

# 2011 GREAT BRITAIN AND NORTHERN IRELAND NATIONAL REPORTS TO THE EUROPEAN COMMISSION

*In relation to Directives 2003/54/EC (Electricity) and 2003/55/EC (Gas)*

Date of submission: 25 July 2011

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# Ofgem 2011 National Report to the European Commission

## Overview

The Directives on gas and electricity liberalisation stipulate a monitoring and reporting obligation. To that end, this report covers Ofgem's annual reporting requirements to the European Commission, in accordance with Directives 2003/54/EC (electricity) and 2003/55/EC (gas). The Northern Ireland report is found in the other section of this UK response.

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

- Developments in the GB energy markets in 2010 and 2011 Quarter I
- The regulation and performance of the GB electricity market
- The regulation and performance of the GB gas market
- Security of supply
- Public service issues

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 and 2010. Much of the information remains unchanged, although latest data is supplied where relevant. Where background on particular issues is not included, please see the 2010 GB report. It should be noted that not all of this information is under Ofgem's jurisdiction, and 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 2010-11 is available at the link below.

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=15&refer=Aboutus/annlrprt>

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## Ofgem Foreword

Despite the formidable challenges and uncertainties we have faced, and in many cases continue to face, Ofgem has recorded a remarkable year of delivery in 2010-11. International energy markets have seen renewed upward pressures on prices, with consequences for gas and electricity consumers. We and others have been challenging the working of the GB wholesale and retail markets. The country faces a major investment challenge to meet its low carbon and energy security goals and the government has been reviewing our own role and the role of its delivery vehicles, including Ofgem E-Serve.

In Europe, agreement on a range of market reforms (the "Third Package") was a major development which, among other things, confirmed the value of independent economic regulation. We face some uncertainty in relation to its implementation by all Member States. A further challenge will be the development of the Framework Guidelines and codes which will govern cross border gas and electricity transmission within the European Union. We welcome these moves which should result in more effective markets across Europe. Given Ofgem's leadership in the European debates we are, I believe, well positioned to influence this on behalf of GB consumers.

There are also challenges and uncertainties in terms of gas supplies in continental Europe; the new and very different challenges in the US posed by the development of shale reserves; and, globally, the potential reorientation of Liquefied Natural Gas (LNG) deliveries. The events in Japan (and the continuing concerns about its nuclear plants) and the upheavals in the Middle East underline the potential risks GB's increasing reliance on global energy markets brings.

Against this difficult background, Ofgem has achieved a great deal in protecting consumers' interests, both as regulator and in helping to deliver the government's social and environmental programmes through Ofgem E-Serve.

At the end of March 2011, we published our strategy decision document on the new price control regime for gas and electricity transmission and gas distribution. This document follows our new approach to network regulation, RIIO, which was announced by us in October 2010. Under the RIIO approach we will be expecting a step change in the way we expect companies to engage with their customers and deliver services to them. The year also saw major milestones in the new offshore transmission regime, culminating with our decision in March 2011 to licence the first Offshore Transmission Operator. Early experience suggests the new regime, with competitive tendering, is attracting large-scale investment and saving considerable sums for consumers and generators.

We published in March 2011 the findings of our Retail Market Review (RMR) with its radical recommendations to simplify tariffs and increase the liquidity of the electricity generation market. The industry must now respond to the RMR's recommendations but we believe that the companies can use them as a stepping stone to rebuild trust with the consumer. In a period of rising prices this confidence that the companies are "playing straight" with consumers is even more vital.

With so many factors pulling in different directions, confidence and stability are vitally important to help create the climate to generate the investment Britain needs to deliver the low carbon agenda, and meet its future energy needs. We firmly believe that RIIO and RMR will help to achieve this.

E-Serve's performance has shown our ability to deliver the "nuts and bolts" of important programmes in a high quality and cost effective manner, often at very short notice. The rapid introduction of the new Feed in Tariff, which now has more than 30,000 registered

installations, is a leading example. We have also delivered all that has been asked of us by government in the roll-out by government of smart meters. All this has been done against a background of significant uncertainty for the organisation whilst delivering considerable savings in our operational budget.

Those aspects of our work that most immediately affect consumers, especially the more vulnerable, have been particularly well handled and have elicited a favourable reaction from nearly all sides. That is particularly important. Our duty remains to present and future consumers, more and more of whom are finding it harder to cope as fuel bills rise on the back of higher global demand and the need for large scale investment in Great Britain. How much they have to pay for their energy or indeed their ability to meet their bills is often outside the scope of a statutory regulator's scope. But we do, and will continue to, remind others of their responsibilities whilst focussing on our specific sustainable development duties.

We welcome DECC's announcement, on 19 May 2011, setting out the main conclusions to their Review of Ofgem which confirms its commitment to independent regulation and the critical role we will play to help realise the government's energy and climate change objectives. We also welcome DECC's announcement relating to its Delivery Landscape Review which impacts on E-serve activity along with the positive comments about the strong role E-Serve plays in delivering environmental programmes on behalf of DECC. We look forward to working with DECC in taking forward the recommendations of both reviews.

So what about the year ahead – will we face the same levels of uncertainty in the months to come? In areas where government is responsible – in particular in respect of our role and the government's own Electricity Market Reform - I expect to see greater clarity. We will know more, too, about the way the industry will react to our RMR proposals. And as Member States implement the legislation, we should have a progressive Third Package in Europe with I expect the new regulatory agency bedding down well.

Whilst we can look forward to some areas of greater clarity, there will still be difficult issues and uncertainties facing consumers and the energy supply industry at a European and global level. These include the impact - direct and indirect - of the nuclear disaster in Japan, and the major meteorological events associated with climate change which will present a serious challenge for energy regulators wanting to provide as much predictability and stability as possible.

Whatever the challenges and uncertainties, we have a strong governance structure which plays to the strengths, the breadth and depth of expertise, the enthusiasm and commitment of our staff to whom I offer the Authority's warmest thanks.

Against this background, providing the analysis and stability for effective independent regulation is difficult but essential. Despite the conflicting pressures which have meant we have found ourselves having to navigate through "a sea of troubles", we have held the ship stable, the course steady and achieved results very cost-effectively. That is no mean achievement in itself.



Lord Mogg  
Chairman

## Major Developments

### 2.1 Energy markets

#### *Domestic and small business sector*

1. Building on the findings of our Energy Supply Probe (the Probe) initial findings<sup>1</sup> and retail market remedies<sup>2</sup> reports, on 26 November 2010 Ofgem announced the Retail Market Review - an investigation into the markets for electricity and gas for households and small businesses in Great Britain. In March 2011, we published our findings and initial proposals for consultation<sup>3</sup>.
2. We found 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.
3. 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.
4. 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 this consultation document is also an important next step in our ongoing Liquidity work<sup>4</sup>.
5. In March 2011 Ofgem confirmed new rules that mean domestic energy suppliers must give consumers at least 30 days advance notice before putting up their prices<sup>5</sup>. The changes came into effect on 28 April 2011. This is another step in giving consumers more power to make informed switching choices.

#### *Non-domestic market*

6. Following the Probe, we introduced a range of remedies to address contracting practices that were adversely affecting the non domestic consumers. We are concerned that performance against these remedies has not been complete.
7. For instance, suppliers will need to comply more rigorously with the new supply licence condition on protections for micro business consumers (Standard Licence Condition (SLC) 7A)<sup>6</sup>. Under the provisions of the SLC 7A, suppliers are required to provide Micro Business Consumers with information drafted in plain and intelligible language on all matters relating to the duration and the rollover of the Contract, as well as prohibited to terminate the Contract or apply different terms and conditions on the grounds that the customer no longer satisfies the definition of Micro Business Consumer.

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<sup>1</sup> [Energy Supply Probe - Initial Findings Report, \(Ref 140/08\)](#)

<sup>2</sup> [Energy Supply Probe - Retail Market Remedies \(Ref 99/09\)](#)

<sup>3</sup> [The Retail Market Review - Findings and initial proposals \(Ref 34/11\)](#)

<sup>4</sup> Please refer to section on liquidity, p. 28

<sup>5</sup> [Decision to make modifications to standard conditions 23, 14 and 24 of the supply licences \(Ref 43/11\)](#)

<sup>6</sup> [Standard conditions of electricity supply licence](#)

## Wholesale markets

9. In July 2010 Ofgem published a full assessment of GB power market liquidity. This represented the next step in our ongoing Liquidity project, which was launched in 2009 when low liquidity was observed in the GB power market<sup>7</sup>. Our summer 2010 assessment found the market's performance was mixed. At this point, aggregate churn levels were increasing, though weaknesses in longer term liquidity remained. Independent market participants also continued to find that the market was not fully meeting their needs. In March 2011 we published the latest view of GB power market liquidity<sup>8</sup>. This showed churn declining slightly in 2010 as a whole. We therefore put forward our intended market interventions, which will be taken forward subject to the results of a final full market assessment (due to be published in summer 2011), an impact assessment and the views of stakeholders.

10. In the course of 2010, National Grid ran a market transparency project to enhance the information available on its website in order to comply with Article 18 and the revised Chapter 3 Annex to Gas Regulation (EC) No 715/2009. In January 2011 Ofgem issued a consultation<sup>9</sup> 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 letter, published in May 2011<sup>10</sup>, we 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.

## 2.2 Network developments

### *RIIO price controls*

11. 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.<sup>11</sup>

12. 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.

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<sup>7</sup> Our initial assessment of liquidity was conducted in July 2009; Liquidity in the Great Britain (GB) wholesale energy markets, 8/06/2009, Ref. 62/09,

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=58&refer=Markets/WhlMkts/CompanEff>. In February 2010 we put forward possible options for intervention, in the event that the industry did not deliver improved liquidity; Liquidity Proposals for the Great Britain (GB) wholesale electricity market, 22/02/2010, Ref. 22/10,

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=95&refer=Markets/WhlMkts/CompanEff>

<sup>8</sup>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](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR_Appendices.pdf)

<sup>9</sup>[http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/Documents1/consultation\\_on\\_relevant\\_points\\_FinaI%20180111.pdf](http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/Documents1/consultation_on_relevant_points_FinaI%20180111.pdf)

<sup>10</sup>[http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/Documents1/Relevant\\_Points\\_decision\\_letter.pdf](http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/Documents1/Relevant_Points_decision_letter.pdf)

<sup>11</sup> RIIO: A new way to regulate energy networks:

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



13. 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 documents<sup>12</sup> 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.

14. 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.

#### *Transmission Price Control Rollover*

15. To enable the next transmission price review to reflect fully the new RIIO framework, we delayed implementation of a full price control until 1st April 2013, and will be carrying out a one-year rollover of the current price control to operate over the period from 1st April 2012 to 31st March 2013.

16. In April 2011 we consulted on our preferred approach on the policy and financial scope of this rollover and presented our initial assessment of the licensees' business plans<sup>13</sup>. We considered it important that the TPCR4 rollover is proportionate to a one-year control and where possible that the regulatory burden is kept to a minimum. For this reason, and to facilitate a simpler transition to RIIO-T1, we stated our intention not to introduce any new policy for the TPCR4 rollover.

#### *TransmiT*

17. In September 2010 Ofgem launched an independent and open review of transmission charging and associated connection arrangements – project TransmiT<sup>14</sup>. 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. The immediate priority for TransmiT is *electricity* transmission charging and connection issues, which respondents have indicated as an immediate priority. In taking forward TransmiT we are also mindful of the wider policy context of the energy regulation debate, particularly the increased physical interconnection with the European system and the requirement to integrate more closely the wholesale markets, as well as the potential for change to the fundamental market design and charging principles.

#### *Transmission Investment*

18. In April 2010, we introduced the transmission investment incentives framework (TII framework). This provides funding, within the current transmission price control period (TPCR4), for critical large-scale investments that the transmission owners (TOs) identify are required to support the achievement of the Government's 2020 renewable energy targets. At that time, we provided an initial tranche of funding (worth over £300 million) to cover pre-construction work and urgent construction work up to end 2011-12 when TPCR4 expires. We also introduced a process for considering further funding requests from the TOs within the TII framework.

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<sup>12</sup> 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>

<sup>13</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=32&refer=Networks/Trans/PriceControls/TPCR4Roll-over>

<sup>14</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Networks/Trans/PT>

19. Following consideration of funding requests and consultation<sup>15</sup>, in January 2011 we published a decision letter<sup>16</sup> confirming our intention to take forward the 2012-13 arrangements in line with the approach set out in the December consultation. At that time, we provided the next tranche of funding to be provided under our TII framework to cover £95 million of investment planned for the next two financial years (2011-12 and 2012-13) on specific projects.

#### *Offshore Transmission Regime*

20. In March 2011 Transmission Capital Partners (TCP) secured the first licence to operate a high voltage link with an offshore wind farm in GB. This marked the success of the regime's first tender round for £1.1 billion of offshore transmission links to nine offshore wind farms. The tender attracted almost £4 billion of investment appetite from incumbents and new market entrants alike, and is expected to deliver savings of around £350 million. We expect to grant licences for the other eight links in the first round over the next year.

21. The second transitional round already has eight bidders competing for the first three projects to link over 1.4 GW of offshore wind, with the winners to be announced this summer. These projects are worth a further £1 billion with billions more of investment opportunities to be tendered over the coming years.

22. In August<sup>17</sup> and November<sup>18</sup> 2010 together with Department on Energy and Climate Change (DECC) we jointly consulted on the enduring offshore transmission regime that will replace existing transitional arrangements. In December 2010, following the consultation, jointly with DECC we published a consultation response paper<sup>19</sup>. Government and Ofgem have put in place a regulatory regime that facilitates choice in respect of the division of responsibility for the delivery of transmission assets. Under the enduring regime, offshore developers will have the flexibility to choose whether to design and construct transmission assets with a transfer of ownership to an OFTO (offshore transmission operator) taking place after the offshore developer has completed construction, or to seek to appoint an OFTO to construct the transmission assets. DECC and Ofgem are considering the most appropriate timing at which to fully commence the enduring regime.

#### *North Sea Countries Offshore Grid Initiative*

23. On 3 December 2010 a group of nine Member States and the European Commission signed a Memorandum of Understanding concerning the North Sea Countries Offshore Grid Initiative (NSCOGI). The objective of the Initiative is to define a framework for regional cooperation and to find common solutions to questions related to current and future grid infrastructure developments in the North Seas. Ofgem is working with other relevant National Regulatory Authorities to support Member States in this important work.

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<sup>15</sup><http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Networks/Trans/ElecTransPolicy/CriticalInvestments/InvestmentIncentives>

<sup>16</sup><http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=3&refer=Networks/Trans/ElecTransPolicy/CriticalInvestments/InvestmentIncentives>

<sup>17</sup><http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=20&refer=Networks/offtrans/pdc/cdr/Cons2010>

<sup>18</sup><http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=85&refer=Networks/offtrans/pdc/cdr/Cons2010>

<sup>19</sup><http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/Cons2010/Documents1/Government%20response%20to%20offshore%20transmission%20consultations.pdf>

### *Interconnector policy*

24. In September 2010, we concluded a consultation on GB Electricity Interconnector Policy<sup>20</sup> and published a next steps letter setting out our policy priorities. The letter confirmed our commitment to:

- establish an enduring solution for market coupling in the FUI (France/UK/Ireland) region. We are supporting a project established by transmission system operators (TSOs) in North West Europe with the common objective to put in place a single price coupling mechanism.
- remove GB use of system charges from interconnector flows. A decision was taken to exempt interconnectors from GB charges from October 2010.
- coordinate and optimise long-term capacity allocation and use on existing GB interconnectors. EirGrid, Moyle and East West Interconnector launched a procurement process for a common auction platform in July 2010.
- develop and implement a European target model for cross-border intraday trade. Together with the Dutch and Danish Regulators, Ofgem are co-chairing the regulators' group of the North West European project to establish a common approach to intraday trading.

### *Incentivising investment in new cross-border interconnection*

25. An important conclusion of the 2010 consultation on GB Electricity Interconnector Policy was that we would develop a new approach to regulating interconnectors to encourage greater investment. Ofgem has been working with CREG, the Belgium regulator, on a "pilot project" to implement a "cap and collar" model to regulating the rate of return for proposed NEMO interconnector.

### *BritNed*

26. On the 24 February 2011, Ofgem and the Dutch regulator approved the access rules for the BritNed interconnector between GB and the Netherlands. The BritNed interconnector commenced operation on the 1 April 2011. BritNed increased the interconnection capacity between GB and the continent by 1GW (or 50%). The launch of BritNed also saw the introduction of day-ahead market coupling with Central West Europe and is the first market coupling project in GB. Capacity on BritNed is allocated using a combination of long-term explicit auctions and day-ahead implicit auctions.

### *Market coupling on Interconnexion France Angleterre (IFA)*

27. The FUI Stakeholder Group (SG) has agreed to pursue a coordinated approach to couple GB with mainland Europe via both BritNed and IFA. In May 2011, National Grid Interconnectors Limited (NGIL) set out the timeline for market coupling implementation on IFA<sup>21</sup>. To begin with, the NGIL will launch a procurement exercise for an IFA coupling service provider which will also be required to create a GB Hub. The market coupling implementation is due to be finished by the end of 2012.

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<sup>20</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=2&refer=Europe>

<sup>21</sup> [http://www.energy-regulators.eu/portal/page/portal/EER\\_HOME/EER\\_INITIATIVES/ERI/France-UK-Ireland/Meetings1/IG\\_meetings/21supstsup%20France-UK-Ireland%20IG/AD/Minutes%20and%20actions%20points%20from%20the%2021st%20FUI%20IG%20meeting.doc](http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_INITIATIVES/ERI/France-UK-Ireland/Meetings1/IG_meetings/21supstsup%20France-UK-Ireland%20IG/AD/Minutes%20and%20actions%20points%20from%20the%2021st%20FUI%20IG%20meeting.doc)

### *Transmission Network Use of Service (TNUoS) charges on interconnection*

28. In July 2010 National Grid published a consultation<sup>22</sup> proposing that electricity interconnectors be treated as a separate class of transmission users distinct from generation or demand and that they be exempt from both generation and demand use of system charges. In October 2010 we have approved National Grid's proposal to exempt interconnectors from TNUoS charges.

### *Balgzand Bacton Leiding (BBL) gas interconnection*

29. As from October 1st 2010, BBL Company offers non-physical interruptible reverse flow (IRF) capacity (from the UK to the Netherlands). The IRF service allows shippers to nominate gas flows from the United Kingdom to The Netherlands on an interruptible basis.

30. The fourth BBL compressor station in the Netherlands became operational from April 2011. This increased GB import capacity by 3 bcm/year.

## **2.3 Consumer related issues**

31. Alongside the Retail Market Review described above, the major developments this year in our work on behalf of consumers are presented below.

32. We introduced a modification<sup>23</sup> to gas and electricity suppliers' Standard Licence Conditions in September 2010 obliging energy suppliers to take all reasonable steps to ascertain the status of a customer and the occupants of any affected domestic premises before disconnection. This modification was aimed at ensuring vulnerable consumers are not disconnected in error.

33. Ofgem published a consultation document "Smart Metering Spring Package – Addressing Consumer Protection Issues" in February 2011<sup>24</sup> setting out our proposals for how we will ensure consumer interests remain protected in response to early moves by suppliers to install smart meters ahead of the government's mandated rollout. The document proposed updating some of the important protections around prepayment and disconnection which could in future be done remotely and proposed obligations to help ensure consumers do not face barriers to switching supplier where they have a smart meter.

34. In September 2010 we published a report<sup>25</sup> on the range of measures energy suppliers undertook to assist their vulnerable and fuel poor consumers in the second year of suppliers' voluntary commitment (April 2009 to March 2010). This showed that at the end of March 2010 there were approximately 1.6 million consumer accounts benefiting from social tariffs and rebates, compared to 1.3 million the previous year. This highlights the significant and growing contribution that energy suppliers are making to support fuel poor households.

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<sup>22</sup> <http://www.nationalgrid.com/NR/rdonlyres/2034BAE8-4F0A-485C-ADA9-D2E952256108/42273/GBECM26InterconnectorChargingReview1.pdf>

<sup>23</sup> [http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Modification%20Direction%20for%20insertion%20of%20Standard%20Licence%20Condition%2027.11\(A\)%20in%20the%20gas%20and%20electricity%20supply%20licences.pdf](http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Modification%20Direction%20for%20insertion%20of%20Standard%20Licence%20Condition%2027.11(A)%20in%20the%20gas%20and%20electricity%20supply%20licences.pdf)

<sup>24</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=186&refer=Sustainability/SocAction/Publications>

<sup>25</sup> <http://www.ofgem.gov.uk/Sustainability/SocAction/Suppliers/CSR/Documents1/Monitoring%20Suppliers%20Social%20Spend%202009-10.pdf>

35. Ofgem has also continued work on its Social Action Strategy which describes how it seeks to meet its social responsibilities and help the government deliver its own targets for eradicating fuel poverty. We have updated<sup>26</sup> the strategy in July 2010.

## 2.4 Security of Supply

### *Project Discovery*

36. Following our previous work on Project Discovery<sup>27</sup>, which investigated whether current market arrangements in GB are capable of delivering secure and sustainable energy supplies over the next 10-15 years, in February 2010 we published a consultation<sup>28</sup> on possible policy remedies to address the risks and issues identified the project.

