

2012 GREAT BRITAIN AND NORTHERN IRELAND NATIONAL REPORTS

*In relation to Directives 2009/72/EC (Electricity) and
2009/73/EC (Gas)*

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Ofgem 2012 National Report

Overview

The Directives on gas and electricity liberalisation stipulate a monitoring and reporting obligation. To that end, this report covers Ofgem¹'s annual reporting requirements to the European Commission, in accordance with Directives 2009/72/EC (Electricity) and 2009/73/EC (Gas). The Northern Ireland report is found in the second section of this UK response.

In terms of content, the Great Britain (GB) report covers:

- Developments in the GB energy markets in 2011 and 2012 Quarter I
- The regulation and performance of the GB electricity and gas markets along the themes of Network Regulation; Promoting Competition; Consumer Protection and Security of Supply.

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 in 2007, 2008, 2009, 2010 and 2011. While the structure of the 2012 report has been updated from previous years, reflecting our new reporting requirements as per the Third Package, much of the information remains unchanged, although latest data is supplied where relevant. Where background on particular issues is not included, please see the 2011 GB report. 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, we would draw attention to our Annual Report. The Ofgem Annual Report 2011-12 is available at the link below.

<http://www.ofgem.gov.uk/About%20us/annlrprt/Pages/AnnualReport.aspx>

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¹ The terms "the Authority", "Ofgem" and "we" are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

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1 Ofgem Foreword

Fundamental change is underway in our energy markets.

Rising energy costs for consumers remain a serious concern. We concluded in March last year that further changes were needed in the retail markets so that they meet the concerns of consumers, both domestic and industrial. Our draft retail market proposals focus on radically simplifying tariffs, seeking better information on bills, and pressing for more competition and improved liquidity in the electricity wholesale markets. It is encouraging that the energy companies have begun to respond to the results of our review, making significant moves themselves – though there is more to do.

The Government has recently published its plans for electricity market reform, designed to encourage investment in low carbon generation and to promote security of supply. We will work closely with the Department for Energy and Climate Change (DECC) on these measures: arguably, they represent the greatest change and challenge since the privatisation of the energy markets some 20 years ago.

On price controls, we delivered a series of step changes in the regulation of gas and electricity networks. Our new approach to setting price controls (RIIO model) builds on incentive based regulation (RPI-X model) but includes more focus on innovation, investments and outputs. It will address the way in which network companies engage with their customers and deliver their services. In addition our regimes will focus on bearing down on transmission and distribution costs, encouraging efficient investment and enabling environmental improvements, over longer periods.

The year also saw a big boost in renewable generation, which yielded almost 35,000 GWh in 2011. We believe that our innovative approach to priming the necessary investment for the connection of offshore wind farms to mainland networks, combining regulation and competitive tendering, will continue to deliver cost savings.

Last year's Third Package Directives has been transposed to our law. They require Ofgem – as the UK's designated "National Regulatory Authority (NRA)" – to promote an open, competitive, secure and environmentally sustainable single market for energy. We have been working closely with fellow NRAs throughout the Union principally through the Agency for Cooperation of Energy Regulators (ACER) to these ends. The goals are truly challenging, and it has long been evident that the scope, and depth, of these new instruments will increasingly drive our regulatory agenda here. My own involvement as chair of both the Board of regulators in ACER and President of the Council of European Energy regulators (CEER) provides a privileged position to influence and direct that debate.

During the year, DECC completed its review of Ofgem and of our delivery arm, E-Serve. The strong commitment to independent regulation has been re-affirmed, together with Ofgem's increasing role in helping to deliver substantial and still evolving environmental programmes.

Ofgem staff play an active and professional part in delivering these changes, as the outputs in this Report make clear. We owe a great deal to them for their drive and commitment, and for all they do in their work to help energy consumers. Indeed we are more than well aware that there are real strains for many consumers in meeting energy costs, especially at a time of wider economic and financial stringency. Our principal and statutory duty - to protect energy consumers, present and future - could not be more relevant.



Lord Mogg, Chairman

2 Main developments in the gas and electricity markets²

2.1 Market Developments

Retail Market

Retail Market Review (RMR)

1. Building on the findings of our 2008 Energy Supply Probe, on 26 November 2010³ Ofgem announced the Retail Market Review - a study of the markets for electricity and gas for households and small businesses in Great Britain. In March 2011, we published our findings and initial proposals⁴.
2. We identified that further action is needed to make energy retail markets in Great Britain work more effectively in the interests of consumers. Consumers are at risk from a number of features in the market which reduce the effectiveness of competition. We set out our proposals for action. These are designed to make it much easier for consumers to identify who is offering the cheapest tariff; make it easier for new suppliers to enter the market; enforce and strengthen Probe remedies in both the domestic and non-domestic market; and increase the transparency of company accounting practices.
3. Our proposal to make new entry easier is to improve the ability of the wholesale power market to meet independent participants' needs. We suggest intervention to improve liquidity, and outline what this would look like. Therefore our March consultation document is also an important next step in our ongoing Liquidity work.
4. Following the close of the RMR initial proposals consultation in June 2011 we began consulting on a set of proposed remedies for the non-domestic and domestic retail market. The non-domestic consultation⁵ closed on 15 February 2012 and the domestic consultation⁶ closed on 23 February 2012.
5. We are currently in the process of considering responses to this consultation and no firm decisions have been made at this stage. If, following the outcome of our consultative process, we consider that reforms do not have a realistic chance of addressing the concerns identified due to industry opposition or otherwise, we will consider a referral to the Competition Commission (CC)⁷. The CC will then make their assessment on the functioning of a market. Should it find that features of a market are harming competition, it must seek to remedy the harm either by introducing remedies itself or recommending action by others.

² In general, the report should seek to cover developments during the period from January 2011 to December 2011 and data should reflect this period as far as possible. Where data for the calendar year is requested, 2011 is the appropriate reference year.

³ <http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/Retail%20package%20-%20decision%20document.pdf>

⁴ http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR_FINAL.pdf

⁵ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=70&refer=Markets/RetMkts/rmr>

⁶ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=72&refer=Markets/RetMkts/rmr>

⁷ The Competition Commission is an independent public body which helps to ensure healthy competition between companies in the UK for the ultimate benefit of consumers and the economy. It conducts in-depth investigations into mergers and markets and also has certain functions with regard to the major regulated industries: <http://www.competition-commission.org.uk/about-us>

Smart Metering Spring Package

6. In Autumn 2011, we introduced a range of protections for consumers using smart meters as part of the Smart Metering Spring Package. These protections took the form of supply licence modifications along with licence-backed guidance. Suppliers are required to have regard to guidance when identifying vulnerability in a household, designed in part to safeguard consumers where suppliers are considering utilising remote disconnection functionality available with some smart meters. The new measures also require suppliers to have regard to detailed guidance when considering whether it is safe and reasonably practicable for a customer to use a prepayment meter, including where a customer may be switched to prepayment remotely using a smart meter. Suppliers have also made voluntary commitments around rapid reconnection where a customer is disconnected in error, along with the provision of compensation payments in these circumstances.

Gas Markets

Gas Security of Supply Significant Code Review

7. In response to Ofgem's Project Discovery⁸, DECC's Energy Bill 2010⁹ and the entry into force of the EU Gas Security of Supply Regulation, in January 2011 we launched the Gas Security of Supply Significant Code Review (Gas SCR). The aim of the SCR was to assess whether reforms to the current gas market arrangements are required to improve security of supply; the primary focus being on the gas emergency cash-out arrangements.

8. We published a draft policy decision in November 2011¹⁰ which sets out our minded-to position to strengthen the incentives on market participants to deliver adequate gas supplies through cash-out reform. This set out our proposals to:

- Raise the cash-out price to £20/th in the event of reduction of supply to firm gas customers to reflect the value that they place on their gas supplies
- Introduce demand side response payments at £20/th to any firm load customers who have their load reduced as a result of a gas deficit emergency

9. Given that GB will be becoming increasingly dependent on gas imports we also recommend investigation of the need for, impacts and effects of, various further measures to enhance gas security of supply¹¹. Responses to the draft policy decision and the draft impact assessment will inform our final decision on the cash-out reform options, which is planned for summer 2012. Investigation of further measures will be progressed through a separate process. Ofgem is working on another report on the gas market in the course of 2012.

Cross-border gas market developments

10. In cooperation with the Dutch and Irish regulators, we agreed arrangements for initial reverse flows on the BBL interconnector (Bacton-Balgzand) between the UK and the Netherlands and on the Moffat interconnector which connects us to Ireland. Arrangements on

⁸ Project Discovery investigated whether current market arrangements in GB are capable of delivering secure and sustainable energy supplies over the next 10-15 years. It identified a number of concerns with the current gas emergency arrangements. As part of Project Discovery we set out a range of policy options for addressing these issues, some of which will be considered as part of the SCR. Project Discovery publications can be found on the Ofgem website: <http://www.ofgem.gov.uk/Markets/WhIMkts/Discovery/Pages/ProjectDiscovery.aspx>

⁹ DECC is seeking to give Ofgem additional legislative powers to allow the Authority to direct modifications to the Uniform Network Code if the Authority considers that such modifications will decrease the likelihood or severity of a gas supply emergency. http://www.decc.gov.uk/en/content/cms/legislation/energy_bill/energy_bill.aspx

¹⁰ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=46&refer=Markets/WhIMkts/CompendEff/GasSCR>

¹¹ See table 7 on page 69

BBL, including an auction process for virtual capacity, were approved on May 2010¹² and arrangements at the Moffat interconnection were approved in December 2011.

Electricity Markets

Electricity Market Reform (EMR)

11. In December 2010 DECC¹³ launched the EMR, the aim being to meet the significant long-term challenge of de-carbonisation and to deliver our renewable energy targets, while maintaining secure and affordable electricity supplies.

12. In July 2011 DECC published 'Planning our electric future: a White Paper for secure, affordable and low-carbon electricity'¹⁴, which was supplemented by a technical update in December 2011. Key elements of the proposed reform package include:

- A carbon price floor
- New long-term contracts - Feed-in-tariffs with Contracts for Difference (FiT CfD)
- Emissions Performance Standard (EPS) set at 450g CO₂/kWh
- A capacity mechanism in the form of a Capacity Market

13. The technical update also set out DECC's view that the system operator (in GB the role of the system operator is carried out by National Grid), best meets the criteria for delivering the FiT CfD and the capacity mechanism. Ofgem is working jointly with DECC on this project to identify the potential conflicts and synergies that may arise from the designation of the system operator as the EMR delivery body¹⁵.

Electricity Cash-out Significant Code Review (SCR)

14. In our February 2010 Project Discovery consultation¹⁶ we expressed concerns that electricity cash-out prices may not be correctly signalling the value of flexibility and peaking generation, increasing the risks to future security of supply. We published an electricity cash-out issues paper in November 2011¹⁷ which set out the importance of cash-out for a secure and competitive electricity market, and highlighted a number of areas where the current cash-out arrangements could be improved.

15. Following this we published an Open Letter in March 2012 signalling our intention to launch a SCR of the electricity cash-out arrangements in summer 2012¹⁸.

¹²

<http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/Interconnectors/Documents1/100430%20BBL%20decision%20letter.pdf>

¹³ Department for Energy and Climate Change

¹⁴ http://www.decc.gov.uk/en/content/cms/legislation/white_papers/emr_wp_2011/emr_wp_2011.aspx

¹⁵ See here for link to consultation and responses on Potential Synergies and Conflicts of Interest:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=27&refer=Markets/WhIMkts/EffSystemOps>

¹⁶ http://www.ofgem.gov.uk/Markets/WhIMkts/monitoring-energy-security/Discovery/Documents1/Project_Discovery_FebConDoc_FINAL.pdf

¹⁷ <http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/CashoutRev/Documents1/Electricity%20cash-out%20issues%20paper.pdf>

¹⁸ <http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/CashoutRev/Documents1/electricity-cash-out-SCR.pdf>

Cross-border electricity market developments

16. We published an Open Letter in March 2012 to seek stakeholder views on the implications of implementing the European Target Model for Electricity in GB and how we should respond to the Network Codes under development. Implementing the Target model will have a significant impact in GB. Beyond changes to existing arrangements to remove obstacles to cross-border trade, efficient implementation will require the development of a liquid day-ahead market, leading to a robust and trusted reference price for GB and consideration of appropriate price zones to manage internal constraints in the most efficient way.

17. We have made progress in 2011 in implementing aspects of the electricity target model. In April 2011, BritNed commenced operations connecting GB to the Netherlands. BritNed capacity is allocated through a blend of explicit auctions and market coupling at the day-ahead stage. BritNed holds explicit medium term and intra-day auctions and day-ahead implicit auctions.

18. The EirGrid East-West Interconnector (EWIC) is still under construction but is due to become operational in September 2012.

19. To facilitate coordinated implementation of market coupling over IFA and BritNed, during 2011 National Grid Interconnector Limited (NGIL)¹⁹ initiated the procurement of a GB hub operator (the 'GB hub'). The GB hub will pool GB liquidity from participating power exchanges, facilitate the formation of a single GB day-ahead reference price and determine flows on participating cross-border interconnectors. This is in line with the objectives of the North West European (NWE) market coupling project.

20. Nord Pool Spot was selected to develop and operate this GB hub in April 2012 following the competitive tendering exercise run by NGIL.

2.2 Network Developments

RIIO price controls

21. In December 2010 Ofgem published its consultation on the next gas distribution price control (RIIO-GD1) and the next transmission price control (RIIO-T1). They will be the first price controls to implement the new regulatory framework that was the outcome of the RPI-X@20 project, which concluded in October 2010.²⁰

22. These price controls will implement the RIIO (Revenue = Incentives + Innovation + Outputs) model. The RIIO model builds on the success of the previous RPI-X regime, but is designed to better meet future investment and innovation challenges. It is designed to drive real benefits for consumers; providing companies with strong incentives to meet the challenges of delivering a sustainable energy sector at a lower cost than under our previous approach. RIIO puts sustainability alongside consumers at the heart of what network companies do and provides a transparent and predictable framework that rewards timely delivery.

¹⁹ GB operator of the electricity interconnector to France (IFA).

²⁰ RIIO: A new way to regulate energy networks:

<http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/Decision%20doc.pdf>

23. Under the RIIO model, network companies will be required to develop well-justified business plans setting out their outputs and how they propose to deliver these. In March 2011 Ofgem published strategy decision documents²¹ outlining our decisions on the key aspects of the framework to aid the networks companies in the completion of their business plans, to be submitted to Ofgem by 31 July 2011.

24. The price controls will set the allowed revenue of the gas distribution networks and the gas and electricity transmission networks for an eight-year period from 1 April 2013 to 31 March 2021.

Electricity Transmission Access Regime

25. In August 2010, the British Government announced changes to the electricity grid access regime in GB. The Government's changes followed from work Ofgem and the industry had been progressing under the "Transmission Access Review"²². The Government's changes introduced a "Connect and Manage" regime for access to the electricity grid, effective from 11 February 2011.

26. Under this approach, generators are able to connect to the system in GB ahead of wider system reinforcements, as soon as any identified "enabling works" (local transmission works required to connect) are complete. It is the responsibility of the System Operator to ensure that the power flows across major system boundaries are within the capability of certain network boundaries. The additional cost of these actions and the resulting 'Constrained Dispatch' of generation (constraint costs) are socialised across all generation and demand (levied 50:50) in GB.

Project TransmiT

27. In September 2010 Ofgem launched Project TransmiT as an independent and open review of transmission charging and associated connection arrangements²³. The aim of TransmiT is to ensure that we have in place arrangements that facilitate the timely move to a low carbon energy sector whilst continuing to provide safe, secure and high quality network services at value for money to existing and future consumers. This has culminated in two strands of ongoing work –

28. An electricity transmission charging "Significant Code Review" (SCR) of transmission use of system (TNUoS) charges was launched in July 2011. In December 2011 we consulted on: i) Ruling out a socialised charging approach to transmission charging; ii) Ofgem's initial view that incrementally changing the current Investment Cost Related Pricing (ICRP) charging approach ("Improved ICRP") is the right direction for transmission charging. In spring 2012 Ofgem announced its SCR conclusions, for a direction to National Grid Electricity Ltd to raise a proposal for industry to further develop an Improved ICRP charging approach. Once this industry-led process is complete we will then be presented with the industry's amendment proposal, which we will decide whether to approve for implementation.

29. Our work on connections produced separate, but related, work on Timely Connections and User Commitment:

²¹ Decision on strategy for the next transmission price control - RIIO-T1:
<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decision.pdf>

Decision on strategy for the next gas distribution price control - RIIO-GD1:
<http://www.ofgem.gov.uk/Networks/GasDistr/RIIO-GD1/ConRes/Documents1/GD1decision.pdf>

²² <http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Pages/Traccrw.aspx>

²³ <http://www.ofgem.gov.uk/Networks/Trans/PT/Pages/ProjectTransmiT.aspx>

- *Timely connections*: Ofgem introduced new reporting requirements for onshore transmission licensees in December 2011. These reports will allow us identify and monitor issues that may be delaying timely connections to the network and inform our view on what changes to the existing framework may be appropriate to facilitate timely connections.
- *User commitment*: User commitment arrangements place liabilities on users that trigger investment in the transmission network so that customers are protected from stranded assets if a user decides to reduce its capacity or cancel its project without giving sufficient notice to the transmission owners. During 2011 industry developed a proposed new enduring approach (CMP 192) to user commitment which will come into effect in April 2013.

Interconnector Charges

30. Ofgem have accepted two modification proposals to remove charges for access to networks from interconnector users to comply with the Electricity Regulation requirements and to facilitate cross border trade towards the development of a single European market in electricity. In October 2010, accepted the modification proposal to remove Transmission Network Use of System (TNUoS) charges for interconnector flows on the basis that interconnector asset owners are to be treated as a separate class of transmission users as distinct from generation or demand and are thus exempt from both TNUoS demand and generation charges.

31. In May 2012, we also approved a modification proposal to remove transmission losses for interconnector users. Because GB participates in the ITC Mechanism (via NGET as the national TSO) GB transmission losses under the BSC should no longer be allocated to Interconnector BM Units.

32. There is a third modification proposal to remove the Balancing and Use of System (BSUoS) charges from interconnector users. The Final Modification Report is due on 11 July 2012.

Incentivising investment in new cross-border interconnection

33. We are currently in the process of developing a new approach to regulating interconnectors in order to facilitate more interconnector investment. Ofgem has been working with CREG, the Belgium regulator, to develop a regulated regime based on a "cap and floor" approach, using the proposed NEMO interconnector (UK-Belgium link) as the pilot project. We consulted on the principles and design parameters of this new cap and floor regime in June 2011, and published our preliminary conclusions, jointly agreed with CREG, on the high-level principles and basic design for NEMO and on development of a GB enduring regulated regime for electricity interconnectors in December 2011. We intend to take a decision on the open issues regarding the cap and floor design and parameters for NEMO in early 2013.

3 The Electricity Market

3.1 Network regulation

34. The National Electricity Transmission System (NETS) is used to transfer bulk electricity at high voltage from generating power stations to substations near demand. The NETS

comprises both onshore and offshore transmission networks. In order to participate in the transmission of electricity for the purpose of enabling a supply to be given, a transmission licence needs to be granted by Ofgem.

35. Transmission assets are owned and maintained by regional monopoly Transmission Owners (TOs)²⁴. The NETS is operated by National Grid Electricity Transmission plc (NGET) which is the sole System Operator (SO). The SO has responsibility for making sure that electricity supply and demand stay in balance and the system remains within safe technical and operating limits.

36. Electricity distribution networks carry electricity from the transmission system, and some generators that are connected to the distribution networks, to industrial, commercial and domestic users. Domestic and most commercial consumers buy their electricity from suppliers who pay the Distribution Network Operators for transporting their customers' electricity along their networks. Suppliers pass on these costs to consumers. Distribution costs account for about 20% of electricity bills.

37. In order to participate in the distribution of electricity for the purpose of enabling a supply to be given, a Distribution Licence needs to be granted by Ofgem. There are currently 14 electricity distribution operators (DSOs) each responsible for a distribution services area in Great Britain, these are owned by six different groups. There are also six independent network operators who own and run smaller networks embedded in the DNO networks²⁵.

3.1.1 Unbundling

Transmission System Operators (TSOs) Articles 10 & 11, Article 3 Regulation 714/2009

38. On 10 November 2011, the Electricity and Gas (Internal Markets) Regulations 2011 ("the GB Regulations") came into force. The GB Regulations implement the Third Package into GB domestic legislation, including the ownership unbundling requirements set out in the Third Package Directives and Regulations. The GB Regulations have amended the Gas Act 1986 (Gas Act) and the Electricity Act 1989 (Electricity Act) to include the requirement for the holders of gas transporter, gas interconnector, electricity interconnector and electricity transmission licences to be certified as independent pursuant to one of the grounds for certification set out in the Gas Act or in the Electricity Act (as appropriate).

39. The GB Regulations have designated the Authority as the National Regulatory Authority (NRA) for GB and have given it 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.

40. We had active discussions during 2011 with current and potential transmission system operators to prepare them for the application process. In early 2012 we submitted preliminary certification decisions to the European Commission for three National Grid group companies²⁶,

²⁴ Three onshore TOs: National Grid Electricity Plc (NGET) who own the transmission system in England and Wales; SP Transmission Limited (SPTL) who own the transmission system in southern Scotland and Scottish Hydro Electric Transmission Limited (SHETL) which owns the transmission system in northern Scotland

²⁵ The relatively small independent DSOs do not have area-specific obligations and provide both embedded distribution networks and site specific infrastructure, such as gas pipelines serving power stations.

²⁶ National Grid Electricity Transmission plc – which owns the electricity transmission network in England and Wales and operates, in its role as GB NETSO, the transmission system in the whole of GB (including Scotland); National Grid Gas

SP Transmission Limited and Scottish Hydro Electric Transmission Limited (which own the electricity transmission systems in Scotland).

41. When considering the certification applications of cross-border interconnectors, Ofgem cooperates and consults other relevant NRAs to facilitate a coherent certification process on both sides of the border.

Distribution system operators (DSOs) Article 26

42. The GB Regulations also make amendments to the Electricity Act and the Gas Act in connection with the requirements relating to DSOs under the Electricity and Gas Directives. These amendments enhance the existing legal and regulatory frameworks and include:

- prohibition of a DSO from holding a production/generation licence (in addition to the prohibition from holding a supply licence),
- obligations on licence-exempt distributors (especially in relation to third party access to networks), and
- provisions to bring independent distributor licences into line with incumbent DSO licences in respect of unbundling.

43. As well as the duties imposed on each DSO by its licence, there are specific conditions of those licences which relate to the implementation of Article 26 in GB. These include a requirement to:

- maintain managerial and operational independence of the distribution business from the vertically integrated undertaking (where the DSO is part of a VIU), and
- appoint a compliance officer and prepare compliance statements in respect of business independence.

44. Each DSO in GB is a separate legal entity. This means that it prepares and files individual financial statements and has a board responsible for promoting its interests.

45. There was one significant corporate transaction affecting an electricity DSO group in 2011 when ownership of the two electricity distribution networks in the English Midlands was transferred from E.ON to PPL Corporation (US). This reduced the number of incumbent electricity DSO owners in GB from seven to six, and resulted in one fewer vertically integrated group. One new licence was granted to an independent electricity distribution network operator.

3.1.2 Technical functioning

Balancing services

46. NGET is the system operator (SO) for the high voltage electricity transmission system in GB, with responsibility for making sure that electricity supply and demand stay in balance and

plc, which owns and operates the gas transportation system in GB; and National Grid Interconnectors Limited, which jointly owns Interconnexion France Angleterre with the French TSO RTE.

the system remains within safe technical and operating limits. NGET's licence contains conditions²⁷ 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 (*Article 37(8)*).

47. The current electricity balancing arrangements are designed to provide commercial incentives for generators to physically match the amount they notify²⁸ to that which they deliver to the system and for suppliers to physically match the amount they notify they will offtake to that they offtake from the system. Generators' imbalance relates to the difference between the amount they physically deliver and supplier's imbalance related to the difference between that notified and that offtaken (*Article 37(6)(b)*). They impose cash-out charges for these imbalances and Ofgem is considering improvements to these arrangements as part of its the cash-out review.

48. 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 the Ofgem. Ofgem is required to approve any change to the charging methodology (*Article 37(8)*). How BSUoS charges are levied is discussed in more detail in section 3.3.1.

Security and reliability standards, quality of service and supply (Article 37(1)(h))

Transmission

49. The National Electricity Transmission System Security and Quality of Supply Standard (NETS SQSS) sets out a coordinated set of criteria and methodologies that TOs and the SO are required by their respective licences to use when planning and operating transmission systems. The Authority is required to approve any change to the NETS SQSS.

50. NGET (in its role as the SO) produces an annual report on the overall performance of the transmission system. This report includes information on system availability, security and quality of service²⁹.

System Reliability

51. There is also a regulatory mechanism in place to incentivise Transmission Owners (TOs) to maintain a reliable and secure system. Each of the onshore TO licensees is set a target for availability, reliability and for minimising loss of supply events as part of the price control. They are either rewarded or penalised according to their level of performance against targets set by the Authority. Under standard licence condition C17 (Transmission System Security, Standard and Quality of Service) the licensee is required to report on the security and quality of service of the national electricity system.

²⁷ 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.

²⁸ 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.

²⁹ The latest version of the report covers the period to 31 March 2011 and is available on National Grid's website. <http://www.nationalgrid.com/uk/Electricity/Info/performance/>

52. Offshore Transmission Owners (OFTOs) are allocated an incentive target, which is set out in the licensee's offshore transmission licence and is enforceable by the Authority. The mechanism incentivises the OFTO to maintain availability, reliability and to minimise loss of supply events. Special conditions E12-J4 oblige OFTOs to report their offshore transmission system performance and whether that performance has fallen below the monthly incentive target set out in its licence, on a quarterly basis. Any reduction in system availability below the agreed target has an impact on the OFTO's revenue.

53. From April 2013, Ofgem will regulate the GB onshore network companies using the RIIO (Revenue = Incentives + Innovation + Outputs) price control model. This model is proposed to include a reliability output which (for RIIO-T1 which will apply from April 2013) will be based on performance in relation to maintaining a low level of Energy Not Supplied (ENS). There will also be a suite of secondary output measures that inform the safety and reliability of a TO's network.

Distribution

54. In GB, licensed electricity DNOs are required by their licence to design their networks to meet the requirements of Engineering Recommendation P2/6. This sets out the maximum supply interruption times for specified contingencies. In the event that a licensee cannot comply with this licence condition it is able to apply to Ofgem for a derogation.

55. All DSOs provide Ofgem with data on their respective network's performance on an annual basis as required under the licence.

56. In April 2010, the current electricity distribution price control took effect and as part of this Ofgem chose to continue operating the "Interruptions Incentive Scheme" (IIS). This scheme was introduced a number of years ago, to incentivise the 14 incumbent electricity distribution service providers (DSPs) in Great Britain, to deliver a good level of performance in respect of customer interruptions, and customer minutes lost. It encourages the DSPs to invest in and operate their networks to manage and reduce both the frequency and duration of power cuts experienced by their customers. This scheme does not apply to Independent DSPs³⁰, but they do return interruptions information to Ofgem.

57. Ofgem set the targets and incentive rates for customer interruptions and customer minutes lost for each DSP as part of the price control process. The incentive rates for the current price control for each DSO are based on customer "willingness to pay" research conducted by Ofgem. The major changes between the previous price control and the current one are that DSOs now face asymmetric annual rewards and penalties depending on each DSO's performance against its targets. For the 2010/11 regulatory year, DSOs were rewarded by £45million in total due to their performance.

58. In 2011, in order to monitor the companies' compliance against these standards, Ofgem conducted an expanded audit of three licensees (based on their 2010/11 data). All three licensees passed this audit based on the required overall accuracy thresholds for the audit.

59. The Authority also updated the "Electricity (Standards of Performance) Regulations 2010" (SI 698) as part of the price control. The purpose of these standards is to provide signals to DSOs to meet certain expected levels of service and to provide payments to end customers in the event of individual standards not being met. The major changes in this area

³⁰ Independent DSPs are independent network operators who own and run smaller networks embedded in the DNO networks, for example they can serve new housing developments.

have been in adjusting the payment levels to account for inflation, and the introduction of new standards³¹.

60. Ofgem has published annual reports on DSO IIS performance since 2001/02. Recently this report³² has moved beyond focussing exclusively on interruptions performance and looks at a wide range of DSO activities, which include: Reliability and Availability; Network Investment; Customer Satisfaction; Connections; Social Responsibility; and Environment. This report is intended to be as useful as possible to customers, and is structured in a format similar to Ofgem's new RIIO price control format.

