8%	12.6%	6.8%
Wingas	0.0%	4.9%	0.0%
Statoil UK	0.0%	3.5%	0.0%
Others	0.1%	0.0%	0.1%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Datamonitor

### *Monitoring competition – HHIs*

Herfindal-Hirschman Indices (HHI)<sup>182</sup> indicators are often used to gauge market concentration. Though HHI does not provide conclusive evidence on the level of competition, it offers pointers as to whether a market has the potential to deliver competitive outcomes. The relevant HHIs<sup>183</sup> for gas are:

- domestic (Dec 2013) – 2,190
- non-domestic, non-daily metered sites (Nov 2013) – 2,075
- non-domestic, daily metered sites (Nov 2013) – 1,197

Both domestic and non-domestic, non-DM gas supply markets are 'highly concentrated' according to the threshold HHI levels (1,800) used by the CMA. The non-domestic, DM gas supply market is judged to be 'concentrated'.

<sup>182</sup> HHI is commonly used to assess market concentration, ranging from 10,000 for a monopoly to just above zero for perfect competition. Office of Fair Trading Guidelines categorise a market as 'concentrated' if its HHI exceeds 1,000 and 'highly concentrated' if its HHI exceeds 1,800.

<sup>183</sup> Domestic HHIs have been calculated using suppliers' monthly customer numbers and non-domestic HHIs have been calculated using market shares information provided to us by Datamonitor.

## **Distortion or restriction of competition**

The previous sections have set out both our State of the Market Assessment and our regular ongoing monitoring activities in respect of assessing distortions and/or restrictions of competition. These work streams are helping us to identify where further intervention in the market is needed to enhance competition and improve outcomes for 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 UK Government environmental and social policies such as the Renewable Obligation and the Warm Home Discount which can vary over time.

We use our Supply Market Indicator to explore the relationship between retail bills and these costs.<sup>184</sup>

Ofgem actively monitors domestic suppliers' gas prices across GB. We receive price change notifications from suppliers but also contract with Energylinx, an independent data provider and one of the comparison sites accredited by the Confidence Code run by Ofgem. Ofgem uses this information to calculate the implications for domestic customers' retail bills based on characteristics such as their consumption level, payment type, and region.

Figure 15 shows the change in average domestic gas bills in GB's gas market between January and December 2013. Overall, average gas bills increased by 6 per cent (£46) over the year.<sup>185</sup> Prices rose for each payment method in the first and last quarters.

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<sup>184</sup> Available on the Ofgem website at: <https://www.ofgem.gov.uk/gas/retail-market/monitoring-data-and-statistics/understanding-energy-prices-great-britain/supply-market-indicator>

<sup>185</sup> The change relative to 2012 for the three payment methods was the following: direct debit 6% (£45); prepayment 5.9% (£47); standard credit 5.8% (£46).

**Figure 15: Typical domestic gas bills by payment method, Jan– Dec 2013**

Source: Ofgem analysis of Energylinx data

Notes: 1) Average of Big six's standard tariffs, 2) Revised consumption level: 13,500 kWh per year

## **Switching rates**

### *Domestic*

Consumers' ability to switch their energy supplier is important to a well-functioning, competitive energy market. Ofgem monitors switching rates on an ongoing basis. We receive monthly data from gas suppliers on the number of customers they have lost and gained and use this data to calculate switching rates. In 2013, approximately 2.3m domestic consumers switched their gas supplier, equivalent to 190,000 per month. This is a switching rate of 10.4 per cent, almost unchanged relative to 10.5 per cent in 2012. We also saw an increase in switching away from the six largest suppliers, with 25-30 per cent of customers that switched at the end of 2013 moving to smaller suppliers. We think this is due to extensive publicity and media interest surrounding the recent price rises. It is not clear whether these trends will be sustained.

Rates of switching are one indicator of the extent of competition in a market. However, the figures should not be viewed in isolation. The speed and reliability of switching is

important (see chapter 5.1 for our change of supplier project within our smarter markets programme of reforms), as is the quality of the outcome, such as the new tariff being better value than the old one. Switching rates have steadily fallen since 2008, despite persistent price differentials and potentially large savings from switching. This may be explained, at least in part, by the gradual withdrawal from doorstep selling of the six largest suppliers. We also noted an increase in customers switching to different tariffs or payment methods from their existing supplier. While this may be evidence of customer engagement, we cannot yet determine the extent of this.

We also noted that large numbers of people don't switch, or switch very rarely. Surveys<sup>186</sup> have revealed that, 62 per cent of customers could not recall ever having switched supplier. We also noted 39 per cent of gas customers were being supplied by British Gas more than 15 years after the market was liberalised.

The evidence gathered through the Ipsos Mori Tracking Survey 2013, used for our State of the Market Assessment, confirms the previous findings from our Retail Market Review. Many consumers continue to lack the ability to access, assess and act on information on offerings in the market, and therefore cannot exercise effective consumer choice. The main barriers are a combination of the complexity of tariffs, unclear and incomplete information, and continued lack of trust and confidence in suppliers and the market. These all contribute to an overall lack of engagement in the market. This is likely to cause consumer detriment by failing to put competitive pressure on suppliers to offer the products and services consumers want.

### *Non-domestic*

Our latest quantitative survey<sup>187</sup> on non-domestic consumer engagement, published in December 2013, showed that around one in seven business customers (15 per cent) had switched suppliers in the last year, rising to more than two in five over the last five years. Businesses appear to be making informed switching decisions. Respondents who had switched reported that, on average, they had contacted more than three suppliers and also that more than three suppliers had provided offers in return.

On the other hand, this research has also shown that smaller businesses are more likely to have never considered switching than larger businesses. For example, 41 per cent of micro businesses (<10 employees) surveyed said they had not switched supplier in the last five years, compared to 19 per cent of large businesses (≥250 employees).

Although non-domestic switching is primarily price-driven, some customers reported they had not switched in the past 12 months due to perceptions that it was too complex and time-consuming.