### *Electricity Market Reform*

37. In December 2010 DECC launched The Electricity Market Reform (EMR)<sup>29</sup>. The EMR aims to ensure that there are sufficient incentives to invest in secure and sustainable electricity generation. Through the EMR project, the Government has consulted on four possible changes to the electricity market arrangements to provide incentives for investment. These are:

- capacity payments
- carbon price support
- feed in tariffs
- emissions performance standard.

38. The consultation on all four proposals closed in March 2011. The Government released a White Paper containing legislative proposals to implement the new electricity market arrangements in July 2011.

### *Gas Security of Supply Significant Code Review*

39. In January 2011 we launched the Gas Security of Supply Significant Code Review (Gas SCR)<sup>30</sup> to assess whether reforms to the current gas market arrangements are required to improve security of supply.

40. We have conducted an initial round of consultation on a range of options, including:

- potential changes to the emergency cash-out arrangements
- appropriately compensating customers with firm contracts in the event of an interruption to supply
- the potential case for enhanced security of supply obligations.

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<sup>26</sup> <http://www.ofgem.gov.uk/Sustainability/SocAction/Documents1/socialactionstrategyfs%20July%202010.pdf>

<sup>27</sup> <http://www.ofgem.gov.uk/Markets/WhlMkts/Discovery/Pages/ProjectDiscovery.aspx>

<sup>28</sup> [http://www.ofgem.gov.uk/Markets/WhlMkts/Discovery/Documents1/Project\\_Discovery\\_FebConDoc\\_FINAL.pdf](http://www.ofgem.gov.uk/Markets/WhlMkts/Discovery/Documents1/Project_Discovery_FebConDoc_FINAL.pdf)

<sup>29</sup> A copy of the 'Electricity Market Reform' December 2010 consultation can be found at this link -

<http://www.decc.gov.uk/en/content/cms/consultations/emr/emr.aspx>

<sup>30</sup> <http://www.ofgem.gov.uk/Markets/WhlMkts/CompandEff/GasSCR/Documents1/Initial%20Consultation%20-%20Gas%20Security%20of%20Supply%20Significant%20Code%20Review.pdf>

We are aiming to publish a draft decision in September 2011 and a final decision in February 2012.

## 2.5 Enforcement actions

41. On 22 December 2010, Ofgem made a provisional order in respect of a contravention and likely contravention by First Utility Ltd ("First Utility") of Standard Licence Condition ("SLC") 27 of its gas and electricity supply licence. This was because of First Utility's continuing failure to offer prepayment terms to customers who are or may be in payment difficulty. This is a particular concern during the winter when customers may have difficulty in managing their fuel debt without the option of using a prepayment meter.

42. In September 2010, Ofgem launched an investigation into four of the Big 6 suppliers (EDF, Npower, SP and SSE) compliance with obligations under the gas and electricity supply licences (Standard Licence Condition 25). The standard licence condition 25 requires domestic suppliers to provide estimates and comparisons during face-to-face sales activities (with effect from 18 January 2010).

# Regulation and Performance of the Electricity Market

## 3.1 Regulatory Issues

### Management of congestion on interconnectors

#### *Existing interconnection*

43. The GB electricity market currently has around 3.5GW of interconnection: with the Netherlands (Britned), France (IFA) and Northern Ireland (Moyle). This is expected to increase to around 4GW by 2012 with the development of a new interconnector between GB and Ireland. Total interconnector capacity could potentially reach around 8GW in 2020.

#### *Access rules on interconnection*

44. Ofgem has a separate licensing regime for interconnectors.

45. The England-France Interconnector (IFA) connects the electricity market in Great Britain with France. The interconnector is jointly operated by National Grid Interconnector Limited (NGIL) and Réseau de Transport d'Électricité (RTE), the French Transmission System Operator (TSO). The IFA is a high voltage direct current (HVDC) line with a nominated capacity of 2000MW.

46. Capacity is allocated explicitly in long-term, day-ahead and intraday auctions, using a single coordinated capacity platform and harmonised capacity products. Netting 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. There is physical congestion on IFA to the extent that NGIL and RTE earn congestion rents through the explicit allocation of capacity.

47. The FUI Stakeholder Group (SG) has agreed to pursue a coordinated approach to couple GB with mainland Europe via both BritNed and IFA. In May 2011, National Grid

Interconnectors Limited (NGIL) set out the timeline for market coupling implementation on IFA<sup>31</sup>. To begin with, the NGIL will launch a procurement exercise for an IFA coupling service provider which will also be required to create a GB Hub. The market coupling implementation is due to be finished by the end of 2012.

48. 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 with duration of no more than 1 year. BritNed does not enter into long term capacity contracts. BritNed holds medium term and intra-day explicit auctions and day-ahead implicit auctions. The implicit auction day-ahead system will also be used to implement UIOLI (use-it-or-lose-it).

49. In February 2011, Ofgem and NMA, the Dutch regulator approved the access rules for BritNed. The consultation and subsequent approval process led to a number of material improvements in the access rules. These included: a shift to financial firmness for nominated explicit capacity; amendment of the use-it-or-sell-it mechanism to pass through all revenue to the original capacity owner; inclusion of detailed transparency provisions in an additional schedule and greater transparency of the reserve price for long-term capacity allocation.

50. At regional level, BritNed has connected the GB electricity market to the Central West (CWE) Market Coupling area of Belgium, Netherlands, Luxembourg and France. It offers 300MW (plus any remaining capacity from long term auctions which was not nominated) of its 1000MW capacity through implicit auctions<sup>32</sup>. The provision of day-ahead implicit auctions has resulted in a degree of market coupling between GB and the above-mentioned region. BritNed is the first market coupling project in GB.

51. The Moyle interconnector links Scotland to Northern Ireland and offers capacity to the market in long term (1-3 years) and short term (monthly) capacity auctions. Capacity is sold in 5MW blocks with a reserve price. A non-standard product was introduced which reserves a minimum amount of MWh per month, with any additional usage charged per MWh on a pay as you go basis. Moyle access rules are currently under review pending implementation of the new electronic platform in Q3 2011.

52. Ofgem is also working closely with the Irish regulator to develop and approve common trading arrangements for the 500MW East-West Interconnector, expected to commence operation in September 2012. East West and Moyle interconnectors will use the same electronic platform.

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<sup>31</sup> [http://www.energy-regulators.eu/portal/page/portal/EER\\_HOME/EER\\_INITIATIVES/ERI/France-UK-Ireland/Meetings1/IG\\_meetings/21supstsup%20France-UK-Ireland%20IG/AD/Minutes%20and%20actions%20points%20from%20the%2021st%20FUI%20IG%20meeting.doc](http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_INITIATIVES/ERI/France-UK-Ireland/Meetings1/IG_meetings/21supstsup%20France-UK-Ireland%20IG/AD/Minutes%20and%20actions%20points%20from%20the%2021st%20FUI%20IG%20meeting.doc)

<sup>32</sup> Market coupling is an approach used for a certain proportion of interconnector capacity at the day-ahead stage and links interconnected wholesale energy markets with an "implicit" auction that determines efficient cross border power flows according to price differentials between markets. Power exchanges, in close cooperation with national TSOs, are responsible for delivery of market coupling. Power exchanges in a market coupled area collate all bids and offers submitted into a single "bid-offer ladder", and national TSOs in the coupled area provide detail on the available interconnection capacity between jurisdictions in the coupled zone. Power exchanges submit this information into a "coupling algorithm" that simultaneously clears the market and determines optimal flows on cross border connections. For more information please refer to: <http://www.ofgem.gov.uk/Europe/Documents1/Interconnector%20policy%20consultation.pdf>



### *Electricity interconnector policy*

53. Ofgem recently concluded a consultation on GB Electricity Interconnector Policy<sup>33</sup>. In September 2010, we published a next steps letter setting out our policy priorities. The letter confirmed our commitment to:

- establish an enduring solution for market coupling in the FUI region. We are supporting a project established by TSOs in North West Europe with the common objective to put in place a single price coupling mechanism.
- remove GB use of system charges from interconnector flows. A decision was taken to exempt interconnectors from GB charges from October 2010.
- coordinate and optimise long-term capacity allocation and use on existing GB interconnectors. EirGrid, Moyle and East West Interconnector launched a procurement process for a common auction platform in July 2010.
- develop and implement a European target model for cross-border intraday trade. Together with the Dutch and Danish Regulators, Ofgem are co-chairing the regulators group of the North West European project to establish a common approach to intraday trading.

### *Incentivising investment in new cross-border interconnection*

54. An important conclusion of the 2010 consultation on GB Electricity Interconnector Policy was that we would develop a new approach to regulating interconnectors to encourage greater investment. Ofgem has been working with the Belgium regulator on a "pilot project" to implement a "cap and collar" model to regulating the rate of return for proposed NEMO interconnector.

55. In addition to project NEMO, Ofgem is actively in discussion with a number of other investors seeking to develop new interconnection between GB and France, Norway, Spain and Iceland. We are also assisting Member States to develop a coordinated approach to financing future grid infrastructure developments as part of the North Seas Offshore Grid Initiative.

### **Management of congestion on national networks**

56. In August 2010, the UK 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'<sup>34</sup>. The Government's changes introduced a 'Connect and Manage' regime for access to the electricity grid. Under this approach, generators are able to connect to the system in GB ahead of wider system reinforcements, once any identified 'enabling works' (local transmission works required to connect) are complete. Any resultant constraint costs are socialised across all consumers in GB, along with constraint costs more widely.

57. The aims for an enduring access regime were set in the context of protecting the interests of consumers, including minimising the cost to consumers. These aims are to:

- provide sustained, commercially viable connection opportunities and firm connection dates reasonably consistent with project development timescales which will ensure the right environment for investment in new generation

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<sup>33</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=2&refer=Europe>

<sup>34</sup>For more information please refer to:

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



- deliver security of supply and a clear path to delivering our renewable energy targets
- implement in a time-scale consistent with delivery of the Government's aspirations for 2020.

58. 'Connect and Manage' will increase constraints on the system, and it is National Grid's responsibility as system operator (SO) to minimise these constraints. In addition, Ofgem has made significant funding available to the transmission licensees in GB to take forward the necessary investment in the network to accommodate the new generation connecting to meet UK and EU renewable targets. This is discussed in more detail in the Transmission Investment section of this report (see below).

59. Ofgem publish regular reports monitoring the 'Connect and Manage regime'. These reports include analysis on the levels of constraints.

## **The regulation of the tasks of transmission and distribution companies**

### **Transmission**

60. The National Electricity Transmission System (NETS) is used to transfer bulk electricity 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.

61. Electricity transmission assets are owned and maintained by regional monopoly Transmission Owners (TOs). Since the granting of the first offshore transmission licence in March 2011 there are four 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
- Scottish Hydro Electric Transmission Limited (SHETL) who own the transmission system in northern Scotland
- TCP Robin Rigg OFTO Limited who own the first operational part of the offshore transmission system.

62. Additional offshore transmission licences will be granted as the offshore network develops.

63. The NETS is operated by NGET who are 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.

64. The SO and each onshore TO are subject to regular price controls. This means that Ofgem approves specific revenue for each company, thereby incentivising them to improve efficiency and to keep transmission costs for electricity and gas customers low. Previous price control periods have been for a period of five years but under the RIIO approach these price controls will last for eight years.

65. It is Ofgem's task to enforce and supervise the licensees' compliance with their licence conditions. In recent years we have started using an annual regulatory reporting pack to improve the quality of our information on cost, revenue, incentive and output reporting as well as help us to monitor performance and set future price controls and incentives<sup>35</sup>.

## *RIIO*

66. In October 2010 we completed our detailed review of energy network regulation – the RPI-X@20 review<sup>36</sup>. This review looked at how best to regulate energy network companies to meet the challenges and opportunities of delivering the networks required for a sustainable, low carbon energy sector. The result of this review was the introduction of a new regulatory framework known as the RIIO model (Revenue = incentives + innovation + outputs).

67. The RIIO model has taken the elements of the old RPI-X framework which work well, adapted other elements to ensure they are focused on delivery of a sustainable energy sector and long-term value for money, and added elements to encourage significant change in the network companies' approach to delivery. This includes encouraging greater innovation, longer-term thinking and being accountable to clear customer-focused outputs. The model is designed to promote smarter gas and electricity networks for a low carbon future. Under the RIIO model, network companies will be required to develop well-justified business plans (which will include among other things working with stakeholders to understand future needs and interactions) setting out their outputs and how they propose to deliver these.

68. The first price controls under this new model are:

- RIIO-T1 which will set the outputs that the gas and onshore electricity transmission owners (TOs) must deliver over the eight-year period 1 April 2013-31 March 2021 and the associated revenues they may collect from consumers.
- RIIO-GD1 which will set the outputs that the eight Gas Distribution Networks (GDNs) need to deliver for their consumers and the associated revenues they are allowed to collect for the eight-year period from 1 April 2013 to 31 March 2021.

69. In March 2011 we published our RIIO-T1<sup>37</sup> and RIIO-GD1<sup>38</sup> strategy decision document. This included the outputs that companies will need to deliver and the associated incentive mechanisms; how we will go about assessing the companies' business plans; proposed mechanisms for handling uncertainty and for encouraging innovation; and our approach to financeability.

70. We have decided on a range of measures including:

- **Business planning** – Network companies will need to outline the strategy they will employ to play a full role in delivering a sustainable energy sector.
- **Environment focussed output measures** – We are proposing a suite of measures to promote timely connection of new sources of energy, reduce

<sup>35</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=42&refer=Networks/Trans/RegReporting>

<sup>36</sup> <http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/Decision%20doc.pdf>

<sup>37</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=77&refer=Networks/Trans/PriceControls/RIIO-T1/ConRes>

<sup>38</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=312&refer=Networks/GasDistr/RIIO-GD1/ConRes>

greenhouse gas emissions, reduce the visual impact of the networks, and reduce the companies' own business carbon footprints.

- **Greater encouragement for innovation** – We are extending our innovation funding, to encourage transmission and gas distribution companies to invest in new ideas and practices that drive value for consumers and the environment.
- **A broad environmental measure** – In both RIIO-T1 and RIIO-GD1 we are including a reputational incentive on promoting low carbon energy flows. For the electricity transmission companies we also intend, subject to further consultation, to introduce a financial reward to facilitate a greater contribution to the UK's environmental objectives.

71. This new approach remains consistent with ensuring efficient companies are able to finance their businesses. We are establishing a strong financial package which will allow efficient companies to finance their activities using equity and debt. It will also ensure the costs of investment are spread appropriately across existing and future consumers.

72. Companies' business plans will be submitted at the end of July 2011. We will publish our initial assessment of all companies' plans in October 2011. Finally, we will undertake a more detailed assessment and publish our proposals for proportionate treatment for consultation in December 2011.

#### *Transmission Price Control Rollover*

73. To enable the next transmission price review to reflect fully the new RIIO framework, we delayed implementation of a full price control until 1<sup>st</sup> April 2013, and will be carrying out a one-year rollover of the current price control to operate over the period 1<sup>st</sup> April 2012 to 31<sup>st</sup> March 2013.

74. In April 2011 we consulted on our preferred approach on the policy and financial scope of this rollover and presented our initial assessment of the licensees business plans<sup>39</sup>. We do not consider it proportionate to introduce any new policy for one-year price control, but we need to make a number of decisions on how existing policy should adapt for 2012-13. In August 2011 we will present our initial proposals on the policy scope and allowances for operational and capital expenditure for the rollover year. In December 2011 we will communicate our final proposals on these matters, before the new price controls come into force on 1 April 2012.

#### *Network tariffs – structure of charges*

75. Users of the electricity transmission system are subject to three types of transmission charges: Balancing Services Use of System (BUSoS) charges, connection charges and Transmission Network Use of System (TNUoS) charges. Each of these charges is payable to NGET as SO.

76. In terms of charging, the primary requirement of the transmission licence<sup>40</sup> 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. It is the transmission companies' responsibility to propose and consult on changes to the methodology. The transmission licence describes the process which must be followed in

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<sup>39</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=32&refer=Networks/Trans/PriceControls/TPCR4Roll-over>

<sup>40</sup> <http://epr.ofgem.gov.uk/index.php?pk=folder100984>

modifying the charging methodologies so that the relevant objectives are better achieved.

### BSUoS Charges

77. BSUoS (Balancing Services Use of System) charges relate to the costs of the day-to-day operation of the transmission system and include charges for the recovery of constraint costs.

78. 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.

79. 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.

80. The Statement of the Use of System Charging Methodology<sup>41</sup> includes a detailed methodology for the calculation of daily BSUoS charges, some worked examples, and information on timing of BSUoS charges and financial settlement.

### Connection Charges

81. Connection charges are charges for 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 the remit of NGET's connection charging methodology<sup>42</sup>. 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.

### TNUoS Charges

82. The Transmission Network Use of System (TNUoS) charging methodology<sup>43</sup> is applied by National Grid Electricity Transmission plc (NGET) in its role as SO. TNUoS charges have four component parts:

- **'Local' circuit charge.** A locationally varying element reflecting the cost of transmission infrastructure assets used by generators to connect to the Main Interconnected Transmission System (MITS). This charge is derived with reference to the incremental power flows along "local" infrastructure circuit assets between the generation node and the next MITS substation.
- **'Local' substation charge.** This charge relates to the unit costs of relevant design and type of local infrastructure substation assets which are required for each generation connection.

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<sup>41</sup> <http://www.nationalgrid.com/uk/Electricity/Charges/chargingstatementsapproval/>

<sup>42</sup> <http://www.nationalgrid.com/uk/Electricity/Charges/chargingstatementsapproval/index.htm>

<sup>43</sup> <http://www.nationalgrid.com/uk/Electricity/Charges/chargingstatementsapproval/index.htm>

- **'Wider' locational charge.** A locationally varying element reflecting the zonal average long-run forward-looking costs of connecting an incremental (or decremental) Megawatt (MW) of generation or demand at a given point on the transmission network. This charge component will be calculated on the generic cost base for carrying unit power over unit distance.
- **Residual charge.** The locational elements of the TNUoS charge do not recover the total amount of revenue allowed to the companies. This is because the transmission network is not optimally sized (as assumed by the charging model), and because the network comprises "non-locational" assets, such as substations, that contribute to overall security. Hence, once the 'local' and 'wider' locational tariffs have been calculated, a non-locational correction factor – generally called a residual charge – is applied to the tariffs to ensure that 27% of total revenues is recovered from all generators and 73% from all demand customers.

83. There are 20 charging zones for generation and 14 for demand. For 2010/11 the demand charge varies between £6.53/kW and £28.40/kW whereas the 'wider' locational generation charge varies between £-7.04/kW and £21.49/kW.

84. National Grid published a consultation<sup>44</sup> in July 2010 proposing that interconnectors be treated as a separate class of transmission users as distinct from generation or demand and that they be exempt from both generation and demand use of system charges. In October 2010 we approved National Grid's proposal to exempt interconnectors from TNUoS charges.

### *TransmiT*

85. In September 2010 Ofgem launched an independent and open review of transmission charging and associated connection arrangements – project TransmiT<sup>45</sup>. 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, high quality network services at value for money to existing and future consumers. The immediate priority for TransmiT is *electricity* transmission charging and connection issues, which respondents have indicated are an immediate priority. In taking forward TransmiT, we are also mindful of the wider policy context of the energy regulation debate, particularly the increased physical interconnection with European system and the requirement to integrate more closely the wholesale markets and the potential for change to the fundamental market design and charging principles.

### *Transmission Investment*

86. In April 2010, we introduced the transmission investment incentives framework (TII framework). This provides funding, within the current transmission price control period (TPCR4), for critical large-scale investments that the TOs identify are required to support the achievement of the Government's 2020 renewable energy targets. At that time, we provided an initial tranche of funding (worth over £300 million) to cover pre-construction work and urgent construction work up to end 2011-12 when TPCR4 expires. We also introduced a process for considering further funding requests from the TOs within the TII framework.

<sup>44</sup> <http://www.nationalgrid.com/NR/rdonlyres/2034BAE8-4F0A-485C-ADA9-D2E952256108/42273/GBECM26InterconnectorChargingReview1.pdf>

<sup>45</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Networks/Trans/PT>

87. Following consideration of funding requests and consultation<sup>46</sup>, in January 2011 we published a decision letter<sup>47</sup> confirming our intention to take forward the 2012-13 arrangements in line with the approach set out in the December consultation. At that time, we provided the next tranche of funding to be provided under our TII framework to cover £95 million of investment planned for the next two financial years (2011-12 and 2012-13) on specific projects.

#### *Balancing of the transmission system*

88. National Grid Electricity Transmission plc (NGET) is the system operator (SO) for the high voltage electricity transmission system in Great Britain (GB), with responsibility for making sure that electricity supply and demand stay in balance and the system remains within safe technical and operating limits.

89. The current electricity balancing arrangements are designed to provide commercial incentives for generators (suppliers) to physically match the amount they notify that are going to deliver (offtake) to or from the system. Generators' (suppliers) imbalance relates to difference between the amount they physically deliver (offtake) and their notified contracted position.