61. The next price control for electricity distribution, known as RIIO ED1, is currently being discussed by Ofgem with stakeholders. This new price control will cover the period from on April 2015 until March 2023. At this point, Ofgem is considering the options available to enhance the outputs from both the Interruptions Incentive Scheme and the Electricity Standards of Performance.

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

Transmission

62. In August 2010, the British Government announced changes to the electricity grid access regime in GB. The Government's changes followed from work Ofgem and the industry had been progressing under the "Transmission Access Review"³³ project. The Government's changes introduced a "Connect and Manage" regime for access to the electricity grid, effective from 11 February 2011. Under this approach, generators are able to connect to the system in GB ahead of wider system reinforcements, as soon as any identified "enabling works" (local transmission works required to connect) are complete. It is the responsibility of the SO to ensure that the power flows across major system boundaries are within the capability of certain network boundaries. The additional cost of these actions and the resulting 'Constrained Dispatch' of generation (constraint costs) are socialised across all generation and demand (levied 50:50) in GB.

63. Ofgem publishes regular half-yearly reports³⁴ to the Secretary of State for Energy monitoring the impacts of the "Connect and Manage" regime. These reports include analysis of the following effects -

- Impact on connections by generation type and region.
- Developers' confidence in the new arrangements.
- Costs and benefits to consumers of the new arrangements.
- Progress and costs of delivering the necessary wider grid investments.

³¹ The new standards are: a "5,000 customer standard" (payments are due to customers if 5,000 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).

³² <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=702&refer=Networks/ElecDist/PriceCntrls/DPCR5>

³³ <http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Pages/Traccrw.aspx>

³⁴ <http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Pages/Traccrw.aspx>

64. The most recent report (September 2011)³⁵ noted that under the new "Connect and Manage" regime the time taken to connect was, on average, five to six years less than under the previous "Invest and Connect" approach.

65. Offshore Transmission Owners (OFTOs) are allocated an incentive target, which is set out in the Licensee's offshore transmission licence. The mechanism incentivises the OFTO to maintain availability, reliability and to minimise loss of supply events. Special condition E12-J4 obliges an OFTO to report its offshore transmission system performance and whether that performance has fallen below the monthly incentive target set out in its licence, on a quarterly basis. Any reduction in system availability below the agreed target has an impact on the OFTO's revenue.

66. In terms of reporting, the each transmission licensee is required to report on the security and quality of service of the NETS 36 under standard licence condition C17 (Transmission System Security, Standard and Quality of Service).

Distribution

67. Section 47(1C) of the Electricity Act has been introduced as part of the changes implementing the Third Package Electricity Directive monitoring obligations, requiring the Authority to monitor the time taken to make connections and repairs. In addition, standard licence condition 6.1 of the electricity distribution licence has been amended to allow the Authority to require DNOs to provide information that it considers necessary to enable the Authority to perform its functions under the Electricity Directive as well as domestic legislation.

68. Historically, Ofgem³⁷ has monitored the maximum, minimum and average time taken by DNOs to provide connection offers. Since October 2010 it has also monitored the time taken by DNOs to provide connections. It has also set connections guaranteed standards, i.e. a minimum level of service that it expects DNOs to deliver. Those standards cover the provision of quotations, scheduling agreed dates for works with customers and completing works on the dates agreed with customers.

69. Ofgem has monitored the time taken to repair faults through the Interruptions Incentive Scheme (IIS - this is dealt with more fully as part of our response to Article 37(1)(h)³⁸). The time taken to repair has been incentivised as part of the customer minutes lost element of the IIS.

Monitoring technical co-operation between Community and third-country TSOs

70. The Electricity Directive requires us to monitor technical cooperation between Community and third-country TSOs (Article 37(1)(s)). In order for us to meet our new duties in relation to monitoring, the Government has amended the Electricity Act to give us the power to require certain information for the purpose of monitoring from a regulated person, being a licensee, a distribution exemption holder, a supply exemption holder or an electricity

³⁵ http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Documents1/110930_CM_report_to_SoS.pdf

³⁶ The national electricity transmission system includes both onshore and offshore transmission systems.

³⁷

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=702&refer=Networks/ElecDist/PriceCtrls/DPCR5http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/TAR/Pages/Traccrw.aspx>

³⁸ See Page 14

undertaking which is a relevant producer or supplier³⁹. This includes information for the purposes of monitoring technical cooperation between European TSOs.

71. The United Kingdom, along with 8 other EU Member States, is a signatory of the North Seas Countries Offshore Grid Initiative (NSCOGI). NSCOGI aims to provide a common framework for regional cooperation to identify solutions to questions related to potential future development of electricity grid infrastructure in the North Seas. Norway is also a signatory of NSCOGI and its TSO participates, alongside Ofgem, in its Working Groups on "Grid Configuration and Integration" and "Market and Regulatory Issues". We therefore actively engage with Norwegian representatives on this issue.

Monitoring safeguard measures

72. Under the terms set out in the Electricity Act, during a fuel crisis the British 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)⁴⁰. Transmission licensees have licence requirements to comply with the code. Under the Fuel Security Code, in an emergency the Energy Emergencies Executive ("E3") Committee⁴¹ 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.

73. 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.

3.1.3 Network tariffs for connection and access

(Article 37(1)(a), Article 37(6)(a), Article 37(8), Article 37(10))

Transmission

74. Users of the electricity transmission system are subject to three types of transmission charges: connection charges, Transmission Network Use of System (TNUoS) charges and Balancing Services Use of System (BUSoS) charges.

75. In terms of charging, the primary requirement of the transmission licence⁴² 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 and connection businesses. While the form of the methodologies must be approved by Ofgem, we do not set or approve the level of individual charges.

76. 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

³⁹ <http://www.legislation.gov.uk/ukxi/2011/2704/regulation/31/made>

⁴⁰

http://www.decc.gov.uk/assets/decc/what%20we%20do/uk%20energy%20supply/resilience/gas_electric/file41951.pdf

⁴¹ 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.

⁴² <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=32&refer=Networks/Trans/PriceControls/TPCR4Roll-over>

thorough review and consultation, with the final decision of whether to approve change resting with Ofgem⁴³.

Connection Charges

77. 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 NGET's connection charging methodology⁴⁴. NGET defines "connection assets" as assets solely required to connect an individual user to the GB 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

78. The TNUoS charging methodology⁴⁵ is applied by NGET in its role as SO. 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 other than interconnectors. These charges vary by location, reflecting the costs that users impose on the transmission network to source (demand) or send (generators) their electricity⁴⁶.

79. There are 20 charging zones for generation and 14 for demand. For 2012/13 the demand charge varies between £10.74/kW and £31.17/kW whereas the "wider" locational generation charge varies between £-13.35/kW and £22.05/kW.

Balancing Services Use of System (BSUoS) Charges

80. 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.

81. 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 (i.e. half hourly) settlement periods.

82. 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.

⁴³ If a proposal meets the self governance criteria, it may proceed without Authority approval, and the CUSC Modifications Panel may consult on and determine itself whether to implement the CUSC Modification Proposal.

⁴⁴ <http://www.nationalgrid.com/uk/Electricity/Charges/chargingstatementsapproval/index.htm>

⁴⁵ <http://www.nationalgrid.com/uk/Electricity/Charges/chargingstatementsapproval/index.htm>

⁴⁶ See 2010 National Report for a more detailed description of the components of the TNUoS charge.

83. Section 14 of the CUSC⁴⁷ includes a detailed methodology for the calculation of daily BSUoS charges, some worked examples, and information on timing of BSUoS charges and financial settlement.

Project TransmiT

84. In September 2010 Ofgem launched Project TransmiT as an independent and open review of transmission charging and associated connection arrangements. The aim of TransmiT is to ensure that we have in place arrangements that facilitate the timely move to a low carbon energy sector whilst continuing to provide safe, secure and high quality network services at value for money to existing and future consumers. A key development coming out of this project was the electricity transmission charging "Significant Code Review" (SCR) of TNUoS charges⁴⁸. More detail on this workstream can be found in the Network Developments section on page 10.

Distribution

85. DNOs are required by standard licence condition 13 of the Electricity Distribution Licence (the licence) to have in force at all times a Connection Charging Methodology that has been approved by the Authority on the basis that it achieves relevant objectives.

86. The Relevant Objectives are:

- that compliance with the methodology facilitates the discharge by the licensee of the obligations imposed on it under the Electricity Act and by this licence;
- that compliance with the methodology facilitates competition in the generation and supply of electricity, and does not restrict, distort, or prevent competition in the transmission or distribution of electricity;
- that compliance with the methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the licensee in its Distribution Business;
- that, so far as is consistent with sub-paragraphs (a), (b), and (c), the methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's Distribution Business; and
- compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or ACER.

87. DNOs are also required (by standard licence condition 14 of the licence) to prepare, and make available in a form approved by the Authority, a Connection Charging Statement. Standard licence condition 14.2 requires that DNOs' Connection Charging Statements be prepared in accordance with their approved Charging Methodologies.

⁴⁷http://www.nationalgrid.com/NR/rdonlyres/8FFA9408-9DC7-44C2-AF68-93E684A176D8/47549/CUSC_Section_14combinedmasterclean5July11_FINAL.pdf

88. Standard licence condition 13 requires DNOs to comply with their Charging Methodologies. Standard licence condition 14 requires DNOs to charge in line with their Charging Statements. Standard licence condition 7 of the licence gives us powers to determine if customers do not consider that a DNO's charges reflect those set out in their Charging Methodology. The Electricity Act also gives us powers to determine disputes and we have powers to enforce DNOs' compliance with the licence.

89. Table 1 below gives details of the typical use of system charge for users of the electricity distribution system.

Table 1: Levels of distribution charges

Range of distribution charges for Apr 2011 – Mar 2012 (pence per kWh)		
Domestic customer	1.383 to 2.843	Note 1
Small non-domestic customer	1.095 to 2.420	Note 2
Large non-domestic customer	1.812 to 16.342	Note 3
Non Peak	0.013 to 1.981	

Table Notes:

Note 1: This indicates the standard distribution use of system charge for a typical household customer with annual consumption of 4 MWh/year on average, before the applicable fixed charge.

Note 2: This indicates the standard distribution use of system charge for a typical small non-domestic customer with annual consumption of 15 MWh/year on average, before the applicable fixed charge.

Note 3: This indicates the standard distribution use of system charge for a large non-domestic customer with annual consumption of 3-4 GWh/year on average, before the applicable fixed capacity and reactive power charges. The charge depends on the applicable time band, i.e. peak (typically 16:30-19:00 during weekdays), off-peak (nights and weekends) or medium (all other hours). The exact definition of time bands varies between the DNOs.

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

Transmission

90. All electricity transmission licensees (including onshore and offshore licensees) are required to comply with business separation requirements as stipulated in their electricity transmission licences. Transmission licensees are prohibited from giving cross subsidies to, or receiving cross subsidies from, any other business of the licensee or of an affiliated or related business. Interconnector licensees are required to keep separate accounts for each of their activities to avoid cross-subsidisation.

91. The unbundling requirements as described under section 3.1.1⁴⁹ also provide for greater structural separation of transmission interests from generation, production and supply interests in order to prevent cross-subsidisation.

⁴⁹ See Page 12

Distribution

92. In GB, licensed electricity distribution, gas distribution and transmission network operators are required by their licence to provide the Authority with sufficient information to assess if there is any actual or potential cross subsidy⁵⁰.

93. Information provided by licensed network operators is subject to agreed upon procedures by an external auditor, to verify that the obligation to avoid discrimination and cross-subsidies is respected. Ofgem review the report prepared by the licensees' external auditors and raise supplementary questions as appropriate. Under these regulatory procedures Ofgem is satisfied that there were no clear instances of cross subsidies over 2011.

3.1.4 Cross-border issues

94. Access to cross-border infrastructure including the procedures for the allocation of capacity and congestion management

Existing Interconnection

95. The GB electricity market currently has 3.5GW of interconnection: with the Netherlands (BritNed), France (IFA) and Northern Ireland (Moyle). This is due to increase to ~4GW in September 2012 when a new interconnector between GB and Ireland (the EirGrid East-West Interconnector) becomes operational. Total interconnector capacity could potentially reach around 8GW in 2020.

Access rules on interconnection

96. The Third Package has 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.⁵¹

97. Licensees are now 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. (Article 37 6(c)).

98. The GB interconnector standard licence conditions place a responsibility on both us and the interconnector operator to ensure that tariff methodologies, and any modifications to these, comply with certain objectives. These are objectivity, transparency, non-discrimination and compliance with the Electricity Regulation or any decision of the European Commission and ACER. (Article 37(8))

⁵⁰ This 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); paragraph 44.8 of Electricity Distribution Standard Licence Condition 44, the general prohibition on cross subsidies at paragraph 4.9 in Standard Licence Condition 4; Gas Transportation Standard Licence Condition 41, the general prohibition on cross subsidies, and standard special condition A35; Electricity Transmission standard licence condition B5; Electricity Transmission standard licence condition E6 (in respect of offshore transmission).

⁵¹ See standard conditions 10, 11 and 11A of the Electricity Interconnectors Licence: <http://epr.ofgem.gov.uk/EPRFiles/Electricity%20Interconnector%20Standard%20Licence%20Conditions%20Consolidated%20-%202010-11-2011%20-%20Current%20Version.pdf>

99. Interconnector operators are now required to review their access rules at least once a 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 any suggestions we might have in relation to better achieving the objectives.

100. In addition to the formal review process, we have also continued to informally monitor congestion management on our interconnectors. (Article 37(9))

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

IFA

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

103. Capacity is allocated explicitly in long-term, day-ahead and intraday closed auctions, using a single coordinated capacity platform and harmonised capacity products. Netting⁵² 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.

104. In October 2011, NGIL notified us of their intention to amend the IFA access rules.⁵³ This was primarily to reflect ongoing developments in the France, UK and Ireland (FUI) Electricity Regional Initiative (ERI)⁵⁴, which is working towards the greater harmonization of access rules for interconnectors in the region. NGIL and RTE have been jointly coordinating work with BritNed, Moyle and Eirgrid to develop a common set of access rules in view of this objective. NGIL also notified us of their intention to amend the IFA charging methodology.⁵⁵

105. We welcomed these amendments and considered that they better facilitated the relevant IFA charging methodology and access rules objectives.⁵⁶ However, on 21 November 2011 we requested NGIL to review both the charging methodology and access rules against the requirements of the interconnector licence, which had been amended following the transposition of the Third Package into domestic legislation. NGIL has provided us with reports on these reviews, in line with the requirements of the interconnector licence. We have subsequently made several recommendations that we consider will help ensure the access rules and charging methodology better meet the relevant objectives.

⁵²Netting 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

⁵³Open letter on Revised Access Rules for the IFA:

[http://www.ofgem.gov.uk/Europe/Documents1/Revised%20access%20rules%20for%20England-France%20Interconnector%20\(IFA\).pdf](http://www.ofgem.gov.uk/Europe/Documents1/Revised%20access%20rules%20for%20England-France%20Interconnector%20(IFA).pdf)

⁵⁴In 2006, the European Regulators Group for Electricity and Gas (ERGEG) launched seven Electricity Regional Initiatives (ERIs), aimed at bringing together National Regulatory Authorities (NRAs), TSOs and electricity market participants on a voluntary process to advance electricity market integration.

⁵⁵Open letter on Revised Charging Methodology for the IFA:

<http://www.ofgem.gov.uk/Europe/Documents1/Revised%20England-France%20interconnector%20charging%20methodology.pdf>

⁵⁶ Licence conditions require that the access rules (charging methodologies) shall be objective, transparent, non-discriminatory and compliant with the Regulation and any relevant legally binding decision of the European Commission and/or the Agency (collectively the "relevant access rules (charging methodology) objectives")

BritNed

106. The 1000MW BritNed HVDC cable between GB and the Netherlands commenced operations 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. The implicit auction day-ahead system is also used to implement use-it-or-lose-it (UIOLI).

107. BritNed has a 25-year exemption from rules around the use of interconnector revenues and charging methodologies.⁵⁷ However, it must still comply with the interconnector licence condition around access rules, introduced as a result of the Third Package.⁵⁸ BritNed is currently consulting on proposed changes to its access rules.

Moyle

108. The Moyle interconnector, which links Scotland to Northern Ireland, offers around 500MW of capacity to the market through explicit long-term, daily and intraday auctions. It offers a range of long-term products from 1 month to 1 year. To maximise the availability of capacity, UIOSI applies to all long-term capacity.

109. Similarly to BritNed, Moyle has an exemption from regulations around charging methodologies, but not from access rules. In October 2011, we gave informal⁵⁹ approval to the Moyle access rules.⁶⁰ These amendments were made to reflect ongoing work in the FUI Regional Initiative. Further amendments are due to be made to accommodate the planned introduction of intraday trading in July 2012. We seek to formally approve the access rules, providing the amendments meet the relevant access rules objectives, later in 2012.

EirGrid East-West Interconnector

110. The EirGrid East-West Interconnector (EWIC) is still under construction but is due to become operational in September 2012. It will offer 500MW of capacity between Wales and Ireland, using the same electronic platform as Moyle. It is also due to offer capacity through explicit long-term (monthly and annual), daily and intraday auctions and apply UIOSI to long-term capacity.

111. The EirGrid EWIC does not have any exemptions from regulations around access rules and charging methodologies. We informally approved the EirGrid EWIC access rules in October 2011.⁶¹ However, further amendments are due to be made to accommodate the planned introduction of intraday trading in July 2012.

Monitor TSO investment plans in view of TYNDP

112. National Grid and the Scottish TOs are obliged to consider the European energy market and its implications for its network when developing their business investment plans. The consistency of these business plans with the Ten Year Network Development Plan is also being

⁵⁷ Standard conditions 9 and 10 of the Electricity Interconnector Licence

⁵⁸ Standard condition 11A of the Electricity Interconnector Licence

⁵⁹ Ofgem did not have the power to formally approve access rules prior to the transposition of the Third Package to domestic legislation on 10 November 2012

⁶⁰ <http://www.ofgem.gov.uk/Europe/Documents1/Moyle%20Access%20Rules%20Approval%20Letter.pdf>

⁶¹ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=88&refer=Europe>

considered as part of Ofgem's Integrated Transmission Planning and Regulation⁶² (ITPR) work stream.

113. Ofgem monitors the investment plans of the electricity TOs taking these European considerations into account in a number of ways and at different stages of development.

114. Firstly, we monitor high level planning as part of our involvement in the Electricity Networks Strategy Group (ENSG⁶³). The ENSG is jointly chaired by the DECC and Ofgem. Its broad aim is to identify, and co-ordinate work to help address key strategic issues that affect the electricity networks in the transition to a low-carbon future. This joint industry work is actively considering the wider context within which onshore transmission investments might be applied including onshore grid reinforcements located offshore⁶⁴.

115. Secondly, Ofgem determines the efficient funding requirements of NGET (the GB TSO) and SP Transmission Limited (SPTL) and Scottish Hydro Electric Transmission (SHETL) (Scottish TOs). We review their business plans under a price control process to assess the efficient levels of revenue. We also determine what is to be delivered during the period, the incentives in place and mechanisms for dealing with different types of uncertainty during the period. We also establish procedures for assessing the efficient funding of major investments during control periods. Specifically in 2012 we are assessing (NGET) or have assessed (SPTL/SHETL) the business plans for the control period April 2013 – March 2021.

116. For the years between price controls, where we are not reviewing the companies' business plans as part of the price control process, we will continue to seek information on major projects. This will form part of the regulatory instructions and guidance we will issue for annual reporting. We will make sure this provides us with the necessary information as required under *Article 37 (1) (g)*. Where necessary, we consider funding for strategic discrete assets, outside of the price control process, under a mechanism called Strategic Wider Works.

Cooperation

117. Article 37(1)(c) imposes new duties on us to consult and cooperate with ACER and the NRAs of other member states, over cross-border issues. Changes have been made to the Electricity Act to reflect this.⁶⁵ This includes the requirement to provide ACER and other NRAs with the information they may need to carry out their responsibilities under the Third Package.

118. 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 supporting jointly managed cross-border trade in electricity and the allocation of cross-border capacity.

⁶² Open Letter: <http://www.ofgem.gov.uk/Europe/Documents1/ITPR%20Open%20Letter%20-%20Final%20version%20-%2023%20March%202012.pdf>

⁶³ The ENSG is a high level forum which brings together key stakeholders in electricity networks that work together to support Government in meeting the long-term energy challenges of tackling climate change and ensuring secure, clean and affordable energy. Membership includes network companies, generators, Trade Associations and Devolved Administrations.

⁶⁴ The ENSG does not approve funding of transmission network investments. This is a matter for Ofgem. It also does not approve planning applications for transmission networks, which is a matter for the planning regimes in England & Wales and Scotland.

⁶⁵ 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/ukxi/2011/2704/regulation/35/made>

Examples of cooperation

119. 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 regulator to develop and approve common trading arrangements for the EirGrid East-West Interconnector (EWIC). We have also been coordinating with the French and Dutch regulators over the access rules and/or charging methodologies on IFA and BritNed.

120. In addition, we have been cooperating closely with the Belgian regulator, CREG, over project NEMO, the proposed interconnector between GB and Belgium. In June 2011, Ofgem and CREG launched a joint consultation on the principles and design of a new regulatory framework for electricity interconnector investment.⁶⁶

121. Under the Third Package, 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.

122. In April 2011 ACER requested the lead NRAs of each Energy Regional Initiative (ERI) to develop a regional roadmap as an input to the European Energy Work Plan. As lead regulator for the France-UK-Ireland (FUI) region, we have coordinated the development of the FUI roadmap. This has involved close consultation with the relevant member states and with ACER.

123. 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. The NWE projects were established by 13 TSOs, covering nine countries, with the objective of developing a common approach to cross-border capacity allocation and implementing an enduring day-ahead market coupling solution and an interim intraday solution on cables across NWE countries.

124. We have also actively contributed to many other ERIs and have fully supported other lead regulators in coordinating these projects.

3.1.5 Compliance

Ensuring compliance with binding decisions of the Agency and the Commission, and with the Guidelines⁶⁷

125. Under the Third Package NRAs are required to ensure compliance with and implement binding decisions of ACER and of the European Commission (*Article 37(1)(d)*) and with the Guidelines (*Article 39*). In order to enable Ofgem to do this, the Electricity Act has been amended so as to provide the Authority with the necessary powers to carry out its functions 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.

126. Once the European network codes are finalised, we will have an obligation to ensure these are fully implemented in GB.

⁶⁶

<http://www.ofgem.gov.uk/Europe/Documents1/Cap%20and%20floor%20regime%20for%20regulation%20of%20new%20subsea%20interconnector%20investment5.pdf>

⁶⁷ The Guidelines being those Guidelines referred to in the Gas and Electricity Directives and Regulations under the Third Package.

Power to carry out investigations and impose measures to promote competition Articles 37(4)(b-d) and 37(1)(b) and (q)

Key changes to Ofgem's enforcement powers following the Third Package

127. Changes brought about by the Third Package have strengthened Ofgem's enforcement and information gathering powers in a number of key respects.

128. A number of obligations have been added to licences and to legislation, which are relevant conditions and requirements, enforceable by Ofgem. For example, a number of additions have been made to the standard licence conditions of gas and electricity supply licensees to implement consumer protection measures contained in the Third Package. These include obligations on licensees to improve the current switching process in order to achieve the objective of switching all consumers within three weeks of the relevant date and to take more pro-active steps to ensure the accuracy of meter readings and where appropriate, incorporate them into customer bills and statements.

129. In addition, the class of persons subject to Ofgem's enforcement powers has been extended: Ofgem's enforcement powers now apply to licence-exempt DNOs and suppliers.

130. Ofgem also has a number of new broad monitoring duties, which are backed up with new information gathering powers. We are now able to require, by notice, any regulated person to provide Ofgem with any documents or information specified which relate to certain activities which Electricity Directive requires Ofgem to monitor⁶⁸. Ofgem can, where necessary, use its powers to make final or provisional orders to help secure compliance with such requests.

Update on Ofgem's enforcement investigations

131. We have set out below some of the key enforcement investigations and actions we undertook in 2011 against both gas and electricity undertakings.

Investigations concluded

Complaints handling standards investigations

132. In July 2011, we gave notice of our intention to impose a financial penalty of £2.5 million on British Gas for contraventions of the Consumer Complaints Handling Standards Regulations (CHSR)⁶⁹. Furthermore, in October 2011, we issued a notice stating our intention to impose a financial penalty of £2 million on RWE npower for breach of the CHSR. Both penalties were subsequently confirmed on 10 January 2012.

133. We closed our investigations into compliance with the CHSR by Scottish Power, E.ON and SSE in April 2011. Our investigation into EDF Energy's compliance continued during 2011.

⁶⁸ See s47(1C) Electricity Act 1989

⁶⁹ The CHSR are designed to provide effective protection for customers and comprise a number of key requirements which companies must adhere to when a customer makes a complaint. In July 2010, we launched investigations into the "Big 6" suppliers (Centrica plc (three retail brands, British Gas, Scottish Gas and Nwy Prydain in England, Scotland and Wales respectively), E.ON UK, Scottish and Southern Energy (SSE), RWE npower, EDF Energy and ScottishPower) to determine whether they were complying with the Gas and EI

Customers in payment difficulties

134. *First Utility Limited* - In December 2010, we made a provisional order against First Utility Limited requiring the company to comply with Standard Licence Condition 27 of its gas and electricity supply licences. This was because of First Utility's continuing failure to offer prepayment terms to customers who were or may have been in payment difficulty. We continued to progress our investigation during 2011 and following a review of First Utility's evidence, Ofgem was satisfied that it had met the terms of the provisional order within the required deadlines. We therefore issued a notice of non-confirmation of the provisional order on 28 April 2011.

Connections cases

135. In April 2011, we imposed financial penalties on three local power grid companies (Electricity North West Limited, Central Networks East plc and Central Networks West plc and Scottish Hydro Electric Power Distribution plc) totalling £1 million for failing to meet time limits for providing customers with connection offers (Standard Licence Conditions 4D, 12 and 30 of its electricity distribution licence).

136. Ofgem considered it was important for both customers and the evolution of competition in connections that the incumbent distribution network operator provided offers for those services in accordance with the relevant licence condition.

Misreporting cases

137. *National Grid* - In May 2011, we imposed a financial penalty of £8 million National Grid Gas plc for failing to provide us with accurate regulatory information in relation to its mains decommissioning work (Special Conditions E2B, E6 and E20, Standard Special Condition D9 and A40 of its gas transporter licence).

138. Ofgem regarded the contravention as serious, as we rely on the submission of accurate information by regulated entities to enable us to carry out our statutory functions and to set the charges which National Grid Gas may levy from its customers. However, we gave significant weight to the co-operation and corrective action taken by National Grid Gas to address the issue.

139. *British Gas* - In November 2011, we imposed a financial penalty of £1 million on British Gas for failing to report accurate supply data under the Renewables Obligation ("RO").

140. Again, we regarded British Gas's breach as serious, as we rely on accurate information being submitted by licence holders to carry out our statutory functions and administer environmental programmes, including the RO. However, we made clear in our decision that the penalty would have been higher had British Gas not co-operated with us and taken prompt action to address the harm suffered by other market participants.

Gas Emergency Standards investigations

141. In October 2011, we launched investigations into National Grid Gas plc (NGG) and Northern Gas Networks Limited (NGN) for failing to comply with obligations under Standard Special Condition D10 paragraph 2(g) of its gas transporters licence for attending gas escapes within certain time limits. In December 2011, we proposed penalties of £4.3 million and

£900,000 against NGG and NGN respectively for contraventions of SSC D10 paragraph 2(g). Both penalties were subsequently confirmed on 17 February 2012.

142. Ofgem recognised that the standards are an extremely important part of the licence conditions, as they are directly related to public safety and unattended gas escapes have the potential to cause harm to consumers. However, we made clear that the proposed penalty would have been higher had NGG and NGN not co-operated with our investigations and taken action to revise their plans and increase available resources in time for the following winter.

Ongoing investigations

Mis-selling

143. In September 2010, we launched investigations into four of the "Big 6" suppliers (RWE npower, Scottish Power, SSE and EDF Energy) to determine whether they were complying with obligations under standard licence condition 25 of both the gas and electricity supply licences relating to the marketing of gas and electricity to domestic customers.

144. These new obligations were brought in following our 2008 [Energy Supply Probe](#) and include requirements for domestic suppliers to provide estimates and comparisons during face-to-face sales activities and to secure the achievement of an objective in respect of both face-to-face and telesales activities. The objective essentially requires domestic suppliers to take all reasonable steps to ensure that information provided is complete and accurate, understandable, appropriate and not misleading, and that sales activities are conducted in a fair, transparent, appropriate and professional manner.