<sup>186</sup> We annually commission IPSOS MORI, an independent research company, to explore switching with consumers. See Ipsos MORI, *Customer Engagement with the Energy Market - Tracking Survey 2013*, p.35-36 <https://www.ofgem.gov.uk/ofgem-publications/74756/customer-engagement-energy-market-tracking-survey-2013.pdf>

<sup>187</sup> Element Energy and The Research Perspective (Dec 2013) <https://www.ofgem.gov.uk/ofgem-publications/85187/non-domquantfinalforpublication181213.pdf>

Consumers and suppliers have also expressed concerns that transfer blocking ('objections') rules set out in licences and industry codes are not adhered to in some circumstances. The impact of objections can be significant for consumers. Those that have a transfer blocked incorrectly may incur high out-of-contract prices and be persuaded to enter a new contract with their current supplier. We are therefore looking to increase our monitoring of supplier behaviour in this area as well as consulting on wider reforms to the switching process as part of our Smarter Markets Programme described in Section 5.1.

### **Disconnection rates**

Suppliers' licences require that they only disconnect customers for debt as a last resort and avoid disconnecting consumers who are of pensionable age, disabled or chronically sick in the winter months. In addition to this, the six main suppliers have committed through their self-regulatory 'Safety Net' not to disconnect any consumer in a vulnerable position at any time of the year. We require suppliers to provide us with information about disconnections for debt 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.

Latest published data shows that there were 38 gas disconnections in the first six months of 2013, 3 more gas disconnections than in the same period the previous year. While disconnection levels remain well below previous highs, for example 30,000 energy customers were disconnected in 1998, we have made public our concern that some suppliers' disconnection rates are much higher than others. We have reminded suppliers that disconnection should only be used as a last resort and that we expect them to actively seek out alternative solutions to disconnection wherever possible. We also discussed disconnection at a small supplier debt management workshop we held in January 2014 and smaller suppliers were encouraged to adopt the principles of the Energy UK safety net into their debt management processes.

In 2013 we introduced further monitoring to increase our oversight of the reasons customers are disconnected for debt. Responses showed that in most cases disconnections had occurred where it was not possible to agree a debt repayment arrangement with the customer and it was not safe or practicable for the supplier to fit a pre-payment meters. Our latest data related to domestic energy debt and disconnection can be found at our Social Obligations Monitoring webpage.

#### **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.

## 4.3 Security of supply

No single body is responsible for ensuring security of supply as we rely on the market to provide us with 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 on a minute-by-minute basis each day.

In November 2012 we published our Gas Security of Supply report, which showed that whilst the GB gas market is working well in delivering security of supply for consumers and that disruption to gas supplies for consumers is highly unlikely, a number of risks remained. Following this report, the government commissioned independent analysis to determine if subsidies were required to increase GB gas storage capability. The analysis found that the UK gas market is continuing to function well in attracting gas from a range of sources to meet current and future demand.<sup>188</sup>

GB has never suffered a gas deficit emergency<sup>189</sup>, and the likelihood of having an emergency remains low. The response to the combination of relatively high demand and an interconnector outage in March 2013 indicates that GB gas supply remains robust, and that the market does respond as we would expect.

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<sup>188</sup> No new subsidy needed for gas storage (<https://www.gov.uk/government/news/fallon-no-new-subsidy-needed-for-gas-storage-decision-saves-bill-payers-up-to-750-million>)

<sup>189</sup> See Ofgem's Gas Security of Supply Significant Code (SCR) Review Final Policy Decision in February 2014



## 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 2013. This includes developments in both the domestic and non-domestic sectors and further information on smart metering and smarter markets, our work to further protect vulnerable consumers and our ongoing consumer insight and engagement activities.

### 5.1 Consumer protection

#### **Compliance with Annex 1**

Ofgem complies with the provisions of Annex 1 of the Electricity and Gas Directives. The relevant provisions were either already reflected in relevant licences or in domestic legislation or they were incorporated into the relevant licences or into domestic legislation through amendments made by the Electricity and Gas (Internal Markets) Regulations 2011. The majority of the requirements of Annex 1 of the Electricity Directive are either “relevant conditions” or “relevant requirements” for the purposes of the Electricity Act 1989 and the Gas Act 1986, which Ofgem can enforce.

#### **Smart metering**

The government’s updated Impact Assessment<sup>190</sup> in January 2014 continued to show a positive economic benefit from introducing Smart Metering in GB with an estimated net benefit of £6.2bn.

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 which comply with the Smart Meter Technical Specification (SMETS) are installed in their domestic and smaller non-domestic premises by the end of 2020. For their larger non-domestic consumers, energy suppliers will begin the roll out of advanced gas and electricity meters in April 2014.

Ofgem’s role has been to provide independent advice and expertise to the government’s Smart Meter Implementation Programme. We play a key role in monitoring and, where appropriate, enforcing compliance with any new regulatory obligations relating to smart meters to ensure that the interests of consumers remain protected during the transition to smart metering.

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<sup>190</sup> Smart meter roll-out for the domestic and small and medium non-domestic sectors (GB), DECC, January 2014: <https://www.gov.uk/government/publications/smart-meter-roll-out-for-the-domestic-and-small-and-medium-non-domestic-sectors-gb-impact-assessment>

Ofgem has also advised the government during its procurement of the Data Communications Company (the DCC), which was awarded to Capita PLC on 14 August 2013. The DCC has an important role in providing secure communications between energy suppliers, network operators and authorised third parties on the one hand, and compliant smart metering equipment in domestic and certain non-domestic premises on the other. The DCC is governed by its licence which sets out its core obligations, restrictions and entitlements. It is also bound by the Smart Energy Code (SEC), which constitutes the DCC's contractual relationship with its users and enables them to gain access to DCC services. Ofgem will monitor the DCC to ensure it abides by its licence conditions and approve any changes to the SEC. Our monitoring includes price control arrangements and the approval of DCC's charging statements. We are also responsible for overseeing changes to the regulatory framework to facilitate the DCC's evolving roll.

Considerable effort has gone into ensuring the interoperability of meters, both in the meter design and the role of meters when a consumer changes supplier. The DCC will centrally manage communication to and from domestic smart meters and will play an important role in ensuring interoperability. We are also supporting the government's development of a technical specification (SMETS) that is intended to ensure that all smart metering equipment fitted in consumer premises is fully interoperable. The first version of SMETS (SMETS1) is already in place and was notified to the European Commission in accordance with the requirements of Article 8 of Directive 98/34/EC.