#### *Offshore Transmission Regime*

90. Offshore wind is playing an important part in meeting the government's ambitious renewable energy targets. Ofgem worked with Department of Energy and Climate Change (DECC) to introduce the transitional offshore transmission regime to deliver the required offshore transmission investment in an efficient and timely manner, which came into effect in 2009. A key part of the regime is the grant of Offshore Transmission Licences on the basis of a competitive Tender Process. Ofgem is responsible for managing this process.

91. In March 2011 Transmission Capital Partners (TCP) secured the first licence to operate a high voltage link with an offshore wind farm in GB. This marked the success of the regime's first tender round for £1.1 billion of offshore transmission links to nine offshore wind farms. The tender attracted almost £4 billion of investment appetite from incumbents and new market entrants alike, and is expected to deliver savings of around £350 million. We expect to grant licences for the other eight links in the first round over the next year.

92. The second transitional round already has eight bidders competing for the first three projects to link over 1.4 GW of offshore wind, with the winners to be announced this summer. These projects are worth a further £1 billion with billions more of investment opportunities to be tendered over the coming years.

93. In August<sup>48</sup> and November<sup>49</sup> 2010 together with Department on Energy and Climate Change (DECC) we jointly consulted on the enduring offshore transmission regime that will replace existing transitional arrangements. In December 2010, following

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<sup>46</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Networks/Trans/ElecTransPolicy/CriticalInvestments/InvestmentIncentives>

<sup>47</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=3&refer=Networks/Trans/ElecTransPolicy/CriticalInvestments/InvestmentIncentives>

<sup>48</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=20&refer=Networks/offtrans/pdc/cdr/Cons2010>

<sup>49</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=85&refer=Networks/offtrans/pdc/cdr/Cons2010>

the consultation, jointly with DECC we published a consultation response paper<sup>50</sup>. Government and Ofgem have put in place a regulatory regime that facilitates choice in respect of the division of responsibility for the delivery of transmission assets. Under the enduring regime, offshore developers will have the flexibility to choose whether to design and construct transmission assets with a transfer of ownership to an OFTO (offshore transmission operator) taking place after the offshore developer has completed construction, or to seek to appoint an OFTO to construct the transmission assets. DECC and Ofgem are considering the most appropriate timing for full commencement of the enduring regime.

94. The development of the offshore transmission regime in GB contributes to the North Sea Countries Offshore Grid Initiative project (please refer to chapter 2) which aims to develop an integrated offshore energy grid across the North Seas of Europe and requires effective national offshore transmission regimes developed across the North Sea countries.

## **Distribution**

### *Structure of charges*

95. Ofgem launched the structure of charges project in 2000, with the aim of reviewing the basis upon which electricity distribution network operators (DNOs) calculate their electricity distribution charges. Ofgem was concerned that existing charging arrangements did not properly reflect costs and benefits from generation connected to the network and could represent a barrier to the connection of small scale low carbon generation.

96. In July 2004 Ofgem made a modification to the DNO's licences to place a requirement on them to establish connection and use of system charging methodologies. In 2009 the DNOs accepted a licence obligation to implement a common use of system charging methodology for lower voltage customers (customers connected at high- and low-voltage networks) from 1 April 2010, and a common methodology to higher voltage customers (customer connected at extra-high-voltages) from 1 April 2011. In 2010 Ofgem issued a derogation revising the implementation date of the EHV charging methodology to 1 April 2012. From 1 October 2010 DNOs implemented largely common connection charging methodologies for lower voltage customers.

97. Each methodology must meet four relevant objectives, broadly:

- that compliance with the charging methodology facilitates the efficient discharge by the licensee of the obligations imposed upon it under the Electricity Act and by the licence;
- that compliance with the charging methodology facilitates effective 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 charging methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the distribution business;

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<sup>50</sup><http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/Cons2010/Documents1/Government%20response%20to%20offshore%20transmission%20consultations.pdf>

- that the charging methodology, as far as is reasonably practicable, properly takes account of the developments in the distribution business.

98. Since April 2010 the system for making modifications to the methodology has changed. The new common use of system methodology to lower voltage customers is subject to open governance arrangements. The methodology has been incorporated into an industry code, which is a multi-party contract between the licensed electricity distributors, suppliers and generators. This incorporation gives these parties and other 'materially affected parties' the opportunity to propose changes to the methodology. The same arrangements are expected to apply at the higher voltages from April 2012.

99. Each DNO must comply with the approved charging methodology when setting charges for connection and use of system. Ofgem has also imposed obligations on each DNO to publish statements of these charges in an approved form that is made available to interested parties. The use of system statement at lower voltages is now essentially common, and a common statement is expected at higher voltages. The use of system and connection charging statements also set out the general terms and conditions associated with use of the distribution system, the network charges, terms and processes for obtaining a connection.

100. 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 2010 – Mar 2011 (pence per kWh)		
Domestic customer	1.234 - 2.588	Note 1
Small non-domestic customer	0.942 - 2.055	Note 2
Large non-domestic customer		Note 3
Peak	1.226 - 11.68	
Non Peak	0.013 - 0.16	

Table Notes:

- 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.
- 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.
- 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.

#### *Quality of service incentives for DNOs*

101. A number of amendments to quality of service and customer themed arrangements came into force on 1 April 2010, as the Distribution Price Control Review Five (DPCR5) began. These will be in force until the end of the current price control on 31 March 2015. For further details of these arrangements, please refer to Chapters 10-18 of the DPCR5 Final Proposals document.<sup>51</sup>

102. Since the introduction of the interruptions incentive scheme in April 2002 the underlying number of customer interruptions per 100 customers has fallen by 20 per cent (2002-03 to 2009-10). These figures exclude the impact of exceptional events. Figures for 2009-10 show a downturn in both customer interruptions and customer minutes lost compared to the previous year. On average each customer experienced 0.69 interruptions over the year, with the average duration of the interruption approximately 70 minutes, excluding exceptional events.

103. With exceptional events included the picture is less clear as changes are far more variable depending on the year chosen. This is due to the impact of major events such as the October 2002 storms and further storms and flooding in January 2005 in many parts of Great Britain. In 2009-10 there was a moderate level of successful exceptional event claims. Severe weather and storms featured heavily, while there were two one-off events that were excluded.

#### *Guaranteed Standards of Performance for DNOs*

104. The latest Guaranteed Standards of Performance (GSOPs) for DNOs came into effect on 1 April 2010 as part of the latest electricity distribution price control. These standards are detailed in the DPCR5 Final Proposals document.

#### *Electricity Connections Standards of Performance for DNOs*

105. The Connections Standards of Performance for DNOs came into effect on 1 October 2010. The aim of this is to encourage DNOs to improve the level of service they provide to customers seeking a connection. It imposes financial penalties on DNOs that fail to meet specified service levels at each stage in the connections process.

#### *Electricity Distribution Annual Reports*

106. Ofgem has previously published eight reports on quality of service on the electricity distribution networks, these data will now be incorporated in the consolidated electricity distribution annual report. The first annual report was published in March 2011.<sup>52</sup> It presents the DNOs' performance in 2008-09 and 2009-10. It also sets out an overall picture of trends in performance from 2005-06 to 2009-10, the fourth electricity distribution price control period (DPCR4). The annual report covers key areas such as customer service, connections, the environment and provision of network reliability in a cost effective manner.

107. Across the entire DPCR4 period, we saw an improvement in the average performance of the DNOs in the areas of customer service and network reliability. DNOs

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<sup>51</sup> DPCR5 Final Proposals – Incentives and Obligations:

[http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/FP\\_2\\_Incentives%20and%20Obligations%20FINAL.pdf](http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/FP_2_Incentives%20and%20Obligations%20FINAL.pdf)

<sup>52</sup> Electricity Distribution Annual Report:

[http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/Electricity\\_Distribution\\_Annual\\_Report\\_for\\_2008-09\\_and\\_2009-10v2\[1\].pdf](http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/Electricity_Distribution_Annual_Report_for_2008-09_and_2009-10v2[1].pdf)

also spent 31.0 per cent of the total allowance for undergrounding in Areas of Outstanding Natural Beauty and National Parks. Overall, the companies managed their networks within 6.7 per cent of the capital expenditure allowances set as part of DPCR4 but overspent on average by 9.1 per cent against operating expenditure allowances. DNOs that achieved the highest indicative return to shareholders were both cost efficient and performed well against the DPCR4 incentives.

## **Effective unbundling**

### *Transmission*

108. All electricity transmission licensees (i.e. SP Transmission Limited, Scottish Hydro Electric Transmission Limited, National Grid Electricity Transmission plc, TC Robin Rigg OFTO Limited and future Offshore Transmissions Owners (OFTOs)) are required to comply with business separation requirements as stipulated in their electricity transmission licences. Transmission owners 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 owners are required to keep separate accounts for each of their activities to avoid cross-subsidisation.

109. Requirements for greater structural separation of transmission interests from generation, production and supply interests are a key aspect of the Third Package. It sets out three models for ownership unbundling, with a further derogation provided certain criteria are satisfied. Ofgem will be expected to certify the GB transmission system operators as compliant with one of these options. This, we understand, will include transmission owners, interconnectors and offshore transmission owners (OFTOs) and will be possible after the government transpose the unbundling provisions into national legislation. We have also publically consulted<sup>53</sup>, in July 2010, to seek views on the ownership arrangements of the GB transmission system operators and their compliance with the unbundling provisions.

### *Distribution*

110. Please refer to the 2008 Ofgem National Report for details of the licence requirements for ring fencing and separation for the fourteen DNOs established at privatisation.

111. The ownership structure of the electricity distribution companies in Great Britain is listed in the Table 2 below. The changes in ownership from 2009 are: Cheung Kong Group purchased the three DNOs and one independent distribution network operator (IDNO) previously operated by EDF in October 2010, and ECG (Distribution) Ltd had its licence revoked in October 2010.

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<sup>53</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=30&refer=Europe>

**Table 2 Ownership structure of electricity distribution companies in Great Britain, as of 31 December 2010**

<b>Network Company</b>	<b>Activity</b>	<b>Owner</b>
Northern Electric Distribution Ltd	DNO	Berkshire Hathaway Inc
Yorkshire Electricity Distribution Ltd	DNO	Berkshire Hathaway Inc
Central Networks East Plc*	DNO	E.ON AG plc
Central Networks West Plc*	DNO	E.ON AG plc
UK Power Networks (EPN) Plc	DNO	Cheung Kong Group
UK Power Networks (LPN) Plc	DNO	Cheung Kong Group
UK Power Networks (SPN) Plc	DNO	Cheung Kong Group
SP Manweb Plc	DNO	Iberdrola S.A.
SP Distribution Ltd	DNO	Iberdrola S.A.
Western Power Distribution (South Wales) Plc	DNO	PPL Corporation
Western Power Distribution (South West) Plc	DNO	PPL Corporation
Electricity North West Limited	DNO	North West Electricity Networks (Jersey) Ltd
Scottish Hydro Electric Power Distribution Plc	DNO	Scottish and Southern Energy Plc
Southern Electric Power Distribution	DNO	Scottish and Southern Energy Plc
Energetics Electricity Ltd	IDNO	Energetics Networked Energy Ltd
ESP Electricity Limited	IDNO	ABN Amro – Infrastructure Capital Equity Fund
Independent Power Networks Limited	IDNO	Inexus Group Ltd
The Electricity Network Company Ltd	IDNO	Prime Infrastructure Ltd
UK Power Networks (IDNO) Ltd	IDNO	Cheung Kong Group

\*PPL Corporation (owner of the Western Power Distribution networks) bought Central Networks' two distribution networks in April 2011.

### **3.2 Competition Issues**

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

112. Detailed information on the structure of the wholesale electricity market was provided in Ofgem's 2008 National Report and has broadly remained unchanged. In brief, the GB wholesale market is 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 settlement.

### *Over the counter (OTC) trading*

113. A description of OTC trading was provided in Ofgem's 2009 National Report; please refer to this for more information.

114. On the basis of analysis undertaken by the Financial Services Authority (FSA), total OTC trading (excluding exchange based trading) in 2009/10 (Aug 09 to Jul 10) was around 1289TWh<sup>54</sup>. This is around 14 per cent higher than total OTC traded volume for the same period the previous year. However, data for the rest of the year suggests that trading activity across OTC fell off dramatically towards the end of 2010.

### *Power exchanges*

115. There are now three exchange providers in the GB electricity market: the APX Group, Nasdaq OMX N2EX (a Nord pool Spot and Nasdaq OMX commodities joint venture) and the Intercontinental Exchange (ICE)<sup>55</sup>. Total traded volume on the APX Power UK Exchange in 2010 was around 18.6 TWh, an increase of around 6TWh on the calendar year 2009. Traded volume on the Intercontinental Exchange (ICE) UK Power Futures exchange totalled around 81 TWh in 2010, a small increase on volumes traded in calendar year 2009.

116. A more recent development was the opening of a new power exchange, N2EX, which started to operate in the GB wholesale market in January 2010. Over the duration of 2010, the exchange saw trading of around 2.6 TWh for its day-ahead auction. N2EX also operates a day-ahead continuous market, which trades more significant volumes, 17TWh in the course of 2010<sup>56</sup>. However the continuous volumes do not originate on the platform – they are OTC trades which have been given up for clearing on the N2EX exchange. On 31 January 2011 a market for cash-settled futures was launched.

117. For 2010 as a whole, around 91 percent of all power traded in GB was OTC traded and around 9 percent was exchange traded.

### *Liquidity*

118. In July 2010 Ofgem published a full assessment of GB power market liquidity. This represented the next step in our ongoing Liquidity project, which was launched in 2009 when low liquidity was observed in the GB power market<sup>57</sup>. Our summer 2010 assessment found the market's performance was mixed. At this point, aggregate churn levels were increasing, though weaknesses in longer term liquidity remained. Independent market participants also continued to find that the market was not fully meeting their needs.

119. In December 2010 we published a further update, and again the market's performance appeared to be mixed<sup>58</sup>. Then in March 2011 we published the latest view

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<sup>54</sup> [http://www.fsa.gov.uk/pubs/other/energy\\_2010.pdf](http://www.fsa.gov.uk/pubs/other/energy_2010.pdf)

<sup>55</sup> A description of these exchanges was provided in Ofgem's 2009 National Report.

<sup>56</sup> [http://www.n2ex.com/newsroom/exchange\\_information/volumereport2010/](http://www.n2ex.com/newsroom/exchange_information/volumereport2010/)

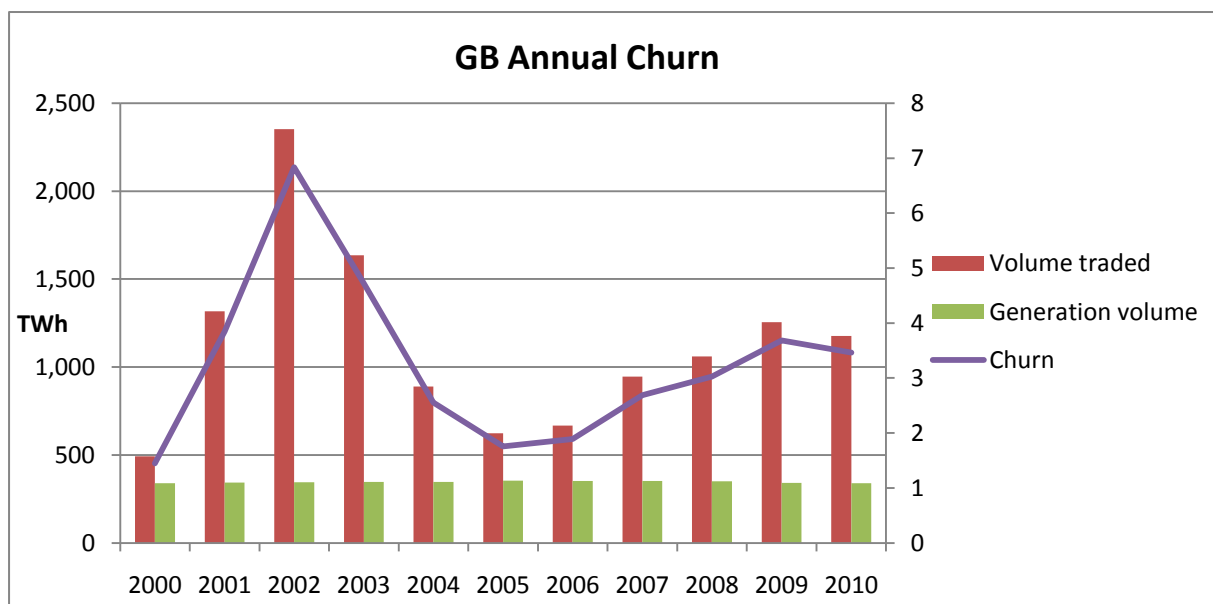
<sup>57</sup> Our initial assessment of liquidity was conducted in July 2009; Liquidity in the Great Britain (GB) wholesale energy markets, 8/06/2009, Ref. 62/09, <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=58&refer=Markets/WhIMkts/CompandEff>.

In February 2010 we put forward possible options for intervention, in the event that the industry did not deliver improved liquidity; Liquidity Proposals for the Great Britain (GB) wholesale electricity market, 22/02/2010, Ref. 22/10, <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=95&refer=Markets/WhIMkts/CompandEff>

<sup>58</sup> Open letter: Liquidity in the GB power market update and next steps, 3/12/2010, <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=163&refer=Markets/WhIMkts/CompandEff>

of GB power market liquidity<sup>59</sup>. This showed churn declining slightly in 2010 as a whole (see figure 3). We therefore put forward our intended market interventions, which will be taken forward subject to the results of a final full market assessment (due to be published in summer 2011), an impact assessment and the views of stakeholders. At the time of writing we are in the process of consulting stakeholders on our proposed liquidity interventions.

**Figure 3: GB traded volume, generation output and churn ratios**



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

#### *Balancing mechanism (BM)*

120. A description of the GB BM was outlined in Ofgem’s 2009 National Report. Around 5.8TWh of offers and 6.8TWh of bids were accepted in 2010 – this compares to 5TWh of offers and 8.1 TWh of bids in 2009.

#### *Generation capacity*

121. The total transmission entry capacity on the GB system at the beginning of 2010/11 was 87.3 GW. This is an increase of around 4 GW on the previous year. New capacity has/is come/ing from 1.7 GW of combined cycle gas turbine (CCGTs) plants. Significant construction of both offshore and onshore wind farms has also increased capacity. From 1 April 2011, 1GW of capacity has been available through the Britned interconnector linking GB and the Netherlands.

122. Recent increases in generation capacity have increased capacity margins in the market, which has prompted some generators to mothball or consider mothballing lowly

<sup>59</sup> 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](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR_Appendices.pdf)

utilised plant<sup>60</sup>. So, despite the overall increase in connected capacity for 2010/11, we have also seen around 3GW of CCGT plant mothballed over the same period.

### Market integration

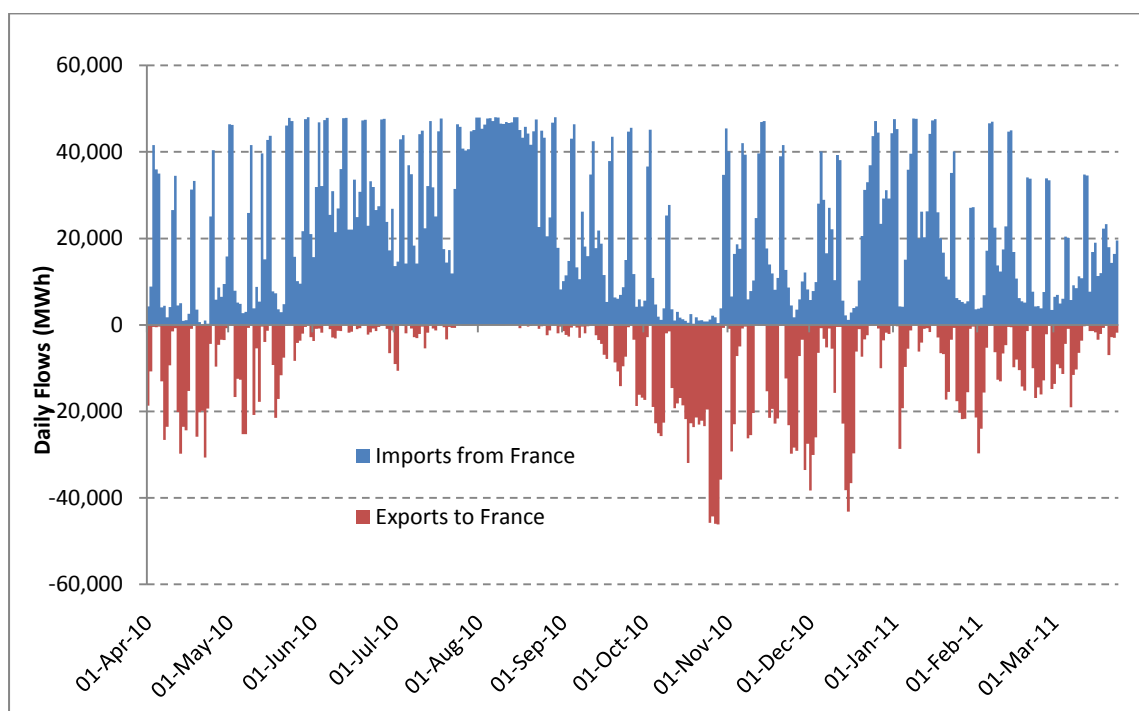
123. For background information on GB interconnection, interconnection policy and market coupling please refer to the *Management of congestion on interconnection* section<sup>61</sup> of the National Report.