145. Consumer confidence in switching and customers' ability to make the right choice for their needs are crucial to healthy domestic energy markets that allow consumers to receive choice and value. The obligations under SLC 25 are therefore designed to ensure more competitive markets.

146. We continued to progress our investigations into mis-selling during 2011⁷⁰.

Competition law

147. In January 2009, we launched an investigation into allegations of abuse of a dominant position by Electricity North West Limited ("ENW"), under section 18 of the Competition Act 1998 (the Chapter II prohibition). The allegations related to the terms imposed by ENW on independent networks connecting to ENW's pre-existing network; and whether these terms foreclosed the market to competitors in the area in which ENW was the incumbent Distribution Network Operator.

⁷⁰ On 9 March 2012, we published notice of our intention to impose a financial penalty on EDF Energy Customers plc ("EDF") for non-compliance with SLC 23 (Notification of Domestic Supply Contract Terms), SLC 25 (Marketing Gas/Electricity to Domestic Customers) and SLC 27 (Provision of information to customers who pay for electricity/gas by way of regular direct debit payments of a fixed amount) of the electricity and gas supply licences. The settlement package consists of an agreement by EDF to make payments amounting to £4.5 million which will benefit consumers, together with a penalty of £1. This approach has been taken as the Authority considers that the payments offered by EDF will benefit electricity and gas consumers more than would be the case if a significant penalty were to be imposed.

148. We continued to progress our investigation into this matter during 2011. In November 2011, we published notice of our intention to accept binding commitments from ENW in order to address our competition concerns.

149. We are committed to ensuring that network businesses provide their customers with the best possible service at fair prices. Where appropriate, we have taken action to open up aspects of network business to competition so that consumers have a choice, and so that competition or the threat of it keeps prices down and stimulates innovation. We will continue to consider using the range of our tools as regulator – including competition law enforcement, price controls, and licence obligations and enforcement to help markets deliver benefits for consumers.

New investigations

150. In addition to the above, we opened a number of *new* investigations in 2011:

- Investigation into Scottish Power for compliance with the Consumer Protection from Unfair Trading Regulations 2008;
- Investigation into the reporting under the RO by Opus Energy Limited;
- Investigation into Wales and West Utilities for compliance with obligations on regulatory reporting under the gas transporter licence;
- Investigation into E.ON for misreporting of the distribution of compact fluorescent lamps (CFLs) (Article 16(1)(a) of the Electricity and Gas (Carbon Emissions Reduction) Order 2008);
- Investigation into Scottish Power for compliance with obligations under the gas and electricity supply licences (Standard Licence Condition 27.2A);
- Provisional order against MA Energy Ltd in relation to compliance with obligations under the supply licence (standard licence condition 11).

151. Our investigations into these matters are ongoing and further information can be found on our website⁷¹

3.1.6 Dispute settlement

152. Sections 44B-D of the Electricity Act sets out the Authority's Electricity Directive (set out in Article 37(11) and in Article 37(4)(e)) dispute resolution functions. They were amended by the GB Regulations . The amended provisions largely mirror the Article 23|(5) provisions from the Second Internal Markets Directive (Directives 2003/54/EC) which was implemented by the Gas and Electricity (Dispute Resolution) Regulations 2009. Sections 44B-D of the Electricity Act now reflect the wider range of disputes under Article 37 of the Electricity Directive which can be referred to the Authority.

⁷¹ <http://www.ofgem.gov.uk/About%20us/enforcement/Investigations/CurrentInvest/Pages/CurrentInvstqtns.aspx>

153. Any Article 37 dispute that is referred to the Authority for determination shall be determined by the Authority or, if the Authority thinks fit, by an arbitrator appointed by the Authority. Any determination by the Authority shall be binding on the parties to the dispute. However, it is open to any party to seek a judicial review of the Authority's decision.

154. Section 44C(3) of the Electricity Act, provides that the "practice and procedure to be followed in connection with an [Article 37] dispute ...shall be such as the Authority may consider appropriate". This provision coupled with the general powers set out in Section 44B-D of the Electricity Act provides the Authority with the appropriate rights of investigation and powers to require information with which to investigate and settle any dispute referred to it under Article 37 of the Electricity Directive.

155. No Article 37 disputes were raised in 2011.

3.2 Promoting Competition

3.2.1 Wholesale Markets

3.2.1.1 Price Monitoring

156. 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 exchanges. ICIS Heren and Platts provide pricing based on reported OTC trades, and this is made available to the market via a subscription service. Both data providers produce pricing data for a wide variety of peak and baseload contracts up to three years ahead of delivery. Bloomberg also provides close to real time energy broker pricing based on OTC trades.

157. In addition to a wide range of OTC pricing data, the three exchange providers in the GB electricity market⁷² all provide pricing data to the market. Please see below for a description of GB wholesale power exchanges.

158. The consultation closed on May 8 2012 and we are now in the process of considering the responses and taking forward our further policy development. We expect to publish a minded-to position and, if appropriate, our final proposals in Summer 2012. Please see paragraphs 165-169 for additional information on our liquidity proposals.

Description of the wholesale market

159. 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 over the counter (OTC) trading and power exchange trading, followed by Balancing Mechanism (BM) activity and imbalance settlement⁷³.

Over the counter (OTC) trading⁷⁴

⁷² The APX Group, N2EX (a Nord pool Spot and Nasdaq OMX commodities joint venture) and the Intercontinental Exchange (ICE). A description of these exchanges was provided in Ofgem's 2009 National Report.

⁷³ Further detail on the structure of the wholesale electricity market was provided in Ofgem's 2008 National Report and has broadly remained unchanged.

⁷⁴ Bilateral trading between two market participants or where an intermediary (the broker) brings together a buyer and seller

160. On the basis of analysis undertaken by the Financial Services Authority (FSA), total OTC trading (excluding exchange based trading) in 2010/11 (Aug 10 to Jul 11) was around 919TWh⁷⁵. This is around 29% lower than total OTC traded volume for the same period the previous year.

Power exchanges

161. Total traded volume on the APX Power UK Exchange in 2011 was around 20.8 TWh, an increase of around 2 TWh on the calendar year 2010.

162. N2EX, which started to operate in the GB wholesale market in January 2010, saw trading of around 18.9 TWh for its day-ahead auction in 2011, up from 2.6 TWh in 2010. N2EX also operates a near-term continuous market, which trades more significant volumes, 27 TWh in the course of 2011⁷⁶, up from 17 TWh in 2010⁷⁷. 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).

163. For 2011 as a whole, around 95 percent of all power traded in GB was OTC traded and around 5 percent was exchange traded.

Liquidity

164. In March 2011 we published the findings of our Retail Market Review in which we observed static market structure in the supply market, and also that liquidity in the GB power market was continuing to stagnate according to several high-level indicators. As a result, we put forward two proposals to address liquidity: a Mandatory Auction and Mandatory Market Making obligations.

165. We continued to assess power market liquidity throughout 2011, and published a summer assessment in June⁷⁸. This latest assessment showed churn declining slightly in 2010 as a whole.

166. In February 2012⁷⁹, we published a consultation document which: set out our high-level objectives for the wholesale market; tracked progress against these objectives; and set out our proposals for intervention in support of the objectives. These proposals were based on a refined and strengthened model of the Mandatory Auction proposed in March 2011.

⁷⁵ http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/other/energy_2011.pdf

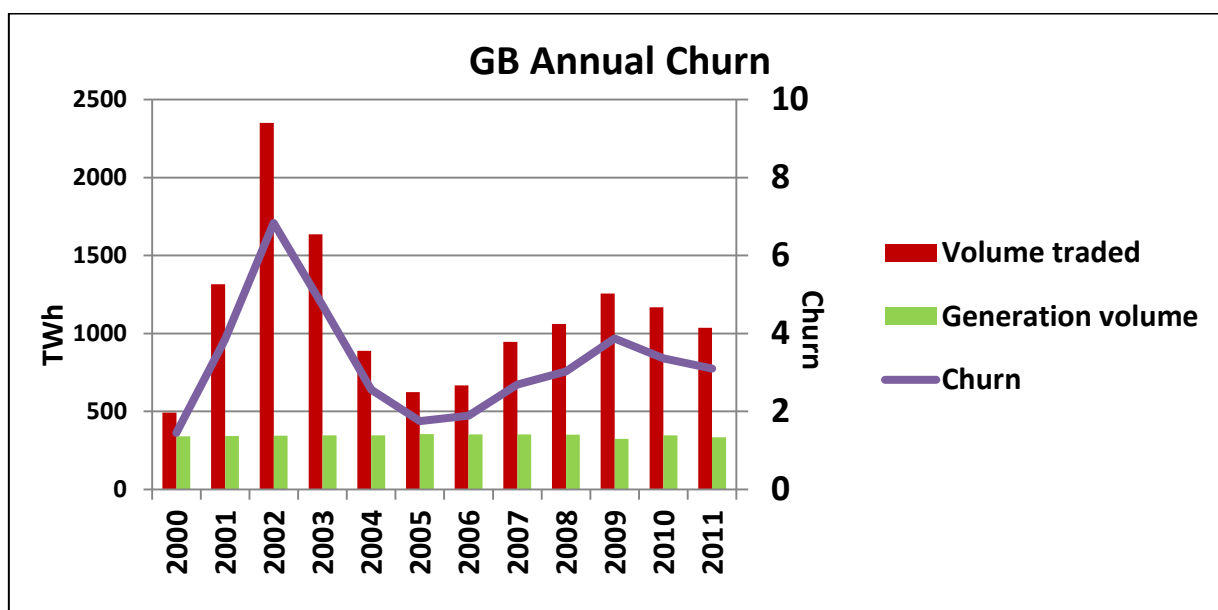
⁷⁶ http://www.n2ex.com/digitalAssets/77/77422_2011weeklytotals.pdf

⁷⁷ http://www.n2ex.com/newsroom/exchange_information/volumereport2010/

⁷⁸ The Retail Market Review – Findings and initial proposals, 21/03/2011, Ref. 34/11. See Supplementary Appendix 7: http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR_Appendices.pdf

⁷⁹ <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Liquidity%20Feb%20Condoc.pdf>

Figure 1: GB traded volume, generation output and churn ratios



Source: APX, DUKES, ICE, N2EX, E.ON

167. In February 2012⁸⁰, we published a consultation document which: set out our high-level objectives for the wholesale market; tracked progress against these objectives; and set out our proposals for intervention in support of the objectives. These proposals were based on a refined and strengthened model of the Mandatory Auction proposed in March 2011.

168. This consultation on our objectives and the MA proposal closed in May 2011 and we are considering next steps.

Balancing mechanism (BM)

169. 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 NGET. Note that NGET is the system operator in GB, responsible for balancing supply and demand in real time. The Balancing Mechanism (BM) is the mechanism where NGET may accept bids and offers to increase or decrease electricity to assist it in balancing the system.

170. Around 6.7 TWh of offers and 8.4 TWh of bids were accepted in 2011 – this compares to 5.8 TWh of offers and 6.8 TWh of bids in 2010.

171. In November 2011, we published a consultation document⁸¹ which highlighted our concerns regarding the current cashout arrangements. We sought views from market participants and industry on whether to launch a Significant Code Review (SCR) of the electricity cash-out arrangements. In March 2012 we published an open letter⁸² announcing

⁸⁰ <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Liquidity%20Feb%20Condoc.pdf>

⁸¹ Electricity cash-out issues paper, 1/11/2011, Ref. 143/11, <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=148&refer=Markets/WhlMkts/CompandEff/CashoutRev>

⁸² Open letter Ofgem decision to launch a Significant Code Review (SCR) of the electricity cash-out arrangements, <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=174&refer=Markets/WhlMkts/CompandEff/CashoutRev>

our intention to launch an SCR in summer 2012. We are currently refining the scope of the SCR.

Generation capacity

172. The total installed capacity on the GB system at the beginning of 2011/12 was 83.5 GW. This was broadly unchanged from 83.4 GW reported at the start of the previous year, owing to delays to the commissioning/construction of several CCGT units and wind farms that were originally due to become operational during the year.

173. Recent increases in generation capacity have, nevertheless, increased capacity margins in the market which, alongside a fall in energy demand and a shift in the economics of generation towards coal, has prompted some generators to mothball or consider mothballing lowly utilised plant⁸³.

Market integration

174. For background information on GB interconnection, interconnection policy and market coupling please refer to the *Cross Border* section⁸⁴ of the National Report.

175. In broad terms, the GB market is 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.

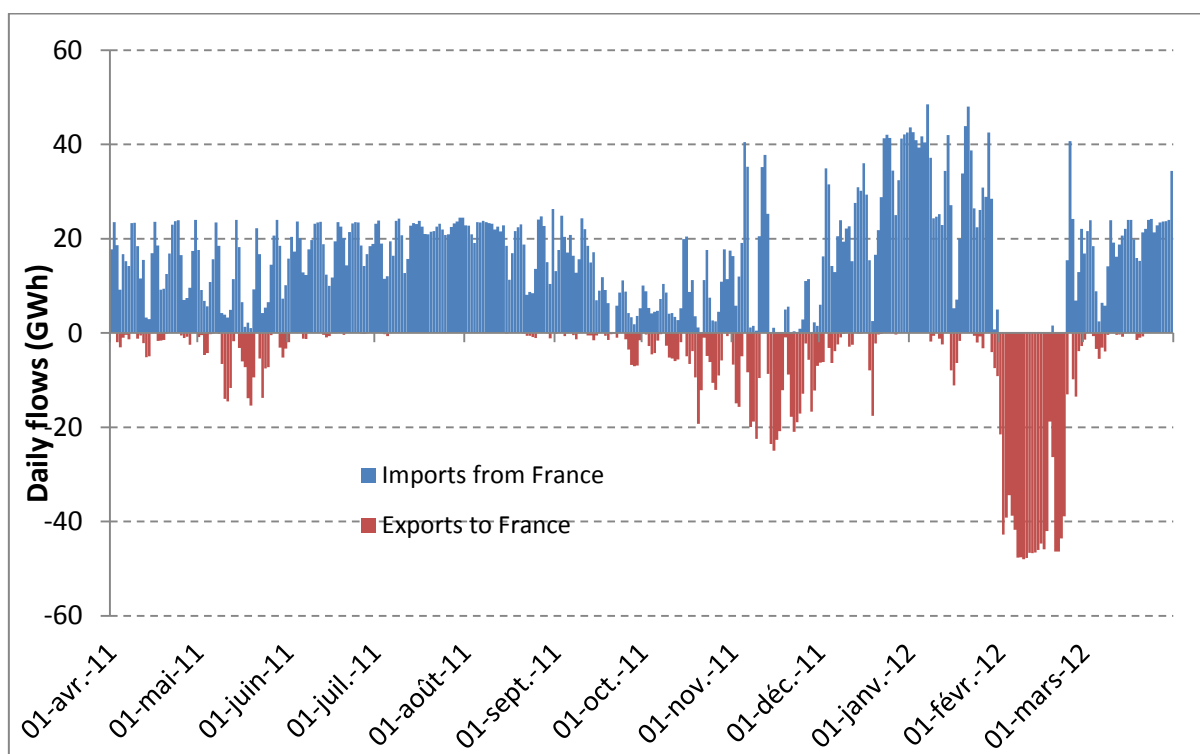
176. GB typically imports from France, through the IFA interconnector, and exports to Northern Ireland via the Moyle interconnector. In winter, when there are high demands in France, GB often exports to France through the IFA. In Winter 2011/12 exports to France were evident at the end of 2011, and were particularly strong during the cold snap in February. Prices for access to interconnectors reflect market dynamics, with non-discriminatory auctions regularly held for daily, weekend, monthly, quarterly, seasonally and annual capacity.

177. Figure 2 shows flows across the GB-France interconnector from April 2011 – March 2012. Exports to France in 2011 were lower than the previous year. Total imports from France for April 2011 - March 2012 were 6.0 TWh, while total exports to France were 1.9 TWh. This represents, respectively, 76 per cent and 24 per cent of absolute flows across the interconnector over the period.

⁸³ In this context, mothballing is taking a plant out of service, but in such a way that it can be brought back into service if required. The amount of time required to bring a plant back into service will vary.

⁸⁴ Please see page 22.

Figure 2: Average net system transfers for IFA, April 2011 - March 2012⁸⁵



3.2.1.2 Price Monitoring: Market opening and competition Article 37(1)(j)

178. As noted above, 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 Mechanism (BM) activity and imbalance settlement also takes place.

179. 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. Ofgem is bound by its statutory duties to protect the interests of consumers, both existing and future, wherever appropriate, by promoting effective competition.

Monitoring competition

180. Ofgem actively monitors competition in the market for generation. Competition indicators such as market concentration levels are assessed both in terms of metered volume and total generation capacity.

181. Ofgem has concurrent powers, together with the Office of Fair Trading, 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.⁸⁶ Ofgem may

⁸⁵ Sourced from National Grid

⁸⁶ In so far as agreements or conduct relate to commercial activities connected with the generation, transmission or supply of electricity or licensable activities or other activities (such as off-shore activity) which are ancillary to those subject to licences for transportation, shipping or supply of gas. (See section 36A of the Gas Act and section 43 of the Electricity Act

undertake an investigation where it has reasonable grounds to suspect a breach of these provisions.

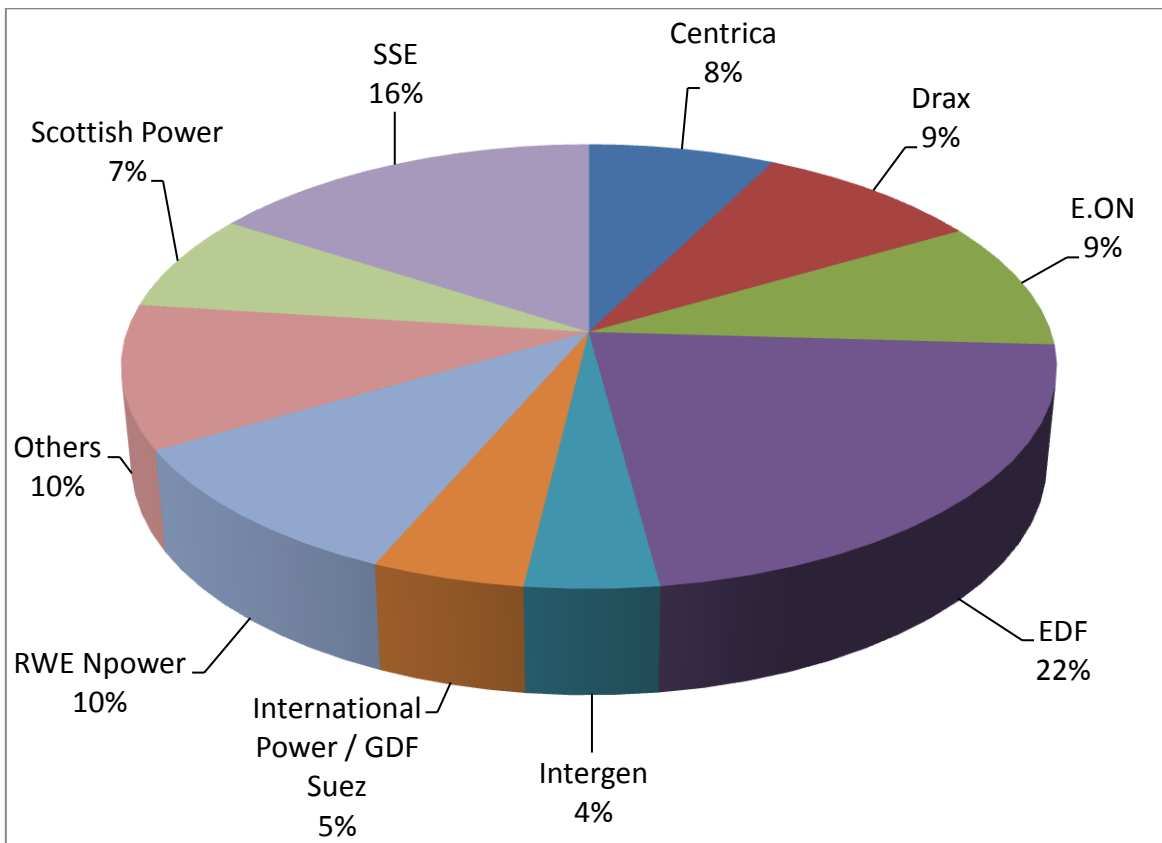
182. Ofgem may also be asked to assist relevant competition authorities (such as the OFT or European Commission) during their assessment of mergers affecting the GB energy market. In the past, Ofgem has conducted various assessments into proposed mergers and acquisitions.

Market concentration

183. As illustrated in Figure 3 below, seven companies have market shares exceeding five per cent and, of these, the largest three companies generated nearly half of electricity consumed in GB in 2011⁸⁷.

184. Metered volumes in 2011 indicate that EDF again contributed the largest proportion of power generation in GB. Centrica, Drax, E.ON, Scottish Power and SSE all produced more than 5 per cent total GB generation. The combined generation portfolios of International Power and GDF/Suez was slightly below 5 per cent in 2011.

Figure 3: 2011 electricity market share in GB based on metered volume⁸⁸



185. Table 2 provides Herfindahl-Hirschman Index (HHI) analysis based on metered volume by different companies in GB in 2011. The largest individual HHI by capacity is EDF (HHI of

⁸⁷ Please note that following the acceptance of GDF/Suez’s bid in April 2012 to buy out the remaining share of International Power, the two companies portfolios have been combined in the following analysis.

⁸⁸ Produced from proprietary data

484) which acquired British Energy in late 2008 and now owns and operates a number of nuclear plants in GB.

Table 2: Herfindahl-Hirschman Index (HHI) based upon 2010 metered volume⁸⁹

Company	Capacity (HHI) ⁹⁰
Centrica	56
Drax	83
E.ON	86
EDF	484
Intergen	16
International Power / GDF Suez	21
RWE Npower	102
Others	109
Scottish Power	51
SSE	251
Total	1259

Measures to avoid abuses of dominance

186. 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)⁹¹. In January 2010 Ofgem approved a modification to improve the granularity of available generation information. Since November 2010 forecast generation capacity information from generators has been published by Balancing Mechanism Unit (BMU) and by fuel type (previously it was only published on an aggregated basis).

187. 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

188. The Energy Act 2010 contained enabling powers for the Secretary of State for energy to introduce a licence condition relating to periods of transmission constraint which may effectively confer market power on generators. This is in addition to the possibility of Ofgem taking powers under CA 98.

189. In December 2011, the Department for Energy and Climate Change (DECC) launched a consultation on a draft Transmission Constraint Licence Condition (TCLC).

190. That draft TCLC aims to prohibit output manipulation in order to achieve excess profit from either 'offers' or 'bids' during transmission constraint periods and exploitative bids and inter-trip prices when an export constraint is active. These behaviours can significantly increase the costs of balancing the electricity system during periods of transmission constraint.

⁸⁹ Produced from proprietary data

⁹⁰ Small suppliers are counted as one company in the following analysis, and generation embedded into the distribution network is not considered

⁹¹ Further information relating to the operation of the BMRS and the information available on this website can be found in Ofgem's 2008 National Report and at the following link: www.elexon.co.uk

191. In parallel, Ofgem consulted on guidance as to how we will interpret and monitor the TCLC. Finalised guidance will be published when the TCLC commences.

Market surveillance

192. Ofgem's market surveillance team monitors the gas and electricity markets, including the wholesale gas market and the Balancing Mechanism. 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 Ofgem. On the basis of active surveillance and monitoring of the markets, Ofgem can investigate the behaviour of market participants if anti-competitive conduct is suspected and, where necessary, enforce domestic and European competition law.

193. Additionally, the Financial Services Authority (FSA)⁹² has responsibilities for the operation of financial markets in the UK. The FSA works to prevent abuse or distortion of financial markets. The FSA has the power to fine persons who have abused the market, where "market abuse" is defined under the Financial Services Market Act 2000.

Experience with virtual power plant auctions or other capacity release measures

194. There were no virtual power plant auctions or other capacity release measures in 2011. We are currently consulting stakeholders on measures to increase market liquidity in our liquidity proposals (please see *Liquidity* section, page 31)

3.2.2 Retail markets

195. The electricity supply market in Great Britain has been open to competition since the late 1990s. Initially this applied to large industrial consumers and then was rolled out across all consumers, including at the household (domestic) level. Although some regulations exist to protect consumers and facilitate competition, price controls on domestic retail energy prices were removed by April 2002 and since that time prices retail prices have been set by energy suppliers based on their costs and other factors related to their business and market forces. The majority of the domestic electricity supply market⁹³ is accounted for by 6 large vertically integrated suppliers, which evolved from the 15 former incumbent electricity and gas suppliers between 1998 and 2003.⁹⁴ There are also seven small domestic electricity suppliers. Within the non-domestic market, there were 22 active suppliers at the end of 2011 and independent suppliers have greater market penetration.

⁹² <http://www.fsa.gov.uk/>

⁹³ A domestic customer is a customer supplied or requiring to be supplied with electricity at Domestic Premises but excludes such customer insofar as he is supplied or requires to be supplied at premises other than Domestic premises. A Non-Domestic customer is one that uses energy wholly or mainly for commercial purposes. See the glossaries in the [domestic and non-domestic](#) Retail Market Reviews.

⁹⁴ These companies are (i) Centrica plc: Centrica plc owns British Gas Trading, which operates three retail brands: British Gas (in England), Nwy Prydain (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.

3.2.2.1 Price monitoring Article 37(1)(i)

196. Ofgem is committed to ensuring the electricity market is sufficiently transparent. In this section, we set out the expectations and rules regarding transparency of supplier activity. We also set out proposals to enhance transparency and benefit the interests of consumers.

Financial transparency

197. Ofgem requires suppliers to adhere to strict standards of financial reporting, enforced through the Licence Conditions we set. For example, since 2009 we have required large, vertically-integrated suppliers to publish annual Consolidated Segmental Statements on their websites. These Statements provide a breakdown of suppliers' revenues and operating costs 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). The Statements set a level of transparency that allows us to assess where revenues are being generated and costs incurred and to compare this across suppliers.

198. Ofgem produces an annual summary of the Statements, the archive of which can be found on our Retail Market Review webpage⁹⁵. We published a summary of the 2010 and 2010/11 in January 2012.⁹⁶ Earlier in 2011 we also produced additional guidance to assist suppliers in completing the Consolidated Segmental Statements⁹⁷.

199. To help identify areas where suppliers could improve the quality of information they provide to us, in 2011 we commissioned an independent accountancy firm (BDO) to review suppliers' energy accounts. The review recommended several changes to the way suppliers prepare their accounts to improve transparency and cross-company comparability. We recently launched a consultation on a set of proposals that resulted from BDO's findings.⁹⁸ We expect the companies to publish the 2011 and 2011/12 Statements later this year, following the culmination of the consultation process.

Transparency for domestic consumers

200. In 2008 Ofgem conducted the Energy Supply Probe and found that consumers often did not have key information needed to make informed decisions about their energy supplier. To aid transparency and improve the quality of information suppliers send to consumers, we proposed that suppliers should include certain pieces of standard information on bills (tariff name; annual consumption; and an illustrative projection of annual costs) and send each customer an annual statement. We also proposed minimum standards that suppliers should meet when conducting sales and marketing activities to consumers.⁹⁹

201. More recently, Ofgem has identified areas where suppliers could improve the transparency of the information they provide to domestic consumers through our 2011 Retail Market Review. We consulted on changes to bills, annual statements and price increase notifications to (i) ensure consumers have access to key information that enables them to understand their tariff and be able to compare tariffs within the market; and (ii) help domestic consumers better understand the information suppliers provide them and how they can use it

⁹⁵ <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Pages/rmr.aspx>

⁹⁶ Ofgem (Jan 2012), "[Financial Information Reporting: 2010 Results](#)"

⁹⁷ Ofgem (May 2011), "[Financial Information Reporting: Amended Guidance.](#)"

⁹⁸ Ofgem (Jan 2012), "[Improving Reporting Transparency](#)"

⁹⁹ Ofgem (Aug 2009), "[Energy Supply Probe – Proposed Retail Market Remedies](#)" p.2

to help them.¹⁰⁰ We note that we are in the process of considering responses to this consultation and no firm decisions have been made at this stage. Our proposals included:

- using standardised language and terminology to note key concepts across these communications
- introducing standard formatting on a specific section of bills and for the majority of the annual statement; and
- personalising information on price change notifications.

202. To further increase the transparency of electricity prices and to help consumers understand the components of their electricity bill, we published an update to our 'Household Energy Bills Explained' factsheet in January 2011¹⁰¹. This is designed to clearly and simply show the relationship between energy bills, wholesale energy costs, and other costs such as those associated with transmission and distribution.