In February 2013 we issued a consultation on the Metering Installation Code of Practice (SMICOP) and in April we designated the SMICOP for use by all domestic and micro-business suppliers, taking effect from 1 June 2013.<sup>191</sup> The code contains consumer protection and engagement measures for those consumers having a smart metering system installed for the first time.

### **Smarter Markets Programme**

In July 2012, we published a decision document on our Smarter Markets Programme.<sup>192</sup> This programme aims to proactively identify, and implement, market changes that have been made possible by the introduction of smart meters. This will enable the development of smarter markets that are more efficient, dynamic and competitive which ultimately will deliver better outcomes for consumers.

As part of this programme, we focussed on several key areas of reform in 2013:

(i) Change of Supplier

In 2012, Ofgem put in place new licence obligations for gas and electricity suppliers designed to support effective switching for customers during the early, voluntary

<sup>191</sup> Decision on the designation of the SMICOP <https://www.ofgem.gov.uk/publications-and-updates/designation-smart-metering-installation-code-practice>

<sup>192</sup> Promoting smarter energy markets: a work programme – <http://www.ofgem.gov.uk/Markets/sm/strategy/Documents1/Promoting%20smarter%20energy%20markets%20-%20a%20work%20programme.pdf>

deployment of domestic meters with smart capability. The licence obligations aim to help domestic customers understand if the advanced meter services they are receiving will be maintained when they switch supplier and therefore to facilitate the switching process for customers with these meters. We continue to work closely with industry to enable the wider introduction of a fast, reliable and cost-effective change of supplier process.

(ii) Electricity settlement

We have concluded that the existing arrangements need to change. We consider that all consumers will benefit from half-hourly charging, and smart meters are the best way to allocate energy in an accurate, timely and cost-effective way. We are developing options for half-hourly settlement on the 29 million domestic and smaller non-domestic sites.

(iii) Demand-side response (DSR)

We are taking forward work to enable the development of a market that supports the efficient, system-wide use of DSR. Our priority in this area is a project to formalise how the different parties involved, such as network, suppliers, the system operator and consumers, would interact.

(iv) Consumer Empowerment and Protection

In December 2013 we published a consultation on how smart meters can protect and empower consumers. We identified nine focus areas of key importance and set out how these should be prioritised across three phases from now to the end of the mass rollout in 2020. We also set out how we intend to incorporate our Consumer Vulnerability Strategy into this work, as well as our proposed approach to micro-businesses.<sup>193</sup>

This workstream also includes the development of the Smart Meter Installation Code Of Practice (SMICOP) outlined above.

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

Ofgem is committed to ensuring consumers have access to consumption data in the gas and electricity markets. We expect suppliers to adhere to guidance on providing this information to their customers, which is enforced through the Licence Conditions.

In 2013 we issued final proposals for our retail market reforms which came into force in March 2014 (See *Main Developments* for further information). This included the requirement for clearer information.

Ofgem has provided regulatory expertise and advice to the UK government's development of the data access and privacy framework. The aim is to provide a clear framework for who can access consumers' consumption data and at what level of granularity. The government introduced data access and privacy licence conditions into the supply and network

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<sup>193</sup> <https://www.ofgem.gov.uk/publications-and-updates/consumer-empowerment-and-protection-smarter-markets>

company licences in June 2013. Ofgem will monitor and, where appropriate, enforce these licence conditions.

The Information Commissioner's Office (ICO) has responsibility for promoting data privacy for individuals and taking appropriate action when the law is broken. Ofgem and the ICO are discussing how best to work together to ensure consumers' interests remain protected.

Ofgem has also provided regulatory expertise and advice to the UK government's implementation of the Energy Efficiency Directive (EED). The EED includes provisions which relate to the roll-out of smart meters in Member States and domestic consumers' rights to having easy access to certain consumption data.

The government is currently considering how best to implement the data access elements of the EED requirements. They consulted on a number of options in December 2012, their preferred options being some form of licence obligation on suppliers. Ofgem will monitor and, where appropriate, enforce any licence obligations on suppliers.

Some other major developments in consumer protection in 2013 are outlined below:

### ***Domestic Consumers***

#### **Consumer Vulnerability Strategy**

In 2013 we established our Consumer Vulnerability Strategy which recognises that vulnerability can be complex, multi-dimensional and transitory. It is not just about the individual and it can be exacerbated by the market. Our new definition of vulnerability is when a consumer's personal circumstances and characteristics combine with aspects of the market to create situation where he or she is: (i) significantly less able than a typical consumer to protect or represent his or her interest in the energy market or (ii) significantly more likely than a typical consumer to suffer detriment, or that detriment is likely to be more substantial.

#### **Unreturned closed account credit balances**

When a consumer closes their account with a supplier (if they are switching or changing tenancy) it is possible that they are owed money. This may be because the latest bill was estimated, or because fixed direct debit calculations resulted in a positive overall credit balance. In 2013, Ofgem enquired into the value of closed account credit balances held by energy suppliers, and into suppliers' policies and practices in this area. Our initial analysis revealed an unacceptably large amount of money was being retained rather than returned to consumers and a wide variation in practices between suppliers. Our enquiries into closed account credit balances continued into 2014<sup>194</sup> when we made a public announcement calling on suppliers to do more to return outstanding credit to consumers,

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<sup>194</sup> <https://www.ofgem.gov.uk/press-releases/ofgem-calls-suppliers-take-action-over-%C2%A3400-million-they-hold-customers-closed-accounts>

building on commitments made by suppliers to provide automatic refunds to current direct debit customers who are in credit.

### **Monitoring suppliers' social obligations**

In 2013, we continued to collect social obligations reporting from domestic suppliers. We also published the data collected from suppliers in 2012. 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>195</sup>

### **Energy Best Deal**

2013 was the sixth year of a very successful partnership with Citizens Advice (a registered charity that provides free and independent advice to consumers) delivering the Energy Best Deal consumer advice campaign, with funding support from energy suppliers. The campaign provides Citizens Advice advisers and other front line advice workers with the right training they need to deliver a package of face-to-face advice to lower income households on their energy rights and how to get the best from their energy deal.