124. 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.

125. 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 2010/11 exports to France were quite strong during the cold period in November and December, but reduced during the relatively mild first quarter of 2011. Prices for access to interconnectors reflect market dynamics, with non-discriminatory auctions regularly held for daily, weekend, monthly, quarterly, seasonally and annual capacity.

126. Figure 4 shows flows across the GB-France interconnector from April 2010 – March 2011. Excellent nuclear availability in France has meant that exports to France were lower than last year. Total imports from France for April 2010 - March 2011 were 8.2TWh, while total exports to France were 2.9TWh. This represents, respectively, 74 per cent and 26 per cent of absolute flows across the interconnector over the period.

**Figure 4: Average net system transfers for IFA, April 2010 - March 2011<sup>62</sup>**



### Market concentration

<sup>60</sup> 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.

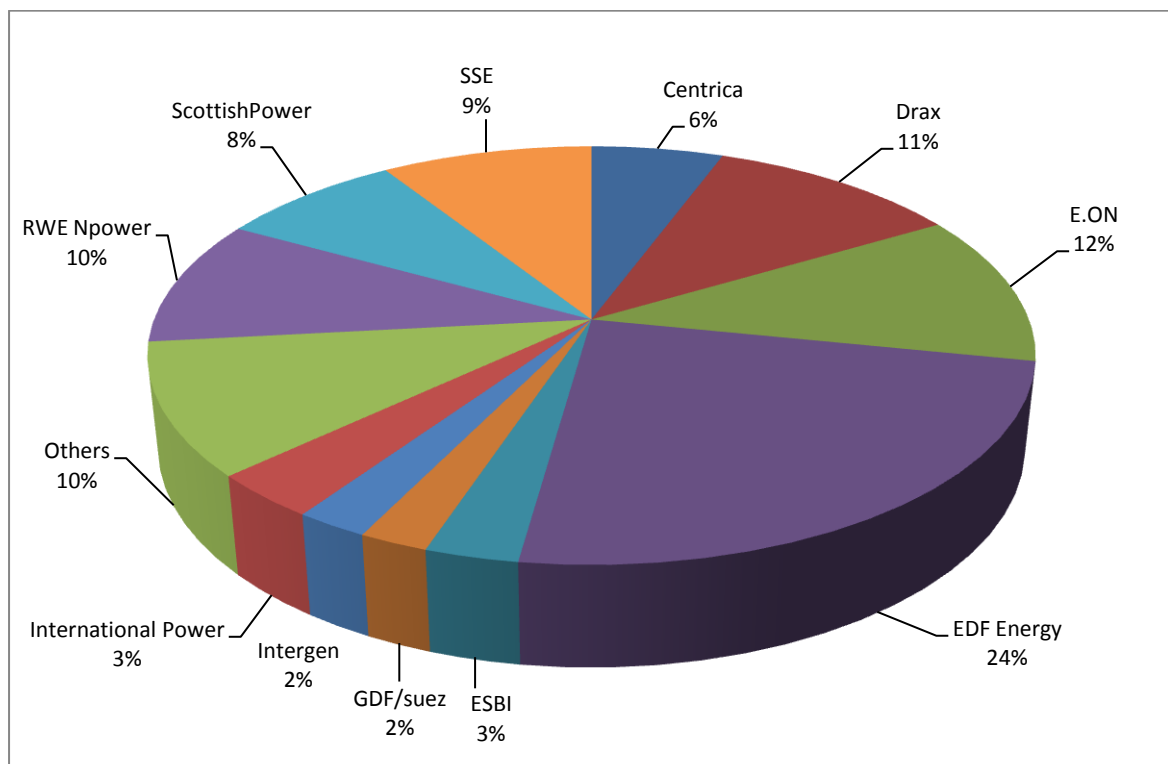
<sup>61</sup> Please see pp. 13-14.

<sup>62</sup> Sourced from National Grid

127. As illustrated in figure 5 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 2010.

128. Please note that in this year's National Report, we are basing our market share statistics on metered volume, rather than transmission entry capacity. This means that direct comparisons with last year's figures are limited. However, we believe that metered volume better reflects market share of actual electricity produced, as transmission entry capacity does not necessarily equate to energy produced.

**Figure 5: 2010 electricity market share in GB based on metered volume<sup>63</sup>**



129. Table 6 provides Herfindahl-Hirschman Index (HHI) analysis based on metered volume by different companies in GB in 2010. The largest individual HHI by capacity is EDF (HHI of 578) which acquired British Energy in late 2008 and now owns and operates a number of nuclear plants in GB.

**Table 6: Herfindahl-Hirschman Index (HHI) based upon 2010 metered volume<sup>64</sup>**

Company	Capacity (HHI)
Centrica	32
Drax	118
E.ON	136
EDF Energy	578
ESBI	9
GDF/suez	5
Intergen	5

<sup>63</sup> Produced from proprietary data

<sup>64</sup> Produced from proprietary data

International Power	12
RWE Npower	95
Scottish Power	62
SSE	82
Others	105
Total	1238

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

130. Information provision is a key component of the effective and efficient operation of the GB electricity markets. Information relating to the operation of the electricity BM is provided through the Balancing Mechanism Reporting Service (BMRS) website by the Balancing Mechanism Reporting Agent (BMRA)<sup>65</sup>. 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).

131. 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*

132. In cases where Ofgem considers that generators' bidding strategies suggest market manipulation may be occurring, Ofgem will seek to investigate and where appropriate, take enforcement action under its Competition Act 1998 powers.

133. The Energy Act 2010 contained enabling powers for the Secretary of State for energy to introduce a licence condition relating to market power. The Market Power Licence Condition is currently being drawn up by Ofgem and DECC and aims to provide a sector specific tool to address competition issues. In particular the condition is aimed at prohibiting the withholding of output and/or excessive pricing when generators have market power during times of transmission constraints.

#### *Balancing*

134. There have been no significant developments on balancing since last year's National Report.

#### *Market surveillance*

135. Please refer to Ofgem's 2008 National Report for information relating to our wholesale market surveillance activities, which have remained broadly unchanged.

136. As outlined in last year's report, responsibility for the operation of the financial markets, including power exchanges, such as ICE sits with the Financial Services Authority (FSA)<sup>66</sup>.

#### *Experience with virtual power plant auctions or other capacity release measures*

137. There were no virtual power plant auctions or other capacity release measures in 2010. We are currently consulting stakeholders on measures to increase market liquidity in our liquidity proposals (please see *Liquidity* section, p.28).

<sup>65</sup> 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](http://www.elexon.co.uk)

<sup>66</sup> [www.fsa.gov.uk](http://www.fsa.gov.uk)



## Description of the Retail Market

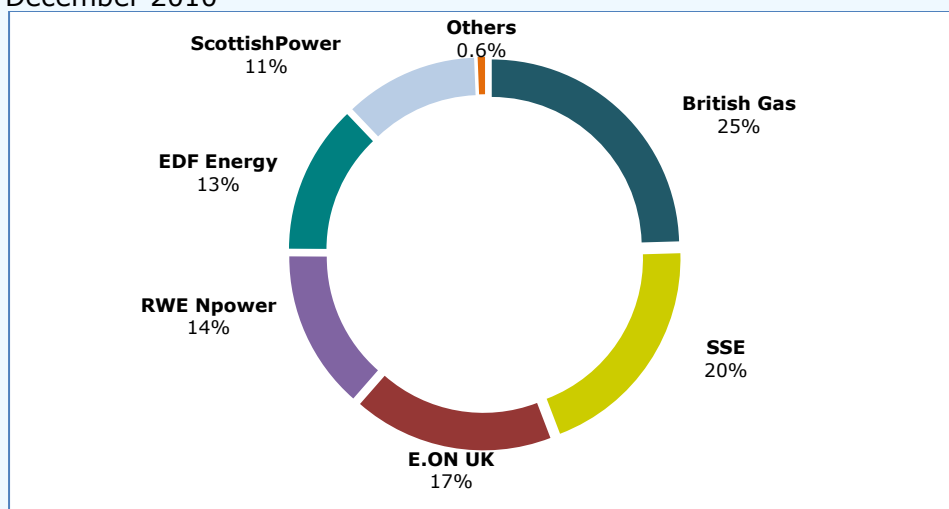
138. The GB retail electricity supply market opened to competition in the late 1990's with all price controls removed by April 2002. Currently, the retail electricity market is characterised by the existence of six large vertically integrated suppliers (Big 6) which evolved from the fifteen former incumbent electricity and gas suppliers over the 1998-2003 period. These 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) **ScottishPower**: a wholly-owned subsidiary of the Spanish energy group, Iberdrola and operates under the ScottishPower brand.

139. At the end of 2010, there twelve domestic and twenty two non-domestic electricity suppliers were active in the market.

### *Market shares and concentration*

140. In December 2010, there were approximately 27.4 million customers in the domestic electricity market. As shown in Figure 7 below, the Big 6 suppliers accounted for over 99% of this market in the same month.

Figure 7: National GB domestic electricity market shares (by customer numbers), December 2010



Source: Ofgem

141. In the domestic electricity market, all of Big 6 suppliers have a market share of above 10%. British Gas, the former gas monopoly supplier has a significant presence with a national market share of 25%. The three suppliers with the highest domestic national market shares are British Gas, Scottish and Southern Energy and E.ON UK, which together account for 62% of the market.

142. There are six smaller suppliers in the market (Ecotricity, First Utility, Good Energy, Utilita, Spark Energy and OVO Energy) accounting for less than 1% of the

national market. However, there has been some growth in market share among small suppliers. In December 2010, the customer numbers for small suppliers grew by 43% compared to January 2010, albeit from a small customer base.

143. The figures relating to national market shares do not reveal regional characteristics of the electricity market, which are a legacy of the regional monopolies that existed in the electricity sector prior to market liberalisation. As a result, the former electricity incumbents in each region have a market share ranging from 32% to 73%. However, these shares continue to fall year-on-year at a rate of around 2% per annum as suppliers penetrate further into each other's markets. British Gas, the former gas incumbent, is the leading challenger to the former electricity incumbents in each region.

144. Within the non-domestic customer group, there are small and medium enterprises (SME) and large industrial and commercial (I&C) customers. The information on market shares in the non-domestic markets (non-half hourly (Non HH) and half hourly (HH)) is acquired from a third party (Datamonitor), which collects the data from suppliers directly. This data is presented in Table 8 below. In addition, this table also shows electricity market shares for small business customers (defined as customers with an annual spend of less than £50,000) based on Datamonitor's Buyer Segment Market Share Monitor.

Table 8: GB non-domestic electricity retail market shares by site of supplied electricity for Non-HH, HH and by number of small business customers

	Sites		
	HH (100 KW - 1 MW, Nov 2010)	Non HH (sub 100 KW, Nov 2010)	Small business customers (Q2 2010)
British Energy	2%		
Centrica	6%	24%	31%
E.ON Energy	12%	21%	27%
EDF Energy	22%	16%	13%
GDF Suez	4%		
Opus Energy		3%	
RWE npower	25%	10%	7%
ScottishPower	5%	10%	10%
SSE	18%	15%	9%
Total Gas and Power	2%		0%
Others	4%	2%	3%

Source: Datamonitor

145. The non-domestic market is supplied by the Big 6 and a group of smaller new entrants. The individual segments of the non-domestic market are dominated by the Big 6, as shown in Table 8, who individually have a market share greater than 5% but who together supply between 91-97% of each segment. However, the smaller suppliers have made significant in-roads into the non-domestic market, supplying between 3-9% of the sites, depending on the segment. Some of these smaller suppliers focus on a specific market niche, such as renewable energy, while others choose to compete more broadly.

146. The three suppliers with highest market shares in the Non HH segment are Centrica, E.ON Energy and EDF Energy, who together have a 61% share of the segment. The HH segment is dominated by RWE npower, EDF Energy and SSE, which together have a 65% share of the sector. In the small business sector Centrica, E.ON Energy and EDF Energy are the three largest suppliers together capturing 71% market share in this segment.

### *Market concentration*<sup>67</sup>

147. Herfindal-Hirschman Indices (HHI)<sup>68</sup> indicators are often used to gauge market concentration. Though HHI does not provide conclusive evidence on the level of competition, it offers pointers as to whether a market has the potential to deliver competitive outcomes.

148. In December 2010, the HHI for national domestic electricity market was 1,768 (compared to 1,751 in December 2009). On account of presence of electricity incumbent suppliers, regional markets are more significantly concentrated for electricity supply and regional HHIs are higher than the national average. The GB regional HHI average in the electricity domestic retail supply market in December 2010 was 2,923 (compared with 3,084 in December 2009).

149. In November 2010, the HHI for HH market segment was 1,682 and 1,690 for Non HH market. This represents an increase of 5.2% in HH market and a decrease of 3.6% in non-HH market compared to 2009 concentration levels (1,599 and 1,753 respectively). For the small business customers market at the end of June 2010 HHI was 2,103.

150. Small business electricity supply markets is "highly concentrated" while regional electricity domestic market and non-domestic Non HH and HH markets are "concentrated" according to the threshold HHI levels used by the Office of Fair Trading (OFT).

### *Vertical integration*

151. Significant vertical integration has taken place in the GB electricity market over the past 10 years. The Big 6 suppliers in the domestic market are vertically integrated, i.e. they are part of corporate groups that are active in both the wholesale and retail markets while it is observed that the smaller independent domestic electricity suppliers are not vertically integrated.

152. However, in contrast to the domestic supply markets, where the independent sector accounts for less than 1% of the market, non-Big 6 generators accounted for around 32% of generation output in 2010<sup>69</sup>. Although this could appear to be a healthy share of generation controlled by independent generators such as International Power, Drax and InterGen remain, their market share is lower from a few years ago, in part due to the process of further consolidation.

153. The increase in vertical integration in the GB electricity market has had a detrimental impact on wholesale market liquidity because the vertically integrated companies do not need to access the wholesale market, as their own plant will provide the necessary price and volume protection. One of the key concerns is that the wholesale market might not be delivering the products and signals that all market participants need to operate their businesses effectively. In particular, independent suppliers and generators have expressed concerns that they find it difficult to manage risk with the wholesale products currently available. This could have a negative impact

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<sup>67</sup> The figures for the domestic gas and electricity HHI have been sourced from Ofgem's databases while the non-domestic HHI figures are based on Ofgem's calculations derived from Datamonitor's data.

<sup>68</sup> HHI is commonly used to assess market concentration, ranging from 10,000 for a monopoly to just above zero for perfect competition. Office of Fair Trading Guidelines categorise a market as 'concentrated' if its HHI exceeds 1,000 and 'highly concentrated' if its HHI exceeds 1,800.

<sup>69</sup> Data based on the Neta report and published in the factsheet '[Retail markets: review and remedies](#)'.

on the outcomes for consumers in the supply market, especially if it means that there is no viable threat to existing suppliers.

154. Ofgem investigated this further and presented a range of policy options, in its report on Liquidity<sup>70</sup>, which will be considered if the market does not deliver<sup>71</sup>.

### *Switching*

155. In 2010, more than 4.7 million domestic electricity customers changed their supplier (on average around 400,000 each month). This is equivalent to a switching rate of 17%. There has been a small decrease in the level of switching among domestic electricity customers in 2010 compared with the level seen in 2009. Table 3.9 below shows the number of annual switchers of domestic electricity customers and annual switching rate.

Table 3.9: Domestic customers' annual switching in electricity

	2006	2007	2008	2009	2010
Total switchers	4,820,756	5,157,028	5,419,334	5,025,210	4,749,538
Switching rate	18%	19%	20%	18%	17%

Source: Ofgem

156. Historically, Ofgem has not looked into switching data for the non-domestic electricity market. However, as stated in the Energy Supply Probe decision document, published in August 2009<sup>72</sup>, we developed our market monitoring to provide us with better information on the non-domestic market, specifically on the small business sector, to enable monitoring of the effectiveness of the Probe remedies. Consequently, from April 2010 we have been collecting data from suppliers on customer gains and losses, which will indicate switching, and data on number of objections to customer transfer. However, the data has not yet been verified and is not ready for the publication in the 2011 National Report.

### *Switching procedure*

157. The Customer Switching Processes used in the retail electricity market is initiated following agreement between a supplier and a customer to enter into a contract. Once the customer has decided that they wish to switch supplier, they can either directly approach an alternative supplier, use a third party supplier price comparison service (Consumer Focus has put in place processes to accredit these comparison services) or delegate the responsibility for negotiation to a broker or consultant (which is used in the case of a number of I&C customers). Alternatively, the customer may be contacted directly by the supplier, eg on the doorstep, and asked whether they want to transfer supplier.

158. The rules and processes used with regard to customer switching in the electricity market are found pre-dominantly in a supplier's Standard Licence Conditions, the Master Registration Agreement (MRA) and its subsidiary documents. Other supporting processes are found in the Balancing and Settlement Code (BSC).

<sup>70</sup> Please see page 28

<sup>71</sup> [Liquidity proposals for the GB wholesale electricity market \(22/10\)](#)

<sup>72</sup> [Energy Supply Probe - Retail Market Remedies \(Ref 99/09\)](#)

159. Once the terms and conditions for supply are agreed, the customer has a period of time to consider the contract and decide whether to cancel it – the Cooling Off Period. This period is a legal obligation with regard to domestic customers and is seven business days. However, many domestic suppliers have extended this period to 14 days and some I&C suppliers have also adopted the cooling off period. If the customer does not cancel the contract, the new supplier using a shared network called the Data Transfer Network notifies the relevant distributor of the intended transfer who then performs a simple validation check. If successful the distributor stores the transfer details on a central system called MPAS (Metering Point Administration Service) and then contacts the old supplier to notify them of the specific meter point (MPAN – meter point administration number) to be transferred and the intended supply start date. The old supplier then has five business days to object to the transfer. If no objection is raised then the transfer and intended supply start date are agreed and the new supplier must appoint agents (e.g. a meter reader, data aggregator and meter operator) to fulfil its duties (i.e. collecting meter readings, provision and maintenance of a meter etc) as prescribed in the supplier's Standard Licence Conditions, the BSC and the MRA.

160. The last task the new supplier must complete is to procure and submit a change of supplier meter reading that falls within +/- 5 working days of the Supply Start Date (SSD) by SSD +8 days.

161. The duration of the switching period, when switching on a dual fuel basis, is currently on average between 4 to 6 weeks (i.e. switching times for gas and electricity are different and this period is needed for a synchronised switching date for both electricity and gas). In order to meet the third Package requirement for switching to be carried within three weeks, as part of the third Package implementation, the Department of Energy and Climate Change (DECC) is putting in place supply licence condition which would require suppliers to make it clear in the customer contract that switching would be carried out in 3 weeks.

#### *Factors which influence switching*

162. Price is still the overwhelming trigger for switching, with no change since the Probe research. From the January 2011 Omnibus survey<sup>73</sup> at least 77% of gas and electricity switchers quote price as their main motivation, distantly followed by improved customer service at 7%.

163. Door-knocking by sales agents continues to be the principal method by which switchers find out about energy deals offered (~29% of switches in 2010) followed by online comparison services (24%). When it comes to making the switch, around 28% of consumers sign up on the doorstep, around 28% phone the supplier and 16% switch via a comparison website.

164. The 2011 Omnibus survey shows direct sales are the main channel used to switch by prepayment customers, those aged over 65, those in social group E<sup>74</sup> and those without internet access. For some consumers, direct sales offer the only way that they are able to switch. Almost all switching discussed in the vulnerable consumer research was reactive, i.e. in response to being contacted by a sales agent. However, there is also some distrust of such methods and a reluctance to engage. Suppliers are increasingly using telesales and direct selling in public places such as stores and shopping centres.

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<sup>73</sup> Customer Engagement with the Energy market - Tracking Survey, Ipsos MORI, January 2011

<sup>74</sup> Casual or lowest grade workers, pensioners and others who depend on the state for their income

165. Some consumers at our research sessions tell us they dislike talking to sales reps and fear being pressurised into making a decision that may not be best for them. Sales agents usually only represent one supplier and may not provide a supplier's full range of tariffs. Furthermore, the cheapest tariffs, such as those online, may not be proactively pushed.

166. Proactive consumers are more willing and able to compare tariffs across suppliers and so are more likely to find a good deal. They are also more likely to be able to take up offers such as direct debit offers and on-line accounts. Price comparison websites are the most popular way for proactive consumers to research a new deal, with 16% of switchers going on to complete their switch using a comparison website. More common is consumers phoning the relevant supplier, which around 28% of consumers did to complete the switch.

167. The Consumer First Panel<sup>75</sup> recognised that switching sites aided comparison without the pressure of sales agents. However, some consumers had faced out-of-date, conflicting or complex results or got different information depending on which site they used. Some switching sites do not list all the tariffs available, which narrows the choices available to consumers. These experiences can reduce trust in switching sites and has led some consumers to question the impartiality of information provided.

#### *Difficulties in switching*

168. The key barriers to switching remain consistent with those identified in the Probe. The most common reason, given by 77% of consumers who did not switch in 2010 was that they are happy with their existing supplier<sup>76</sup>. However, through our qualitative work, a range of other barriers emerge. Consumers' attitudes or perceptions towards the market and/or their circumstances can all create barriers to switching.