203. Finally, consumers can access information on supplier prices by contacting Consumer Focus (a consumer advocacy body). It aids transparency for domestic consumers by publishing price comparison tables for each GB supply region, hosting an interactive online search tool to allow consumers to see the cheapest deal available and by maintaining a list of over 10 accredited online energy switching sites, each of which enables consumers to compare a wide range of suppliers' tariff prices and service offerings and determine which offer best suits their needs.¹⁰² Consumer Focus' 'Confidence Code' sets out the minimum requirements that a provider of an online domestic electricity Price Comparison Service (Service Provider) must meet in order to be, and remain, accredited to this voluntary scheme.

Transparency for non-domestic consumers

204. Ofgem is also working to increase the transparency of the non-domestic electricity market. As part of our non-domestic RMR proposals, we consulted on applying transparency rules that currently only apply to micro business customers, to more business customers. These include rules around the information that needs to be given to customers before and during their contract. We also set out best practice and requirements on the information customers must receive when there is an objection to their supply transfer. And we consulted on how best to increase the transparency of Third Party Intermediaries' (TPIs) activities¹⁰³. TPIs act as brokers between non-domestic customers and suppliers, assisting customers in finding the most appropriate energy deal for their needs. However, our RMR has found evidence that TPIs are not delivering the best outcomes for consumers in all cases. There is a need for further intervention in this area of the non-domestic market. We consulted in December 2011 on adopting some or all of the following proposals, as with the domestic RMR proposals we are considering responses to consultation before noting next steps or final policy decisions:

- introducing a new Standard Licence Condition on suppliers governing the sales and marketing activities of both the supplier and their representative in a non-domestic context.

¹⁰⁰ Ofgem (Dec 2011), "[The Retail Market Review: Domestic Proposals](#)"

¹⁰¹ Ofgem (Jan 2011), "[Household Energy Bills Explained](#)"

¹⁰² <http://www.consumerfocus.org.uk/get-advice/energy/confidence-code>

¹⁰³ Ofgem (Dec 2011), "[The Retail Market Review: non-Domestic Proposals](#)"

- an Accreditation Scheme for TPI Codes of Practice; and
- additional powers to allow us to take enforcement action directly against non-domestic TPIs.

3.2.2.2 **Monitoring the level of transparency, including compliance with transparency obligations, and the level and effectiveness of market opening and competition (Article 37(1)(j))**

Market opening

205. As noted in section 3.2.2, the GB electricity supply market has been open to competition since 2002. Since then, market opening rules and regulations have been removed and introduced, where appropriate, to facilitate competition and protect consumers. Ofgem has a central role in protecting the interests of consumers, present and future, wherever appropriate by promoting effective competition. In 2011 we conducted our Retail Market Review which examined the effectiveness of competition in the domestic and non-domestic retail markets.^{104,105} It assessed the extent to which the retail market was acting in the interests of consumers and whether regulatory action should be taken to enhance competition.

206. The 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. This led a large proportion of consumers to disengage from the energy market completely.

207. Our proposals to address the lack of consumer engagement in the energy market are set out in detail in paragraphs 200-203. They aim to increase the transparency of the energy market, generating increased consumer engagement, which ultimately should lead to greater competitive pressure between suppliers and more beneficial outcomes for consumers. We consulted on the domestic and non-domestic proposals between December 2011 and February 2012. We are currently reviewing consultation responses and will be developing the next stage of the Retail Market Review process in 2012.

208. The Review also found that consumers were at risk from a lack of liquidity in the wholesale market, that is, small suppliers were not always able to purchase energy in the quantities that met their commercial objectives. Lack of liquidity was acting as a barrier to entry of new firms and reducing the effectiveness of competition.

209. We have, therefore, set out proposals to address the lack of liquidity and enable new suppliers to better access the wholesale market. Our main proposal is to obligate the main vertically integrated generation and supply companies to sell 25% of their annual energy output through a Mandatory Auction (MA). They would be required to sell specific, key products through the MA in sufficient volume to potentially meet demand and produce robust prices. We completed our initial work programme on this issue in 2011 and published our consultation in February 2012.¹⁰⁶

¹⁰⁴ Ofgem (Dec 2011), "[The Retail Market Review: Domestic Proposals](#)"

¹⁰⁵ Ofgem (Dec 2011), "[The Retail Market Review: non-Domestic Proposals](#)"

¹⁰⁶ Ofgem (2012), "[Retail Market Review: Intervention to Enhance Liquidity in the GB Power Market](#)"

Monitoring competition

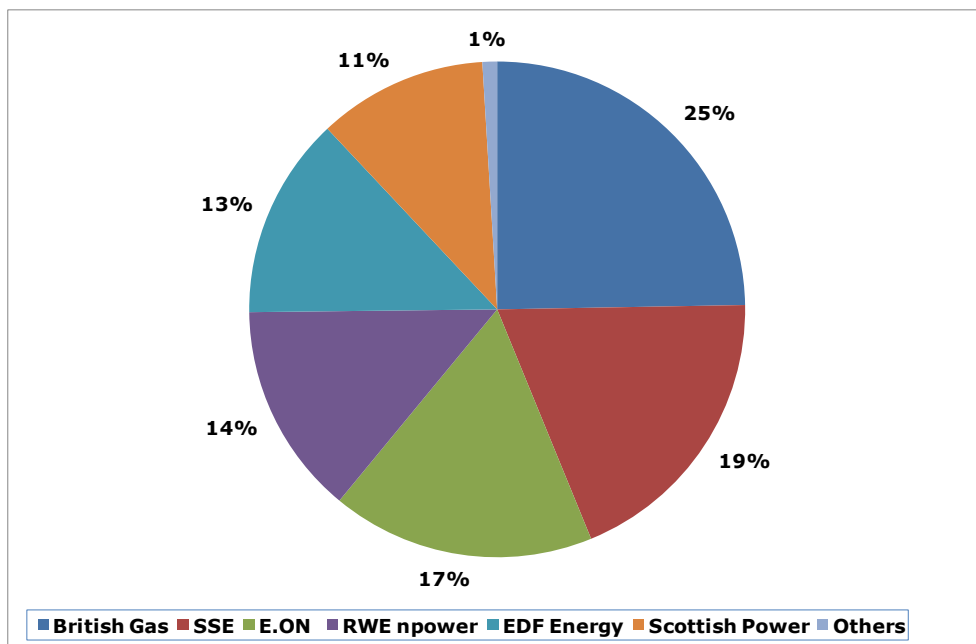
210. Ofgem also monitors competition on an on-going basis. We collect data from suppliers and other industry bodies on a monthly basis. We also regularly commission consumer research and have regard to a wide range of data and information from other sources which also serve to inform our view of the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

Monitoring competition – domestic market share

211. We regularly analyse suppliers' monthly domestic customer numbers using two sources of information: customer numbers data that the Big 6 energy suppliers provide to us every month on a voluntary basis; and Meter Point Administration Number (MPAN) data we receive from DNOs.

212. The MPAN data is also useful at an aggregate level to determine each supplier's total market share. In December 2011 there were 27.5m domestic electricity consumers in GB. As Figure 4 shows, the Big 6 accounted for 99% of electricity supply to these customers.

Figure 4: GB Domestic Electricity Suppliers' Market Share, December 2011



Source: Ofgem

213. There are seven small suppliers active in the market, with a combined market share of 1%. These are Co-Operative Energy; Ecotricity; First Utility; Good Energy; OVO Energy; Spark Energy; and Utilita. Although these suppliers account for less than 1% of the electricity market, we have seen growth in this area. As a group, their customer numbers increased by 47% between January and December 2011, albeit from a low base.

214. The figures relating to the national market shares do not reveal regional variations, which are a legacy of the regional monopolies that existed in the electricity sector prior to market liberalisation. In those regions, the former electricity incumbents have shares of 40%. However, evidence suggests that non-incumbent suppliers are increasingly penetrating the

former incumbents' shares in these regions. Between January and December 2011 the shares of non-incumbents increased by 3% whilst that of incumbents fell by 3%.

Monitoring competition – non-domestic market share

215. Ofgem also monitors non-domestic suppliers' market shares. We gather some data directly from suppliers, but also contract with Datamonitor¹⁰⁷.

216. The individual segments of the non-domestic market are dominated by the Big Six, as shown in Table 3 who individually each have a market share greater than 5% but together supply between 87% and 94% of the Half Hourly (HH) and non HH segments respectively.¹⁰⁸ However, smaller and independent suppliers have begun to penetrate the non-domestic market, and in 2011 supplied 5% of non HH sites and 9% of HH sites. Some of these smaller and independent suppliers focus on a specific market niche, such as renewable energy, while others choose to compete more broadly.

217. The three suppliers with highest market shares in the non HH segment are Centrica, E.ON Energy and EDF Energy, who together have a 62% share of the segment. The HH segment is dominated by RWE npower, EDF Energy and SSE, which together have a 59% share.

Table 3: Electricity suppliers' non-domestic market share November 2011

Electricity supplier	Non Domestic Sites		
	Non HH	HH	All Non Domestic
Centrica	24.8%	6.5%	24.0%
E.ON Energy	21.9%	16.0%	21.6%
EDF Energy	15.5%	19.3%	15.7%
SSE	15.1%	17.4%	15.2%
RWE npower	9.4%	22.3%	9.9%
ScottishPower	7.6%	5.7%	7.5%
Opus Energy	4.0%	0.0%	3.8%
Haven Power	1.4%	0.3%	1.3%
Gazprom	0.2%	1.4%	0.3%
GDF	0.0%	3.8%	0.2%
British Energy	0.0%	2.3%	0.1%
Good Energy	0.1%	0.1%	0.1%
Total Gas and Power	0.0%	2.0%	0.1%
Others	0.1%	2.9%	0.2%
Total	100%	100%	100%

Source: Datamonitor

¹⁰⁷ An independent consultancy, to provide non-domestic customer numbers. Datamonitor collates information based on feedback from industry and other analysis and releases it on a quarterly basis

¹⁰⁸ HH customers have their electricity meters read every half-hour. HH customers tend to be large organisations that consume a peak load of more than 100kWh at any time during the day. 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.

Monitoring competition – HHIs

218. Herfindal-Hirschman Indices (HHI)¹⁰⁹ 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 HHIs¹¹⁰ for electricity are:

- domestic (July 2011) - 1,766
- non-domestic, non-half hourly metered sites (July 2011) - 1,669
- non-domestic, half-hourly metered sites (July 2011) - 1,497

219. All three electricity markets are judged to be 'concentrated' according to the threshold HHI levels (1,800) used by the OFT.

Distortion or restriction of competition

220. The previous sections have set out both our in-depth investigation of the electricity market as part of our Retail Market Review and our regular ongoing monitoring activities in respect of assessing distortions and/or restrictions of competition. These work streams have helped us to identify where further intervention in the market is needed to enhance competition and improve outcomes for consumers.

221. For further information on how we investigate anti-competitive activity please refer to section 3.1.5¹¹¹

Prices for household consumers including prepayment systems

222. 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 and transmission charges, and as such continue to be price controlled.

223. Ofgem actively monitors domestic suppliers' electricity prices across GB. We receive price change notifications from suppliers and use these to calculate the implications for domestic customers' retail bills based on characteristics such as their consumption level, payment type, and region. We also contract with an external data provider for detailed historical tariff and pricing information. We operate a Domestic Price Database that stores

¹⁰⁹ 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.

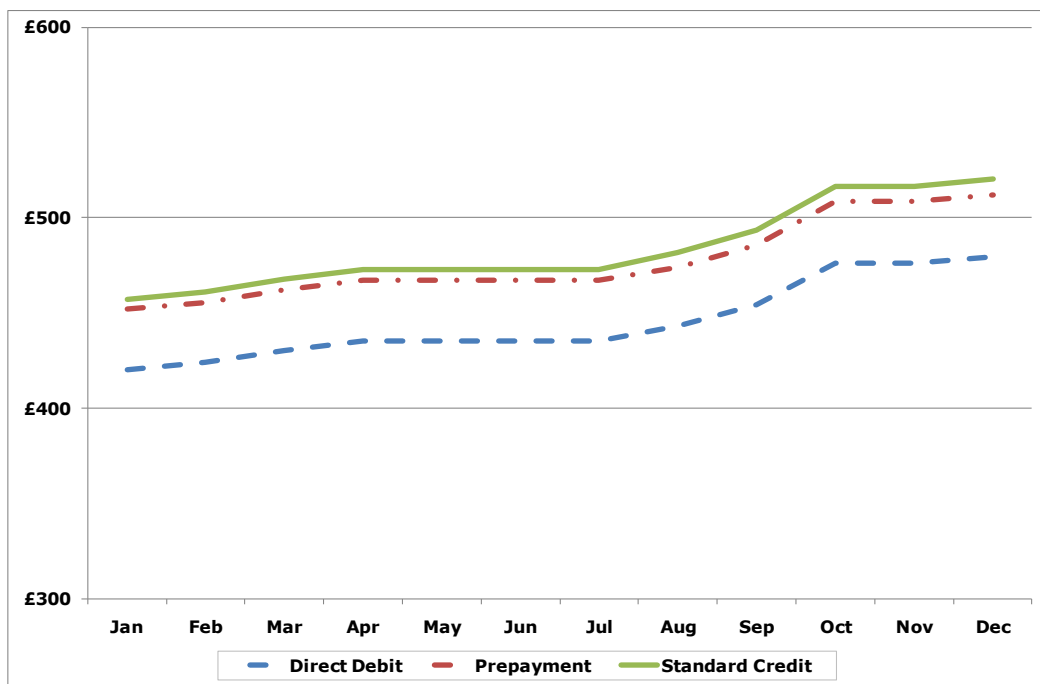
¹¹⁰ Domestic HHIs have been calculated using suppliers' monthly customer numbers and non-domestic HHIs have been calculated using market shares information provided to us by Datamonitor.

¹¹¹ See page 25

historical bill and pricing data, giving us an additional source of information with which to track price developments over time.

224. Figure 5 shows the change in average domestic electricity bills in GB’s electricity market for Direct Debit, Prepayment and Standard Credit customers between January and December 2011. Overall, average electricity bills increased by 13.7% (£61) over the year.¹¹² The first half of the year was characterised by gradually rising bills for all three payment methods. This trend accelerated between August and September as the Big 6 announced increases in their electricity prices.

Figure 5: Average domestic electricity bills by payment method, Jan – Dec 2011



Source: Ofgem

Notes: 1) Standard tariffs 2) Medium consumption levels, 3300kwh per year

225. As well as monitoring domestic electricity bill levels, we also assess the extent to which 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 Renewable Obligation Certificates and the Warm Home Discount, and transmission and distribution costs. Ofgem explores through a quarterly Supply Market Report the relationship between retail bills and these costs.¹¹³ Our December 2011 report provides information on how average supplier costs changed in 2011 and how retail prices changed in response to these¹¹⁴.

Switching rates

¹¹² Change for the three payment methods was: Direct Debit, 11.4% (£49); Pre-Payment, 11.9% (£54); Standard Credit, 11.6% (£57).

¹¹³ The Supply Market Report has been published on a weekly basis on the Ofgem website from February 2012 onwards.

¹¹⁴ Ofgem (Dec 2011), "[Electricity and Gas Supply Market Report](#)"

Domestic

226. 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 electricity suppliers on the number of customers they have lost and gained and use this data to calculate switching rates. In 2011, 4.2m domestic consumers switched their electricity supplier, equivalent to 354,000 per month. This is a switching rate of 15%.

227. As part of our monitoring of switching rates, we annually commission IPSOS MORI, an independent research company, to explore switching with consumers. The company interviewed a sample of 1,461 domestic electricity customers on a face-to-face basis and explored whether they had switched in 2011, their reasons for switching (or not), and what would make them more likely to switch. It found that in 2011, 14% of the sample had switched electricity supplier.

228. In 2011 we also published the results of two additional strands of qualitative research with consumers. Firstly, findings from discussions with our Consumer First Panel, which includes 100 consumers from across Great Britain¹¹⁵ and secondly, the findings from 10 qualitative focus groups and 8 in-depth interviews with different types of vulnerable consumers from across Great Britain¹¹⁶.

229. The evidence base gathered from our regular consumer research helped to inform the initial findings of our Retail Market Review¹¹⁷ published in March 2011. We considered that consumer engagement levels in the market were low, and that this was contributing to competition within the retail energy markets not being as strong as it could be. In December 2011 we drew on this, and other, evidence and published our domestic Retail Market Review proposals.¹¹⁸ Our RMR Core domestic proposal includes features that aim to improve consumers' ability to identify the best electricity deal and make informed switching decisions. Examples of proposals we are consulting on include:

- a requirement that standard tariffs consist of a standardised Ofgem-set fixed element allowing consumers to compare tariffs on a single unit rate;
- a requirement for non-standard tariffs to present price information in a 'standard equivalent' format to allow comparisons with standard tariffs; and
- a requirement for all tariffs to include key information in a Tariff Information Label with the format mandated by Ofgem.

Non-domestic

230. Our non-Domestic RMR proposals, published in November 2011¹¹⁹, examined issues around non-domestic switching. We found evidence that suppliers were objecting to customer transfers more than we would expect. And we have received complaints from, or on behalf of, businesses concerning the ease of switching. In particular, data shows that most suppliers object to around a quarter of attempted transfers. We believe this experience could

¹¹⁵ Ofgem Consumer First Panel Year 3, Report from the second set of workshops, Opinion Leader, March 2011

¹¹⁶ FDS International (March 2011), "2011 Vulnerable Customer Research"

¹¹⁷ Ofgem (March 2011), ["The Retail Market Review: Findings and Initial Proposals"](#)

¹¹⁸ Ofgem (Dec 2011), ["The Retail Market Review: Domestic Proposals"](#)

¹¹⁹ Ofgem (Dec 2011), ["The Retail Market Review: non-Domestic Proposals"](#)

negatively affect non-domestic customers' perceptions of the energy industry and their willingness to engage in switching in the future.

231. To improve non-domestic consumers' experience of switching, we published an open letter to suppliers reminding them of their obligations and what we consider to be good practice¹²⁰. We will also use our market monitoring powers to ask suppliers for data on their objections actions.

232. We currently collect voluntarily provided data from non-domestic suppliers on customer numbers and switching levels, but differences in customer segmentation make it difficult to compare suppliers against each other and to track the switches made by customers in given subsets of the non-domestic market. This is partly a reflection of differences in the way suppliers define non-domestic customers. For example, suppliers often choose to segment their customers by energy consumption or number of sites, but use different criteria to define their small, medium and large customers.

233. Further, as Table 7 above has shown, there are many more non-domestic suppliers than domestic and the market is considerably more fragmented than the domestic market. This makes it more challenging to collect switching data in a consistent way. Nonetheless, we are currently investigating ways to collect a consistent source for non-domestic switching rates.

Disconnection rates

234. Ofgem requires electricity suppliers to record and report on the number of disconnections they carry out on domestic customers. Suppliers are required to submit quarterly and annual returns on disconnections. Ofgem also submits these returns to Consumer Focus, the consumer advocacy body. The data we receive allows us to monitor disconnection rates between suppliers and the rate of change between quarters and years. It also gives us a basis to engage with suppliers if they have an abnormally high number of disconnections. Our latest quarterly and annual reports on electricity disconnections can be found at our [Social Obligations Monitoring webpage](#)¹²¹. In summary, there were 419 electricity disconnections in Q3 2011. This represents a 39% decrease from the 685 disconnections reported in Q3 2010.

Charges for and the execution of maintenance services

235. To assess performance, the electricity 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 electricity bills are maintenance costs associated with the volume of maintenance work undertaken.

236. The value in this information to Ofgem is to allow 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.

Complaints by household consumers

¹²⁰ Ofgem (Dec 2011), "[The Retail Market Review: non-Domestic Proposals- Appendix 3](#)", p.49

¹²¹ <http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Pages/SocObMonitor.aspx>

237. Ofgem does not directly monitor domestic customer complaints. However, we do set the standards that suppliers must adhere to when dealing with and processing customer complaints.¹²² If a consumer wishes to make a complaint about their electricity supplier, they should contact the relevant supplier in the first instance. The supplier then has eight weeks to resolve the complaint. If a customer requires assistance with their complaint, they can go to Consumer Direct¹²³ for independent advice and information. Consumer Direct will assess whether they are dealing with vulnerable customers or customers threatened with disconnection, and where applicable, refer them directly to Consumer Focus. Consumer Focus has a dedicated Extra Help Unit to deal with vulnerable customers' complaints.¹²⁴

238. If, at any point before the eight week time period prescribed in the complaints handling standards, 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 Energy Ombudsman. The Energy Ombudsman, 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 the power to make a financial award to the customer of up to £5000. Its decisions are binding on the energy company but not the customer.

239. Figure 6 shows, for the Big Six suppliers, the number of cases per 100,000 customers received by Consumer Direct and referred onto the suppliers' dedicated handling teams, Consumer Focus's Extra Help Unit, or the Energy Ombudsman. Consumer Focus' methodology takes account of both the seriousness of the complaint and suppliers' markets shares, and weights the data accordingly.¹²⁵ It is not possible to break down these figures for the electricity market only, therefore, data represents relevant contacts for issues relating to both gas and electricity. The data shows that complaints were on a downward trend during the first half of 2011, however they began to rise again in June and July. This coincides with price increases by the main energy suppliers, which were announced around that time.

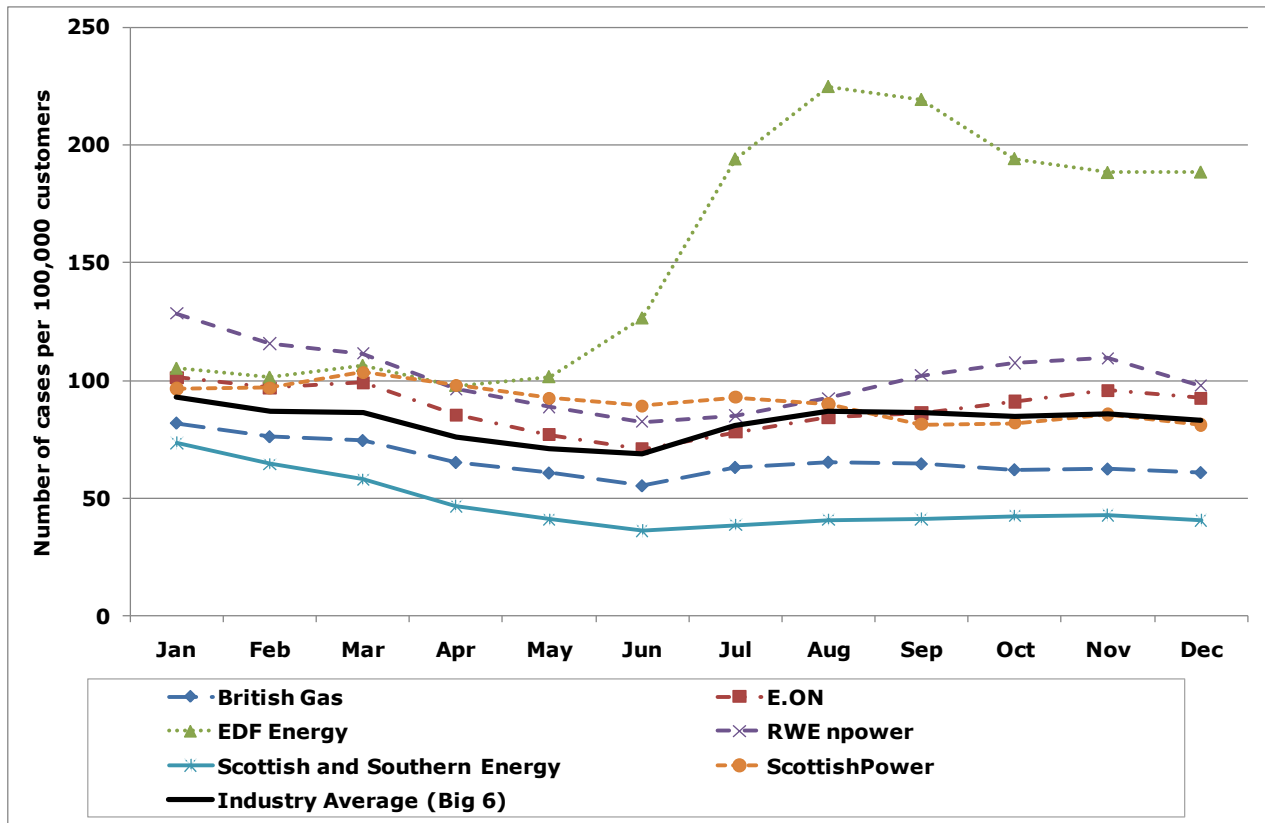
¹²² The complaint standards are prescribed by "The Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008" which come into force on 1 October 2008 and are published at: http://www.opsi.gov.uk/si/si2008/uksi_20081898_en_2#pt2-l1q3

¹²³ More information on Consumer Direct is available here <http://www.consumerdirect.gov.uk/>

¹²⁴ More information on the Consumer Focus Extra Help Unit is here <http://www.consumerfocus.org.uk/about-us/extra-help-unit>

¹²⁵ Full details of the methodology can be accessed on the Consumer Focus website at <http://energyapps.consumerfocus.org.uk/performance/methodology>

Figure 6: Domestic suppliers' performance on cases received by Consumer Direct, Consumer Focus Extra Help Unit and the Energy Ombudsman, Jan-Dec 2011



Source: Consumer Focus

Note: the graph uses quarterly data and uses a 3 month rolling average to smooth out any fluctuations

Monitoring restrictive contractual practices (Article 37(1)(k))

240. Ofgem recognises the importance of monitoring restrictive contractual practices in the electricity market. We have dedicated Retail (responsible for monitoring and policy development relating to domestic and non-domestic 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.

241. Whilst it is challenging to actively monitor all bilateral contractual interactions in the entire domestic and non-domestic electricity markets, we have a range of data and information that we regularly analyse and assess to help us understand trends and identify issues. Further, we may seek additional information where needed and have a legal power to investigate further where we receive information that suggests restrictive practices are occurring. Article 37(1)(k) is implemented into GB legislation which enables us to require any information for the purpose of performing our monitoring duty from any regulated person and require that person to provide information we specify in that notice.

Respecting contractual freedom (Article 37(1) (l))

242. Ofgem issues licences which prescribe the regulatory requirements with which energy suppliers must comply. Suppliers must comply with the conditions of their licences. 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.

243. 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. However, as part of our Retail Market Review, we are proposing to put in place stronger rules to ensure the transparency of contractual information for household customers.

244. At present, there are no bespoke regulatory rules that seek to regulate the fairness of terms expressly agreed between a supplier and customer. However, household customers are protected by the legislation which transposed 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 (as amended) and Ofgem is one of the public bodies with enforcement powers.

Contributing to the compatibility of data exchange processes (Article 37 (1)(u))

245. Ofgem is obligated under the Electricity Act 1989 – 3F (2) (f)) to cooperate with ACER and other NRAs to establish coordinated network codes. Once work begins in the development of the Draft Framework Guidelines on Interoperability and Data Exchange Rules, Ofgem will participate in the appropriate manner.

3.2.3 Recommendations on supply prices

246. 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. And prices can be affected by numerous costs, most notably wholesale energy prices, costs associated with environmental and social programmes such as Renewable Obligation Certificates and the Warm Home Discount, and transmission and distribution costs.

247. Therefore 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.

248. However, Ofgem's primary role is to protect the interests of present and future consumers by promoting competition, wherever appropriate. By fulfilling this role we aim to ensure the electricity and gas markets are sufficiently competitive and delivering 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, namely:¹²⁶

- clearly comparable prices

¹²⁶ Our interpretation of Article 3 is that paragraph 3 has the most relevance for supply prices. It 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."

- transparent prices
- non discriminatory prices:

3.2.4 Carry out investigations and imposing measures to promote effective competition

249. Please see section 3.1.5¹²⁷

3.3 Consumer protection

Compliance with Annex 1

250. Under *Article 37(4)(b)*, Ofgem has a duty to ensure compliance with the provisions of Annex 1 of the Electricity Directive. We have achieved this through amendments to both licences and domestic legislation. The relevant provisions, where they were not already reflected in relevant licences or in domestic legislation, have been incorporated into the relevant licences or into domestic legislation through amendments made by the GB Regulations. 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; all of which are enforceable by Ofgem. No instances of non-compliance with Annex 1 were noted for 2011.

Ensuring access to consumption data

251. *Article 37(1)(p)* obliges regulatory authorities to ensure consumers are readily able to access consumption data. Ofgem is committed to achieving this and we expect suppliers to adhere to guidance on providing this information to their customers, which is enforced through the License Conditions we set.