5,602 consumers and 3,334 frontline workers attended Energy Best Deal sessions in 2012-13. An independent evaluation of Energy Best Deal in this period found that consumers found the session useful and that 32 per cent (of 150 consumers interviewed) had taken action to get a better deal on their energy bills since the session.

### **Debt Assignment Protocol**

In 2013 we began a review of changes we made in 2012 to allow prepayment consumers to switch supplier even if they have debts. Our review concluded in March 2014 and found that more prepayment consumers are now trying to switch, but that few are actually doing so. We now want companies to make these customers more aware that they can change supplier, and to make that move easier.

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<sup>195</sup> <https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/supplier-performance-social-obligations>

## **Complaints Handling**

In 2013, energy suppliers began to publish their direct complaints data in response to our work in this area.

We commissioned research in 2013 to find out why so few consumers ask the Ombudsman to investigate their unresolved complaints. As a result of the findings, energy suppliers have redesigned their letters to customers to include information about their right to take their complaint to the Ombudsman. We expect the Ombudsman to begin publishing complaints information by supplier in 2014.

## ***Non-domestic Consumers***

### **Protecting businesses from misleading marketing**

In 2013 we successfully made the case to Government for powers to address mis-selling by third party intermediaries in the non-domestic market.

The Business Protection from Misleading Marketing Regulations 2008 includes a number of protections such as the prohibition of advertising products in a way that misleads traders. They also set out conditions under which comparative advertising to consumers and business is permitted. In November 2013 we were given concurrent powers with the Office of Fair Trading (now the Competition and Markets Authority) to enforce the regulations in the energy sector.

### **Back billing**

In 2013 we requested and published data showing the value and number of back-bills issued to micro-businesses by suppliers. We did this to monitor suppliers' performance against voluntary standards introduced in 2012 which limit the time period for which micro business customers can be back-billed to three years in electricity and four to five years in gas (where the customer has taken all reasonable steps to avoid receiving a back-bill).

In line with their commitments, the data<sup>196</sup> shows suppliers moving towards a one year limit with the majority of back-bills arising no more than three years from the issue date and of less than £2,000 in value. However, a small minority are worth over £20,000 and/or last over five years. We will continue to monitor supplier performance in this area and expect to see a significant reduction in the value and number of back-bills from any future information we might request from suppliers.

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<sup>196</sup> <https://www.ofgem.gov.uk/ofgem-publications/85031/micro-businessback-billing-supplierdatacoveringapril2012-march2013.pdf>

## ***Protecting domestic and non-domestic consumers***

### **Guaranteed Standards of Performance (GSOP)**

We published a Call for Evidence in 2013 on a broad range of issues related to the GSOP. This included considering the relevance of the existing standards, whether new standards are needed, which customers standards should apply to, and how customers should be made aware of their rights and supplier performance levels. In 2014 we will add to this evidence base by undertaking consumer research. We then plan to consult on proposals to improve the guaranteed standards.

### **Consumer Insight and engagement**

In 2013, we continued to commission and publish a wide range of research and insight to inform our key policy decisions and to put consumer perspectives at the heart of our regulatory processes. In conducting our research we considered the needs of consumers in vulnerable situations, e.g. by enabling a range of different consumers to participate, and commissioning specific research to understand in detail the challenges and barriers they may face. We also carried out targeted work with non-domestic consumers, with a particular focus on the needs of micro and small businesses.

We listen to consumers through regular surveys and workshops, and through innovative approaches such as video research and ethnographic in-home interviewing. For example:

- Our Consumer First Panel consisted of 100 everyday domestic customers recruited from six locations across Great Britain. The Panel met to discuss the following issues, central to our work last year:
  - the role of the Priority Services Register in supporting vulnerable customers
  - how a reformed 'change of supplier' process can best meet consumer expectations
  - the future role of standards of performance in driving up the quality of service offered by suppliers; and
  - consumer engagement campaign messages to help consumers benefit from, our reforms to make the energy market simpler, clearer and fairer.
- To feed in to a review of 'Green' energy tariffs available in the market, we carried out research with existing Green tariff customers and others with an interest in sustainability to understand their expectations of these tariffs and the information that is provided on them.
- We carried out both qualitative and quantitative research with non-domestic (business) consumers to track their engagement and satisfaction with the energy market, and their expectations for a reformed 'change of supplier' process.
- Ahead of our Retail Market reforms being fully implemented, we undertook a scoping study to consider how best to evaluate the impact of these reforms on levels of consumer engagement going forward. As the evaluation framework was developed, we continued to monitor consumer engagement in the market through our long-standing annual tracking survey.

We also continue to work with stakeholders to ensure consumer interests are considered in all parts of the energy supply chain. For example

- We have continued to work with a dedicated Consumer Challenge Group to make sure that the consumer view is being taken into account in network price control price controls. The Group comprises a small number of consumer experts who act as Ofgem's 'critical friend' and brings additional expertise that we could not address through market research alone
- To incentivise transmission and distribution network companies to engage with their stakeholders, as part of the of RIIO approach (revenue = incentives + innovation + outputs), we have set up an independent panel to judge the quality of network companies' stakeholder engagement. The Panel comprises senior stakeholder experts from other industries and backgrounds. The process includes an initial sift by Ofgem then an assessment by the expert Panel, against agreed criteria. The Panel gives score out of 10, which then translates into financial reward which can be worth up to several million pounds.

## 5.2 Dispute settlement

### **Electricity**

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 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 dispute resolution functions and procedures under Article 37 of the Electricity Directive. They were amended by the Electricity and Gas (Internal Markets) Regulations 2011. Any Article 37 dispute that is referred to us for determination is determined by us or, if we think fit, by an arbitrator appointed by us. The determination's decision is binding on the parties to the dispute. However any party can seek a judicial review of our decision.

One Article 37 dispute, raised in 2012, was investigated during 2013. The dispute related to a licence exempt distribution system at Heathrow Airport. The Authority reached a decision on the investigation in March 2014.<sup>197</sup>

### **Gas**

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. Any Article 41 dispute that is referred to us for determination is determined by us or, if we think fit, by

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<sup>197</sup> <https://epr.ofgem.gov.uk//document/Download/36668>



an arbitrator appointed by us. The determination's 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 2013.