169. A significant number of consumers are not interested in switching supplier. Some consumers fear that something will go wrong if they do try to switch. A small number of consumers perceive that their supplier would put them automatically on the best deal, so have not considered taking action themselves. Consumers often consider switching to be a hassle and that there is not enough difference between offers and/or suppliers to make it worthwhile. This is compounded by the fact that some consumers think any potential savings will only be temporary.

170. In some cases consumers' circumstances may limit their ability to compare different tariffs or switch. For example, those without internet access find it more difficult to compare tariffs and will not be able to access suppliers' lowest (online) tariffs.

171. Private tenants are also less likely to switch supplier. For some this is because their landlord prevents them switching or they think that their landlord will prevent them. For others it is linked to their circumstances being more transitory than home owners.

172. Customers on prepayment meters may also face additional obstacles when switching. They may need to change meter in order to change tariff to a more competitive online or fixed offer. For example, before a consumer can switch their

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<sup>75</sup> A group of 100 everyday domestic customers recruited from five locations across Great Britain that meets regularly to discuss key issues impacting on their participation in the energy market, as well as other key issues related to energy.

<sup>76</sup> Ipsos MORI (2011) Customer Engagement with the Energy Market – Tracking Survey, January

supplier may charge for installation of a new meter to enable the switch to a non-prepayment tariff. Consumers with a poor credit rating or who do not have a bank account may be unable to use direct debit and may be limited to prepayment tariffs.

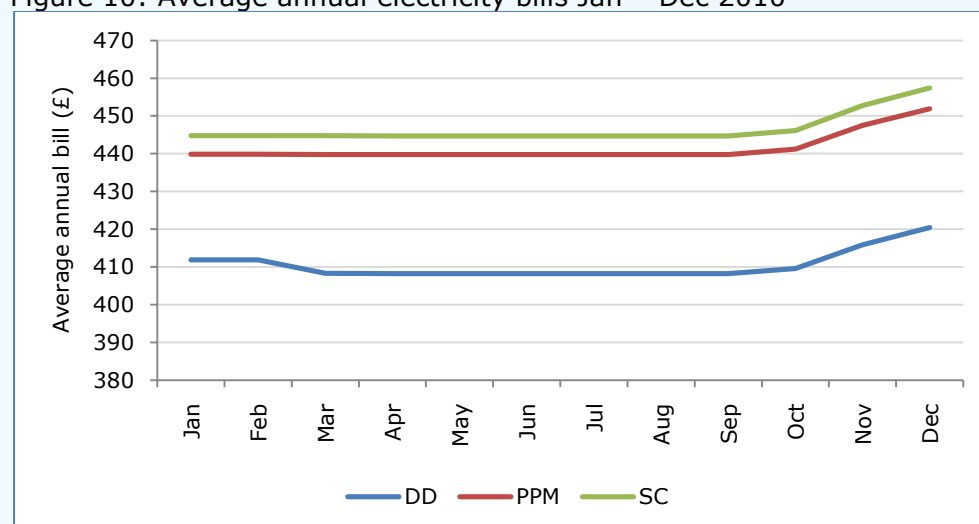
173. More active consumers can find the large number and low comparability between tariffs acts as barriers to switching, generating uncertainty about which is the best deal. In other words they experience 'limited capacity' as identified in our separate paper on behavioural economics. Our research on suppliers' websites and switching sites shows that the numeracy skills required to navigate content limit their effective use to just 25% of the population.

### Price developments

174. Ofgem monitors domestic suppliers' prices across GB. All final consumer prices in the GB wide retail energy markets are determined by market forces as all price controls on final consumer prices were lifted by April 2002. However, there are elements of the final price which are attributable to the regulated aspects of the market, in particular distribution, metering and transmission charges, which as such continue to be price controlled.

175. The retail electricity prices for domestic customers increased slightly in 2010 as five out of six major energy suppliers increased their prices in the last quarter of 2010. Figure 10 shows the impact of 2010 price changes across the three main payment methods: direct debit (DD)<sup>77</sup>, standard credit (SC)<sup>78</sup> and prepayment (PPM)<sup>79</sup>. The overall electricity price increases in 2010 were 3% for prepayment and standard credit and 2% for direct debit customers.

Figure 10: Average annual electricity bills Jan – Dec 2010<sup>80</sup>



Source: Ofgem

176. Wholesale energy costs were cited by suppliers as being one of the primary reasons for these changes as they are a major consideration in supplier's retail pricing

<sup>77</sup> Fixed or variable amount is taken from a customer's bank account each month, quarter or year.

<sup>78</sup> Customer pays on receipt of bill (payment mechanisms include cash, cheque, credit card and standing order).

<sup>79</sup> Customer pays for energy in advance by inserting electronic tokens, keys or cards into the prepayment meter.

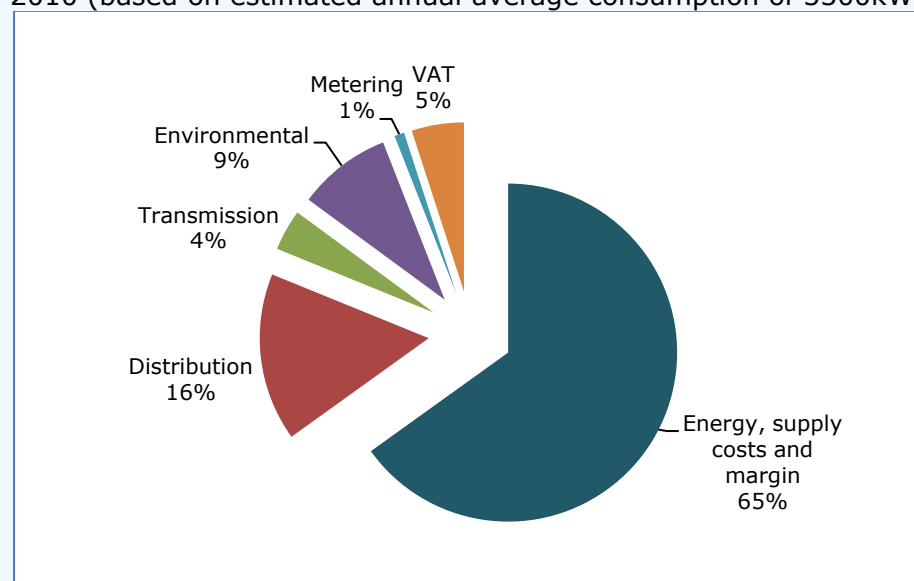
<sup>80</sup> Based on average annual consumption of 3300 kWh

decision. In addition to the wholesale costs, suppliers also face a wide range of other costs such as metering and network charges, which are passed on directly to consumers' bills.

177. There are some other costs which contribute to increase in domestic energy bills. The government has put a number of environmental programmes in place. These give energy companies targets for reducing carbon emissions. These include Renewables Obligation (RO)<sup>81</sup>, the cost of which increases each year, and the Carbon Emissions Reduction Target (CERT)<sup>82</sup>. In addition, the government announced in the 2009 budget its intention to increase the banding of offshore generation which could increase the cost of the Renewables Obligation further. The introduction of the Community Energy Saving Programme (CESP) also contributed to increasing the domestic energy bill. These programmes do impact on the price suppliers charge for electricity but some of them will actually help customers to save money on their bills through increased energy efficiency.

178. Figure 11 provides the estimated breakdown of the domestic electricity bill by the following components: distribution and metering costs, transmission costs, environmental costs, and Value Added Tax (VAT). Generation and retail costs (for example, costs associated with marketing, billing and running call centres) together with the supplier's profit margin make up the remainder of the bill.

Figure 11: Illustrative breakdown of typical domestic electricity customer bill, December 2010 (based on estimated annual average consumption of 3300kWh)



Source: Ofgem

179. At present Ofgem does not actively collect data on prices in the non-domestic sector. However, DECC published a digest of non-domestic prices on their website<sup>83</sup>. Figure 12 below shows prices based on the most recent publication which is for March 2011.

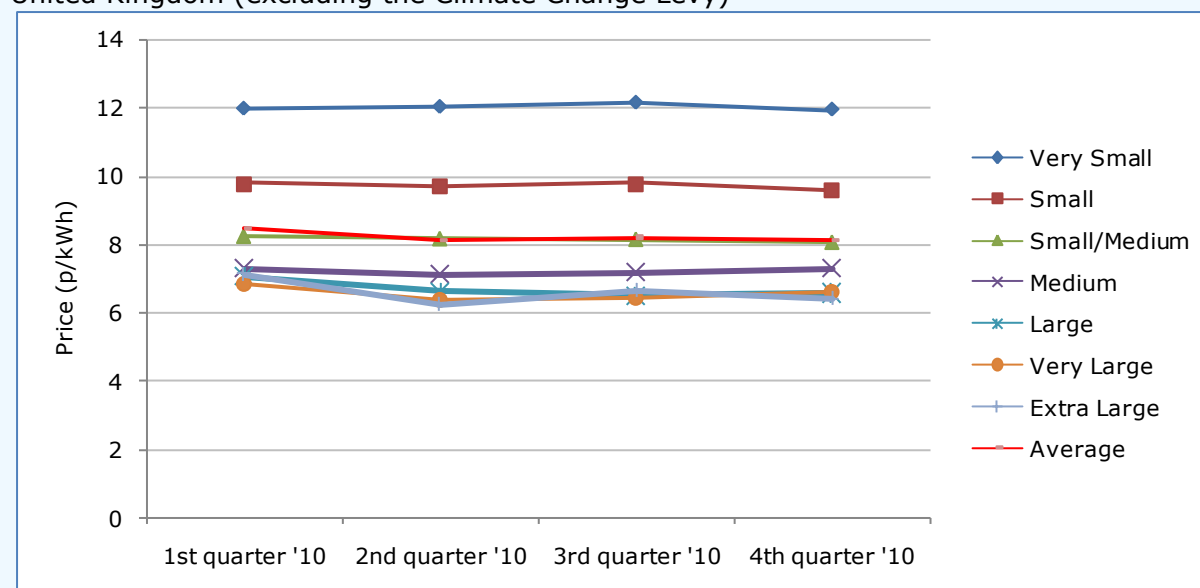
<sup>81</sup> The Renewables Obligation is the government's mechanism for supporting renewable energy. It aims to provide a substantial market incentive for all eligible forms of renewable energy.

<sup>82</sup> The Carbon Emissions Reducing Target (CERT) is a Government policy that sets targets for energy suppliers for reducing carbon emissions by providing energy efficient measures to domestic customers. These costs are passed on to the domestic customers.

<sup>83</sup> <http://www.decc.gov.uk/en/content/cms/statistics/publications/prices/prices.aspx>



Figure 12: Quarterly prices of electricity purchased by non-domestic consumers in the United Kingdom (excluding the Climate Change Levy)



Source: Quarterly Energy Prices: March 2011, DECC

180. In 2010 the electricity prices in the non domestic sector have fallen on average 1.8%<sup>84</sup>, as shown in the figure above. However, different price trends have impacted different segments, with the very large non-domestic consumers benefiting from the greatest price declines (4.4%), whilst the prices for the very small consumers actually have increased by 0.2%.

## Assessment of competition

### General assessment

181. The Probe found no evidence of anti-competitive behaviour and reported that the market is working well in many important respects with the fundamental competitive market structure in place and continuing to advance. However, we found that competition is not yet fully effective in all sectors of the market – with the result that not all consumers are reaping the full benefits of competition.

182. Subsequently, we announced a detailed package of remedies to promote competition and consumer engagement in the retail energy supply market<sup>85</sup> which included the following:

- rules to prevent unjustified price differences - this removed around £500 million of unjustified premiums and introduced clearer information on bills and Annual Energy Statements to improve transparency for consumers;
- new Standards of Conduct setting out the level of service consumers can expect from energy suppliers, for example on tariff complexity. On this issue, we warned suppliers in July 2010 that we wanted to see more progress in tackling this problem;
- tougher rules on sales and marketing - in September 2010 Ofgem announced an investigation into npower, Scottish Power, Scottish and Southern and EDF Energy

<sup>84</sup> These figures are calculated as an average of the quarterly percentage change for the last four quarters.

<sup>85</sup> For further details please refer to the [Energy Supply Probe – Proposed Retail Market Remedies, \(99/09\)](#)

to establish whether the firms were complying with tougher misselling rules, and new rules to allow more people who are in debt to switch supplier.

183. These measures were approved by our Authority and licensees and were implemented in a phased manner from September 2009 to July 2010.

*Measures to promote market transparency (initiatives to promote consumer information)*

184. As part of our post Probe remedies agenda, we introduced a package of new rules which aim to improve domestic customers' experience of the energy market. One of the key objectives is to improve market transparency and better customer engagement. The measures regarding consumer information and transparency were introduced through obligations in the suppliers' license conditions and cover broadly the following aspects<sup>86</sup>:

- Improve the information that they provide to customers on their bills and in a new annual statement;
- Improve the conduct of their sales and marketing activities;
- Help small business consumers by providing them with better information regarding the terms and conditions of their contracts; and
- Improve the transparency of their supply and generation activities.

185. These measures were implemented between October 2009 and July 2010.

186. Regarding the non-domestic segment, one of the concerns highlighted in the Probe was that the amount of information small business customers receive about their contract terms and conditions varies significantly. In light of our research and based on the consultation responses, we introduced licence requirements to increase the amount and timeliness of information that suppliers have to provide to small businesses regarding their contract terms and conditions. We have also introduced new measures which restrict supplier's ability to automatically roll a small business customer onto a subsequent fixed-term contract.

*Development of choice brought for customers through competition*

187. The introduction of competition in the retail energy markets has brought significant benefits to all stake holders. In particular customers have a wide variety of choice in terms of (i) switching supplier (ii) tariffs, such as, fixed or variable prices, green energy deals and social tariffs which offer cheaper deals for vulnerable customers (iii) other services such as incentivised and reward based energy services package. Competition in metering services has also helped suppliers to deliver more innovative and competitively priced products to customers.

188. Smart Meter rollout is expected to bring in new energy saving offers/services such as free smart meters, energy monitors, accurate readings, energy efficiency advice and rewards for reducing consumption. As discussed above, price guarantee tariffs are now offered by most suppliers and without the premium previously applied to these tariffs, and are often cheaper than standard offerings.

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<sup>86</sup> Please refer to the same document as above.

189. Non-standard offers also provide a range of benefits to the customers. There is evidence of suppliers competing to acquire customers through discounted offers, particularly online, as well as lower priced fixed offers. Many fixed tariffs which do not require on-line registration or account management are currently cheaper, or are equal to, standard tariffs. Historically non-online fixed tariffs have been offered at a premium to standard tariffs, so this marks a departure from previous trends. We see all of this as a positive indication of competition where suppliers respond to customer requirements. However, we recognise the need to extend these benefits to those customers who may not be able to currently access all of these options, such as, on-line or direct debit offers.

#### *Price comparison service*

190. Customers can obtain information on prices from Consumer Focus (the consumer advocacy body), switching sites and by contacting the energy suppliers directly to check their current energy prices. Consumer Focus provides energy supplier price comparison factsheets and a calculator which calculates average prices based on the information entered by customers.

191. Customers who are thinking about changing energy supplier and want a more detailed price comparison for all suppliers are advised to use one of the internet price comparison services (switching sites) accredited by Consumer Focus. Its 'Confidence Code' sets out the minimum requirements that a provider of an internet domestic gas and electricity Price Comparison Service (Service Provider) must meet in order to be, and remain, accredited by Consumer Focus.

192. The use of comparison and switching sites is an important part of customer engagement with the market. The Probe-Initial Findings Report<sup>87</sup> proposed that a programme to promote confidence in price comparison and switching sites was needed. It also recommended that switching sites extend their scope, in particular to enable prepayment switching and switching among low income and vulnerable groups who do not have internet access. Ofgem is working with Consumer Focus towards extending its accreditation scheme (the Confidence Code) to include internet price comparison and switching sites for non-domestic consumers.

#### **Customer complaints**

193. Ofgem does not deal directly with customer complaints or enquiries where a domestic or a micro business energy customer has a complaint or enquiry relating to their energy supplier or network business, they have to contact their energy company in the first instance. Energy companies have to comply with a stringent set of complaints handling standards set by Ofgem<sup>88</sup>. They have up to eight weeks to resolve the complaint

194. If a customer requires assistance they can go to Consumer Direct for independent advice and information. It will also identify vulnerable customers and those threatened with disconnection or who have been disconnected and refer them directly referred to the consumer body Consumer Focus<sup>89</sup>

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<sup>87</sup> [Energy Supply Probe - Initial Findings Report, \(Ref 140/08\)](#)

<sup>88</sup> 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](http://www.opsi.gov.uk/si/si2008/uksi_20081898_en_2#pt2-l1q3)

<sup>89</sup> Consumer Focus, as well as dealing with vulnerable customers and disconnection cases is also the customer advocacy body, concerned with customer issues.

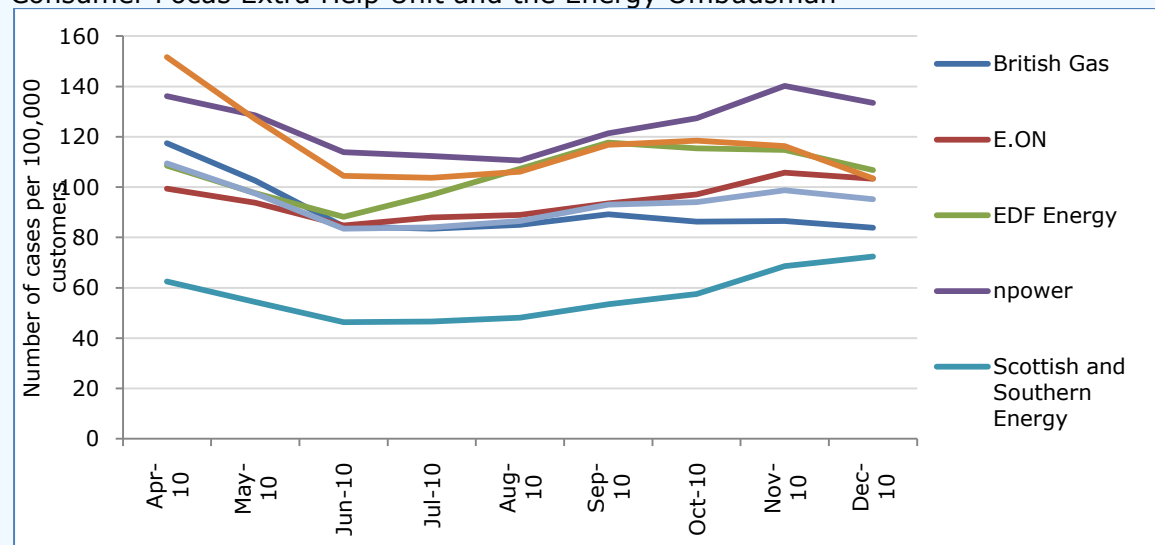
195. If at any point before the eight week time limit the energy company says it can do no more to resolve the complaint or the eight week time limit has expired, it must advise the customer that they can seek redress through the Energy Ombudsman. The Energy Ombudsman, approved by Ofgem, is independent 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

196. From April 2010 Consumer Focus has implemented a new model of reporting energy suppliers' performance which incorporates more measures than their interim measure and figures published in last year's report.

197. They created a proxy for performance based on the number of consumers that have contacted an independent organisation for advice or support with an energy problem. The companies have been ranked on the number of customer contacts to Consumer Direct, Consumer Focus and the Energy Ombudsman in relation to their market share during the last quarter. The different types of complaint have been weighted to reflect the seriousness of the complaint and the time and effort spent by the consumer to get their problem resolved<sup>90</sup>.

198. Figure 13 show historical supplier performance on a three month rolling average since April 2010.

Figure 13 Domestic suppliers' performance on cases received by Consumer Direct, Consumer Focus Extra Help Unit and the Energy Ombudsman



Source: Consumer Focus

## Measures to avoid abuse of dominance

### *Rules governing conduct of supply companies*

199. For the general competition law framework, rules governing conduct of supply companies including transparency, contract structure and provision of information please refer to the 2008 GB National Report pages, 49 and 51-52.

<sup>90</sup> The full details of the methodology can be found at: <http://energyapps.consumerfocus.org.uk/performance/methodology>

## *Transparency*

200. Just like in gas, supply licence conditions are used by Ofgem to control the type and quality of information provided to domestic customers. For example, suppliers to domestic customers are required to ensure that information used in marketing activities is capable of being understood by domestic customers, does not relate to products which are inappropriate to their needs, does not mislead the customer and is otherwise fair in terms of content and presentation.

201. Besides, there are information provision requirements that suppliers must make available to domestic customers in respect of their services to customers having difficulty paying their bills.

## *Market monitoring*

202. Following the Energy Supply Probe, we have stepped up our ongoing monitoring of the retail market. This includes gathering additional data from suppliers and conducting analysis that will allow us to monitor the impacts of the new and amended regulations as well as improve our understanding of how well the market is functioning.

203. We also committed to set out in more detail how we plan to monitor supplier performance against the post probe remedies and published further reports in the focussing on particular aspects of the Probe remedies. The first publication was focused on the tariff differentials and consumer switching<sup>91</sup>, the second on publication of segmental generation and supply accounts by energy companies<sup>92</sup>.