252. A number of proposals coming out of the Retail Market Review 2011¹²⁸ aim to assist consumers in easily understanding their consumption data and to provide prompt access to such data. We consulted on these proposals in December 2011 and also asked for respondents whether more needs to be done to help vulnerable consumers. We are currently in the process of reviewing these responses.

253. Ofgem is also providing regulatory expertise and advice to the government’s central programme responsible for delivering the rollout of smart metering. In 2011 we took steps to put in place appropriate consumer protections, as some suppliers are already providing smart meters to their customers before the Government has implemented the regulatory framework for the rollout. This includes measures to deliver commercial interoperability, so that consumers with smart meters can continue to realise the benefits of smart metering when they switch supplier. And particularly for vulnerable consumers, we have introduced a new licence protecting consumers where suppliers use the remote functionality of smart metering to switch a consumer to prepayment mode or to disconnect their supply. Smart metering can empower consumers by providing valuable, accessible information to help them monitor their consumption and to use energy more efficiently.

¹²⁷ See Page 25

¹²⁸ For example, proposals to improve bills, annual statements, contract renewal statements and price increase notifications.

Public service obligations

254. The EU Third Package, adopted in 2009, sets out rules for facilitating the liberalisation of energy markets across the European Union. The EU Third Package allows governments to impose direct requirements on energy companies through a Public Service Obligation (PSO). A PSO can be used only in particular circumstances, such as on issues of security or environmental protection, including energy efficiency, climate protection and promoting energy from renewable sources. PSOs also have to meet certain criteria, such as being transparent and non-discriminatory.

255. Transmission access provides a recent example of a PSO¹²⁹. Government used this mechanism to embed its proposals for enabling new generators access to the electricity network. This was done on the basis that the proposals would support the UK in meeting its renewable energy targets and enhance security of supply. As in this case, given the existing regulatory framework, introducing any future PSO would also be likely to need domestic legislation to be effective.

Vulnerable customers definition

256. Ofgem's statutory duties require regard to be had to the interests of particular groups of vulnerable consumers: those who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas. Ofgem also develops policies and works in partnership with others to help such consumers.

Smart Metering

257. In Autumn 2011, we introduced a range of protections for consumers using smart meters as part of the Smart Metering Spring Package. More detail on the Smart Metering Spring Package is provided in the Network Developments section.

Citizens Advice

258. Ofgem continues to work hard to deliver its primary objective of ensuring that energy consumers are protected. As part of this work we have now entered the fourth year of a very successful partnership with Citizens Advice¹³⁰ delivering the Energy Best Deal consumer advice campaign. 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. The campaign is an important source of advice for consumers and is a very good example of the positive outcomes that can be achieved through regulator and consumer body joint working.

Government Energy Efficiency Programmes

259. Ofgem also administers two governmental energy efficiency programmes - the Carbon Emissions Reduction Target (CERT) and the Community Energy Saving Programme (CESP)¹³¹.

¹²⁹ Improving Grid Access. DECC, 2010.

http://www.decc.gov.uk/en/content/cms/consultations/mproving_gridi/mproving_gridi.aspx

¹³⁰ A registered charity that provides free and independent advice to consumers in the UK.

¹³¹ CERT 2008–2012 requires energy suppliers to achieve targets for a reduction in carbon emissions generated by domestic consumers. Under the CERT activity equivalent to at least 40 per cent of the target must be targeted at certain low-income domestic consumers or those who are over 70 years old and on certain credits and benefits called the Priority Group. In addition 15 per cent lifetime tonnes of carbon dioxide must be targeted at a Super Priority Group which includes people claiming specific social benefits. CESP requires energy suppliers and electricity generators to

Both of which assist in reducing consumers' bills, particularly those who are vulnerable. While the Department for Energy and Climate Change (DECC) is responsible for the overall policy and sets the targets for these programmes, Ofgem is responsible for administering the programmes.

260. Ofgem commissions a range of consumer research to inform our key policy decisions. In conducting this research we consider the needs of vulnerable groups by recruiting a range of different consumers or commissioning specific pieces of research.

3.4 Security of supply (if and in so far as NRA is competent authority)

261. DECC is the competent authority in GB for electricity security of supply.

262. However, the Third package puts an obligation on NRAs to monitor investment in generation capacities in relation to security of supply (Article 37(1) (r)). Ofgem undertakes this duty in a number of ways:

263. First, we review National Grid Electricity Transmission (NGET)'s annual Seven Year Statement and Future Energy Scenarios documents, which outline detailed electricity demand and generation (closure and investment) projections, and other relevant publications by NGET.

264. Second, our 2009 Project Discovery provided an outlook for de-rated capacity margins up to 2025, and we continue to internally monitor developments in the generation background in GB.

265. Third, in a joint publication with DECC we publish an annual Statutory Security of Supply Report¹³² which analyses the availability of electricity and gas for meeting the reasonable demands of consumers in Great Britain¹³³.

266. The following section provides a brief overview of the peak electricity demand conditions in 2011, a capacity assessment and a summary of the forthcoming generation projects in GB.

Peak electricity demand conditions

267. NGET publishes annually a Seven Year Statement¹³⁴ (SYS), which provides information on outturn and peak electricity demand, and the UK Energy Future Scenarios, which provides a detailed description of the scenarios used in NGET's future analysis. The latter was published in November 2011 for the first time and hence contains updated information. For this reason we present data from this publication along with the SYS that provides detailed information on the generation side. The focus of this section is the period between 2010/11 and 2017/18.

deliver energy saving measures to domestic consumers in specific low income areas to meet a carbon emissions reduction target (obligation period runs from 1 October 2009 to 31 December 2012).

¹³² For more information see:

http://www.decc.gov.uk/en/content/cms/meeting_energy/en_security/sec_supply_rep/sec_supply_rep.aspx#

¹³³ From September 2012, we will also provide the Secretary of State for Energy and Climate Change an annual assessment of electricity de-rated capacity margins and risk of supply shortfalls for the next four years. This capacity assessment report is intended to be used as an input into the design of a potential capacity mechanism under the Electricity Market Reform (EMR).

¹³⁴ Available at: <http://www.nationalgrid.com/uk/Electricity/SYS/>. The SYS publication will be replaced by the Electricity Ten Year Statement (ETYS), due to be released for the first time in November 2012. For more information please see: <http://www.nationalgrid.com/NR/rdoonlyres/1D781F6A-1E62-4744-BE73-B82D8CB0E3E3/52997/ETYSConsultationdocument.pdf>.

268. Actual peak electricity demand rose slightly in winter 2010/11 to 59.1 GW, 0.5 GW higher than in the previous winter¹³⁵, primarily due to the cold weather. Based on demand data by ELEXON, peak demand in winter 2011/12 fell significantly by 3.6 GW (or 6.1%) to 55.5 GW. This was mainly due to higher temperatures in the winter. Correcting historical actual demands for Average Cold Spell (ACS) conditions eliminates the weather effects and gives an improved indication of the underlying pattern of annual peak demand. ACS corrected winter weekday peak demands in 2010/11 yields a provisional 'unrestricted' peak of 58.1 GW, which is 0.6 GW higher than previous winter's ACS peak¹³⁶.

269. NGET's ACS Peak Electricity Demand Outlook is based on a number of factors including the weather, economic activity, energy prices and energy efficiency/conservation. The latest SYS 2011 outlook is outlined in Table 4 along with the Gone Green scenario peak demand forecast. As it is apparent from the table, the differences are very small between the two.

Table 4: NGET base ACS Peak Electricity Demand Forecast¹³⁷

Forecast	Description	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
1	ACS Peak incl Station Demand and Exports to External Systems	59.1	59.2	59.7	59.9	60.0	59.7	59.7	59.7
2	ACS Peak excl Station Demand and Exports (for plant margin evaluation)	58.5	58.6	59.1	59.3	59.4	59.1	59.1	59.1
3	Gone Green Scenario Demand incl Exports - UK Future Energy Scenarios	58.5	58.6	59.1	59.2	59.2	58.9	58.7	58.6

270. Ofgem has also published scenario analysis as part of its Project Discovery¹³⁸ in 2009 – this included projections on peak electricity demand assumptions. This scenario analysis considered a similar range of factors to National Grid, such as economic growth and energy efficiency. These Discovery scenarios indicate a range of peak demand from 58GW to 67GW in 2015 and from 57GW to 70GW in 2020.

Generation fuel mix

271. NGET developed three different scenarios for the Future Energy Scenarios publication. In this report we present Gone Green scenario data. Gone Green is considered the baseline scenario, as it meets the Government's environmental targets and it has been widely consulted with the industry¹³⁹.

272. With regard to electricity generation, the main features of the 'Gone Green' scenario are as follows: the UK's renewable and emission targets are met in the Gone Green scenario. This is largely achieved by the fast development of wind capacity and in particular offshore wind. Nuclear and CCGT capacity remain approximately constant throughout in the period to 2017/18 and the study period overall (up to 2030), while all new thermal capacity after 2023 is CCS-fit.

¹³⁵ National Grid

¹³⁶ NG SYS

¹³⁷ NGET SYS

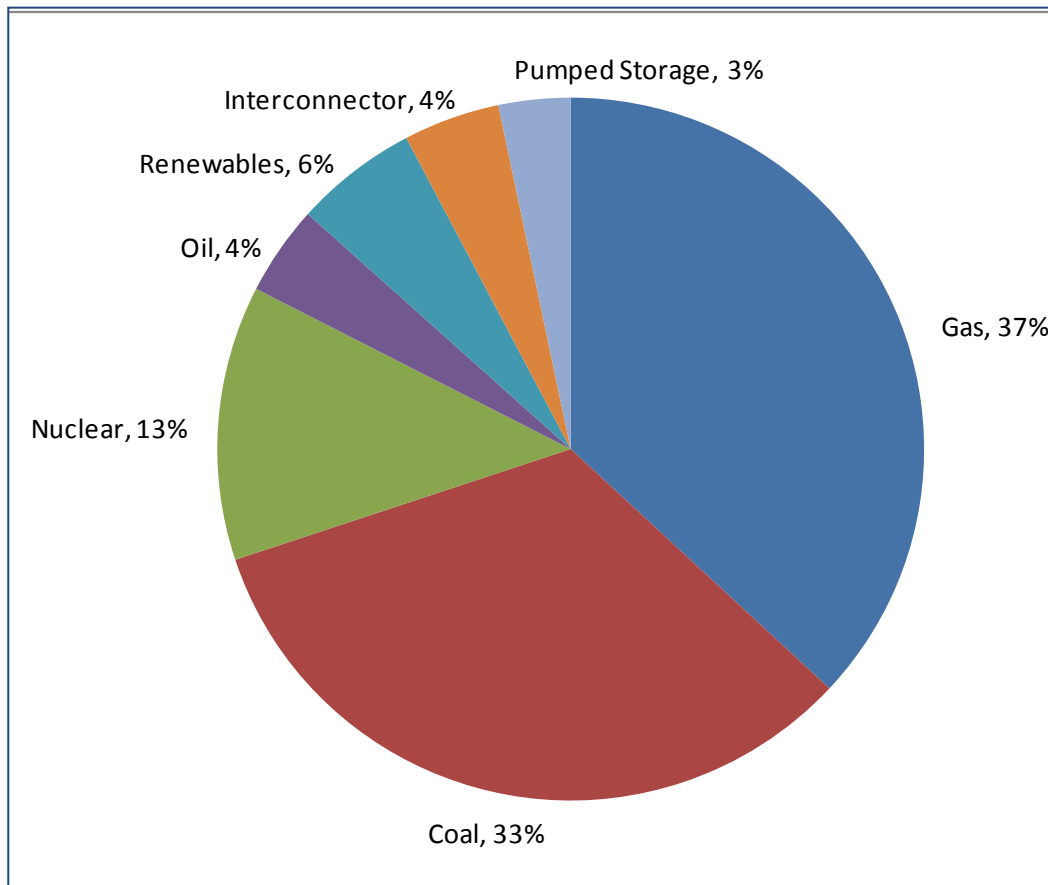
¹³⁸ References to Ofgem's Project Discovery Energy Market Scenarios Update refer to the version published in 4 February 2010, which is available at

<http://www.ofgem.gov.uk/Markets/WhlMkts/Discovery/Documents1/DiscoveryEMSUpdateFINAL.pdf>

¹³⁹ The two other scenarios 'Slow Progression' and 'Accelerated Growth' consider the cases in which either gas-fired generation remains dominant or the case in which wind generation develops faster than expected respectively.

273. A breakdown of current (2011/12) installed capacity is presented in Figure 11. Similar to previous years the majority of GB capacity (83.5 GW in 2011/12 or approximately 80 GW excluding interconnectors' import capacity) comes from CCGT and coal fired plants (37 and 33 percent of total generating capacity respectively).

Figure 7: Generation Capacity by plant type 2011/12 (Source: NG, UK Future Energy Scenarios)



274. The installed capacity of power generation has remained approximately constant in 2011/12. This is due to the delay in the commissioning/construction of several CCGT units and wind farms that were originally planned to become operational during the year.

275. The table below shows expected changes in installed capacity from 2011/12 to 2017/18, based on the Gone Green scenario. This shows that the GB electricity market is set to become increasingly dependent on gas and renewable capacity (over 50% of installed capacity by the end of the period).

Table 5: Growth in Generation Capacity; Change in Installed Capacity (GW) between 2011/12 and 2017/18 by fuel type, Gone Green scenario¹⁴⁰

Fuel type	Installed Capacities (GW)	
	2011/12	2017/18
Coal	30.8	20.8
Gas	27.5	35.2
Oil	3.4	-
Nuclear	10.5	9.5
Renewables	4.7	18
Pump-Storage	2.7	2.7
Interconnector	3.7	4.2
Total	83.5	91.7

Generation Investment

276. The Seven Year Statement provides details of generation projects for which Section 36 consent has been granted as well as those generation projects for which Section 36 consent is being considered¹⁴¹. According to information provided in the 2011 publication, as of May 2011, 6.8GW of new generation projects are under construction (the table below outlines the projects)¹⁴². A further 10GW has received Section 36 consent. Wind farms (both onshore and offshore), which have received or are awaiting consent, account for 10.6 GW, whilst for CCGT's this figure stands at around 9GW.

Table 6: Generation projects under construction/commissioning which have received Section 36 consent.

Plant Type	Power Station	New Capacity (MW)	Year
CCGT	Grain Stage 3	430	2011
CCGT	Pembroke Stage 1	840	2011
CCGT	Pembroke Stage 2	510	2011
CCGT	West Burton B	1370	2011
CCGT	Pembroke Stage 3	750	2012
CCGT	Little Barford (additional capacity)	75	2012
CCGT	Wilton (additional capacity)	42	2014
Wind Offshore	Lincs Offshore Wind Farm	250	2011
Wind Offshore	London Array Stage 1	126	2011
Wind Offshore	Ormonde	150	2011
Wind Offshore	Walney Offshore Windfarm Stage 2	182	2011
Wind Offshore	Gwynt Y Mor Offshore Wind Farm Stage 1	147	2012
Wind Offshore	London Array Stage 2	216	2012
Wind Offshore	London Array Stage 3	288	2012
Wind Offshore	London Array Stage 4	370	2012
Wind Offshore	Gwynt Y Mor Offshore Wind Farm Stage 2	285	2013

¹⁴⁰ Source: National Grid Future Energy Scenarios.

¹⁴¹ These are section 36 consents of the Electricity Act 1989 and section 14 consents of the Energy Act, which authorise new generation projects.

¹⁴² NG SYS, Table 3.2

Wind Offshore	Gwynt Y Mor Offshore Wind Farm Stage 3	142	2014
Wind Offshore	Burbo Bank Extension	234	2015
Wind Onshore	Gordonbush Wind	70	2011
Wind Onshore	Griffin Windfarm, near Aberfeldy	204	2011
Wind Onshore	Hill of Towie	48.3	2011
Wind Onshore	Carraig Gheal Wind Farm	46	2012
Wind Onshore	AChruach Wind Farm	49.9	2013
Wind Onshore	Clyde North & South	519	2011
Wind Onshore	Whitelee Extension	270	2012
Wind Onshore	Harestanes	163.3	2014

Source: NGET Seven Year Statement, Electricity Transmission Networks Quarterly Connections Update (February 2012)¹⁴³

277. The table above only provides information on those projects that have received section 36 approval. Longer term forecasts are available from a number of sources. The UK Renewable Energy Roadmap, compiled by DECC[4], is one of these. In this publication, DECC forecast that a minimum that of 11GW of offshore and 10GW of onshore wind will be connected to the system by 2020.

Generation commissions/retirements

278. Information on generation projects with consents and under construction is provided in the previous section. In terms of plant closures, the Large Combustion Plant Directive (LCPD) opted-out plant comprises of 12 GW of coal and oil capacity. This plant will close before the end of 2015. Including nuclear closures, 13.4GW of plant is due to be disconnected by 2017/18 inclusive¹⁴⁴.

¹⁴³ Some power stations have zero capacity for some years because the power station has contracted capacity with NGET but has not completed that particular stage of construction.

¹⁴⁴ Source: NG UK Future Energy Scenarios

4 The gas market

4.1 Network regulation

279. There is one gas transmission network, the National Transmission System (NTS), which is owned and operated by National Grid Gas plc (NGG).

280. There are eight gas distribution networks (GDNs), which each cover a separate geographical region of Britain. In addition there are a number of smaller networks owned and operated by Independent Gas Transporters (IGTs) - most but not all of these networks have been built to serve new housing.

4.1.1 Unbundling

281. *Please refer to section 3.1.1*

4.1.2 Technical functioning

Balancing services (Article 41(6)(b) and 41(8))

282. In 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 offtakes from the GB high-pressure national gas transmission system (NTS) over the course of each daily balancing period, which corresponds to a gas day. A shipper's imbalance volume is equal to the difference between its aggregated final inputs and offtakes and this is cashed-out at prices determined by trades on the on-the-day commodity market (OCM). The cash-out prices provide the commercial incentives for shippers to balance their positions.

283. National Grid Gas, 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 OCM. Ofgem has oversight over the types of balancing tools that NGG can use and their tendering processes.

284. In addition, Ofgem financially incentivises NGG in its role as a residual balancer. The residual balancing incentive scheme consists of two interacting measures, a price measure and a linepack measure. The 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.

Security and reliability standards, quality of service and supply (Article 41(h))

Transmission

285. The long term reliability standards to which the NTS has to be planned and operated are defined within standard special condition A9 of the gas transporter licence and are enforceable by the Authority. Requirements for quality of service and supply to individual users are encompassed in the Uniform Network Code (UNC).

Distribution

286. Standard special licence condition D10 of the gas distribution licence sets timescales within which GDNs must provide connections 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 90-97 per cent of the time (dependent on the condition) 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.

287. We monitor quality of service through:

- 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

288. Historically, Ofgem¹⁴⁵ has adopted a proactive approach to monitoring connections services and repairs by setting a minimum level of service that it expects GDNs to deliver through connections guaranteed standards. Those standards require GDNs to restore customers' supplies (repair) within prescribed periods. They also cover the provision of connections quotations, scheduling agreed dates for connections works with customers and completing works on the dates agreed with customers.

289. Whilst Ofgem did not monitor the end to end time taken by GDNs to make connections in the regulatory year 2011-12, 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. Also, section 24(1A) Gas Act 1986 has been introduced, requiring the Authority to keep under review the time taken to make connections and repairs.

290. Ofgem has written to all GDNs to notify them that they will be required to report information on the time taken to make connections in the future in order to meet their obligations under *Article 41(1)(m)*.

Transmission

291. The UNC, which describes the commercial arrangements between NGG and users of the system, governs the connections and repair process. In contrast to Distribution, connections are infrequent and for that reason were not actively monitored in 2011. Network users can propose changes in the circumstances that arrangements are considered inadequate.

¹⁴⁵ Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority ("the Authority"), the regulator of the gas and electricity industries in Great Britain.

Monitoring access to storage, linepack and other ancillary services (Article 41(1)(n))

292. In the GB 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 do certain other activities, and
- to offer access to third-parties on non-discriminatory terms.

293. Once the third package legislation entered into force in GB, Ofgem published a guidance document in December 2011 in respect of the new regulatory regime¹⁴⁶. Our approach to monitoring is to pro-actively monitor compliance as well as to receive complaints or hear concerns from market participants.

Monitoring correct application of criteria that determine model of access to storage (Article 41(1)(s))

294. Ofgem must grant 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 key criteria is the test of technical and economic necessity. 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 letter¹⁴⁷.

295. In the last year Ofgem has not granted any new minor facility exemptions.

Monitoring safeguard measures

296. 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). Under Article 10 of the Gas Security of Supply Regulation, the Competent Authority (DECC) is required to prepare an Emergency Plan that outlines the action that it intends to take in an emergency. Ofgem provides comments to DECC on the Emergency Plan as part of 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

Transmission

297. Ofgem regulates the level and structure of charges NGG can levy through the price control reviews. The current gas and electricity transmission price control review (TPCR4) began on 1 April 2007 and will end on 31 March 2013 (having been extended by one year). TPCR4 provides incentives on NGG to operate the system efficiently and provide additional

¹⁴⁶<http://www.ofgem.gov.uk/Markets/WhIMkts/CompanEff/Documents1/Guidance%20on%20the%20regulatory%20regime%20for%20gas%20storage%20facilities%20in%20GB.pdf>

¹⁴⁷http://www.ofgem.gov.uk/Markets/WhIMkts/CompanEff/TPAccess/Documents1/Storage%20Exemptions%20Open%20Letter%2009%20For%20publication_.pdf

capacity on the system in an economic and timely way. It also includes an incentive to encourage innovation.

298. Based upon our assessment of costs and outputs, Ofgem establishes cost allowances and performance targets which form the basis of the price control and incentive framework. Together, these elements determine the total amount of revenue (the “allowed revenue”) that NGG may earn in each year and the network company is required by the regulatory regime to set charges for use of the network 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.

299. The next price control will run from 1 April 2013 to March 2021 and will be based on the RIIO model (Revenue = Incentives + Innovation + Outputs). See section on Network Developments for more detail on this approach¹⁴⁸.

300. Users of the National Transmission System (NTS) are subject to three main elements of transmission charges. Transmission Owner (TO) charges are charges for the provision and maintenance of transmission network assets. There are currently separate TO charges for shippers bring gas on to (entry users) and taking gas off (exit users). TO entry users pay a capacity charge to obtain the commercial right to flow gas onto the network at a given location and a commodity charge that is levied on actual flows. System operator charges are costs incurred by the System Operator (SO) in its day to day operation of the NTS. Connection charges are for the provision of any assets required to connect a user to the NTS.

301. Under its licence NGG is responsible for producing and maintaining a methodology which sets out how the transmission network charges are calculated. This gas transmission charging methodology must meet a number of objectives listed in the gas transmission licence (Article 41(8)). These objectives are that

- charges are reflective of the costs incurred by NGG in its transportation business,
- promote competition between gas shippers and between gas suppliers,
- take account of relevant industry developments,
- and are in compliance with the regulation and legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators (ACER).

302. The Authority originally approved the gas charging methodology (as per Article 41(1)(a) and 41(6)(a)). The gas transmission charging methodology is now part of the contractual framework between users and NGG, the Uniform Network Code (UNC). Including the charging methodology within the UNC increases the independency of the modification procedure, improve the transparency of the tariffs and allow more innovative modification proposals to be brought forward. The UNC is available freely on the Joint Office of Gas Transporters website¹⁴⁹. Any amendments proposed to it are subject to approval by the Authority against the objectives described above (Article 41(10)).

303. The gas transmission charging methodology describes how charges are generated for both entry and exit capacity. These charges are applied to all entry and exit points on the

¹⁴⁸ See Page 8

¹⁴⁹ <http://www.gasgovernance.co.uk>

NTS. In this respect, the same charge setting principles are applied to storage sites, LNG terminal, beach terminals and all other types of entry and exit point.

304. NGG is also required to submit a report each year to Ofgem 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. In 2011, no significant changes were made. Self governance provisions also exist within the charging framework to allow low impact modifications to be considered without reference to the Authority. A number of criteria are set out in the Licence which a proposal must meet in order to be classified as self governance.

Distribution

305. As for Transmission, Ofgem regulates the GDNs through a price control review. The current Gas Distribution Price Control Review (GDPCR) will run until 31 March 2013. The next price control will run from 1 April 2013 to March 2021 and will be the first gas distribution price control review to reflect the RIIO framework.

306. Gas Distribution Network operators (GDNs) are required by Standard Licence Condition (SLC) 4B of the Gas Transporters' Licence (the licence) to have in force at all times a Connection Charging Methodology that has been approved by the Authority on the basis that it achieves Relevant Objectives (*Article 41(1a), 41(6)(a) and 41(1)(8)*).

307. The Relevant Objectives are:

- compliance with the connection charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by this licence;
- compliance with the connection charging methodology facilitates competition in the supply of gas, and does not restrict, distort, or prevent competition in the transportation of gas conveyed through pipes;
- compliance with the connection charging methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the licensee in its transportation business and, where the Act enables, to charge a reasonable profit;
- so far as is consistent with the first three bullets, the connection charging methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's transportation business;
- compliance with the connection charging methodology ensures that the licensee shall not show any undue preference towards, or undue discrimination against, any person who operates, or proposes to operate, a pipe-line system in relation to the connection of that system to the pipe-line system to which this licence relates; and
- the connection charging methodology is compliant with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.

308. Standard licence condition 4B if the licence requires GDNs to comply with their Charging Methodologies. We have powers to enforce this condition. In addition, the Gas Act 1986 gives us powers to determine disputes related to connection charges.

LNG facilities

309. The three LNG facilities currently operating in GB each have an exemption from third party access and therefore the provisions of Articles 41(10) and 41(6) do not apply to them.

310. 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 there is a need to modify the terms and conditions for LNG operators as we believe they are disproportionate or discriminatory we would take actions under the Enforcement provisions contained in the Gas Act- in particular section 28.

311. Ofgem has recently published guidance on regulated third party access to LNG facilities but no investment under this route has taken place yet¹⁵⁰.

Prevention of cross-subsidies

312. In Great Britain, licensed gas distribution and transmission network operators are required by their licence to provide Ofgem/Authority with sufficient information to assess if there is any actual or potential cross subsidy. This prohibition on cross subsidies is prescribed by:

- the Internal Markets in Natural Gas Directive 2009/73/EC at Article 31(3) of 13 July 2009 ("the relevant EC directive");
- Gas Transportation Standard Licence Condition 41, the general prohibition on cross subsidies, and standard special condition A35;

313. Information provided by licensed network operators is subject to agreed upon procedures by an external auditor, to verify that the obligation to avoid discrimination and cross-subsidies is respected. Ofgem review the report prepared by the licensees' external auditors and raise supplementary questions as appropriate. Under these regulatory procedures Ofgem is satisfied that there were no clear instances of cross subsidies over the past reporting year.

Regulated and negotiated access to storage

314. Please see paragraphs 292-293.

¹⁵⁰ Please follow this link for more information on the regulation of LNG facilities in GB:
<http://www.ofgem.gov.uk/Markets/WhlMkts/CompandEff/TPAccess/Pages/TPAccess.aspx>

4.1.4 Cross-border issues

Access to cross-border infrastructure including allocation and congestion management

Existing Interconnection

315. The GB gas system is interconnected with Belgium, Netherlands, Northern Ireland and the Republic of Ireland.

316. The interconnector with Belgium, Interconnector UK (IUK), has an import capacity of 25.5bcm/year and an export capacity of 20bcm/year.

317. The Balgzand Bacton Leiding interconnector (BBL) between GB and the Netherlands has an import capacity of 18bcm/year. It does not currently have the necessary compressor set up to allow physical reverse flow. However, as of October 2010, the BBL Company has offered a non-physical interruptible reverse flow (IRF) service. This allows shippers to nominate flows from GB to the Netherlands on an interruptible basis. Shippers can buy IRF capacity via auctions run by BBL company with a reserve price of zero.

318. The Moffat interconnector with the Republic of Ireland became operational in 1993. 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). The commercial capacity available to exit the system at Moffat is 433.4 GWh/day. In January 2012, a virtual reverse flow service was introduced. This allows shippers to nominate flows from Ireland to GB on an interruptible basis. The maximum entry capacity at Moffat is 432.7GWh/day.