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# 1 Foreword

The past year, both in Northern Ireland and further afield, has been characterised by continuing concerns about both the level and increases in utility bills. Comparisons with our neighbours and trading partners informed these concerns. Big questions around electricity security of supply in both the medium and long-term were also raised. All this has prompted a broader debate about energy markets and the appropriate levels of investment in energy infrastructure to secure both the present and future, particularly those associated with renewables and sustainable development.

These are challenges for us all. Our role is always something of a balancing act with the challenges of addressing both short-term and longer-term issues. As ever we must strike a balance which protects both today's and future consumers from potential or actual abuses arising from monopoly power and inefficient markets. We support necessary investment provided this is based on effective asset management by the regulated enterprises.

Progress on tackling these large issues has been evident during 2013-14. Our job is to make sure that energy bills are only as high as they need to be. For example, the Competition Commission's determination on the NIE price control underlined the importance of our scrutiny of the company's original price control proposals.

We have also, along with the Department of Enterprise, Trade and Investment pro-actively taken steps to identify and mitigate the impact of electricity security of supply risks. The key to mitigating these risks in the medium to longer-term is the second north-south electricity interconnector. It is vital that this major extension to the all Ireland network is delivered as soon as possible.

During 2013-14 we also developed our new corporate strategy for the next five years. We talked to, and listened to the views of our external stakeholders and our staff about what we could and should do to protect consumers. These discussions were really helpful and enabled us to focus on and enrich our new strategy. Our strategy for 2014-19 has now been published and we look forward to meeting the challenges of its implementation.

As an organisation the last year was one of big changes. We said goodbye to Shane Lynch as our chief executive and to a longstanding board member, Alan Rainey, and thank him for his considerable contribution since 2007. Harry

McCracken, David Strahan and Teresa Perchard joined the board in September 2013 and have already made significant contributions. Jenny Pyper joined us as chief executive in November and her enthusiasm and energy has already made a positive impact with stakeholders and staff.

Bill Emery

Chairman

## 2 Main developments in the gas and electricity markets<sup>1</sup>

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

### 2.1 Electricity

We published our price control determination for the period 1 January 2013 - 30 September 2017 (called RP5) on 23 October 2012. Our determination followed a public consultation on our proposals, which were published in April 2012. A separate public consultation was also conducted on an element of the final price control, relating to NIE Transmission and Distribution (NIE T&D) capitalisation practice. The final determination included a decision on the NIE T&D capitalisation practice. NIE T&D rejected our determination in November 2012. In 2013. The price control was referred to the Competition Commission. After significant engagement with the CC during its inquiry, a provisional determination was published in November 2013. A further period of engagement preceded the publication of the CC's final determination by us in April 2014.

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.

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.

The Third Internal Energy Market Package (IME3) has continued to promote the liberalisation of the energy market across the European Union (EU). IME3 requires the separation of the transmission network from generation and supply (this is called unbundling). IME3 specifies several unbundling options to ensure separation of the transmission network from generation and supply.

We are required to certify transmission system operators as being in compliance

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<sup>1</sup> This report covers developments during the period from January 2013 to December 2013. Where data for the is provided 2013 is the appropriate reference year.

with the full ownership unbundling requirements or one of the alternative unbundling models set out in IME3.

During 2013, the Utility Regulator has considered applications for certification from NIE T&D, SONI and Mutual Energy Ltd (Moyle interconnector). The Utility Regulator issued a preliminary decision to the European Commission (EC) in February 2013. The preliminary decision recommended qualified approval for the current Transmission System Operator (TSO) arrangements on the island of Ireland. On 12 April 2013 the Commission set out its decision relating to TSO certification in Northern Ireland. The Commission considered that the arrangements of transmission system operation in Northern Ireland, which are shared between SONI and NIE, deliver more effective independence than the independent transmission operator (ITO) model. The Commission agreed that the arrangements meet the requirements of Article 9(9) of the Directive therefore SONI should be certified as the transmission system operator for Northern Ireland. In addition to this Mutual Energy Ltd (Moyle Interconnector) was certified as a fully unbundled TSO. During 2013 the Utility Regulator has worked to ensure that the relevant TSOs are fully compliant with certification, with final completion of the process in early 2014.

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 2016 (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 2016. 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. Publication of the consultation on options for the high level design is due to be published in early 2014, with a



final decision later in 2014.

A medium term review of the Capacity Payment Mechanism (CPM) was completed in March 2012. The review was aimed at incentivising the availability of both existing generation and new investment in capacity when it is required. The decision for the capacity value for 2014 was published in August 2013. Further to this, the SEM Committee has indicated that no major changes to the CPM are proposed in the medium term in light of the regional integration project.

## 2.2 Gas

In 2013 the rollout of the gas distribution network in Northern Ireland (NI) continued across both distribution areas with 171,000 properties now connected in the Greater Belfast distribution area of PNGL (Phoenix Natural Gas Ltd) and 20,000 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 370,000. This represents nearly 40% of properties within NI.

Natural gas is not available in much of the west of NI but the Department of Enterprise, Trade and Investment in NI (DETI) recently consulted on the possibility of extending the network. As a consequence, work is ongoing to consider a number of issues related to extending the natural gas network to the west of NI.

On the 2 August 2013, the PNGL business was sold to Hastings' managed fund Utilities Trust of Australia and the Royal Bank of Scotland Group Pension.

A referral was made to the Competition Commission by Phoenix Natural Gas Ltd (PNGL) on their PNGL12 distribution price control. The Competition Commission's Inquiry ended on the 30 November 2012, and the decision was published on the 19 December 2012. The license modifications, that brought the decisions by the Competition Commission into effect, occurred on the 11 July 2013.

During 2013, GD14, the price control for both PNGL and FE for the years 2014 through to 2017, was concluded. The determination was published on the 20 December 2013 and it was the first time, price control timelines for PNGL and FE were aligned.

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.

## 3 The electricity market

### 3.1 Network regulation

#### 3.1.1 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. To complete the certification process the Utility Regulator has ensured that these specific measures have been applied, in order to do so a number of licence changes are required it is expected that certification will be completed in early 2014.