204. In 2010 we also published four quarterly reports<sup>93</sup> which update our indicators of energy supply net margins for a typical dual fuel, electricity and gas customer account.

## *Enforcement actions*

### *Customers in payment difficulties and vulnerable customers*

205. On 22 December 2010, Ofgem made a provisional order in respect of a contravention and likely contravention by First Utility Ltd ("First Utility") of Standard Licence Condition ("SLC") 27 of its gas and electricity supply licence.

206. This is because of First Utility's continuing failure to offer prepayment terms to customers who are or may be in payment difficulty. This is a particular concern during the winter when customers may have difficulty in managing their fuel debt without the option of using a prepayment meter.

207. In addition, Ofgem has particular regard to the protection of vulnerable domestic customers and vulnerable occupants of domestic premises. It is concerned by the lack of compliance in relation to First Utility not correctly identifying vulnerable occupants of a household where the customer is not vulnerable.

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<sup>91</sup> [Update on Probe Monitoring: tariff differentials and consumer switching](#) (79/10)

<sup>92</sup> [Update on Energy supply probe remedy: publication of segmental generation and supply accounts by energy companies](#)

<sup>93</sup> <http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Pages/Energysupplyprobe.aspx>

208. Finally, the terms and conditions on potential disconnections were not adequate in relation to the circumstances in which a customer could be disconnected from their electricity or gas supply. This is because the document containing the "Energy Disconnection Policy" is not readily available on First Utility's website and the notice period of disconnecting customers is not provided.

#### *Complaints handling standards*

209. On 1 June 2010 Ofgem published the results of its investigations into EDF Energy's compliance with Regulation 4(1) of the Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008 (the "CHSR") and in particular whether complaints have been recorded correctly<sup>94</sup>.

210. The investigation was launched following Ofgem's review of the monthly complaints returns from all suppliers (received via Consumer Focus or directly) from October 2008 to December 2008. In the investigation it was confirmed that the total number of complaints recorded was significantly lower for EDF Energy when compared with other suppliers.

211. Ofgem found EDF Energy in breach of the complaint handling regulations between October 2008 and March 2009. EDF Energy had not maintained all its records in the way that the new standards require when handling and resolving customer complaints.

212. However, it was decided that the actions taken by EDF Energy to resolve the issue, such as additional payments to two consumer funds to demonstrate its ongoing commitment obviated the need for a financial penalty.

#### *Ongoing investigations*

##### Mis-selling

213. In September 2010, Ofgem launched an investigation into four of the Big 6 (EDF, Npower, SP and SSE) compliance with obligations under the gas and electricity supply licences (Standard Licence Condition 25).

214. Following its 2008 Energy Supply Probe, Ofgem put in place a new version of standard licence condition 25 with a view to helping domestic customers make well-informed decisions in response to telephone and face-to-face sales activities. In particular, there are new requirements for domestic suppliers to provide estimates and comparisons during face-to-face sales activities (with effect from 18 January 2010) and to secure the achievement of an objective in respect of both face-to-face and telesales activities (with effect from 21 October 2009).

##### Complaints handling standards

215. In July 2010, Ofgem launched an investigation into the "Big 6" suppliers' compliance with the Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008 (the "CHSR").

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<sup>94</sup> [Breach of complaints handling regulations by EDF Energy – decision document](#)

216. Ofgem has been investigating whether British Gas, E.On, EDF Energy, npower, Scottish Power and Scottish & Southern Energy are complying with the CHSR.

217. Since October 2008 energy suppliers and network operators have had to meet strict regulations on handling customer complaints. The standards are designed to provide effective protection for customers and comprise a number of key requirements to which these companies must adhere when a customer makes a complaint.

## Regulation and Performance of the Natural Gas Market

### 4.1 Regulatory Issues

#### Management of congestion on interconnectors' capacity

218. Please refer to previous GB National Reports for background.

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

220. The interconnector with Belgium, Interconnector UK (IUK) became operational on 1 October 1998 with import capacity to flow 8.5bcm/year and export capacity of 20bcm/year. Import capacity increased with three phases of investment, costing approximately £160 million, to 25.5bcm/year.

221. The interconnector with the Netherlands, Balgzand Bacton Leiding (BBL), became operational on 1 December 2006 with an import capacity of 15bcm/year. In 2007, an open season was launched for increased import capacity. The open season was concluded in January 2008 and resulted in the construction of a fourth compressor station in the Netherlands to increase import capacity by 3bcm/year. The fourth compressor became operational from April 2011.

222. Under the terms set by the EU Commission, the BBL Company had an obligation to introduce interruptible reverse flow services from GB to the Netherlands. However, as BBL does not have the necessary compressor set up to allow a physical reverse flow of gas it proposed to meet the requirements of the obligation by offering a non-physical reverse flow product between both countries.

223. BBL submitted a proposed methodology to the Authority on the 26 April 2010 which set out the capacity access arrangements for the reverse flow service. The charging methodology was approved by the Authority on the 13 May 2010. As from October 2010, BBL Company offers non-physical interruptible reverse flow (IRF) capacity (from the UK to the Netherlands). The IRF service allows shippers to nominate gas flows from the United Kingdom to The Netherlands on an interruptible basis.

224. 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<sup>95</sup>. The commercial capacity available to exit the GB system at Moffat is 433.4 GWh/day.

225. During 2009, both the UK and Irish governments received a notice of infringement that they were non-compliant with Regulation (EC) 1775/2005<sup>1</sup> for failing

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<sup>95</sup> This is often known as Scotland to Northern Ireland Pipeline (SNIP)

to offer a “backhaul” or “reverse flow” service, at least on a virtual basis, at the Moffat interconnector. Since then the regulatory authorities and TSOs of both member states have been working towards implementing a virtual reverse flow service at Moffat.

226. On the 4 August 2010 Ofgem gave notice that it intended to add Moffat as an entry point on the gas transmission licence. This is necessary to allow the reverse flows from Ireland to be calculated as entering the GB market. After receiving two consultation responses to this Notice Ofgem formally added Moffat as an entry point in the Licence on 21 January 2011.

227. NGG are also progressing a Uniform Network Code (UNC) modification to make necessary changes to various commercial agreements at Moffat in order to implement the virtual reverse flow products. A number of changes are also being undertaken by the Irish energy regulator. Both Ofgem and Irish regulatory authorities aim to have the necessary regulatory changes complete before the end of 2011.

228. Information on the maximum technical capacity, available capacity and actual physical flows of each interconnector are available on the operators’ websites. For the interconnectors with the Netherlands and the Republic of Ireland this information was published as part of the North-West Gas Regional Initiatives (GRI NW) project to improve transparency at cross-border interconnection points. The GRI NW transparency project required transmission operators to publish information on gas flows and capacity availability in 2008. There have also been enhancements to the data published as required under EU Gas Regulation 715/2009.

229. This information provides a picture of whether the interconnectors are physically or contractually congested. For the Belgian and Irish interconnectors, Gaslink and Interconnector UK, publish information on a daily basis and, for the Dutch interconnector BBL, publish information on an hourly basis.

230. The “Use it or Lose it” principle is applied both on IUK and BBL. Capacity which is unused by one or more shippers may be made available by IUK, on a reasonable endeavours basis, to other shippers, with a requirement in excess of their entitlement to capacity, using the mechanism of Secondary Interruptible Capacity. Similarly, BBL may retrieve any unused capacity from its owners and offer this for sale to any other BBL shipper, subject to a number of conditions. All GB interconnectors allow secondary trading of capacity and a bulletin board is in place at BBL and IUK to facilitate such secondary trading.

231. BBL is currently exempt for some of its capacity from Standard Licence Conditions 11 and 12 regarding Third Party Access provision and the publication of a charging methodology to facilitate the latter.

### **Management of congestion on national networks**

232. Transmission system operators are responsible for managing congestion on their networks. The gas transmission system operator (SO), National Grid Gas plc (NGG), is under a statutory obligation to develop and maintain an economic and efficient gas transmission system.

233. NGG faces commercial incentives to reduce the cost of congestion at entry points as it is required to auction firm access rights and to fund a proportion of the cost of buying back any rights to network access that it has sold but which cannot be delivered due to congestion. Under the system operator price control, there are separate commercial incentives to reduce the costs of congestion associated with existing (operational) entry capacity and new (incremental) entry capacity.



234. Under the operational incentive scheme, NGG has an implicit target allowance of £13.5m per annum for capacity congestion management. It is allowed to keep a proportion of any savings made relative to this target allowance, but must fund a proportion of the costs it incurs above the target allowance. Its potential gain is capped at £13.5 million per annum while any potential loss is limited to £10 million per annum from this incentive scheme.

235. Under the incremental incentive scheme, NGG must fund all of the cost of capacity congestion management associated with the late delivery of new entry capacity (i.e., above an implicit target allowance of £0m per annum). However its potential loss from this scheme is subject to a cap of £4m per month and £36m per annum. There is no potential gain to NGG from this scheme. In addition, there is an "entry permits" scheme whereby NGG can vary the lead time for delivery of any new capacity (around a default lead time of 42 months). Through this scheme, the NGG can potentially receive an additional revenue allowance at the end of the five-year price control period, if it commits in advance of the auctions to delivering capacity earlier than the default lead time or if it does not use up its initial endowment of permits (by delivering capacity later than the default lead time) set at the start of the period. The total gains from this scheme to NGG are capped at £36m.

236. There is also a corresponding exit permit scheme where NGG can vary the default lead time for delivery of new exit projects (36 months) and receive an additional allowance at the end of the price control period. The total gains from the exit scheme are capped at £3 million.

237. These mechanisms are intended to incentivise NGG to maximise the technical availability of its network and ensure timely delivery of the capacity.

238. Under its price control NGG is required to offer for sale a defined volume of firm entry capacity at each entry point (known as baseline capacity), but may also make additional entry volumes available as either "non-obligated" firm capacity or interruptible capacity. In addition, it is obliged to make additional incremental capacity available if the auction results satisfy the requirements of a specified capacity release mechanism, when the results of this mechanism demonstrate a sustained demand above the baseline.

239. To date there have been several examples where auction results have demonstrated a sustained demand (i.e. demand above the baselines volume) at existing entry points, including Hole House Farm, Caythorpe and Isle of Grain. Therefore, NGG has been obliged to release incremental capacity at these entry points.

240. A number of large industrial and commercial gas consumers pay a reduced gas transportation charge in return for allowing NGG to interrupt their gas supplies, typically for up to 15 days per year. This provides NGG with an important tool to manage network congestion. Any customers interrupted on more than 15 days receive an additional payment, which is funded from the transmission SO incentive scheme. However, the total costs of the additional interruption are small (the incentive target is around £1.68m per annum).

241. NGG can also constrain the use of Liquefied Natural Gas (LNG) in certain storage facilities. Shippers that book capacity in these constrained LNG sites undertake an obligation to provide transmission support gas to the transmission network on days of very high demand. In recognition of this, shippers get a discount from the charge for the storage service. The target cost for constrained LNG costs incurred by NGG are currently £4.3m.

## **The regulation of transmission and distribution companies**

### **Transmission**

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

243. Ofgem regulates the level and structure of charges NGG can levy through the Transmission Price Control review (TPCR). The current gas and electricity transmission price control began on 1 April 2007 and was planned to end on 31 March 2012. Ofgem announced in 2010 that TPCR4 will be extended by one year to 31 March 2013.

244. In establishing price controls and incentive regimes, a range of information is collected on operating costs, capital expenditure, financial issues and performance outputs for the NTS which is then analysed by Ofgem.

245. 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.

246. NGG is responsible for producing and maintaining a methodology which sets out how the network charges are calculated. This methodology must meet a number of objectives listed in the gas transmission licence. These objectives require that the charges are reflective of the costs of operating the gas transmission network, promote competition, avoid undue preference in the supply of NGG's transportation service and take account of relevant industry developments.

247. The charging methodology, which was previously a standalone document, was transferred into the Uniform Network Code (UNC) in 2010 as part of Ofgem's Code Governance Review (CGR). Ofgem considers including the charging methodology within the UNC will increase the independence 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 website<sup>96</sup>.

248. Any party affected by the UNC can raise a proposal to modify the charging methodology (before the CGR only NGG could raise modifications). These modification proposals are developed by a charging forum and consulted on. If sufficient support exists for them to be taken forward the UNC code panel vote on whether they should be submitted to the Authority for an implementation decision.

249. The CGR also implemented self governance provisions to allow low impact modifications to be considered without reference to the Authority. A number of criteria are set out in the Licence<sup>97</sup> which a proposal must meet in order to be classified as self governance.

250. NGG must use reasonable endeavours to ensure that alterations to the charges only occur twice a year on the 1 April and 1 October. Ofgem is not required to approve the unit rate changes to the charges but is responsible for ensuring that proposed modifications to the charging methodology achieve the relevant objectives listed above.

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<sup>96</sup> <http://www.gasgovernance.co.uk>

<sup>97</sup> A copy of the Licence can be found on the Ofgem website: <http://epr.ofgem.gov.uk/>

251. NGG is also required to submit a report each year to Ofgem which notes developments in the charging methodology in the previous formula year and what further changes may be necessary to improve compliance with the relevant objectives.

#### *Rollover of the current transmission price control review (TPCR)*

252. Ofgem has given notice of the Authority's decision to implement the next price control (known as RIIO-T1) from 1 April 2013. This allows the current TPCR to be 'rolled over' for an additional year starting from 1 April 2012 to 31 March 2013.

253. Work was undertaken throughout 2010 to define the objectives and options for the rollover of the current price control. This included a stakeholder workshop meeting<sup>98</sup> to provide interested parties with the opportunity to input into the scope and parameters of rollover.

254. A full public consultation<sup>99</sup> document outlining the proposed scope of the rollover was also published on 15 March 2010. Based on the responses to this consultation, Ofgem published a decision document<sup>100</sup> on the 30 June 2010 which set out our preliminary decision regarding the treatment of capital expenditure, operating expenditure and other financial issues such as pensions.

255. In April 2011 Ofgem consulted on our preferred approach on the policy and financial scope of this rollover and presented our initial assessment of the transmission licensees (including NGG's) business plans<sup>101</sup>. We do not consider it proportionate to introduce any new policy for one-year price control, but need to make a number of decisions on how existing policy should be adapted.

256. We will present our initial proposals on the policy scope and allowances for operational and capital expenditure for the rollover year later in 2011 with the aim of communicating our final proposals on these matters by December 2011.

#### *Project TransmiT*

257. For background information please refer to Electricity Transmission section<sup>102</sup>

258. The call for evidence<sup>103</sup> we issued in 2010 sought views on whether the gas transmission regime should be included within the Project TransmiT assessment. Stakeholder responses<sup>104</sup> to the call for evidence argued that the gas transmission charging regime should not be a priority area for Project TransmiT. Any proposed modifications to the gas charging regime can be advanced sufficiently through the existing charging framework. However, any interactions between reforms made to the electricity transmission regime as a result of Project TransmiT and knock on effects to gas transmission will be monitored and taken forward by Ofgem as appropriate.

#### *Entry charging review*

259. A fundamental review of the entry charging regime was undertaken in 2010 to investigate concerns that increasing amounts of TO allowed revenue was being collected

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<sup>98</sup> This workgroup was held on 13 April 2010 at Ofgem's Millbank offices.

<sup>99</sup> A copy of the consultation can be found on the Ofgem website:

<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/TPCR4Roll-over/ConRes/Pages/ConRes.aspx>

<sup>100</sup> The decision document can be found at the link in footnote four

<sup>101</sup> The document can be found on the Ofgem website:

<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/TPCR4Roll-over/Pages/TPCR4Roll-over.aspx>

<sup>102</sup> Please see page 17

<sup>103</sup> A copy of this document can be found on the Ofgem website:

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

<sup>104</sup> The consultation responses can be found here:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Networks/Trans/PT>

through commodity charges with corresponding decreases in revenue collected through capacity charges.

260. A review group led by NGG met several times during 2010 to consider if alternative charging arrangements could be devised which would minimise the revenue collected through commodity charges. NGG submitted a charging modification to Ofgem on 30 April 2010 with proposed amendments to the entry charging arrangements based on the review group's work<sup>105</sup>. These amendments proposed removing price discounts for the purchase of short term entry capacity and restricting the release of interruptible capacity.

261. The Authority vetoed the proposed amendments on the 30 July 2010<sup>106</sup>. The decision to veto was based on concerns that the proposals to remove short term capacity discounts would not be cost reflective and could harm competition by creating barriers to market entry. There was also concern that the proposal would have a limited impact on increasing the amount of allowed revenue generated from capacity charges.

#### *NTS Exit capacity substitution and revision methodology*

262. We introduced an obligation for NGG to introduce an exit capacity substitution and revision methodology at the fourth transmission price control which began in April 2007. Exit capacity substitution is the process by which unsold baseline exit flat capacity is moved from one or more NTS exit points to meet the demand for incremental exit flat capacity at another NTS exit point. Substituting exit capacity in this way can avoid or defer the need for new investment to meet incremental capacity needs, and so help reduce the costs of gas transportation to consumers. Exit revision is the process by which exit capacity baselines are revised following investment for the release of incremental entry capacity.

263. The licence conditions we placed on NGG set out objectives that the exit substitution and revision methodology should be compatible with the physical capability of the NTS; avoid any increase in costs (including constraint management costs) and; so far as is consistent with the above objectives, promote competition between gas Shippers.

264. Following development of the methodology during 2010, NGG submitted its proposed methodology to Ofgem on 4 January 2011. In February 2011 we published an impact assessment consultation assessing the effects of the methodology against the licence objectives and our statutory duties. On 31 March we decided to approve the methodology for implementation with effect from 1 July 2011.

## **Distribution**

### *Price control*

265. Ofgem regulates the level and structure of charges levied for using the monopoly gas distribution networks (GDNs) and the quality of service provided by these companies. The level of charges and quality of service provided by gas transporters, with the exception of independent gas transporters (IGTs), is regulated using price controls and various incentive regimes.

266. The current Ofgem five year price control began on 1 April 2008 and ends 31 March 2013. GDNs in total will be allowed to recover on average £2,470 million (in 2005-

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<sup>105</sup> A copy of this modification can be found on National Grid's website:

[http://www.nationalgrid.com/uk/Gas/Charges/consultations/archive\\_consultation\\_papers/](http://www.nationalgrid.com/uk/Gas/Charges/consultations/archive_consultation_papers/)

<sup>106</sup> The decision letter can be found on the Ofgem website:

<http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/TCMF/Pages/Charging.aspx>

06 prices) for each of the five years. For the average domestic customer this represents a real increase of approximately £2 per annum.

#### *Costs and outputs reporting framework*

267. In 2010 work was started on the next price control for gas distribution that will commence on 1 April 2013. As part of the initial consultation on strategy for the price control we have assessed the performance of the GDNs over the first two years of the current price control, 2008-09 and 2009-10. Within our December consultation document<sup>107</sup> we set out the revenue earned by each of the networks as well as expenditure and returns on regulatory equity for the eight licensed GDNs. It also summarises quality of service information, and gives Ofgem's provisional assessment of Regulatory Asset Value (RAV) for each licensee.

268. Over time the information assembled in this way will show how efficiently and effectively businesses are delivering their customer service and other obligations. It also provides valuable information for the GDNs themselves to understand how well they are doing compared to their peers.

#### *Network tariffs*

269. There are no significant changes in this area - please see the 2008 report.

#### *Balancing*

270. There have been no significant changes - please see the 2008 report.

### **Effective Unbundling**

#### *Transmission*

271. There is one gas transmission network, the National Transmission System (NTS), which is owned and operated by National Grid Gas Plc (NGG). The NTS, GDN and IGT licences require that licence holders:

- do not undertake transactions that create a cross-subsidy with another entity
- only enter into agreements on an arm's length basis and on normal commercial terms
- carry out activities only for the purposes of gas transportation, metering and meter reading subject to the de minimis activities provisions which allow a small amount of non gas transportation, metering and meter reading activities to be undertaken.

272. NGG, the Gas Transmission System Operator in GB, is prohibited from becoming a gas supplier or shipper to secure a level playing field for participants in the GB gas market.

273. The Third Package requires transmission systems and transmission system operators (including NGG) to be unbundled from generation, production and/or supply undertakings. It sets out three models for unbundling which the regulatory authority is required to certify that transmission system operators are compliant against. As part of

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<sup>107</sup> Consultation on strategy for the next distribution price control – Tools for cost assessment:  
<http://www.ofgem.gov.uk/Networks/GasDistr/RIIO-GD1/ConRes/Documents1/GD1%20costs%20assess.pdf>  
Consultation on strategy for the next distribution price control – Financial issues:  
<http://www.ofgem.gov.uk/Networks/GasDistr/RIIO-GD1/ConRes/Documents1/T1%20and%20GD1%20finance.pdf>

this we issued a consultation paper <sup>108</sup>in July 2010 to seek views on the ownership arrangements of all GB transmission system operators and their compliance with the unbundling provisions.

### *Distribution*

274. There are eight GDNs<sup>109</sup> in Great Britain. These eight networks are operated by four GDN operators (National Grid Gas Plc, Scotia Gas Networks Plc, Northern Gas Networks Ltd and Wales & West Utilities Ltd). GDN operators transport gas from the NTS using a low pressure system to serve domestic customers, business consumers and IGTs.