Access rules on interconnection

319. The Third Package has introduced new responsibilities for regulatory authorities regarding the rules for granting access to cross-border gas infrastructures.¹⁵¹ Changes have been made to the standard conditions of the Gas Interconnectors Licence to take full account of these new responsibilities.¹⁵² The requirements of the Third Package were transposed to domestic legislation on 10 November 2011 and are reflected in the Interconnector Licences as follows:

320. The interconnector licence has been changed to require licensees to submit to us any new or amended access rules. The interconnector licence also gives us the power to request licensees to review and amend these access rules. (*Article 41 6(c)*)

321. The interconnector licence conditions place a responsibility on both us and the interconnector operator to ensure that tariff methodologies, and any modifications to these, comply with certain objectives. These are objectivity, transparency, non-discrimination and compliance with the Regulation or any decision of the Commission and ACER. (*Article 41(8)*)

322. The interconnector licence conditions have also been changed to require interconnector operators to review their access rules at least once a year, or at our request, and to provide us

¹⁵¹ See Articles 41(6)(c), 41(8), 41(9) and 41(10) of the Gas Directive 2009/73/EC

¹⁵² See standard conditions 10, 11 and 11A of the Gas Interconnector Licence:

<http://epr.ofgem.gov.uk/EPRFiles/Gas%20Interconnector%20Standard%20Licence%20Conditions%20Consolidated%20-%2010-11-2011%20-%20Current%20Version.pdf>

with a report. This report should highlight what amendments, if any, will be made to better facilitate the objectives above. The review must take account of any suggestions we might have in relation to better achieving the objectives. (*Article 41(9)*)

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

IUK

324. 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. The Use-it-or-lose-it (UIOLI) principle is applied on IUK to ensure that the maximum possible capacity is available to other capacity holders.

325. Across both out interconnectors we have continued to informally monitor congestion management in 2011 and we will request them to review their access rules if we consider it necessary for better meeting the relevant access rules objectives.

BBL

326. The BBL Company offers forward flow capacity, on a first-come first-served basis, to any shipper that signs an agreement to become a BBL Shipper. 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. Capacity on BBL is also subject to UIOLI.

327. BBL has an exemption from licence requirements around access rules and charging methodologies for some of its forward capacity.¹⁵³

Moffat

328. Until 30 September 2012 existing exit capacity (including GB exit capacity at Moffat) is released on a first come first served basis; thereafter users will be able to purchase long-term forward capacity (GB to Ireland) at the Moffat interconnection point through applications made during a window each year in July. In addition, from October 2012 incremental capacity may be allocated if the interconnector is oversubscribed; it will be possible to purchase short-term forward capacity through explicit auctions; interruptible reverse capacity on the GB side will also be available through explicit daily auctions with a zero reserve price. Oversubscription and UIOLI will be applied at exit capacity at Moffat to ensure the maximum amount of capacity is available.

¹⁵³ Standard conditions 10,11 and 11A of the Gas Interconnector Licence

Access to LNG Terminals and Storage Facilities

329. The Regulation gives NRAs the authority to modify the tariffs or charging methodologies of LNG Terminal Operators and Storage System Operators (SSOs), to ensure that they are proportionate and applied in a non-discriminatory manner.¹⁵⁴

330. In GB, we do not have a separate licensing regime for LNG terminal operators. All LNG terminal operators currently have an exemption from third party access and rules around use of revenues. However, in the event there is a need to change charging methodologies and access rules when we consider that they are disproportionate or discriminatory, we would take actions under the enforcement provisions contained in the Gas Act.¹⁵⁵ For these reasons, we have not made any specific changes to domestic legislation in this area.

331. Storage is also a non-licensed activity in GB and is regulated 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 the Regulation. We have the power to proactively monitor SSOs' compliance with the Regulation and can take enforcement action if we deem that any tariffs or tariff methodologies are disproportionate or are discriminatory.¹⁵⁶

Cooperation

332. The Regulation imposes new duties on 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 this¹⁵⁷.

333. 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

334. We have been cooperating with the regulators of adjacent member states over a number of issues around interconnectors. For example, over the last two years, we have worked closely with the Irish regulators to develop and approve a virtual reverse flow service at Moffat. We have also cooperated over the virtual reverse flow product on BBL.

335. In addition, we have been closely coordinating with the Belgian, Dutch and Irish regulators to evaluate exemption applications and certify that our interconnectors are compliant with the rules around ownership unbundling, introduced under the Third Package.

336. In implementing the Security of Supply Regulation, cross border Transmission System Operators (TSOs) had to provide physical reverse flow on their cross-border interconnection points if they did not already do so. They could request an exemption if there was insufficient

¹⁵⁴ See Article 41(10) of the Gas Directive 2009/73/EC

¹⁵⁵ See section 28 of the Gas Act 1986:

<http://www.legislation.gov.uk/ukpga/1986/44>

¹⁵⁶ See sections 28 and 34 of the Gas Act 1986

¹⁵⁷ 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/uksi/2011/2704/regulation/34/made>

market demand or security of supply benefits to justify this. We regularly met with our counterparts in Ireland and the Netherlands in order to agree a process for the TSOs to run this exercise and to agree common views to feedback to the TSOs when they were running the process. However it is noted that the Department of Energy and Climate Change is the competent authority in the UK under the Security of Supply Regulation. Therefore, decisions relating to exemptions for physical reverse flows remain with them and Ofgem currently has no formal powers in this respect.

337. The Gas Regional Initiatives (GRI) project was launched by the European Regulators Group for Electricity and Gas (EREG) in 2006. The overall aim of the GRI is to push forward, the development of gas markets through direct collaboration between regulators, industry, member states, the European Commission and other relevant stakeholders. In the North West Europe (NWE) gas region, we have contributed to various specific projects aimed at addressing market barriers, including on short-term capacity allocation, secondary markets and investment. We are leading the NWE project on TSO transparency on behalf of the other NRAs in the region.

338. 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 and have been actively involved in the development of the capacity allocation management Framework Guidelines. We continue to contribute to the development of transmission tariff structures and interoperability rules.

339. Through embarking on work to promote the efficient interaction between our market and adjacent markets, we have been holding informal discussions and facilitated information sharing with the Dutch and Belgian regulators.

340. We co-chaired, alongside two other regulators, CEER's work on a vision for the development of a European gas target model. We also regularly contribute to CEER's projects around sharing experiences on regulatory matters, including on storage, LNG and retail market issues.

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

341. We set price controls for the gas transmission system operator. As part of this process we review the company's (National Grid Gas Transmission) business plan. We explicitly require the business plan 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 the period for which the control is set (and across a longer period).

342. Specifically in 2012, we are assessing National Grid's plan for the period April 2013 – March 2021. Therefore we have detailed information to inform us meeting the requirement of Article 41(1)(g).

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

4.1.5 Compliance

Ensuring compliance with binding decisions of the Agency and the Commission, and with the Guidelines¹⁵⁸

344. Under the Third Package NRAs are required to ensure compliance with and implement binding decisions of the Agency and the Commission (*Article 41(1)(d)*) and with the Guidelines (*Article 43*). In order to enable Ofgem to do this, the Gas and Electricity Acts have been amended so as to provide the Authority with the necessary powers to carry out its functions in the manner that it considers is best calculated to implement or ensure compliance with any binding decision of the Agency or the Commission.

345. Once the European Network Codes are finalised, we will have an obligation to ensure these are fully implemented in GB. While no network codes have yet entered into force, we are confident that when we do the necessary provisions are in place within our legislative and regulatory framework to ensure they can be implemented.

Power to carry out investigations and impose measures to promote competition

346. Changes brought about by the Third Package (*particularly with regard to Articles 41(1)(b) and 41(4)(c,d,r) and 41(5)(a)*) have strengthened Ofgem's enforcement and information gathering powers in a number of key respects.

347. *Please see Section 3.1.5 for detail on the changes along with an update of on Ofgem's enforcement actions for 2011.*

4.1.6 Dispute settlement

348. Sections 27B-D of the Gas Act 1986 sets out the Authority's Article 41(11) and Article 41(4)(e) dispute resolution functions. They were amended by the GB Regulations. The amended provisions largely mirror the Article 25|(5) provisions from the Second Internal Markets Directive (Directives 2003/55/EC) which was implemented by the Gas and Electricity (Dispute Resolution) Regulations 2009. Sections 27B-D now reflect the wider range of disputes under Article 41 which can be referred to the Authority.

349. Any Article 41 dispute that is referred to the Authority for determination shall be determined by the Authority or, if the Authority thinks fit, by an arbitrator appointed by the Authority. Any determination by the Authority shall be binding on the parties to the dispute. However, it is open to any party to seek a judicial review of the Authority's decision.

350. Section 27C(3) of the Act, provides that the "practice and procedure to be followed in connection with an [Article 41] dispute ...shall be such as the Authority may consider appropriate". This provision coupled with the general powers set out in Sections 27B-D of the Act provides the Authority with the appropriate rights of investigation and powers to require information with which to investigate and settle any dispute referred to it under Article 41."

351. No Article 41 disputes were raised in 2011.

¹⁵⁸ The Guidelines being those Guidelines referred to in the Gas and Electricity Directives and Regulations under the Third Package.

4.2 Promoting Competition

4.2.1 Wholesale Markets

4.2.1.1 Price monitoring (41(1)(i))

352. Ofgem is committed to ensuring the gas market is sufficiently transparent. In this section, we set out the expectations and rules regarding transparency of supplier activity.

Wholesale price transparency

353. 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. 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, Bloomberg provide close to real time energy broker pricing based on OTC trades.

354. In addition to a wide range of OTC pricing data, the two exchange providers in the GB gas market both provide pricing data to the market. Please see below for a description of GB wholesale gas exchanges.

Description of the wholesale market

355. In brief, the GB wholesale market is based mostly on trading between gas producers, shippers, suppliers, traders and customers across a series of markets. Trade on the wholesale market consists of OTC trading (through brokers and off-market) and exchange trading¹⁵⁹.

Over the counter trading (OTC)

356. OTC trading (i.e. bilateral deals between two market participants, including via an intermediary (the broker) brings together a buyer and seller) typically operates from a year or more ahead of real time up until 24 hours ahead of real-time.¹⁶⁰

357. OTC traded volumes are traded through brokers in the UK and the Financial Services Authority (FSA) conducts an annual survey to determine the total volume, as outlined below.

Table 7: Estimated value of UK gas market¹⁶¹

	Volume traded (bcm)	Est. value of market (£ billion)
2010/11	1557.3	299
2009/10	1211.5	146
2008/09	910.0	157
2007/08	934.9	176

¹⁵⁹ Further information relating to OTC and power exchange trading can be found in Ofgem's 2008 National Report and Ofgem's June 2009 Liquidity Discussion document.

¹⁶⁰ 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.

¹⁶¹ Source: FSA, available at: http://www.fsa.gov.uk/static/FsaWeb/Shared/Documents/pubs/other/energy_2011.pdf. The data covers the period August to July and excludes exchange trading.

Exchanges, including the OCM (on the day commodity market)

358. Although trading on exchanges can extend out as far as the contract market (OTC), 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.

359. Total traded volume on the APX Gas UK (OCM) and APX Gas UK (NBP)¹⁶² exchanges in calendar year 2011 was 137.6 TWh (~12.6bcm), slightly higher than 2010's figure of 130 TWh (~12 bcm)¹⁶³. Traded volume on the Intercontinental Exchange (ICE) UK Gas Futures exchange totalled 508 bcm in 2011¹⁶⁴.

360. Figures from National Grid show that GB gas demand for the year 2011 was 94.6 bcm, approximately 15 bcm lower than the previous year¹⁶⁵, mainly due to warmer weather, substitution of gas-fired generation by coal and subdued economic conditions. Churn rates were high throughout 2011 and above the average rate of 9.92 for 2010. The average monthly churn rate varied between 10 and 16 in the first three quarters of 2011. The average churn rate for the second quarter was 14¹⁶⁶.

Balancing

361. Ofgem launched the Gas Security of Supply Significant Code Review (Gas SCR) in January 2011. The objective of the Gas SCR is to establish whether changes to the current gas market arrangements are required to enhance security of supply and, if so, what these reforms should be. Initial analysis raised a number of concerns with the existing emergency cash-out arrangements. Through consultation with industry, Ofgem is considering a revision to these arrangements to enhance incentives on the industry to avoid an emergency and minimise the duration of an emergency should one occur. In parallel with this review, Ofgem is also considering the need for, and design of, any further measures to enhance gas supply security further. The final decision on revisions to the cash-out reform arrangements will be published in the summer of 2012.

Market integration

Table 8 – UKCS forecast and import requirements¹⁶⁷

	10/1 1	11/1 2	12/1 3	13/1 4	14/1 5	15/1 6	16/1 7	17/1 8	18/1 9	19/2 0	20/2 1
Demand (inc. exports)	97.6	96.8	95.6	93.9	93.8	94.6	94.3	92.4	89.6	86.8	83.5
UKCS production ¹⁶⁸	44.3	43.5	43.0	39.8	37.6	37.9	35.3	31.2	28.9	25.7	24.1
Import requirement %	55%	55%	55%	57%	59%	59%	62%	65%	66%	69%	69%

¹⁶² NBP – National Balancing point

¹⁶³ Source: APX

¹⁶⁴ Source: ICE available at: www.theice.com. Represents total volumes traded in monthly, seasonal and quarterly products from 01 Jan 2011 to 31 Dec 2011

¹⁶⁵ Source: National Grid, available at <http://www.nationalgrid.com/NR/rdoonlyres/AA50AF69-2031-4524-873B-5BF0B460F9C4/51199/ActualDemandTemperatureandCWVHistoricalData19982011Website1.xls>

¹⁶⁶ For more details see http://ec.europa.eu/energy/observatory/gas/gas_en.htm.

¹⁶⁷ Source: National Grid Ten Year Statement 2011

¹⁶⁸ Shale gas production is not included

362. Table 8 shows the decline in production from the UK Continental Shelf (UKCS) and the associated increase in import requirements for the years ahead. Increasing import requirements have led to a close correlation between gas prices in GB and continental Europe, which are typically linked to oil product prices. The relationship was strengthened when Balgzand Bacton Line (BBL) and Langeled came on line, as previously GB prices could decouple from elsewhere in Europe when the IUK was full or not operational. However, ongoing changes to the global demand and supply balance, for example the reduction in global energy demand, has increased the possibility of global gas prices de-coupling from oil price, although it is too early to arrive at firm conclusions regarding oil and gas decoupling.

363. In terms of the 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 September 2018. Currently 14 Shippers hold primary capacity rights¹⁶⁹. The utilisation of these capacity rights has remained unchanged since Ofgem's 2008 National Report¹⁷⁰.

364. Since the installation of a fourth compressor at BBL, in April 2011, no further interconnector capacity expansion has occurred. Interruptible virtual reverse flows have been in use on BBL since the beginning of 2011. 13 shippers subscribed in the first year of its operation (Oct 2010-Sep 2011), while participation fell to 9 shippers in the second year. Experience so far 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 prices while during other times they are underutilised despite TTF prices exceeding NBP prices. Interruptible virtual reverse flows were also introduced on the Irish interconnectors at the beginning of this year. So far, they have only been utilised in two instances.

Interactions with Global LNG markets

365. 2010 saw the completion of two new LNG importation terminals in GB (Isle of Grain Phase 3 and South Hook Phase 2), taking the country's total LNG importation capacity to 49.2 bcm/year¹⁷¹ (or 53.3 bcm/year including the Teeside GasPort facility; the facility lacks any storing capability).

366. In 2010/11, LNG represented 23% of total gas supplies in GB¹⁷². The relevant market for LNG is increasingly a global one, with supply and demand conditions in regions such as Asia impacting upon the volume of LNG deliveries available to GB. This has been demonstrated over the past few years. For example, deliveries in 2009 and 2010 were high as economic conditions suppressed LNG demand in competing markets, GB had increased import facilities, and US domestic production was boosted by high volumes of unconventional gas. More recently, there has been some evidence that global LNG prices have been driven by high gas demand in Japan. Following the Fukushima Daiichi nuclear accident, the country shut down much of its nuclear power plant fleet, and supply has mainly shifted to gas- and oil-fired generation. In part reflecting this, LNG imports fell slightly in GB in 2010/11 – the first annual decline since 2007/08.

¹⁶⁹ Information correct as of 11/04/2012 (<http://www.interconnector.com/Commercial/shippers.htm>)

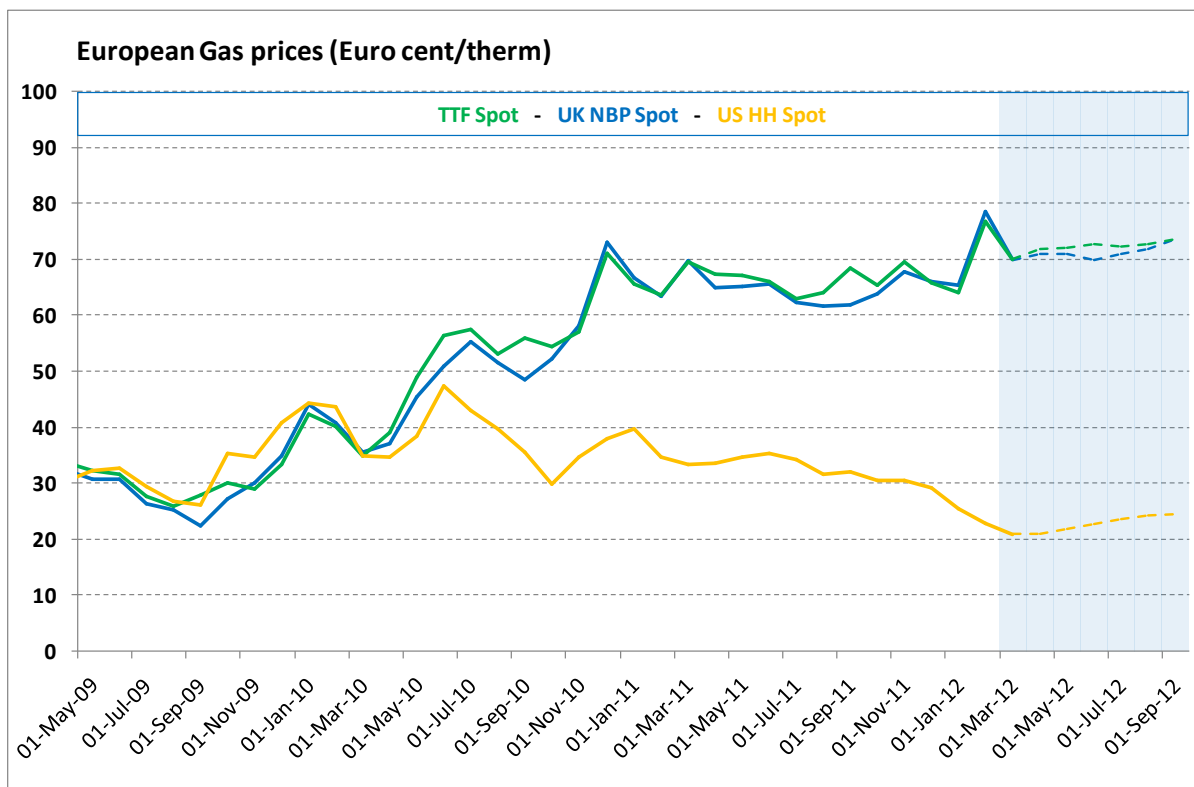
¹⁷⁰ For further information please see Ofgem 2008 National Report and the IUK website available at the following link: www.interconnector.com.

¹⁷¹ Source: National Grid Ten Year Statement 2011 and <http://www.dragonlng.co.uk/dragon-lng-terminal.html>. While Dragon LNG has the capability of delivering up to 10.5 bcm/year to the National Transmission System (NTS), it only has the capacity to unload up to 7.9 bcm/year.

¹⁷² Source: National Grid Ten Year Statement 2011

367. Figure 8 below shows that UK NBP and US gas prices have diverged significantly, in part due to the global dynamics mentioned above.

Figure 8: GB, US and Belgian Gas Prices for 2010¹⁷³



4.2.1.2 Market opening and competition (Article 37(1)(j))

368. As noted above, 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 over the counter (OTC) trading and power exchange trading. The market underwent the first stages of privatisation in the late 1980s, and is now open to competition.

369. 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. Ofgem is bound by its statutory duties to protect the interests of consumers, both existing and future. Wherever appropriate, Ofgem performs its functions in a manner which it considers would further this principal objective by promoting effective competition. However, before exercising its functions in this manner, Ofgem must consider whether the interests of consumers would be better protected by exercising its functions in other ways.

Monitoring competition

370. Ofgem actively monitors competition in the market for generation. Competition indicators such as market concentration levels are assessed both in terms of metered volume and total generation capacity.

¹⁷³ Source: Bloomberg

371. Ofgem has concurrent powers, together with the Office of Fair Trading, 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. Ofgem may undertake an investigation where it has reasonable grounds to suspect a breach of these provisions.

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

Market Concentration

373. The GB market receives its gas supplies from a variety of different sources encompassing indigenous supplies from the 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).

374. In terms of gas from the UKCS, there are five companies whose market share of production exceeds five per cent. 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. For example, there are currently 14 shippers who hold primary capacity on the Interconnector UK, and 16 shippers on the Langeled pipeline¹⁷⁴. In contrast, since BBL became operational (December 2006), it has typically been used by two to three shippers.

375. 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%), ExxonMobil (24.15%) and Total (8.35%). Dragon LNG is equally owned by two shareholders, BG Group and Petronas.

376. It is difficult to make precise quantitative evaluations in terms of market shares in the overall GB wholesale gas market. However, in terms of market share for gas storage, over 50 per cent of capacity in Rough, the largest gas storage facility in GB, was held by four parties when last full¹⁷⁵, similar to last year. Market share figures are liable to change as capacity can be traded on the secondary market.

377. In addition, it is also possible to assess the market share of gas shippers¹⁷⁶ in the GB gas market. There are a total of 292 holders of Shipper Licences in GB. Market concentration is also low. Based on the latest available data, four shippers had a market share over 5%, with the largest market share recorded at under 8%. The data underlying these estimates are market sensitive and therefore confidential.

¹⁷⁴ Information correct as of 11/04/2012

¹⁷⁵ Data corresponds to 1st November 2011, when Rough was 98.6% full.

¹⁷⁶ To ship gas on the GB transmission system, a firm must hold a Shippers licence from Ofgem. This licence allows the licensee to arrange with a Gas Transporter (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.

Storage services

378. 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.

379. The two largest storage facilities in GB (Rough and Hornsea) are required to offer Third Party Access (TPA), whilst the other facilities are exempt from this requirement. Table 9 below provides details of the technical characteristics and the TPA status of existing UK storage facilities.

Table 9: Existing UK storage and TPA status¹⁷⁷

Facility	Space (bcm)	Deliverability (mcm/d)	Owner	TPA Status
Rough	3.3	45	Centrica Storage	Operated under nTPA + (varied) Rough Undertakings
Hornsea	0.3	17	SSE Hornsea	Operated under nTPA
Avonmouth LNG Storage	0.08	13	National Grid LNGS	TPA offered under section Z of the Uniform Network Code
Aldbrough (by the end of 2012)	0.2 (0.33)	12 (37)	Statoil/SSE	Exempt
Hatfield Moor	0.1	2	Scottish Power	Exempt
Holehouse Farm	0.06	7	EDF Trading	Exempt
Humbly Grove	0.3	7	Star Energy	Exempt
Holford (by the end of 2012)	0.06 (0.16)	22	E.ON	Exempt
Total	4.4 (4.63)	125 (150)		

Source: National Grid (Tables 3.3D & 3.3E - Ten Year Statement 2011)

380. Total gas storage capacity increased in 2011/12 with the opening of the Holford facility¹⁷⁸. It is expected to further increase by the end of 2012 when Holford becomes fully operational. Furthermore, Aldbrough is set to complete its Phase II expansion in 2012.

381. The Rough and Hornsea 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 more than that – with the record to date, reached in October 2011, being 3.7 bcm¹⁷⁹. The LNG storage facilities account for a further 1.7 per cent of space and approximately 10 per cent of total daily deliverability.¹⁸⁰

¹⁷⁷ Space is working gas capacity and deliverability is withdrawal capacity

¹⁷⁸ Holford started operating at the end of 2011. See E.On press release: <http://pressreleases.eon-uk.com/blogs/eonukpressreleases/archive/2011/12/19/1768.aspx>

¹⁷⁹ Source, National Grid, available at: <http://www.nationalgrid.com/NR/rdonlyres/F3CE10A8-AD99-4A26-8815-762A899C289D/53363/ST26042012.xls>

¹⁸⁰ The LNG storage facilities are required to offer TPA under sections Z of the Uniform Network Code.

382. 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.

383. Undertakings at the Rough storage facility were provided by Centrica PLC to the Secretary of State in 2003 following the referral to the Competition Commission (CC) of its purchase of Dyengy, the owner of the Rough facility. In April 2010, Centrica PLC and Centrica Storage Limited (CSL) wrote to the Office of Fair Trading and the Competition Commission to request a review of the undertakings. In January 2011, the Competition Commission provisionally decided that the Undertakings should stay in place. In April 2011, the CC confirmed its provisional decision and therefore the undertakings have been retained, albeit some variations which took effect in March 2012¹⁸¹.

384. 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 and has in the past auctioned five year capacity contracts. Annual average prices are published on its website. Ofgem has no information on rejected applications for storage capacity. Furthermore, Ofgem has not received complaints regarding the allocation mechanism, and currently all capacity has been sold.

385. The Transmission System Operator tenders for its Operating Margins gas requirements. Gas storage, LNG importation with storage are some of the sources that can provide this service. It is up to the operators to decide whether to participate in the tender. In 2011-12 the TSO requirements for operating margins are around 105 mcm¹⁸².

Measures to avoid abuses of dominance

Transparency

386. Transparency is a key component in the effective and efficient operation of the GB gas market. National Grid have 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 website¹⁸³.

387. Ofgem issued a consultation in January 2011¹⁸⁴ of what points should be considered as "relevant points" of a transmission system for the purposes of Article 18(4) of the Gas Regulation (EC) No 715/2009. As part of the consultation, an assessment was made of the information now published for relevant points. In Ofgem's decision letter¹⁸⁵, published in May 2011, Ofgem found that all the information required to be published for relevant points was now made available except for two items: Exit capacity data at least 18 months ahead and Historical data for a five year rolling basis.

388. In November 2010, the regulators of the Gas Regional Initiative North-West (GRI NW) agreed to examine compliance of TSOs with the new transparency legislation. As part of the

¹⁸¹ The varied undertakings, as well as detailed information on the review process, are available at <http://www.competition-commission.org.uk/our-work/reviews-of-orders-and-undertakings/completed-reviews/review-of-centrica-undertakings>

http://www.competitioncommission.org.uk/inquiries/ref2010/centrica_review/pdf.

¹⁸² http://www.nationalgrid.com/NR/rdonlyres/F364AE0B-1E03-417B-BBA0-A28669892877/49075/OM_Tender_Info_Report_11_12_FINAL_2_.pdf

¹⁸³ For more information, see: <http://www.nationalgrid.com/uk/Gas/Data/>

¹⁸⁴ http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/Documents1/consultation_on_relevant_points_Final%20180111.pdf

¹⁸⁵ http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/Documents1/Relevant_Points_decision_letter.pdf

exercise, the TSOs completed a questionnaire regarding the provision of the relevant information as required in the Third Package. In November 2011, ACER published a letter consolidating the answers submitted by the TSOs¹⁸⁶ for public consultation with a view to developing conclusions.

389. With respect to exit capacity, National Grid currently publishes information only for the transitional period which runs until September 2012. After the end of the transitional period, National Grid will publish exit capacity data for at least 18 months ahead and updated on a monthly basis¹⁸⁷.

390. With respect to historical data, Ofgem noted that not all historical information per relevant point is published for five years as is now required under the Gas Regulation. Our understanding is that, given that a number of European TSOs do not have five years' data for every data set required under the Gas Regulation, the approach being adopted by European TSOs is to build up to five years' historical data on a rolling basis.

391. The enhanced level of transparency we now have in the GB gas market as a result of this initiative is beneficial to market participants and also to our market monitoring activities.

Market surveillance

392. Ofgem's market surveillance team monitors the gas and electricity markets, including the wholesale gas market and the Balancing Mechanism. 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 Ofgem.

393. Additionally, the Financial Services Authority (FSA)¹⁸⁸ has responsibilities for the operation of financial markets in the UK. The FSA works to prevent abuse or distortion of financial markets. The FSA 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 Markets

394. As with the electricity retail market, the GB retail gas supply market is open to competition and final domestic consumer prices are set by suppliers according to the prevailing market forces they face. Today, the domestic gas supply market is characterised by the existence of the 'Big 6' suppliers.¹⁸⁹ There are also seven small suppliers active in the market. For the non-domestic market, there were 25 active suppliers at the end of 2011.