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. To complete the certification process a number of licence changes are required and it is expected that certification will be completed in early 2014.

### 3.1.2 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<sup>2</sup> which provides its forecast of generation capacity and forecast electricity demand for the upcoming ten-years. This allows for the assessment of

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<sup>2</sup> [http://www.eirgrid.com/media/All-Island\\_GCS\\_2013-2022.pdf](http://www.eirgrid.com/media/All-Island_GCS_2013-2022.pdf)

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.

### 3.1.3 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 and SONI, and the maximum amount recoverable is approved by the Utility Regulator. The "Regulated Tariffs Values" for the tariff year beginning October 2013 was published by the Utility Regulator on 23 Aug 2013, detailing the use of system tariffs for that year.

The transmission network owner in NI is NIE plc. NIE is also the distribution system owner and operator. The current 5 year price control commenced in 2007. NIE 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. During 2009 work began on RP5, the fifth price control for NIE plc, to run from 2012. This will be the most challenging price control yet as it is set in the context of large planned expansions to the transmission and distribution system to facilitate renewable generation. Following the rejection of our price control (called RP5) by NIE we referred the matter to the Competition Commission (CC) in April 2013.

After significant engagement with the CC during its inquiry, a provisional determination was published in November 2013. Some detail of this provisional determination was published in last year's annual report. The CC's final determination is due to be published in 2014.

Under NIE T&D's licence obligations it is required to ensure that no separate business gives any cross-subsidy to, or receives any cross-subsidy from, any other business of the Licensee or of an affiliate or related undertaking of the Licensee (whether or not a Separate Business).

#### **3.1.4 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 Utility Regulator and Ofgem with input from the Regulator in Ireland regarding the East West Interconnector.

The export and import capacity of Moyle has been limited due to a number of technical faults. A fault on one line of Moyle occurred between 24 August 2011 and 19 February 2012. This fault reduced export and import capacity to 250MW. A second fault has since occurred on the second line beginning on 23 June 2012. This fault has not been resolved, resulting in a reduced export and import capacity of 250MW.

### 3.1.5 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.

## 3.2 Promoting Competition

### 3.2.1 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 the 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 for Northern Ireland and an independent member. A SEM Annual report is published every year highlighting the developments in various work streams. The report can be found on <http://www.allislandproject.org>

2013 was the sixth 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.

In 2013 the SEM Committee set out its recommendations on the implementation of the European Target Model in the Single Electricity Market. This programme of work will result in significant changes to the design of the existing trading arrangements in Northern Ireland and the Republic of Ireland. The High Level Design of the electricity trading arrangements is due for completion in the second half of 2014. The new trading arrangements are to be in place by the end of 2016. The SEM has not undergone any significant changes in 2013.

#### **3.2.1.1 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**

The Market Monitoring Unit (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 continuously reviews generator participants' behaviour in the market, 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.

### **Transparency**

The Market Operator for the SEM (SEMO) publishes all commercial and technical data relating to bids for any trading day.<sup>3</sup> This information is published four days after the trading day, and also includes all relevant price information for each half hour period.

### **Effectiveness of competition**

The SEM Committee publishes an annual report providing an overview of the market structure and developments in the market over the previous year. The report for 2013 is due for publication in the second half 2014.

On 23 May 2013, the RAs published a decision paper on the collection and publication of information regarding generators' financial performance. The paper sets out the financial reporting template to be completed by generation companies with a combined capacity greater than or equal to 25 MW. It also commits the RAs to publishing an annual report on generation financial performance in SEM, aggregated to preserve commercially sensitive information.

The first report on financial performance was published on 23 May 2013, the RAs publish a report on the financial performance of generation companies operating in the SEM, with a view to improving transparency. This covers the financial year from April 2012 to March 2013<sup>4</sup>.

### **3.2.2 Retail market**

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<sup>3</sup> <http://www.sem-o.com>

<sup>4</sup> Report on Generator Financial Performance in the SEM - [http://www.allislandproject.org/en/market\\_decision\\_documents.aspx?article=e6d2c21b-cba5-4dfa-a0a8-24ce40fc3e1a](http://www.allislandproject.org/en/market_decision_documents.aspx?article=e6d2c21b-cba5-4dfa-a0a8-24ce40fc3e1a)



*Please provide a brief illustration of the state of competition of retail market and 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. By December 2013, there were 8 active suppliers in the electricity sector, 5 of them operating in both, domestic and industrial sectors.

To keep the development of the retail energy sector in Northern Ireland under closer review, we regularly gather and analyse market information. Following the principle of transparency, we publish related reports.

The Utility Regulator's annual *Energy Retail Report*<sup>5</sup> provides relevant information relating to the state of evolution of the retail market in Northern Ireland, along with background information. Section two of the report relates specifically to the retail market.

The *Quarterly Transparency Reports*<sup>6</sup> provide quarterly a range of information about the retail energy market in Northern Ireland.

Over 2013 the market share of the incumbent supplier in the domestic sector has continued to decrease (from 80% customer numbers in the domestic credit sector and 76% of prepayment in Dec 2012, to 78% and 65% respectively in December 2013).

Competition is more mature in the non-domestic market. By the end of 2013, the share of the non-incumbent suppliers in the non-domestic sector was just below 83% of the volume supplied to this sector.

Also, the level of switching activity has reduced from 2012. The number of domestic switches in the domestic sector in 2013 was 72,000 compared to 103,000 domestic switches in 2012.

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<sup>5</sup> [http://www.uregni.gov.uk/publications/view/utility\\_regulators\\_annual\\_energy\\_retail\\_reports/](http://www.uregni.gov.uk/publications/view/utility_regulators_annual_energy_retail_reports/)

<sup>6</sup> [http://www.uregni.gov.uk/publications/view/utility\\_regulator\\_publishes\\_retail\\_energy\\_market\\_monitoring\\_report/](http://www.uregni.gov.uk/publications/view/utility_regulator_publishes_retail_energy_market_monitoring_report/)

### 3.2.2.1 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 – using the tariff applying from October 2013, for an average customer consuming 3,300 kWh per annum, is close to the median of the EU countries in the band of 2,500-4,999 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>7</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).