275. In 1995 the Gas Act 1986 was amended to allow for the creation of IGTs which develop, operate and maintain local gas transportation network extensions onto the GDNs (or other IGTs). There are fourteen licensed IGTs owned by nine businesses.

276. The ownership structure of the gas distribution companies in Great Britain is listed in the Table 14 below.

**Table 14 Ownership structure of gas distribution companies in Great Britain, as of 31 December 2010**

<b>Network Company</b>	<b>Activity</b>	<b>Owner</b>
National Grid Gas – East of England	GDN	National Grid Gas Plc
National Grid Gas – North West	GDN	National Grid Gas Plc
National Grid Gas – London	GDN	National Grid Gas Plc
National Grid Gas – West Midlands	GDN	National Grid Gas Plc
Northern Gas Networks Limited	GDN	Cheung Kong Holdings, Power Assets Holdings, SAS Trustee Corporation
Wales & West Utilities Limited	GDN	Macquarie European Infrastructure Fund
Scotland Gas Networks Plc	GDN	SSE Plc, Borealis Infrastructure Management Inc, Ontario Teacher’s Pension Plan Board
Southern Gas Networks Plc	GDN	SSE Plc, Borealis Infrastructure Management Inc, Ontario Teacher’s Pension Plan Board
ES Pipelines Ltd	IGT	ES Pipelines Ltd
ESP Networks Ltd	IGT	ES Pipelines Ltd
ESP Pipeline Ltd	IGT	ES Pipelines Ltd
ESP Connections Ltd	IGT	ES Pipelines Ltd
Fulcrum Pipelines Limited	IGT	Fulcrum Group Holding Limited
GTC Pipeline Limited	IGT	GTC Pipeline Ltd

<sup>108</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=30&refer=Europe>

<sup>109</sup> In gas distribution, there is no distinction between asset owners and system operators. Distribution network owners both own and operate the system.

Energetics Gas Ltd	IGT	Energetics Networked Energy Ltd
Independent Pipeline Limited	IGT	Inexus Group Limited
Quadrant Pipelines limited	IGT	Inexus Group Limited
SSE Pipelines Ltd	IGT	Scottish and Southern Energy Ltd
Severn Gas Transportation Ltd	IGT	Severn Power Limited
Green Park Energy Transportation Ltd	IGT	Green Park Energy Limited
SP Gas Transportation Cockenzie Ltd	IGT	Scottish Power UK Holdings Limited
SP Gas Transportation Hatfield Ltd	IGT	Scottish Power UK Holdings Limited

## 4.2 Competition Issues

### Description of the wholesale market

277. Ofgem provided a description of the structure of the wholesale gas market in its 2008 National Report. The structure of the gas market has remained broadly unchanged since. In brief, the GB wholesale market is based on trading between gas producers, shippers, suppliers, traders and customers across a series of markets. Trade on the wholesale market consists of both over-the-counter (OTC) trading (through brokers and off-market) and exchange trading<sup>110</sup>.

#### *Over the counter trading (OTC)*

278. A description of OTC trading was provided in Ofgem's 2008 and 2009 National Reports. Please refer to these reports for more information.

279. 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 15: Estimated value of UK gas market**

	Volume traded (billion therms)	Est. value of market (£ billion)
2009/10	438	146
2008/09	329	157
2007/08	338	176
2006/07	437	134

Source: Financial Services Authority<sup>111</sup>

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

280. 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

<sup>110</sup> 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.

<sup>111</sup> [http://www.fsa.gov.uk/pubs/other/energy\\_2010.pdf](http://www.fsa.gov.uk/pubs/other/energy_2010.pdf). The data covers the period August to July and excludes exchange trading.



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.

281. Total traded volume on the APX Gas UK (OCM) and APX Gas UK (NBP)<sup>112</sup> exchanges in calendar year 2010 was 130 TWh (~12bcm), down slightly from 2009's figure of 148 TWh (~13.5 bcm). Traded volume on the Intercontinental Exchange (ICE) UK Gas Futures exchange totalled around 1,079 bcm<sup>113</sup> in 2010, an increase from the calendar year 2009. This may be partly accounted for by cold weather conditions at the start and end of the year.

282. Figures from National Grid show that GB gas demand for the year 2010 was 110bcm, around 10bcm<sup>114</sup> higher than typical levels, due largely to cold winter weather. Total churn in GB for the year 2010 was therefore 9.92<sup>115</sup>

## Market integration

**Table 16 – UKCS forecast and import requirements<sup>116</sup>**

	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18	18/19	19/20
Demand (inc. exports)	100.87	102.6	100.52	99.9	98.59	98.16	98.28	96.98	96.91	96.32
UKCS production	47.22	45.13	41.97	42.37	40.95	41.73	39.46	34.53	31.08	27.18
Import requirement %	53%	56%	58%	58%	58%	57%	60%	64%	68%	72%

283. Table 16 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, impacting GB. The relationship was strengthened when Balgzand Bacton Line (BBL) and Langeled came on line, as previously GB prices could de-couple from elsewhere in Europe when the IUK was full or not operational. However, recent 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 prices; however, it is too early to arrive at firm conclusions regarding oil and gas decoupling.

284. 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 16 Shippers hold primary capacity rights. The utilisation of these capacity rights has remained unchanged since Ofgem's 2008 National Report<sup>117</sup>.

285. BBL has installed a fourth compressor to upgrade capacity by three bcm per year and is currently developing new commercial arrangements for interruptible non-

<sup>112</sup> NBP – National Balancing point

<sup>113</sup> Data taken from [www.theice.com](http://www.theice.com), represents total volumes traded in monthly, season and quarter products from 01 Jan 2010 to 31 Dec 2010.

<sup>114</sup> <http://www.nationalgrid.com/NR/rdonlyres/AA50AF69-2031-4524-873B-5BF0B460F9C4/45084/ActualTemperatureHistoricalData.xls>

<sup>115</sup> Calculated as the total volume of gas contracts traded in GB divided by total volume of gas physically delivered in GB over the same period.

<sup>116</sup> Source: National Grid Ten Year Statement Table 4.8G. Available at:

<http://www.nationalgrid.com/uk/Gas/TYS/current/TYS2009.htm>

<sup>117</sup> For further information please see Ofgem 2008 National Report and the IUK website available at the following link: [www.interconnector.com](http://www.interconnector.com).



physical reverse flow. The fourth compressor is operational from April 2011. Virtual reverse flows are in use and since the beginning of 2011 there have been numerous instances of reverse flows.

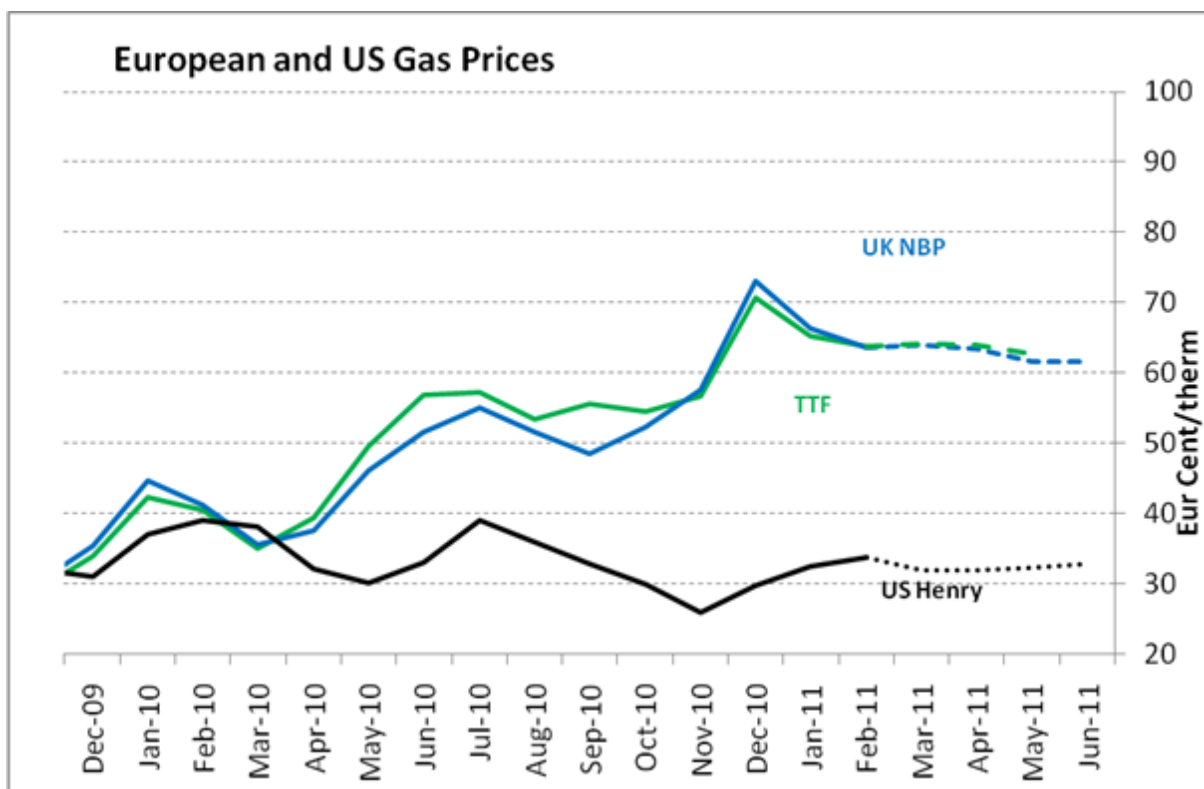
#### Interactions with Global LNG markets

286. 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 51 bcm/year.

287. In 2009/10, LNG represented 17% of total gas supplies in GB. 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 in 2008, LNG deliveries to GB were low, despite a high NBP price, due to high Asian demand which meant that the majority of available cargoes were diverted to this region. In contrast, deliveries in 2009 and 2010 were substantially higher 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.

288. Figure 17 below shows that UK NBP and US gas prices have diverged significantly, in part due to the global dynamics mentioned above.

**Figure 17: GB, US and Belgian Gas Prices for 2010<sup>118</sup>**



#### Market Concentration

<sup>118</sup> Sourced from Bloomberg

289. 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 importation terminals.

290. 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 16 shippers who hold primary capacity on the Interconnector UK, and seven main shippers on the Langeled pipeline.

291. In contrast, since BBL became operational (December 2006), it has typically been used by two to three shippers. There are six shippers (BP, Centrica, GDF Suez, E.ON, Iberdrola and Sonatrach) who import gas through the Isle of Grain. South Hook Terminal is capable of delivering up to 21 bcm of gas per year into the National Transmission System. 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 has three shareholders: BG Group (50%), Petronas (30%) and 4Gas (20%).

292. Taking these factors into account, as in our National Report last year, it is extremely difficult to make precise quantitative evaluations in terms of market shares in the GB wholesale gas market. However, in terms of market share for gas storage, when last full, over 45 per cent of capacity in Rough, the largest gas storage facility in GB, was held by four parties (Rough's capacity is around 3.5 bcm of space, and its daily deliverability rate is around 43 mcm/d), similar to last year. However, market share figures are liable to change as capacity can be traded on the secondary market.

#### *Storage services*

293. 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.

294. 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 18 below provides details of the technical characteristics and the TPA status of existing UK storage.

**Table 18: Existing UK storage and TPA status<sup>119</sup>**

<b>Facility</b>	<b>Space (bcm)</b>	<b>Deliverability (mcm/d)</b>	<b>Owner</b>	<b>TPA Status</b>
Rough	3.5	43	Centrica Storage	Operated under nTPA + Rough Undertakings <sup>120</sup>
Hornsea	0.3	18	SSE Hornsea	Operated under nTPA
LNG Storage	0.2	32	National Grid LNGS	TPA offered under section Z of the Uniform Network Code

<sup>119</sup> Space is working gas capacity and deliverability is withdrawal capacity

<sup>120</sup> The Competition Commission is currently reviewing the Rough Undertakings. For further details on the Rough inquiry, please refer to [http://www.competitioncommission.org.uk/inquiries/ref2010/centrica\\_review/pdf](http://www.competitioncommission.org.uk/inquiries/ref2010/centrica_review/pdf).

Aldbrough (part completed)	~0.1	~10	SSE	Exempt
Hatfield Moor	0.1	2	Scottish Power	Exempt
Holehouse Farm	0.05	8	Energy Merchants Gas Storage	Exempt
Humbly Grove	0.3	7	Star Energy	Exempt
<b>Total</b>	<b>4.6</b>	<b>120</b>		

Source: National Grid (Table 18 - 7 Ten Year Statement 2010)

295. In the GB market, the Rough and Hornsea facility account for approximately 84 per cent of total storage space and 51 per cent of total daily deliverability. The LNG storage facilities account for a further 4 per cent of space and 27 percent of total daily deliverability is offered to the market.<sup>121</sup>

296. The main change in the data presented in this table related to the use of National Grid data provided in its Ten Year Statement. Using this data has resulted in a reduction in the capacity which is considered available from the Aldbrough storage facility<sup>122</sup>.

297. 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.

298. 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. However, the CC proposes to consult on a number of possible variations to the Undertakings. The CC is expected to make its final decision on the Undertakings in spring/summer 2011.

299. National Grid LNG 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, however it has not received complaints regarding the allocation mechanism, and currently all capacity has been sold.

300. The Transmission System Operator tenders for its Operating Margins gas requirements. Gas storage is one of the supply sources that can provide this service. It is up to the storage operators and other parties to decide to participate in the tender. In 2010-11 the TSO requirements for operating margins are around 114mcm<sup>123</sup>.

## Measures to avoid abuses of dominance

### Transparency

301. Transparency is a key component in the effective and efficient operation of the GB gas market.

<sup>121</sup> The LNG storage facilities are required to offer TPA under sections Z of the Uniform Network Code.

<sup>122</sup> The provided in last year's report represent the total expected capacity from Aldbrough. However, the maximum technical capacity from Aldbrough is not expected to be available until 2012. See:

(<http://www.statoil.com/en/NewsAndMedia/News/2009/Pages/StartOfOperationsAtAldbroughGasStorage.aspx>)

<sup>123</sup> [http://www.nationalgrid.com/NR/rdonlyres/51971797-6CE0-4368-ABEB-CB80C7D1E36C/40049/Operating\\_Margins\\_Statement\\_2010\\_11.pdf](http://www.nationalgrid.com/NR/rdonlyres/51971797-6CE0-4368-ABEB-CB80C7D1E36C/40049/Operating_Margins_Statement_2010_11.pdf)

302. National Grid has been working to ensure that the information required by Article 18 and the revised Chapter 3 Annex to Gas Regulation (EC) No 715/2009 is available on its website. In the course of 2010, National Grid ran a project to enhance the information available on its website so that the information required by the Regulation is freely available to all users. Details of this project can be found on the National Grid website<sup>124</sup>.

303. Ofgem issued a consultation in January 2011<sup>125</sup> 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 letter<sup>126</sup>, 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.

304. With respect to exit capacity, Ofgem noted that National Grid published 12 months ahead data based on current booking arrangements. National Grid has committed, by the end of May 2011, to include indicative values for the additional 6 months ensuring 18 months of information is published going forward.

305. 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.

306. 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*

307. Ofgem's market surveillance activities have remained broadly unchanged since our previous report.

#### **Description of the Retail Market**

308. As with electricity retail market, the GB retail gas supply market is characterised by the existence of Big 6 suppliers which evolved from the fifteen former incumbent electricity and gas suppliers. They are: E.ON UK (formerly Powergen), RWE npower (owned by RWE AG), EDF Energy (owned by Electricité de France), Scottish and Southern Energy, Scottish Power (owned by Iberdrola) and British Gas (owned by Centrica).

309. At the end of 2010, there thirteen domestic and twenty six non-domestic gas suppliers were active in the market.

#### *Market shares and concentration*

310. In December 2010, there were approximately 22.5 million domestic customers in the gas market, 99.5% of which were supplied by the Big 6 as presented in Figure 19.

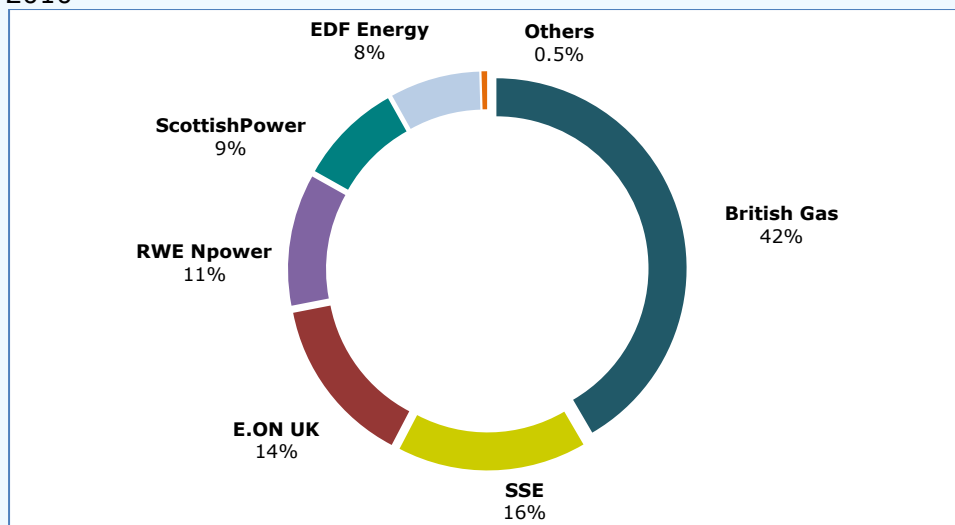
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<sup>124</sup> <http://www.nationalgrid.com/NR/rdonlyres/0A7A1EF0-CAA9-4FFC-85CA-FAA2E98B1082/43081/MIPIETPv7.ppt>

<sup>125</sup> [http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/Documents1/consultation\\_on\\_relevant\\_points\\_Financial%20180111.pdf](http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/Documents1/consultation_on_relevant_points_Financial%20180111.pdf)

<sup>126</sup> [http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/Documents1/Relevant\\_Points\\_decision\\_letter.pdf](http://www.ofgem.gov.uk/Networks/Trans/GasTransPolicy/Documents1/Relevant_Points_decision_letter.pdf)

Figure 19: National GB domestic gas market shares (by customer numbers), December 2010



Source: Ofgem

311. The Big 6 suppliers all have a market share of above 8% with British Gas, Scottish and Southern Energy and E.ON UK being the three highest suppliers with a combined market share of 72%. British Gas, the former gas monopoly supplier has the largest market share of 42%. The other Big 6, all of whom are new entrants into gas supply since liberalisation, have market share ranging from 8% for the smallest (EDF Energy) to 16% for the largest (SSE) of these. There are also seven smaller suppliers active in the domestic gas supply market (First Utility, Good Energy, Utilita, Spark Energy, Ecotricity, OVO Energy and Co-operative Energy) accounting for just 0.5% of the market.

312. Within the non-domestic customer group, there are both non daily metered (Non DM) and daily metered (DM) gas customers. The information Ofgem collects on market shares in the non-domestic markets is acquired from a third party (Datamonitor), which collects it from suppliers. The 2010 data is presented in Table 20 below. It also includes the latest available gas market shares for small business customers (defined as customers with an annual spend of less than £10,000) based on Datamonitor's Buyer Segment Market Share Monitor.

Table 20: GB non-domestic gas retail market shares by site of gas supplied for NDM and DM supply points and by number of small business customers

	Sites		
	DM (Nov 2010)	NDM (Nov 2010)	Small business customers (Q2 2010)
Centrica	2%	42%	51%
Corona Energy	4%	11%	1%
EDF Energy		1%	1%
E.ON Energy	15%	25%	34%
ENI	8%		
Gazprom	8%	4%	
GdF	17%	2%	
RWE npower	6%	1%	3%
ScottishPower		1%	
Shell Gas Direct	17%	2%	
SSE		7%	5%
Statoil UK	7%		
Total Gas and Power	11%	3%	3%
Wingas	5%		
Others		0%	2%

Source: Datamonitor

313. The non-domestic gas market is characterised by a larger number of suppliers compared to the domestic gas market. In addition to the Big 6, there are twenty independent suppliers, with varying focus and market share across the non-DM, DM and SME segments.

314. The DM segment is by far the most fragmented of the three segments, with the top three suppliers holding 49% of the market share. It is also the segment that the non-Big 6 suppliers have made the most significant inroads into, with the most significant suppliers (in-terms of market share by sites) being ENI, Shell Gas Direct and GdF. The three suppliers with the highest market shares in the Non-DM segment are Centrica, E.ON Energy and Corona Energy, who together capture 78% of this segment. Whilst the small business segment is dominated by Centrica with 51% market share, who jointly with E.ON Energy and SSE capture 90% market share in this segment.

#### *Market concentration*

315. Herfindal-Hirschman Indices (HHI)<sup>127</sup> indicators are often used to gauge market concentration. Though HHI does not provide conclusive evidence on the level of competition, it offers pointers as to whether a market has the potential to deliver competitive outcomes.