¹⁸⁶ http://www.acer.europa.eu/portal/page/portal/ACER_HOME/Activities/Regional_Initiatives/Gas_Regional_Initiatives/North-West/Public%20Consultations/1supstsup%20Public%20Consultation%20NW%20Regional%20Initiative/Agenda_and_distributed_docs/Transparency%20cover%20letter_FINAL.pdf

¹⁸⁷ http://www.acer.europa.eu/portal/page/portal/ACER_HOME/Activities/Regional_Initiatives/Gas_Regional_Initiatives/North-West/Public%20Consultations/1supstsup%20Public%20Consultation%20NW%20Regional%20Initiative/Agenda_and_distributed_docs/Great%20Britain.xlsx

¹⁸⁸ <http://www.fsa.gov.uk/>

¹⁸⁹ These companies are (i) Centrica plc: Centrica plc owns British Gas Trading, which operates three retail brands: British Gas (in England), Nwy Prydain (in Wales) and Scottish Gas (in Scotland). (ii) E.ON UK: A wholly-owned subsidiary of the German energy group BD, 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.

395. In contrast to the electricity retail supply market, there has been limited vertical integration between supply and production businesses in the GB gas market.

4.2.2.1 Price monitoring (Article 41(1)(i))

Transparency

396. Ofgem is committed to ensuring the gas market is sufficiently transparent. In this section, we set out the expectations and rules regarding transparency of supplier activity. We also set out proposals to enhance transparency and benefit the interests of consumers.

Financial transparency

397. Please see section 3.2.2.1

Transparency for domestic consumers

398. Following the 2008 Energy Supply Propose we proposed that suppliers should including certain pieces of standard information on bills (tariff name; annual consumption; and illustrated projected cost for the following year) and send each customer an annual statement so as to aid transparency and improve the quality of information suppliers send to consumers. We also proposed minimum standards that suppliers should meet when conducting sales and marketing activities in the domestic retail energy market.¹⁹⁰

399. More recently, through the 2011 Retail Market Review Ofgem has identified areas where suppliers could improve the clarity and transparency of information they provide to domestic consumers.¹⁹¹ We note that we are in the process of considering responses to the consultation and no firm decisions have been made at this stage. Our proposals included:

- using standardised language and terminology to note key concepts across these communications;
- introducing standard formatting on a specific section of bills and for the majority of the annual statement; and
- personalising information on price changes notifications.

400. To further increase the transparency of gas prices and to help consumers understand the components of their gas bill, we published an update to our 'Household Energy Bills Explained' factsheet in January 2011.¹⁹² This is designed to clearly and simply show the relationship between energy bills, wholesale energy costs, and other costs such as those associated with transmission and distribution.

401. Finally, consumers can access information on supplier prices by contacting Consumer Focus (a consumer advocacy body). It aids transparency for domestic consumers by publishing price comparison tables for each GB supply region, hosting an interactive online search tool to allow consumers to see the cheapest deal available and by maintaining a list of

¹⁹⁰ Ofgem (Aug 2009), "Energy Supply Probe – Proposed Retail Market Remedies" p.2

¹⁹¹ Ofgem (Dec 2011), "[The Retail Market Review: Domestic Proposals](#)"

¹⁹² Ofgem (Jan 2011), "[Household Energy Bills Explained](#)"

over 10 accredited online energy switching sites, each of which enables consumers to compare a wide range of suppliers' tariff prices and service offerings and determine which offer best suits their needs.¹⁹³ Consumer Focus' 'Confidence Code' sets out the minimum requirements that a provider of an online domestic electricity Price Comparison Service (Service Provider) must meet in order to be, and remain, accredited to this voluntary scheme.

Transparency for non-domestic consumers

402. Ofgem is also working to increase the transparency of the non-domestic electricity market. As part of our non-domestic RMR proposals, we consulted on applying transparency rules that currently only apply to micro business customers, to more business customers. These include rules around the information that needs to be given to customers before and during their contract. We also set out best practice and requirements on the information customers must receive when there is an objection to their supply transfer. And we consulted on how best to increase the transparency of Third Party Intermediaries' (TPIs) activities¹⁹⁴. TPIs act as brokers between non-domestic customers and suppliers, assisting customers in finding the most appropriate energy deal for their needs. However, our RMR has found evidence that TPIs' are not delivering the best outcomes for consumers in all cases. There is a need for further intervention in this area of the non-domestic market. We consulted in December 2011 on adopting some or all of the following proposals, as with the domestic RMR proposal we are considering responses to consultation before noting next steps or final policy decisions:

- introducing a new Standard Licence Condition on non-domestic suppliers governing the sales and marketing activities of both the supplier and their representative.
- an Accreditation Scheme for TPI Codes of Practice; and
- additional powers to allow us to take enforcement action directly against non-domestic TPIs.

4.2.2.2 Price Monitoring: Market opening and competition Article 41(1)(j)

Market opening

403. As noted at the start of section 4.2.2, the domestic gas market exhibits the same characteristics as the domestic electricity market. The majority of the market is accounted for by six large vertically integrated suppliers. Before market opening there was only one incumbent gas provider for the whole of Great Britain, following market opening some former electricity incumbents started to offer gas supply and gained market share.

404. Since market opening rules and regulations have been removed and introduced, where appropriate, to facilitate competition and protect consumers. And Ofgem has a central role in protecting the interests of consumers, present and future. Our Retail Market Review examined the effectiveness of competition in the domestic and non-domestic retail markets.^{195,196} It assessed the extent to which the retail market was acting in the interests of consumers and whether regulatory action should be taken to enhance competition.

¹⁹³ <http://www.consumerfocus.org.uk/get-advice/energy/confidence-code>

¹⁹⁴ Ofgem (Dec 2011), "[The Retail Market Review: non-Domestic Proposals](#)"

¹⁹⁵ Ofgem (Dec 2011), "[The Retail Market Review: Domestic Proposals](#)"

¹⁹⁶ Ofgem (Dec 2011), "[The Retail Market Review: non-Domestic Proposals](#)"

405. The 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. This led a large proportion of consumers to disengage from the energy market completely.

406. Our proposals to address the lack of consumer engagement in the energy market are set out in detail in paragraphs 398-401. They aim to increase the transparency of the energy market, generating increased consumer engagement, which ultimately should lead to greater competitive pressure between suppliers and more beneficial outcomes for consumers. We began consulting on the domestic and non-domestic proposals between December 2011 and February 2012. We are reviewing consultation responses and will be developing the next stage of the Retail Market Review process in 2012.

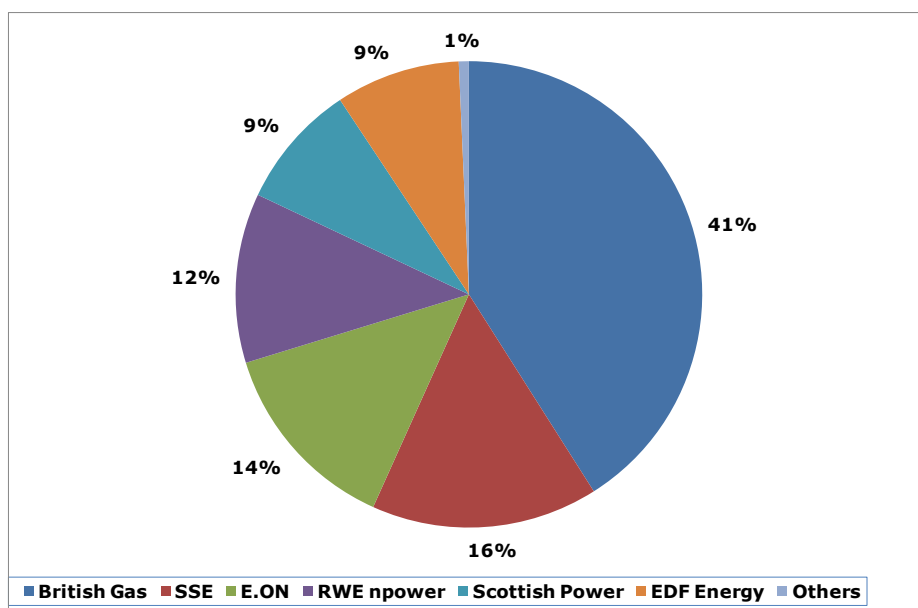
Monitoring competition

407. As noted above, we have launched wider reviews of the market where needs has arisen, but Ofgem also monitors competition on an on-going basis. We collect data from suppliers and other industry bodies on a monthly basis. 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.

Monitoring competition – domestic market share

408. Ofgem regularly analyses suppliers’ monthly domestic customer numbers, from which we calculate each supplier’s market share. In December 2011 there were 22.5m domestic gas consumers in GB. As Figure 9 shows, the ‘Big 6’ accounted for over 99% of gas supply to these customers.

Figure 9: GB Domestic Gas Suppliers’ Market Share, December 2011



Source: Ofgem

Note: Percentages do not sum to 100 per cent due to rounding

409. There are seven small suppliers active in the market, with a combined market share of 0.5%. These are Co-Operative Energy; Ecotricity; First utility; Good Energy; OVO Energy; Spark Energy; and Utilita.

Monitoring competition – non-domestic market share

410. Ofgem also monitors non-domestic suppliers' market shares. We gather some data from suppliers but also contract with Datamonitor¹⁹⁷.

411. The non-domestic gas market is characterised by a larger number of independent suppliers compared to the domestic gas market. In addition to the Big Six, there are 9 independent suppliers, with varying focus and market share across the non-Daily Metered sites (Non-DM) and Daily Metered sites (DM) sectors.¹⁹⁸

412. The DM segment is by far the most fragmented, with the top three suppliers holding 46% of the market share. It is also the segment into which non-Big 6 suppliers have penetrated most, with the most significant suppliers being Shell Gas Direct and GDF Suez. The three suppliers with the highest market shares in the Non-DM segment are Centrica, E.ON Energy and Corona Energy, who together capture 74% of this segment.

Table 10: Gas suppliers' non-domestic market share November 2011

Gas	Non Domestic Sites		
	Non-DM	DM	All Non Domestic
British Gas	38.2%	2.8%	38.1%
E.ON Energy	24.5%	13.9%	24.5%
Corona Energy	10.7%	3.8%	10.7%
Total Gas and Power	8.0%	12.7%	8.0%
Gazprom	5.5%	9.5%	5.5%
SSE	5.5%	0.0%	5.5%
Shell Gas Direct	2.2%	16.5%	2.2%
GDF Suez	1.5%	16.5%	1.6%
Opus Energy	1.5%	0.0%	1.5%
ScottishPower	1.0%	0.0%	1.0%
RWE npower	0.8%	3.2%	0.8%
EDF Energy	0.4%	0.0%	0.3%
ENI	0.1%	8.2%	0.1%
Statoil UK	0.0%	8.9%	0.0%
Wingas	0.0%	5.1%	0.0%
Others	0.1%	0.0%	0.1%
Total	100%	100%	100%

Source: Datamonitor

¹⁹⁷ An independent consultancy which provides non-domestic customer numbers. Datamonitor collects the information from suppliers and releases it on a quarterly basis.

¹⁹⁸ Daily Metered sites are fitted with a meter that records gas consumption on a daily basis, allowing high-usage consumers to better track their gas consumption. Non-Daily Metered sites do not have this type of meter and usage is recorded on a monthly or quarterly basis.

Monitoring competition – HHIs

413. Herfindal-Hirschman Indices (HHI)¹⁹⁹ indicators are often used to gauge market concentration. The relevant HHIs²⁰⁰ for gas are:

- domestic (July 2011) – 2,560
- Non-domestic, non-daily metered sites (July 2011) - 2,261
- Non-domestic, daily metered sites (July 2011) - 1,214

414. Both domestic and non-domestic, non-DM gas supply markets are 'highly concentrated' according to the threshold HHI levels (1800) used by the Office Fair Trading. The non-domestic, DM gas supply market is judged to be 'concentrated'.

Distortion or restriction of competition

415. The previous sections have set out both our in-depth investigation of the gas market as part of our Retail Market Review and our regular ongoing monitoring activities in respect of assessing the market and levels of competition. These workstreams have helped us to identify where further intervention in the market is needed to enhance competition and improve outcomes for consumers.

416. For further information on how we investigate anti-competitive activity please refer to section 4.1.5.

Prices for household consumers including prepayment systems

417. 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, and as such continue to be price controlled.

418. Ofgem actively monitors domestic suppliers' gas prices across GB. We receive price change notifications from suppliers and use these to calculate the implications for domestic customers' retail bills based on characteristics such as their consumption level, payment type, and region. We contract with an external data provider for detailed historical tariff and pricing information. We operate a Domestic Price Database that stores historical bill and pricing data, giving us an additional source of information with which to track price developments over time.

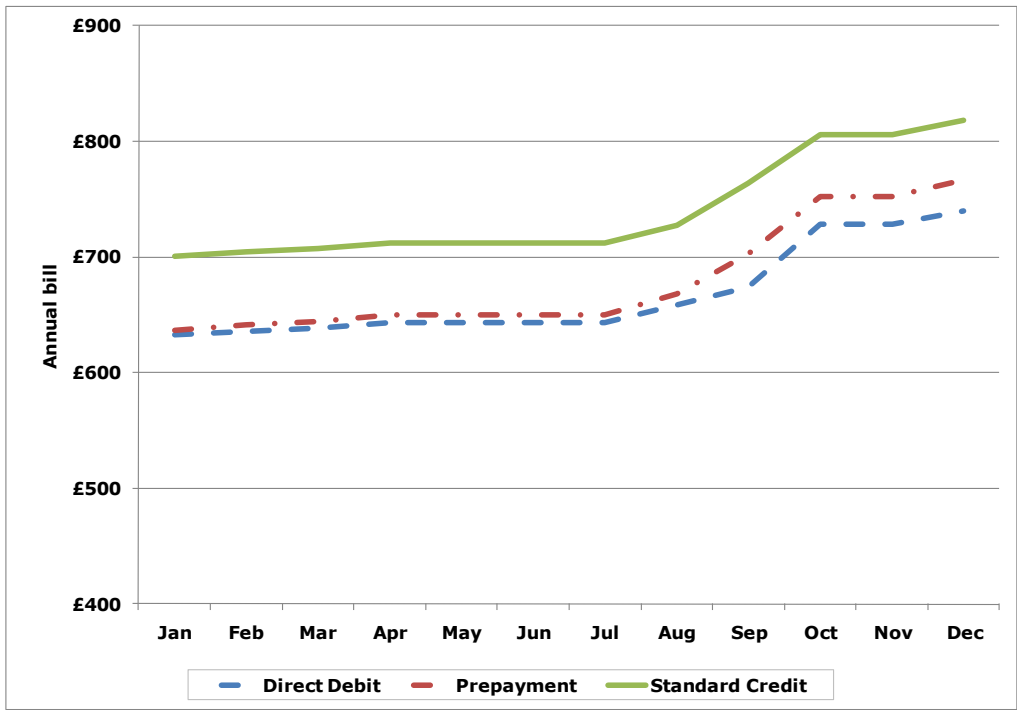
419. Figure 10 shows the change in average domestic gas bills in GB's gas market between January and December 2011. Overall, average gas bills increased by 20.3% (£128) over the

¹⁹⁹ 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.

²⁰⁰ 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.

year.²⁰¹ The first half of the year was characterised by gradually rising bills for all three payment methods. This trend accelerated between August and September as the Big 6 announced increases in their gas prices.

Figure 10: Average domestic gas bills by payment method, Jan – Dec 2011



Source: Ofgem

Notes: 1) Standard tariffs 2) Medium consumption levels, 16,500kwh per year

420. As well as monitoring domestic gas bill levels, we also assess the extent to which costs have an impact on these bills. Suppliers face a range of costs that influence how they set retail gas prices. These costs can vary within and between years, and include wholesale energy costs, the costs of UK Government policies such as the Warm Home Discount, and transmission and distribution costs. Ofgem explores through a quarterly Supply Market Report the relationship between retail bills and underlying costs.²⁰² Our December 2011 report provides information on how average supplier costs changed in 2011 and how retail prices changed in response to these.²⁰³

Switching rates

Domestic

421. 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

²⁰¹ Change for the three payment methods was: Direct Debit, 16.9% (£107); Pre-Payment, 20.4% (£130); Standard Credit, 16.8% (£118).

²⁰² However, the Supply Market Report has been published weekly on the Ofgem website from February 2012 onwards.

²⁰³ Ofgem (Dec 2011), [“Electricity and Gas Supply Market Report”](#)

use this data to calculate switching rates. In 2011, 3.2m domestic consumers switched their gas supplier, equivalent to 272,000 per month. This is a switching rate of 15%.

422. As part of our monitoring of switching rates, we also commissioned IPSOS MORI, an independent research company, to explore switching with consumers on an annual basis. Recently, the company interviewed a sample of 1,232 domestic gas customers on a face-to-face basis and explored whether they had switched in 2011, their reasons for switching (or not), and what would make them more likely to switch. It found that in 2011, 13% of the sample said they had switched gas supplier in the previous year.

423. In 2011 we also published the results of two additional strands of qualitative research with consumers. Firstly, findings from discussions with our Consumer First Panel, which includes 100 consumers from across Great Britain²⁰⁴ and secondly, the findings from 10 qualitative focus groups and 8 in-depth interviews with different types of vulnerable consumers from across Great Britain.²⁰⁵

424. The evidence base gathered from our regular consumer research helped to inform the initial findings of our Retail Market Review²⁰⁶ published in March 2011 as well as our ongoing policy work and development. We considered that consumer engagement levels in the market were low, and that this was contributing to levels of competition within the retail energy markets not being as strong as it might be. In December 2011 we drew on this, and other, evidence and published our domestic Retail Market Review proposals.²⁰⁷ Our RMR Core domestic proposal includes features that aim to improve consumers' ability to identify the best gas deal and make informed switching decisions.

Non-Domestic

425. Our non-Domestic RMR proposals, published in November 2011²⁰⁸, examined issues around non-domestic switching. We found evidence that suppliers were objecting to customer transfers more than we would expect. And we have received complaints from, or on behalf of, businesses concerning the ease of switching. In particular, data shows that most suppliers object to around a quarter of attempted transfers. We believe that this experience could negatively affect non-domestic customers' perceptions of the energy industry and their willingness to engage in switching in the future.

426. To improve non-domestic consumers' experience of switching, we published an open letter to suppliers reminding them of their obligations and what we consider to be good practice²⁰⁹. We will also use our market monitoring powers to ask suppliers for data on their objections actions.

427. We currently collect voluntarily provided data from non-domestic suppliers on customer numbers and switching levels, but differences in customer segmentation make it difficult to compare suppliers against each other and to track the switches made by customers in given subsets of the non-domestic market. This is partly a reflection of differences in the way suppliers define non-domestic customers. For example, suppliers often choose to segment

²⁰⁴ Ofgem Consumer First Panel Year 3, Report from the second set of workshops, Opinion Leader, March 2011

²⁰⁵ FDS International (March 2011), "2011 Vulnerable Customer Research"

²⁰⁶ Ofgem (March 2011), "[The Retail Market Review: Findings and Initial Proposals](#)"

²⁰⁷ Ofgem (Dec 2011), "[The Retail Market Review: Domestic Proposals](#)"

²⁰⁸ Ofgem (Dec 2011), "[The Retail Market Review: non-Domestic Proposals](#)"

²⁰⁹ Ofgem (Dec 2011), "[The Retail Market Review: non-Domestic Proposals- Appendix 3](#)", p.49

their customers by energy consumption or number of sites, but use different criteria to define their small, medium and large customers.

428. Further, as Table 19 above has shown, there are many more non-domestic suppliers than domestic and the market is considerably more fragmented than the domestic market. This makes it more challenging to collect switching data in a consistent way. However, we are currently investigating ways to collect a consistent source for non-domestic switching rates.

Disconnection rates

429. Ofgem requires gas suppliers to record and report on the number of disconnections they carry out on domestic customers. Suppliers are required to submit quarterly and annual returns on disconnections. Ofgem also submits these returns to Consumer Focus, the consumer advocacy body. The data we receive allows us to monitor disconnection rates between suppliers and the rate of change between quarters and years. It also gives us a basis to engage with suppliers if they have an abnormally high number of disconnections. Our latest quarterly and annual reports on gas disconnections can be found at our [Social Obligations Monitoring webpage](#)²¹⁰. In summary, there were 128 gas disconnections in Q3 2011. This represents a 58% decrease from the 305 disconnections reported in Q3 2010.

Charges for and the execution of maintenance services

430. To assess performance, the 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 gas bills are maintenance costs associated with the volume of maintenance work undertaken.

431. The value in this information to Ofgem is to allow 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.

Complaints by household consumers

432. Ofgem does not directly monitor domestic customer complaints. However, we do set the standards that suppliers must adhere to when dealing with and processing customer complaints.²¹¹ If a consumer wishes to make a complaint about their gas supplier, they should contact the relevant supplier in the first instance. The supplier then has eight weeks to resolve the complaint. If a customer requires assistance with their complaint, they can go to Consumer Direct²¹² for independent advice and information. Consumer Direct will assess whether they are dealing with vulnerable customers or customers threatened with disconnection, and where applicable, refer them directly to Consumer Focus. Consumer Focus has a dedicated Extra Help Unit to deal with vulnerable customers' complaints.²¹³

²¹⁰ <http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Pages/SocObMonitor.aspx>

²¹¹ The complaint standards are prescribed by "The Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008" which come into force on 1 October 2008 and are published at: http://www.opsi.gov.uk/si/si2008/uksi_20081898_en_2#pt2-l1q3

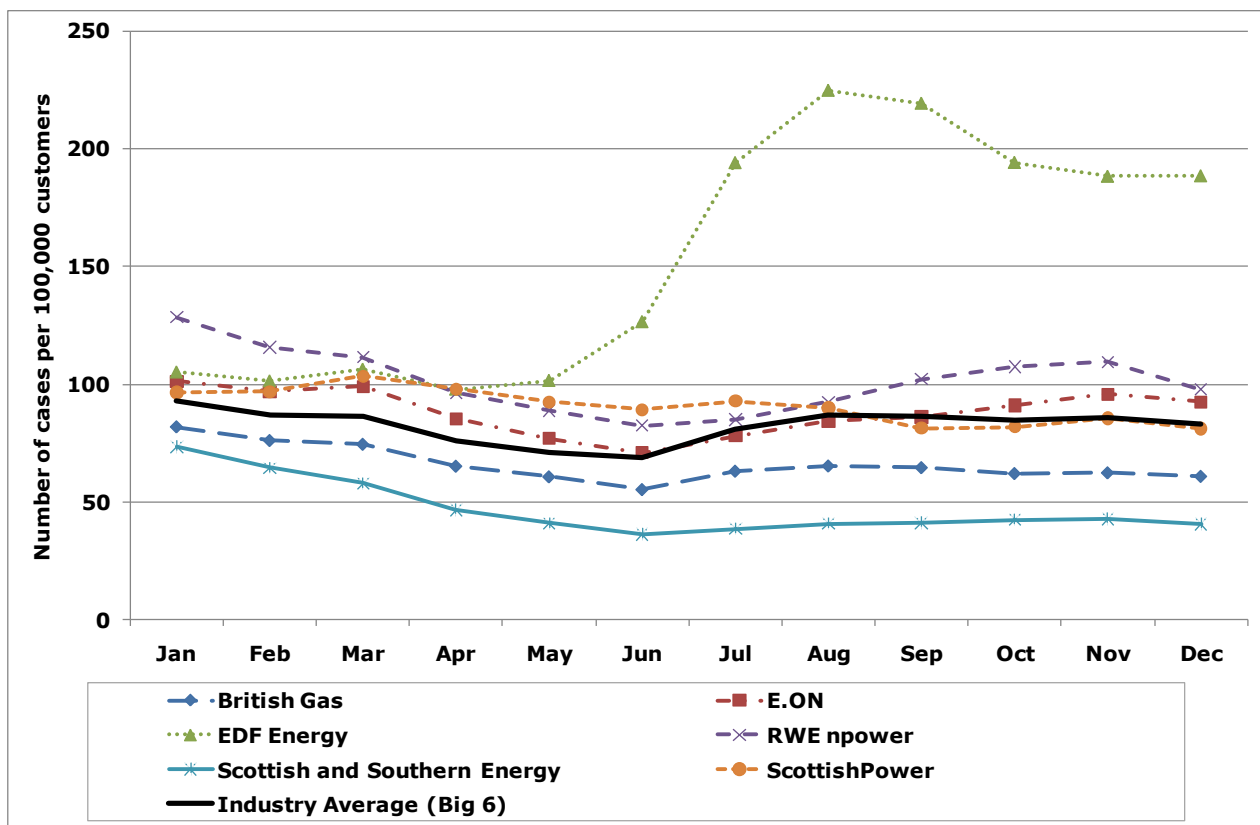
²¹² More information on Consumer Direct is available here <http://www.consumerdirect.gov.uk/>

²¹³ More information on the Consumer Focus Extra Help Unit is here <http://www.consumerfocus.org.uk/about-us/extra-help-unit>

433. If, at any point before the eight week time period prescribed in the complaints handling standards, 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 Energy Ombudsman. The Energy Ombudsman, 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 the power to make a financial award to the customer of up to £5000. Its decisions are binding on the energy company but not the customer.

434. Figure 10 below shows, for the Big Six suppliers, the number of cases per 100,000 customers received by Consumer Direct and referred onto the suppliers’ dedicated handling teams, Consumer Focus’s Extra Help Unit, or the Energy Ombudsman. Consumer Focus’ methodology takes account of both the seriousness of the complaint and suppliers’ markets shares, and weights the data accordingly.²¹⁴ It is not possible to break down these figures for the gas market only, therefore, data represents relevant contacts for issues relating to both gas and electricity. The data shows that complaints were on a downward trend during the first half of 2011, however they began to rise again in June and July. This coincides with price increases by the main energy suppliers, which were announced around that time.

Figure 10: Domestic suppliers’ performance on cases received by Consumer Direct, Consumer Focus Extra Help Unit and the Energy Ombudsman, Jan-Dec 2011



Monitoring restrictive contractual practices (Article 41(1)(k); Respecting contractual freedom (Article 41(1)(l))

433. Please see paragraphs 240-241.

²¹⁴ Full details of the methodology can be accessed on the Consumer Focus website at <http://energyapps.consumerfocus.org.uk/performance/methodology>

Contributing to the compatibility of data exchange processes (Article 41(1)(u))

435. Ofgem is obligated under the Gas Act 1986 – 4D (2) (f)) to cooperate with ACER and other NRAs to establish coordinated network codes, we have fully contributed to development of the Draft Framework Guidelines on Interoperability and Data Exchange Rules. The draft guidelines propose to place a responsibility on all European Transmission System Operators (TSOs) to adhere to a common, standardised messaging protocol to facilitate the smooth exchange of information among TSOs and other relevant parties.

4.2.3 Recommendations on supply prices

436. As with electricity, 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 and therefore 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.

437. However, 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 in order to ensure the gas markets are sufficiently competitive and deliver the best outcomes for consumers, namely²¹⁵ clearly comparable; transparent and non discriminatory prices. Article 3 also highlights Member States’ obligations to protect vulnerable consumers. As part of this, we highlighted through our RMR the differentials between Prepayment Meter (PPM - the method by which most vulnerable consumers pay for energy) and other payment methods. The analysis showed that suppliers had reduced the premium charged for PPM customers, largely as a result of SLC 27.2A.^{216,217} And our Retail team regularly monitors these differentials through its ongoing analysis work. We also produce an annual report that assesses domestic suppliers’ progress in meeting their social obligations, including reporting on average levels of debt per consumer and average debt repayment periods.²¹⁸

4.2.4 Carry out investigations and imposing measures to promote effective competition

438. Please refer to section 3.1.5

4.3 Consumer protection

Compliance with Annex 1

439. Under *Article 41(1)(o)*, Ofgem has a duty to ensure compliance with the provisions of Annex 1 of the Gas Directive. We have achieved this through amendments to both licences and domestic legislation. The relevant provisions, where they were not already reflected in relevant licences or in domestic legislation, have been incorporated into the relevant licences or into domestic legislation through amendments made by the GB Regulations. The majority of the requirements of Annex 1 of the Gas Directive are either “relevant conditions” or “relevant

²¹⁵ Our interpretation of Article 3 is that paragraphs 2 and 3 are of most relevance to supply prices – these Articles are concerned largely with consumer protection in general and vulnerable consumer protection in particular.

²¹⁶ Ofgem (March 2011), [“The Retail Market Review: Findings and Initial Proposals”](#), p.25

²¹⁷ SLC 27.2A of the supply licence stipulates that any difference in terms and conditions between payment methods for paying charges for the supply of domestic electricity or gas shall reflect the costs to the supplier of the different payment methods. The licence condition clarifies that price is included in the definition of terms.