The Utility Regulator deals directly with complaints and disputes, with regard to the transmission and distribution operator. Details of our process are given on our

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<sup>7</sup> Consumer Council for Northern Ireland <http://www.consumercouncil.org.uk/>

website

[www.uregni.gov.uk/publications/appeals\\_complaints\\_and\\_disputes\\_policy\\_update\\_d\\_june\\_2013](http://www.uregni.gov.uk/publications/appeals_complaints_and_disputes_policy_update_d_june_2013)

With regard to complaints, IME3 has been implemented and all suppliers are fully compliant with the Code of Practice on Complaints Handling. The Utility Regulator continues 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, the Utility Regulator has 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. We have mandated that all suppliers must comply with a supplier marketing code of practice which has clear, firm and enforceable rules for protecting consumers. This code of practice was developed through a process of extensive stakeholder engagement and consultation. The Code is due to come into effect in 2014.

In addition to developing the marketing code of practice, we have also approved interim codes of practice for: the payment of bills; provision of services for persons who are of pensionable age or disabled or chronically sick; complaints handling procedure; prepayment meter customers; and the efficient use of electricity/gas. This process has ensured that all suppliers are providing high levels of customer protection. We will develop minimum standard guidance for these codes and the suppliers' codes will be updated to reflect these minimum standards.

In 2013 we also worked with Power NI and NIE to ensure that Supplier of Last Resort (SoLR) arrangements are in place and fully tested. This will provide reassurance to customers on continuity of supply in the unlikely event of any

supplier exiting from the market. Power NI has been appointed to immediately assume responsibility for providing supply in this situation.

We now have a role in legal dispute resolution between customers and suppliers. If a customer's billing dispute cannot be resolved by engagement with the supplier, or intervention by CCNI, we may legally determine on the billing dispute. In 2013-14 we made a determination on the first formal billing dispute which was referred to us.

### **3.2.2.2 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.

The Utility Regulator has 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.

## **3.3 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 is 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.

### **3.3.1 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 2013 shows:

- Current level of electricity peak demand is 1843 MW<sup>8</sup>. This has been forecasted to reach 1857 MW<sup>9</sup> by 2023. This forecasted peak is a decrease on previous estimates<sup>10</sup>;
- The large reduction in demand forecasts in NI and Ireland has led to a significant increase in generation adequacy, although a number of conventional plant are due to be decommissioned by 2016 due to environmental constraints (loss of 510MW of capacity);
- During the period 2014 to 2020 there is sufficient generation capacity to achieve compliance with the generation security standard. The removal of 3 Units at Ballylumford at the end of 2015 would result in the surplus dropping to levels of about 200 MW.
- 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;

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<sup>8</sup> Observed generation, excludes house load.

<sup>9</sup> Total Energy Requirement

<sup>10</sup> Further information available at:

<http://www.eirgrid.com/media/Generation%20Capacity%20Statement%202014.pdf>

- There is currently 2609MW of installed capacity, this figure excludes available capacity via imports on interconnector and tie lines. There is also 596 MW of Partially dispatchable or non dispatchable generation capacity (including 405MW 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.
- In June 2013, along with the Department of Enterprise, Trade and Investment (DETI), we published an information paper on electricity security of supply in Northern Ireland. The paper set out the factors contributing to the security of supply risk and identified options for addressing the risk. A further information paper around electricity security of supply considerations was published in December 2013, with further work to be undertaken in 2014.

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 (2013) see:

<http://www.eirgrid.com/media/Generation%20Capacity%20Statement%202014.pdf>

### 3.3.2 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 2022<sup>11</sup>.

### **3.3.3 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>11</sup> <http://www.soni.ltd.uk/AboutUs/News/TenYearTransmissionForecastStatement2013.html>

## 4 The gas market

### 4.1 Network regulation

#### 4.1.1 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 two Distribution System Operators (DSOs). In our last report we stated that Phoenix Natural Gas Limited no longer had an integrated supply business following the sale of Phoenix Supply Limited to SSE Airtricity Gas Supply (Northern Ireland) Limited from 22 June 2012. The other DSO, firmus energy (Distribution) Limited continues to have an integrated supply business (firmus energy (Supply) Limited). firmus energy (Distribution) Limited however does not have, and does not expect to ever have, more than 100,000 connected customers, therefore it remains an integrated Distribution and Supply business.

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.

The Utility Regulator received an application from BGE(UK) to be certified as an Independent Transmission Operator (ITO) on 4th July 2012 which was submitted under article 10 of Directive 2009/73/EC. The Utility Regulator is considering the application in conjunction with Ofgem and the CER who received similar applications in respect of BGE(UK) and BGE.

The Utility Regulator received applications from PTL and BGTL on 27th November 2012 for certification as fully ownership unbundled (FOU) entities under article 10 of Directive 2009/73/EC. Premier Transmission Limited and Belfast Gas Transmission Limited were certified as FOU entities on 22nd August 2013.



#### 4.1.2 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 the Utility Regulator, and a Mineral Licence from DETI. The developers continue to seek the further consents that are needed before the project can proceed to full construction and operation.

The project was granted Project of Common Interest status by the European Commission in October 2013.

#### 4.1.3 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**

In NI for gas distribution the entry-exit tariff model is applied. 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. The standard RPI-X price control is applied, alongside a performance-based system, which is retrospectively adjusted based on actual performance, with incentives included to encourage efficiency and network growth. The standard duration of revenue or price caps is usually 5 years. Price control periods for the two distribution companies operating in NI (Phoenix Natural Gas Ltd and Firmus Ltd) have now been aligned, to provide a more transparent and meaningful benchmarking.

The distribution system operator proposes the tariff structure; the Utility Regulator reviews 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 DSO is fixed until 2016 to encourage investment. Distribution system operators provide information on tariffs and connection charges to market participants and other interested parties; this information is available on the website of the individual distribution system operators.

Regulations for guaranteed standards of service measures which have to be upheld by the distribution licence holders have been drafted and consulted on. DETI are reviewing the draft regulations prior to implementation.

In terms of access to the grid in Northern Ireland there have been no cases of refusal of access to the grid, for instance because of insufficient capacity.

## **Transmission**

At the transmission level, the tariff methodology is set by the Utility Regulator 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 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, the Utility Regulator has 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 the Utility Regulator 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.