²¹⁸ Ofgem (June 2011), [“Domestic Suppliers’ Social Obligations: 2010 Annual Report”](#)

requirements” for the purposes of the Gas Act 1986; all of which are enforceable by Ofgem. Ofgem are not aware of any instances of non-compliance with Annex 1 in 2011.

440. Please see section 3.3 for more information on how we met our consumer-related obligations in 2011.

4.4 Security of supply (if and in so far as NRA is competent authority)

441. The Department for Energy and Climate Change (DECC) is the competent authority for gas Security of Supply in the UK. However, Ofgem is currently working on a Gas Report, looking at Security of Supply in light of GB’s declining indigenous gas sources. This will be completed during 2012.

Northern Ireland Authority for Utility Regulation 2011 National Report

Date of Submission: 31 July 2012

Overview:

Northern Ireland (NI) is part of the Member State that is the United Kingdom (UK). Geographically it shares the island of Ireland with another Member State - Ireland, with whom it has recently entered into a Single Electricity Market (SEM) covering the island. The year 2011 was the fourth full year of operation of the SEM. Ireland and Northern Ireland are currently considering a similar arrangement for Gas - the Common Arrangements for Gas (CAG). NI is connected electrically to Great Britain (GB, the 'mainland' of the UK) by the Moyle interconnector and also into the GB gas network.

The Utility Regulator's Annual Energy Retail Report is available at:

http://www.uregni.gov.uk/publications/utility_regulators_annual_energy_retail_reports/

The SEM Annual report for 2011 is due to be published by Quarter 3 2012. However the SEM Annual Report for 2010 is available at:

http://www.allislandproject.org/en/wholesale_overview.aspx?article=9fe266b6-27a8-4692-909e-217048f9791d

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1 Foreword

2011 was a year which saw further developments of the Single Electricity Market (SEM), particularly with new generation entering the market and also the working towards future regional integration.

The economies of both jurisdictions are still in a state of transition and uncertainty over fuel price trends remains. Given this environment, energy tariffs still remain under close scrutiny and the demand for regulatory transparency and effective action to protect customers remained at the forefront of public energy policy and of public opinion.

2 Main Developments in the gas and electricity markets

2.1 Electricity

442. The year 2011 was the fourth full year operation of the Single Electricity Market, the first cross border market in Europe that embraces full integration of market operation and of regulation.

443. Work is ongoing with new harmonised arrangements for ancillary services having been introduced; a harmonised approach for generator use of system charging has been undertaken; and the treatment of losses and the treatment of intermittent generation in dispatch and in the market schedule is also ongoing.

444. During 2011 the Regulatory Authorities have progressed market integration with neighbouring markets in light of increased interconnection (in the form of the East West interconnector due to come on stream in October 2012) and an emerging EU blueprint for a single European electricity market. The SEM Committee issued a Decision Paper (SEM-10-11)²¹⁹ in March 2010 on the approach for integrating the SEM into the wider regional and European electricity markets.

445. Following finalisation of the Capacity Allocation and Congestion Management (CACM), the SEM Committee commenced a project to meet the CACM target models. In 2011 the SEM Committee published its Market Integration Project Initiation Document² for information.

446. Several workshops and bi-lateral meetings with participants were held to discuss and explore issues related to the design of the SEM and how it can be aligned or otherwise with that of the 'target model' for electricity, as outlined in the Framework Guidelines on Capacity Allocation and Congestion Management (FGCACM)

2.2 Gas

447. Significant increases in wholesale fuel costs led to volatile consumer prices. We advanced price controls on three different gas businesses during the year. In the case of Phoenix Natural Gas Limited, the company rejected our price control decision and proposed licence modifications, leading to a Competition Commission (CC) referral.

²¹⁹ <http://www.allislandproject.org/GetAttachment.aspx?id=8dd9e94f-8330-46ce-81b3-ad9ea360ea18>

448. There continued to be developments associated with the growth of the natural gas market, and we consulted on a gas storage licence for the first time.

449. We continue to promote competition in the natural gas market. During the year we took steps to support the increase to consumer switching thresholds in the Greater Belfast area. This was to ensure that any desire by consumers to switch their supplier was not frustrated by system constraints. There has been record number of confirmed switches, between gas suppliers, by domestic non-prepayment consumers during June 2011.

450. We are continuing to progress arrangements for harmonising gas transmission systems across the island of Ireland, we work closely with Commission for Energy Regulation (Ireland) on the project.

3 Regulation and Performance of the Electricity Market

3.1 Regulatory Issues

3.1.1 Unbundling

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

451. The requirements of Directive 2009/72/EC were transposed into Northern Ireland law on 15 April 2011 through The Gas and Electricity (Internal Markets) Regulations (Northern Ireland) 2011. In May the SEM Committee decided that the issue of Transmission System Operator (TSO) certification was a SEM matter and that it was therefore responsible for the process of certification in accordance with the legislative provisions in Northern Ireland and Republic of Ireland. The Utility Regulator on behalf of the SEM Committee then issued guidance to potential applicants in Northern Ireland in December.

452. The Northern Ireland legislation places the obligation to be certified on the transmission system owner which is NIE Limited and it was therefore anticipated that the application would be on the grounds of Article 9(9) of the Directive. NIE was at the date of the test, 3 September 2009, a company within a vertically integrated undertaking, being part of the Viridian Group with power procurement and supply interests in Northern Ireland and generation interests in the Republic of Ireland. By the date of application NIE ownership had been acquired by ESB which had extensive generation and supply interests in the SEM. It was also anticipated that the Moyle Interconnector between Northern Ireland and Scotland would also seek certification under the full ownership unbundling model.

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),)
- Monitoring time taken to connect and repair (Article 37(1)(m))
- Monitoring technical co-operation between Community and third-country TSOs (Article 37(1)(s))
- Monitoring safeguard measures (Article 37(1)(t))

453. The System Operator, SONI, annually publishes the Generation Adequacy Statement which provides its forecast of generation capacity and forecast electricity demand for the

upcoming ten-years. This allows for the assessment of capacity margins and identifies areas in which these could be increased, which highlights area of potential future investment. Above all the Generation Capacity Statement provides an estimation of future security standards based on expected generation capacity margins.

454. 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.

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

455. Electricity Suppliers in Northern Ireland pay a number of regulated charges which they in turn must 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 2011 was published by the Utility Regulator on 15 August 2011, detailing the use of system tariffs for that year.

456. The transmission network owner in NI is NIE plc. NIE is also the distribution system owner and operator. It has a 5 year price control running from 2007 to 2012. 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 (mainly statutory maintenance etc.) 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.

457. 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))
- Monitor TSO investment plans in view of TYNDP art 37(1)(g)
- Cooperation (Article 37(1)(c))

458. 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.

459. During 2011 capacity was auctioned on a monthly or annual basis and this was done manually (couriered bids opened under regulatory supervision). However work has begun to

develop an electronic system which will support weekly, daily or even shorter auctions. This is due for delivery in October 2011 to coincide with the entry of a second interconnector between Ireland and GB (known as the East – West Interconnector), being developed by Eirgrid, the TSO for Ireland.

460. Additionally the export capacity to GB of Moyle has been increased to 300MW (this is limited during the summer months to 287MW). The export capacity is limited below the full capacity of the line due to system security constraints.

461. Full compliance with congestion management guidelines will, however, also depend on developments in the SEM. This is a day ahead gross mandatory pool i.e. no trading can occur after 10.00hrs on day -1. The SEM committee has approved an option for intra day trading which is currently being developed to be in place by Q3 2012.

462. As a result of the 2009 infringement letter and subsequent reasoned opinion letter of June 2010, it is currently planned to make Moyle fully compliant with congestion management guidelines by 2012 at the latest.

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))
- Power to carry out investigations and impose measures to promote competition etc. (art. 37(4)(b) + 35(5)(a))
- Power to ask any information from elec undertakings (art.37(4)(c))
- 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))

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

3.1.6 Dispute Settlement

- Article 37(11), 37(5)(c), Article 37(4)(e)

464. 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.

465. 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.

466. 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.

467. In June 2011 the Utility Regulator published its "*Policy on the Resolution of Complaints, Disputes and Appeals*"²²⁰. 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.

The regulation of the tasks of transmission and distribution companies

468. The transmission network owner in NI is NIE plc. NIE is also the distribution system owner and operator. It has a 5 year price control running from 2007 to 2012. It's 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 (mainly statutory maintenance etc.) 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.

469. 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). SONI has a 5 year price control from 2010 – 2015. Its revenue is collected via Transmission Use of System (TUoS) and System Support Services tariffs (SSS). SONI is also the interconnector administrator for the Moyle interconnector. During 2010 the price control for the period up to 2015 was consulted upon. The method for allocating charges for use of the transmission system was also reviewed in 2010, with improved cost reflectivity being implemented from October 2011.

3.2 Promoting Competition

3.2.1 Wholesale Markets

470. The all-island Single Electricity Market (SEM) is the combination of two separate jurisdictional electricity markets in Ireland and Northern Ireland and is governed by the SEM Committee (SEMC). The SEMC consists of the Commission for Energy Regulation in Ireland, the Utility Regulator in 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 www.allislandproject.org

471. 2011 was the fourth full year of operation of the Single Electricity Market (SEM) – it commenced operation on 1 November 2007. 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.

472. Further interconnection between Ireland and GB is planned however the very different market arrangements currently limit the extent of trading between BETTA and the SEM.

²²⁰ The full document can be found at the following link:

http://www.uregni.gov.uk/uploads/publications/Utility_Regulator_Appeals_Complaints_and_Disputes_Policy_June_11.pdf

During 2009 a programme by the regulators to identify and remove short and long term barriers to trading commenced.

3.2.1.1 Price Monitoring

- Article 37(1)(i) and Article 37(1)(j)

473. The Market Monitoring Unit (MMU) forms part of a Market Power Mitigation strategy developed by the 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.

474. The MMU continuously reviews generator participants' behaviour in the market, including investigations into the exercise of market power, and monitoring 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.

3.2.1.2 Monitoring the Level of transparency, including compliance with transparency obligations, and the level an effectiveness of market opening and competition

- Article 37(1)(i), Article 40(3) and Article 37(1)(u)
- Article 37(1)(j)
- Article 37(1)(k)
- Article 37(1)(l)

475. 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 2011 is due for publication in August 2012.²²¹

476. The Market Operator for the SEM (SEMO) publishes all commercial and technical data relating to bids for any trading day. This information is published 4 days after the trading day, and also includes all relevant price information for each half hour period.

3.2.2 Retail markets

3.2.2.1 Price monitoring

- Article 37(1)(i) and Article 37(1)(j)

477. Competition in the retail market was set up in Northern Ireland in a progressive way, starting on the non-domestic sector in 1999, and extending to the domestic market in 2007.

478. Domestic competition effectively started in June 2010 in the electricity market. Since then, more suppliers have been attracted to our markets. There are currently 8 active suppliers in the electricity sector, 5 of them operating in both, domestic and industrial sectors.

479. To keep the development of the retail energy sector in Northern Ireland under closer review, we regularly gather and analyse a set of information. Following the principle of transparency, we publish related reports.

²²¹ For previous Annual reports please see:
http://www.allislandproject.org/en/wholesale_overview.aspx?article=9fe266b6-27a8-4692-909e-217048f9791d&mode=author

480. The Utility Regulator's annual *Energy Retail Report*²²² 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.

481. The *Quarterly Transparency Reports*²²³ provide quarterly information on a specific set of data for the energy sectors.

3.2.2.2 **Monitoring the level of transparency, including compliance with transparency obligations, and the level and effectiveness of market opening and competition**

- Article 37(1)(i), Article 40(3) and Article 37(1)(u)
- Article 37(1)(j)
- Article 37(1)(k)
- Article 37(1)(l)

482. The indicators we are quarterly informing about 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.

483. In the domestic sector there is still a big share of customers remaining with the previously incumbent supplier. However this situation is progressively changing, and by March 2012 the percentage of domestic credit customers (including direct debit) supplied by Power NI was 85%. In the domestic keypad sector, by March 2012 Power NI share has decreased to 92%.

484. Competition is more mature in the non-domestic market. In the first quarter of 2012, the share of the non-incumbent suppliers in the non-domestic sector was around 85% of the volume supplied to this sector.

485. NI electricity domestic price for medium customers – using current NI tariff applying from Oct 2011 for an average customer consuming 3,300 kWh per annum – is close to the average of the EU countries in the band of 2,500-4,999 kWh.

486. The customer complaints procedure in Northern Ireland is detailed on our website: 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 detailing a transparent, simple and inexpensive 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 both in contracts and on bills.

487. If customers are not satisfied with the supplier's handling of, or response to their complaint they may ask the Consumer Council for Northern Ireland to intervene on their behalf. The Consumer Council has statutory responsibility to assist electricity customers with complaints at the second stage (after the supplier process has been exhausted).

²²² http://www.uregni.gov.uk/publications/view/utility_regulators_annual_energy_retail_reports/

²²³ http://www.uregni.gov.uk/news/view/utility_regulator_publishes_retail_energy_market_monitoring_report/

488. 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 website: http://www.uregni.gov.uk/uploads/publications/Utility_Regulator_Appeals_Complaints_and_Disputes_Policy_June_11.pdf

489. The recording and reporting procedure for enquiries and complaints is currently under review. The Utility Regulator is currently working with the Department for Enterprise, Trade and Investment which has responsibility for energy and consumer policies in Northern Ireland to implement the third package of European energy legislation, ensuring Northern Ireland energy customers are protected to the degree required by the Directives. On implementation of the third package, the current Code of Practice on Complaints Handling Procedures will be reviewed and updated in order to be fully compliant.

490. Under its Competition Law powers, the Utility Regulator has not been involved in any cases of restriction of competition or restriction of contractual practices.

491. The modifications to licences as a result of IME3 will see further improvement of the transparency afforded to energy consumers by licence holders. Each of the conditions aim to ensure energy consumers are better informed about their choices in the energy market and can fully understand their charges, contracts, consumption and rights in relation to dispute settlement. In order to ensure compliance with the conditions, a number of reporting requirements are placed on licence holders to enable monitoring by the UR.

3.2.3 Recommendations on supply prices

- Article 37(1)(o)

492. 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.

3.2.4 Carry out investigations and imposing measures to promote effective competition

- Article 37(4)(b)

493. 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.

494. The UR agreed with NIE (network owner) the scope, timeline and cost recovery arrangements for a project that would deliver a new retail market system in Northern Ireland. These new systems and processes put in place allow unlimited domestic customer switching and create a level playing field for all existing and new entrant suppliers. Without the necessary systems in place to support a fully competitive retail market supply competition would always be hampered.

495. A three year project to develop a new system called the Enduring Solution (ES) is due for implementation in 2012. Following this in September of 2012 we will see the creation of a harmonised market schema that is in place in both Northern Ireland and the Republic of Ireland. The all island schema has been developed by industry after direction from the UR and The Commission for Energy Regulation. The schema will remove the need for suppliers operating in both jurisdictions to have separate systems and processes and will reduce costs.

3.3 Consumer protection

- Compliance with Annex 1 (Article 37(1)(n))
- Ensuring access to consumption data (Article 37(1)(p))
- Public service obligations
- Vulnerable customers definition

496. Article 11A of the Electricity Order²²⁴ provides the Authority with powers to impose conditions on licensees to give effect to this obligation. Part VI of the Energy Order²²⁵ 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 in part II of the electricity supply licence, Customer Related Conditions. The implementation of the third package will see these conditions further enhanced.

497. The Utility Regulator ensures customer access to consumption data via conditions in the supply licences. Licence Condition 38²²⁶ ensures that customers are informed of their consumption and that information is provided in such detail and format approved by the Utility Regulator and the consumer representative body. On implementation of the third package, the updated licence conditions will ensure that consumers will be entitled to further detailed information on their electricity consumption.

498. The definition of vulnerable customers used by the Utility Regulator is the same one used by the Department of Trade, Industry and Investment which comprises the existing Energy (Northern Ireland) Order 2003²²⁷ categories of vulnerable customer to which the Department and the Utility Regulator must have regard. The Energy Order identifies these electricity customers as:

- individuals who are disabled or chronically sick
- individuals of pensionable age;
- individuals with low incomes; and
- individuals residing in rural areas.

3.4 Security of Supply

- Implementation of safeguard measures Art. 42

499. The Fuel Security Code is designed as a Northern Ireland response to a Fuel Security Event. The Fuel Security Code currently in force in Northern Ireland under the Electricity

²²⁴ <http://www.legislation.gov.uk/nisi/1992/231/article/11A>

²²⁵ <http://www.legislation.gov.uk/nisi/2003/419/part/VI/made>

²²⁶ [http://testsite.niaur.gov.uk/uploads/publications/NIE_Energy_Ltd - 22 March 2012 Supply Licence - Consolidated Working Copy 2.pdf](http://testsite.niaur.gov.uk/uploads/publications/NIE_Energy_Ltd_-_22_March_2012_Supply_Licence_-_Consolidated_Working_Copy_2.pdf)

²²⁷ http://www.legislation.gov.uk/nisi/2003/419/pdfs/uksi_20030419_en.pdf

(Northern Ireland) Order 1992 as amended (the 1992 Order) was drafted in 1992 (the 1992 Code) by the then Department of Economic Development, now Department of Enterprise, Trade & Investment (the Department) following the privatisation of Northern Ireland Electricity.

500. 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.

501. 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.²²⁸

3.4.1 Monitoring Balance of supply and demand

- Article 4

502. SONI prepare an annual Generation Capacity Statement which covers both demand predictions and the generation margins. The latest statement published in December 2011 shows:

- Current level of electricity peak demand is 1935 MW. This has been forecasted to reach 2070 MW by 2021. These forecasted peaks are an increase on previous estimates;
- 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 2012 to 2021 there is sufficient generation capacity to achieve compliance with the generation security standard. The report sets out that 2019 is likely to be the year Northern Ireland has the least surplus generation (circa 178MW) mainly due to reasons set out above. 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;
- The current available total fossil fuel net generating capacity is 2321 MW. This figure excludes available capacity via imports on interconnector and tie lines. There is also 429 MW of Partially dispatchable or non dispatchable generation capacity (including 405MW of Wind) installed on the NI system;
- Imports of 450 MW from GB and 100 MW from Ireland are expected to be available to support security of supply.

503. 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. Another project is the East – West Interconnector, a 500 MW capacity transmission line linking Britain’s power system to Ireland’s electricity grid, expected to be completed in October 2012. To view SONI’s most

²²⁸For further information please see: http://www.detini.gov.uk/microsoft_word_published_fuel_security_code_16_dec_2011.pdf

recent Generation Adequacy Report (2012) see: <http://www.soni.ltd.uk/upload/All-Island%20GCS%202012-2021.pdf>

3.4.2 Monitoring Investment in Generation capacities in Relation to Security of Supply

- 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 5-15yrs: Article 7 2005/89/EC

504. In addition to the Generation Capacity Statement SONI are required by licence to publish an annual "Transmission System Capacity Statement"²²⁹ this details the statutory operational requirements, the existing network, its configuration and its planned development over the seven year period to 2017/18.

3.4.3 Measures to cover peak demand or shortfalls of suppliers

- Article 4

505. The Transmission System Capacity Statement analyses the potential for the system to meet peak demand.

²²⁹ http://www.soni.ltd.uk/upload/2011_TSCS_PRINT_VERSION.pdf

4 The gas market

4.1 Network regulation

4.1.1 Unbundling

- Articles 10,11 2009/72/EC and Article 3 Regulation (EC) 715/2009
- Article 26

506. NI has two DSOs. In our last report we stated that both these DSOs have supply businesses. Since the previous report was submitted Phoenix Supply Ltd. has been purchased by Airtricity Gas Supply (NI) Ltd and from 22 June 2012 been renamed Airtricity Gas Supply (NI) Ltd (**Airtricity**). As before the other DSO does not have, and does not expect to ever have, more than 100,000 customers. It remains an integrated D&S business.

507. 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.

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))
- Monitoring time taken to connect and repair (Article 41(1)(m))
- 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))

508. NI currently has no gas storage facilities. However storage developers are at an early stage with one storage company having applied for a storage licence. The Utility Regulator has published a decision on the 3rd party access regime for the proposed facility in line with European requirements.

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)
- Prevention of cross-subsidies (Article 41(1)(f))
- Regulated and negotiated access to storage 41(1)(s)

Network Tariffs

Distribution

509. 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. A co-ordinated period is being established for the two distribution companies operating in Northern Ireland (Phoenix Natural Gas Ltd and Firmus Ltd), to provide a more transparent benchmarking process.

510. The distribution system operator proposes the tariff structure; the Regulator reviews and approves the structure, and then monitors execution. In terms of the regulatory period the distribution system operators have licences extending 30 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, connection charges, to market participants etc. and this information is available on the website of the individual distribution system operators.

511. In relation to the overall regulation of distribution companies the Consumer Council NI (a consumer representative body) is consulted upon in relation to the regulation of distribution companies. At present the regulation of the performance of the network does not include guaranteed standards of service measures which have to be upheld by the distribution licence holders. However, guaranteed standards of service measures are currently being developed for the distribution network and will have associated quality of service indicators.

512. 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

513. At the transmission level, tariff methodology is set by the regulator and tariff setting is overseen on an annual basis. The current postalised transmission tariff is 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 a single forecast transmission tariff is calculated for all sectors. A reconciliation process is applied at the end of the year when actual volumes, capacity and revenues are known.

514. The postalised methodology will be replaced by an entry exit regime as required by Regulation (EC) 715/2009.

515. The TSOs are also price controlled in Northern Ireland. The regulatory approach to the price control depends upon the financing model under which the TSO operates.

516. To improve the rate at which certain pipelines are financed, the Northern Ireland Authority for Utility Regulation has employed a 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.

517. 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.

518. On 29 June 2012 the Utility Regulator published its decision in relation to the tariff arrangements for short term daily and Virtual Reverse Flow (VRF) products in NI which sets out the short term capacity multipliers and the annual charge per exit point registration and/or per each extension of an existing exit point registration for VRF.

LNG

519. 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))
- Cooperation (Article 41(1)(c))
- Monitoring investment plans and assessment of consistency with Community-wide network development plan Article 41(1)(g)

520. The Utility Regulator and Commission for Energy Regulation (CER) have since 2008 worked closely with each other, with the Departments and with the industry, in seeking to progress the CAG project. Work is currently being undertaken to address CER's concerns regarding how a single balancing zone should operate under CAG.

521. Both the Utility Regulator and the CER have designated Gormanstown as the relevant point on the South North pipeline in compliance with Gas Regulation (EC) No 715/2009.

522. We will continue to liaise with the CER on a number of cross-border issues including for instance the gas projects which have been submitted as potential projects of common interest in energy infrastructure.

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))
- 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))
- Power to carry out investigations and impose measures to promote competition etc. (art. 41s(4)(b) + 41(5)(a))
- Power to ask any information from elec undertakings (art.41(4)(c))

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

4.1.6 Dispute settlement

- Article 41(11) and Article 41(4)(e)

524. Under the Gas (NI) Order 1996 billing disputes must in the first instance be referred to the Consumer Council for NI. 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.

4.2 Promoting Competition

4.2.1 Wholesale Markets

4.2.1.1 Price monitoring

- Article 41(1)(i) and Article 41(1)(j)

525. Not applicable in NI Gas Market

4.2.1.2 Monitoring the level of transparency, including compliance with transparency obligations, and the level and effectiveness of market opening and competition

- Article 41(1)(i), Article 44(3) and Article 41(1)(u)
- Article 41(1)(j)
- Article 41(1)(k)
- Article 41(1)(l)

526. Not applicable in NI Gas Market

4.2.2 Retail Markets

4.2.2.1 Price monitoring

- Article 41(1)(i) and Article 41(1)(j)

527. Airtricity Energy Supply (Northern Ireland) Limited (previously Phoenix Supply Ltd) have a regulated tariff for domestic and industrial and commercial customers using less than 25,000 therms per annum. The Utility Regulator enters into a formal tariff review process with Airtricity 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 Airtricity may be initiated at any stage if the Utility Regulator considers that gas prices have increased or decreased enough to warrant a tariff review. T

528. The Utility Regulator monitors the Airtricity 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, UK and ROI.

529. The Utility Regulator also reviews the Airtricity gas purchasing strategy each year and also receives monthly gas purchasing reports from Airtricity showing the volumes and cost of gas purchased each month for the short and long term future.

4.2.2.2 Monitoring the level of transparency, including compliance with transparency obligations, and the level and effectiveness of market opening and competition

- Article 41(1)(i), Article 44(3) and Article 41(1)(u)
- Article 41(1)(j)
- Article 41(1)(k)
- Article 41(1)(l)

530. The Utility Regulator compiles and publishes quarterly transparency reports which provide information on the levels of switching and market shares held by each supplier in the Greater Belfast Gas Market.

531. The Greater Belfast licence area is fully open to competition for all customer and meter types and there are currently four active suppliers operating in this market. These suppliers are Airtricity Energy Supply (Northern Ireland) Limited (previously Phoenix Supply Ltd); firmus energy (Supply) Ltd, Vayu Ltd and Viridian Energy Supply Ltd t/a Energia. Of these suppliers, only Airtricity and firmus energy are active suppliers for the domestic customer market. To date, nearly 15% of the customers in the Greater Belfast market have switched to a supplier other than the incumbent supplier.

532. firmus energy continues to have exclusivity of supply for all customers in the Ten Towns licence area. However from 1st October 2012, the large Industrial and Commercial market (any premises which are expected to exceed 732,500 kWh in a 12 month period) will be open to competition, while the small Industrial and Commercial and domestic market will not open to competition until 1st April 2015.

4.2.3 Recommendations on supply prices

- Article 41(1)(p)

533. In the Greater Belfast gas market Airtricity Energy Supply (Northern Ireland) Limited (previously Phoenix Supply Ltd) 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 company for each year of the control.

4.2.4 Carry out investigations and imposing measures to promote effective competition

- Article 41(4)(b)

534. The Gas Market Opening Group (GMOG) was established by the Northern Ireland Authority for Utility Regulation (NIAUR) 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 licence holders, the Department of Enterprise, Trade and Investment in NI, the Consumer Council in NI and NIAUR. 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.

535. The Northern Ireland Authority for Utility Regulation 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 NIAUR, however the Distribution licence holders also attend to ensure all decisions made for supplier agreements will work in accordance with the distribution market rules.

4.3 Consumer protection

- Compliance with annexe 1 (Article 41(1)(o))
- Ensuring access to consumption data (Article 41(1)(q))
- Public service obligations
- Vulnerable customers definition

536. The Utility Regulator has consulted on licence modifications to be implemented under the EU Third Internal Energy Package. The Utility Regulator’s final decisions on these licence modifications have now been submitted to the Department of Enterprise, Trade and Investment in NI. Subject to their approval, the licence modifications will be enforced for gas supply and distribution companies in NI. Some of the new requirements under the proposed licence modifications will be to provide customers with access to their consumption data, to provide customers with transparent information in relation to tariffs and terms and conditions, to offer customers a range of payment methods, to provide transparent complaints handling procedures, to facilitate supplier transfers within 15 working days, and to provide a code of practice on provision of services for vulnerable customers.

4.4 Security of supply

- (Article 5) (if and to the extent that the NRA is the competent authority)

537. 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.

4.4.1 Monitoring balance of supply and demand

538. 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.

539. 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.

4.4.2 Expected future demand and available supplies as well as envisaged additional capacity

Forecast Total Volumes (bcm)									
2011/2 012	2012/2 013	2013/2 014	2014/2 015	2015/2 016	2016/2 017	2017/2 018	2018/2 019	2019/2 020	2020/2 021

1.364	1.469	1.488	1.503	1.517	1.529	1.541	1.553	1.565	1.582
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[source: data supplied for Joint Capacity Statement 2012)

540. As noted above, 100% of NI gas supplies are currently provided from Great Britain via the NTS Exit Point at Moffat. With the development of the CAG market it is envisaged that NI will have access to additional gas sources from the Republic of Ireland. It is expected that this will include access to indigenous supplies from the Corrib and Inch gas fields and through LNG imports from the planned facilities at Shannon. Additionally there is significant industry interest in developing gas storage facilities in the Larne area of NI. Access to these sources will increase the level of diversification of gas supplies for Northern Ireland and reduce the level of dependence on supplies from Moffat.

541. The Utility Regulator and the Commission for Energy Regulation annually produce a Joint Gas Capacity Statement which examines the capacity of the existing gas network to meet future supply and demand scenarios over a ten year period. This approach ensures that any areas requiring investment are identified and addressed so that future demands on the system can be met.

4.4.3 Measures to cover peak demand or shortfalls of suppliers

542. 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.

543. 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.

544. Supply licenses in NI also require that suppliers have access to gas supplies to meet peak demand during severe winter conditions.