### **4.1.4 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)

The Utility Regulator and Commission for Energy Regulation (CER) and Ofgem have been involved in joint regulatory work in the context of EU network codes, Capacity Allocation Mechanism (CAM), tariffs, and balancing in compliance with Gas Regulation (EC) No 715/2009. All three NRAs continue to monitor the development of the EU network codes and to assess the potential impact to their networks.

#### **4.1.5 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.

## **4.2 Promoting Competition**

### **4.2.1 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.

#### 4.2.1.1 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.

#### 4.2.2 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 five active gas suppliers in the non-domestic sector during 2013: SSE Airtricity Gas Supply (AGS), firmus energy, Energia, Electric Ireland and VAYU. In the Greater Belfast licensed area there has been two active gas suppliers in the domestic sector in 2013. AGS 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 AGS. Other suppliers are free to compete against this maximum average tariff. In the Greater Belfast area, during 2013 the total market share of the incumbent supplier (AGS), based on number of connections, fell from 79% to 72%.

The ten towns gas area opened to competition for large I&C (industrial and commercial) customers in October 2012. AGS entered this market to compete against the incumbent firmus energy from 1 January 2013. In the ten towns large I&C market the market share of the incumbent supplier (firmus energy), based on number of large I&C connections, fell from 100% to 92% during 2013. The domestic and small I&C customers (using less than 25,000 therms per annum) were supplied exclusively by the incumbent supplier (firmus energy) during 2013. The domestic and small I&C market will be open to full competition from 1 April 2015. There is an incentive in the distribution price control on firmus energy to price competitively to acquire domestic and small I&C customers.

#### 4.2.2.1 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 (AGS) has a regulated tariff for domestic and small industrial and commercial customers (using less than 25,000 therms per annum). The Utility Regulator enters into a formal tariff review process with AGS twice per year with a view to tariff changes being effective from 1st April and 1st October each year. The Utility Regulator also monitors gas prices on an ongoing basis and an ad-hoc tariff review for AGS may be initiated at any stage if the Utility Regulator considers that gas prices have increased or decreased enough to warrant a tariff review.

The Utility Regulator monitors the AGS regulated tariff against the tariffs of other supply companies in NI, the UK and ROI. The Utility Regulator published transparency reports every quarter which provides comparisons of the gas tariffs in NI, GB and ROI:

[http://www.uregni.gov.uk/publications/qtrs\\_2013](http://www.uregni.gov.uk/publications/qtrs_2013). During 2013 the AGS regulated tariff for domestic customers (based on the standard domestic tariff) was consistently lower than the domestic tariffs in ROI and the average of the big six suppliers in GB. Supply companies 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).

The Utility Regulator also reviews the AGS gas purchasing strategy each year and also receives weekly and monthly gas purchasing reports from AGS showing the volumes and cost of gas purchased for the short and long term future.

The Utility Regulator monitors 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 the Utility Regulator on a quarterly basis and an analysis of the competition is published in the Utility Regulator's transparency reports:

[http://www.uregni.gov.uk/publications/qtrs\\_2013](http://www.uregni.gov.uk/publications/qtrs_2013).

In the Greater Belfast market there are currently two active gas suppliers for domestic customers. The domestic market share of the incumbent gas supplier (AGS) fell from 80% to 73% during 2013 (based on number of domestic connections). Several other gas suppliers have expressed interest in entering this domestic market in the short to medium term future. During 2013 there were five active suppliers for non-domestic customers in Greater Belfast, however by the end of 2013 the number of non-domestic suppliers had reduced to four. The total I&C market share of the incumbent gas supplier (AGS) fell from 72% to 67% during 2013 (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) is open to competition. In this market there are two active gas suppliers: the incumbent supplier (firmus energy) and AGS. During 2013 the market share of the incumbent supplier fell from 100% to 92% (based on number of large I&C connections). The remaining market of small-medium I&C customers and domestic customers will be open to competition from April 2015.

#### **4.2.3 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 gas market SSE Airtricity Gas Supply (Northern Ireland) Limited (AGS) is price regulated for customers using less than 25,000 therms per annum. A price control is determined and published for Airtricity which sets out a procedure which Airtricity must comply with in setting tariffs. The price control

also sets out a level of operating expenditure for the company for each year of the control which is then used when compiling the supply opex costs for the tariff. At each tariff change the Utility Regulator publishes 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.

### 4.3 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 the Utility Regulator does contribute to some of the elements identified below.

#### 4.3.1 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.

#### 4.3.2 Expected future demand and available supplies as well as envisaged additional capacity

Forecast Total Volumes (bcm)									
2013/2014	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019	2019/2020	2020/2021	2021/2022	2022/2023



1.123	1.175	1.189	1.209	1.205	1.143	1.031	1.046	1.130	1.133
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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.

DETI and the Utility Regulator have also been progressing work to extend the gas network to additional towns in the West and North-West of NI. In January 2013, the Northern Ireland Executive agreed in principle to provide financial assistance towards the cost of constructing new gas networks to the West and North-West. Following this the Utility Regulator consulted on the licence application and award process for the proposed pipelines. The Utility Regulator expects to be in a position to grant a licence in 2014.

The Utility Regulator and the NI TSOs 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 the Utility Regulator website.

#### **4.3.3 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.

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

### **5.1 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.

The Utility Regulator ensures 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.

The Utility Regulator has 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. This provides customers 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 and to inform customers of their right to withdraw prior 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.

## 5.2 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 the Utility Regulator was 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, the Utility Regulator had been, as it still is, 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, the Utility Regulator's 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 the Utility Regulator for resolution.

In June 2011 the Utility Regulator 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>12</sup>.

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<sup>12</sup> [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)

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 the Utility Regulator. We have had no referrals during this period.

The Gas Market Opening Group (GMOG) was established by the Utility Regulator to address any operational barriers to entry into the Greater Belfast gas market. The group has now been extended to cover the Greater Belfast gas market and the Ten Towns gas market. 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 issues are then discussed with the group with a view to making a decision on the best way to address each issue.

The Utility Regulator 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 the Utility Regulator; however the Distribution licence holders also attend to ensure all decisions made for supplier agreements will work in accordance with the distribution market rules.