316. In December 2010, the national gas HHI in domestic market was 2,452 (as opposed to 2,496 in 2009 December) while HHI index for small business customers in 2008<sup>128</sup> was 2,607. Both domestic and small business gas supply markets are "highly concentrated" according to the threshold HHI levels (1800) used by the OFT. Based on November 2010 data the HHI for the Non-DM segment was 2,577 and for DM it was 1,185. Compared to November 2009, this represents 11.3% increase in Non-DM and 1% increase in DM segment market concentration.

<sup>127</sup> HHI is commonly used to assess market concentration, ranging from 10,000 for a monopoly to just above zero for perfect competition. Office of Fair Trading Guidelines categorise a market as 'concentrated' if its HHI exceeds 1,000 and 'highly concentrated' if its HHI exceeds 1,800.

<sup>128</sup> Data for 2009 is unavailable

## *Vertical integration*

317. In contrast to the GB electricity market, there has been limited vertical integration between supply and production businesses in the GB gas market. In addition, the GB market for gas supply is well connected with other markets through import pipelines, interconnectors and LNG import facilities, providing a diverse source of supply of gas.

## **Switching**

318. In 2010, more than 3.5 million domestic gas customers changed their supplier (on average around 300,000 each month). The switching rate for the year was 16%.

319. There has been a slight decrease in the level of switching among domestic gas customers, with the level in 2010 lower than seen in 2009. Table 21 below shows the number of annual switchers of domestic gas customers and the annual switching rate.

Table 21: Domestic customers' annual switching in gas

	2006	2007	2008	2009	2010
Total switchers	3,915,480	3,982,225	4,155,953	3,824,337	3,580,929
Switching rate	18%	18%	19%	17%	16%

Source: Ofgem

320. Historically, Ofgem has not looked into switching data for the non-domestic gas market. However, as stated in the Energy Supply Probe decision document<sup>129</sup> published in August 2009 we intend to develop our market monitoring activities to provide us with better information on the non-domestic market, specifically on the small business sector, to enable us to monitor the effectiveness of the Probe remedies. Consequently, from April 2010 we are collecting data from suppliers on customer gains and losses, which indicates switching, and data on number of objections to customer transfer. However, at this time we do not have a complete time series of data covering a full 12 months period. Therefore, we will aim to include annual switching data in the next year's report.

## *Switching procedure*

321. The rules and processes used with regard to customer switching in the gas market are found predominantly in a supplier's Standard Licence Conditions, the Unified Network Code, and its subsidiary documents.

322. Once the terms and conditions for supply are agreed, the customer has a period of time to consider the contract and decide whether to cancel it – the "Cooling Off Period". A cooling off period of seven days is a legal obligation with regard to domestic customers. However, many domestic suppliers have extended this period to 14 days and some I&C suppliers have also adopted the cooling off period. If the customer does not cancel the contract, the new supplier (via its shipper) notifies the relevant transporter of the intended transfer. The transporter performs a simple validation check and if successful contacts the old supplier to notify them of the specific meter point (MPRN – meter point registration number) to be transferred and the intended supply start date.

<sup>129</sup> Energy Supply Probe - Retail Market Remedies (Ref 99/09)

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=199&refer=Markets/RetMkts/ensuppro>



The old supplier then has seven business days to object to the transfer. If no objection is raised then the transfer and intended supply start date are agreed. The last task the new supplier must complete is to procure and submit a change of supplier meter reading that falls within +/- 5 working days of the Supply Start Date (SSD) by SSD +10 days.

323. For the information on the duration of the switching period, please refer to the electricity retail market section of this report, page 37.

*Factors which influence switching*

324. For the factors which influence switching please refer to the electricity retail market section of this report, pages 37-38.

*Difficulties in switching*

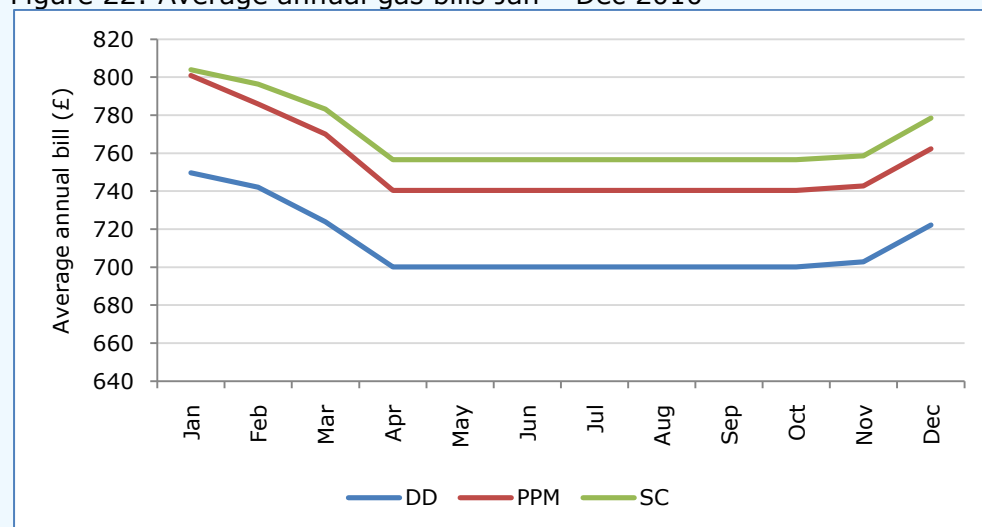
325. For difficulties in switching please refer to the electricity retail market section of this report, pages 38-39.

**Price developments**

326. Ofgem monitors domestic suppliers' prices across GB. As with electricity, all final prices in the GB wide retail energy markets are determined by market forces as all price controls on final 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 transportation and metering charges, and as such continues to be price controlled.

327. As with electricity prices, there has been a small decrease in the retail gas prices for domestic customers over the year, with decreases coming in the first and increases in the last quarter of the year. Figure 22 shows the impact of 2010 price changes across the three main payment methods: direct debit (DD), standard credit (SC) and prepayment (PPM). The overall decreases in 2009 were 4% for direct debit, 5% for prepayment and 3% for standard credit customers.

Figure 22: Average annual gas bills Jan - Dec 2010



Source: Ofgem

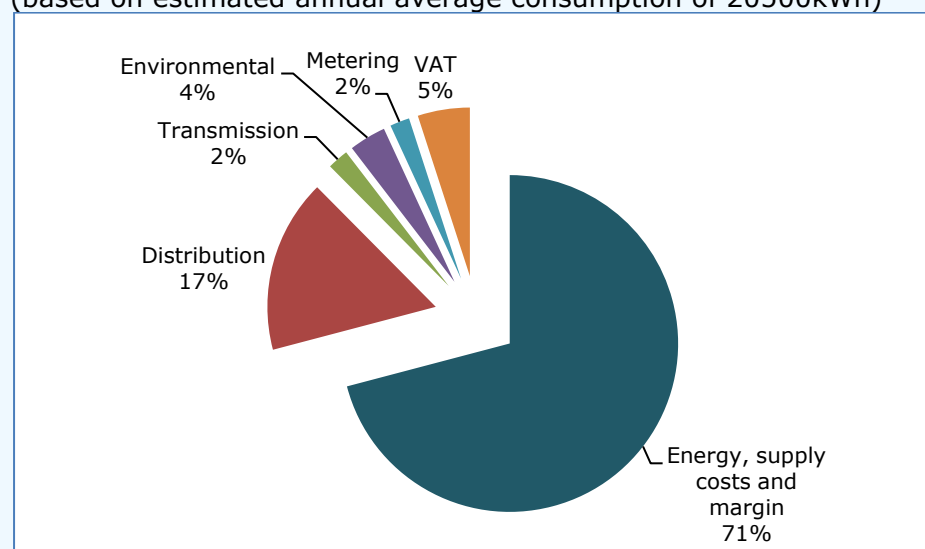


328. Wholesale energy costs were cited by suppliers as being one of the primary reasons for these changes.

329. In addition to the wholesale energy costs, environmental programmes and network investments also have an impact on customer bills. The cost of Government environmental programmes are increasing. The need to upgrade energy networks and infrastructure to maintain secure supplies and import more gas also adds costs to customer bills.

330. The breakdown of the average domestic gas bill consists of the following components: distribution and metering, transmission costs, environmental costs (which include the Carbon Emissions Reducing Target), and Value Added Tax (VAT). Generation costs, retail costs, such as, costs on marketing, billing and call centres and margin make up the remainder of the bill. Figure 23 illustrates the estimated breakdown of the domestic bill into these components.

Figure 23: Illustrative breakdown of typical domestic gas customer bill, December 2009 (based on estimated annual average consumption of 20500kWh)

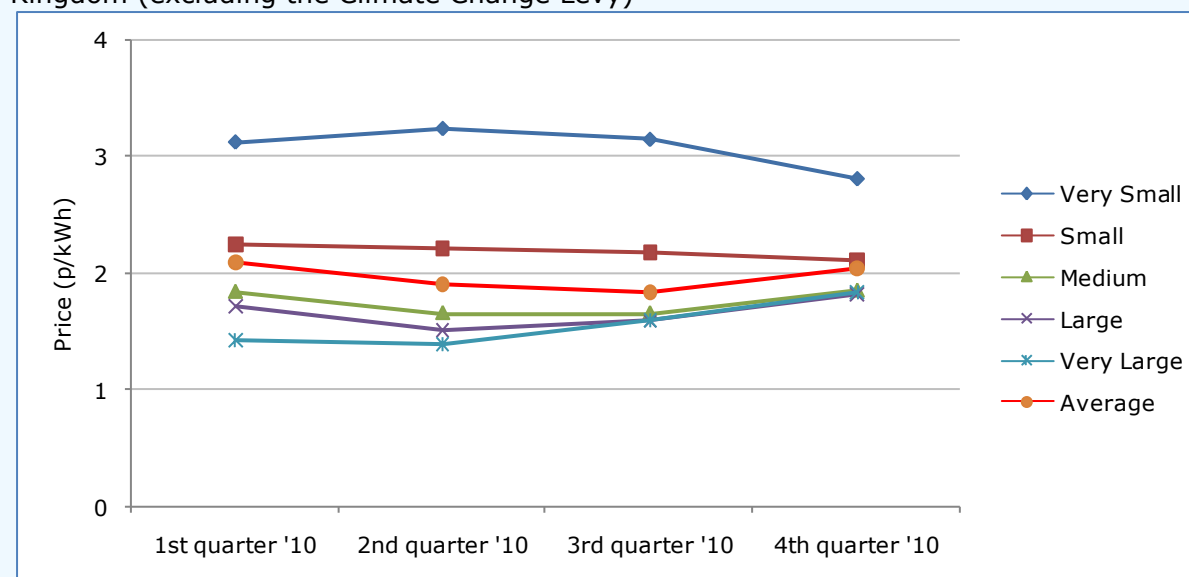


Source: Ofgem

331. At present Ofgem does not actively collect data on prices in the non-domestic sector. However, DECC publishes a quarterly digest of non-domestic prices on their website<sup>130</sup>. Figure 24 below shows prices based on the most recent publication which is for March 2011.

<sup>130</sup> [www.decc.gov.uk/en/content/cms/statistics/publications/prices/prices.aspx](http://www.decc.gov.uk/en/content/cms/statistics/publications/prices/prices.aspx)

Figure 24: Quarterly prices of gas purchased by non-domestic consumers in the United Kingdom (excluding the Climate Change Levy)



Source: Quarterly Energy Prices: March 2011, DECC

332. In 2010 the gas prices in the non-domestic sector have increased on average by 0.2%<sup>131</sup>, as shown in the figure above. However, different price trends have impacted different segments, with the medium non-domestic consumers benefiting from the greatest price declines (2.2%), whilst very large consumers saw prices increasing by 12.9%.

### Assessment of competition

The Probe analysis we conducted did not differentiate between electricity and gas markets and provided a general assessment of competition that covers both sectors. Therefore, for the assessment of competition please refer to the electricity retail market section of this report<sup>132</sup>.

### Consumer complaints

333. For the overview of customer complaints and handling procedures please refer to the electricity retail market section of this report.

### Measures to avoid abuse of dominance

*Rules governing conduct of supply companies*

Competition law

334. For the general competition law framework please refer to the 2008 GB National Report, pages 49-50.

<sup>131</sup> These figures are calculated as an average of the quarterly percentage change for the last four quarters.

<sup>132</sup> Please see pages 41-43.

## *Transparency*

335. Standard Licence Conditions (SLCs) in the gas supply licence are the principal means by which Ofgem requires suppliers to meet minimum requirements for the provision of information and contract terms.

336. Standard Licence Condition 19A of the gas supply licence requires suppliers whose affiliates also hold generation licences to publish financial information on its website about its profits, costs and revenues in its supply and generation activities.

337. There are also additional protections for domestic customers which require suppliers to notify domestic customers of the principal terms of a supply contract prior to entering into a contract with them as well as provisions controlling proposed changes by suppliers to contract terms.

338. Supply licence conditions are also used by Ofgem to control the type and quality of information provided to domestic customers. For example, suppliers to domestic customers are required to ensure that information used in marketing activities is capable of being understood by domestic customers, does not relate to products which are inappropriate to their needs, does not mislead the customer and is otherwise fair in terms of content and presentation.

339. Finally, there are information provision requirements that suppliers must make available to domestic customers in respect of their services to customers having difficulty paying their bills.

## *Contract structure*

340. Please refer to the 2008 GB National Report.

## *Market monitoring*

341. Ofgem's market monitoring role and results of our in-depth investigation in the energy retail markets for households and small businesses are identical to those in the electricity retail market so please refer to the electricity retail market section of this report.

## **Enforcement actions**

342. For the enforcement action please refer to the electricity retail market section of this report (all actions listed there are also relevant for the gas market).

## **Competition policy actions**

### *Anticompetitive foreclosure in metering market (case update)*

343. On 23 February 2010, the UK Court of Appeal ruled that National Grid breached the law and acted anti-competitively in the domestic gas metering market, endorsing Ofgem's April 2008 findings (case update – for the background see our 2010 National Report, page 60-61).

344. This ruling fully endorses the substance of Ofgem's case, that the multi-million pound contracts struck by National Grid with suppliers in 2002 when the metering market was opened to competition harmed new entrants' ability to compete and acted against consumers' interests. Following National Grid's appeal to the Competition Appeal Tribunal (CAT) on 29 April 2009 the CAT upheld Ofgem's finding that National Grid was in breach of competition law and ruled that National Grid should face a £30 million financial penalty. Although lower than the £41.6 million fine imposed by Ofgem, it is the highest penalty for abuse of dominance imposed to date in the UK. In its judgment the CAT has also upheld Ofgem's directions which require National Grid to bring these multi-million pound contracts into compliance with competition law.

## Security of Supply

### 5.1 General

#### *Project Discovery*

345. In Ofgem's 2010 National Report submission, we discussed the findings of Project Discovery<sup>133</sup>. The objective of Project Discovery was to investigate whether current market arrangements in GB are capable of delivering secure and sustainable energy supplies over the next 10-15 years. We considered that markets have delivered secure energy supplies to date. However, we also exposed real risks to and uncertainties about GB energy security of supply in the future. We published a consultation in February 2010 on possible policy remedies to address these risks and issues<sup>134</sup>.

346. Following Project Discovery, the Government published the Energy Market Assessment in March 2010 that shared our concerns about energy security of supply<sup>135</sup>. As a result of these studies, two major projects are being undertaken to ensure the security of GB's energy supplies. The Electricity Market Reform (EMR)<sup>136</sup> is being led by the Government. The Gas Security of Supply Significant Code Review (Gas SCR)<sup>137</sup> is being undertaken by Ofgem.

#### *Electricity Market Reform*

347. The EMR aims to ensure that there are sufficient incentives to invest in secure and sustainable electricity generation. Through the EMR project, the Government has consulted on four possible changes to the electricity market arrangements to provide these incentives for investment. These are:

1. capacity payments
2. carbon price support
3. feed in tariffs

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<sup>133</sup>A copy of 'Discovery: Energy Market Scenarios' can be found at this link -

[http://www.ofgem.gov.uk/Markets/WhlMkts/Discovery/Documents1/Discovery\\_Scenarios\\_ConDoc\\_FINAL.pdf](http://www.ofgem.gov.uk/Markets/WhlMkts/Discovery/Documents1/Discovery_Scenarios_ConDoc_FINAL.pdf)

<sup>134</sup> A copy of 'Project Discovery Options for delivering secure and sustainable energy supplies' can be found at this link -

[http://www.ofgem.gov.uk/Markets/WhlMkts/Discovery/Documents1/Project\\_Discovery\\_FebConDoc\\_FINAL.pdf](http://www.ofgem.gov.uk/Markets/WhlMkts/Discovery/Documents1/Project_Discovery_FebConDoc_FINAL.pdf)

<sup>135</sup> A copy of 'Energy Market Assessment' can be found at this link -

[http://www.decc.gov.uk/assets/decc/1\\_20100324143202\\_e\\_@@\\_budget2010energymarket.pdf](http://www.decc.gov.uk/assets/decc/1_20100324143202_e_@@_budget2010energymarket.pdf)

<sup>136</sup> A copy of the 'Electricity Market Reform' December 2010 consultation can be found at this link -

<http://www.decc.gov.uk/en/content/cms/consultations/emr/emr.aspx>

<sup>137</sup> A copy of 'Gas Security of Supply Significant Code Review (SCR) Initial consultation' can be found at this link -

<http://www.ofgem.gov.uk/Markets/WhlMkts/CompandEff/GasSCR/Documents1/Initial%20Consultation%20-%20Gas%20Security%20of%20Supply%20Significant%20Code%20Review.pdf>

#### 4. emissions performance standard.

348. The Government has proposed introducing capacity payments to ensure security of supply. Capacity Payments are intended to encourage the construction of flexible reserve plants or demand reduction measures. The Government is concerned that adequate reserve capacity may not be available without capacity payments when the amount of intermittent and inflexible low carbon generation increases.

349. The Government believes that transferring the responsibility for ensuring there is adequate capacity from the market to the Government (or a central body) will increase security of supply in two ways. For plants operating with low load factors, capacity payments would replace volatile and uncertain scarcity rents from peak prices with a constant and certain revenue stream. As this reduces uncertainty, capacity payments should reduce the cost of capital and hence increase investment in capacity. Secondly, a higher (and smoother) capacity margin could be achieved than would be delivered by an energy-only market.

350. In its December 2010 consultation document the Government set out its 'lead proposal' for a capacity mechanism that:

- places obligations on a central body to contract for capacity
- requires the central body to ensure a certain volume of capacity is available (rather than setting the price that capacity is purchased at)
- is targeted to encourage additional capacity (rather than providing capacity payments to all generation plant).

351. The purpose of the other three proposals is to help the Government achieve its carbon reduction and renewable targets. Carbon price support will provide more certainty around the cost of high carbon generation. Feed-in Tariffs would give greater revenue certainty for low-carbon generation through long-term contracts. The emissions performance standard would reinforce the existing requirement that no new coal is built without demonstrating carbon capture and storage technology.

352. The consultation on all four proposals closed in March 2011. The Government expects to release a White Paper containing legislative proposals to implement the new electricity market arrangements in late spring 2011.

#### *Gas Security of Supply Significant Code Review*

353. The aim of the Gas SCR is to assess whether reforms to the current gas market arrangements are required to improve security of supply. Ofgem has been working closely with the Government on gas security of supply and the Government fully support this review.

354. Our objective is to enhance gas security of supply. Specifically, we are seeking to:

- minimise the likelihood of a gas emergency ever occurring
- minimise the duration and severity of a gas emergency if one was ever declared
- appropriately compensate firm customers if they are ever interrupted.

355. We have conducted an initial round of consultation on a range of options, including:

- potential changes to the emergency cash-out arrangements
- appropriately compensating customers with firm contracts in the event of an interruption to supply
- the potential case for enhanced security of supply obligations.

356. We are aiming to publish a draft decision in June 2011 and a final decision in October 2011.

## 5.2 Electricity

### *Peak electricity demand conditions*

357. National Grid Electricity Transmission's (NGET) Seven Year Statement<sup>138</sup> (SYS) provides information on outturn and forecast peak electricity demand. Actual peak electricity demand fell slightly in winter 2009/10 due to the impact of the recession and increased use of energy efficiency measures. Figures from 2010/11 however, show that actual peak demand outturn in winter of 2010/11 was 59.6 GW, 0.5 GW higher than in the previous winter<sup>139</sup>. This was primarily due to the cold weather.

358. 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 56.9 GW, which is 1.3 GW lower than previous winter's ACS peak<sup>140</sup>.

359. NGET's ACS Peak Electricity Demand Outlook is outlined in Table 25 and is based on a number of factors including the weather, economic activity, energy prices and energy efficiency/conservation.

**Table 25: NGET base ACS Peak Electricity Demand Forecast<sup>141</sup>**

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, incl Exports to External Systems (for plant margin evaluation)	58.5	58.6	59.1	59.3	59.4	59.1	59.1	59.1

360. Ofgem has also published scenario analysis as part of its Project Discovery<sup>142</sup> 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.

<sup>138</sup> Available at: <http://www.nationalgrid.com/uk/Electricity/SYS/>. All further references to the Seven Year Statement in this chapter will be referenced as NG SYS.

<sup>139</sup> National Grid

<sup>140</sup> NG SYS

<sup>141</sup> NGET SYS

<sup>142</sup> 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>

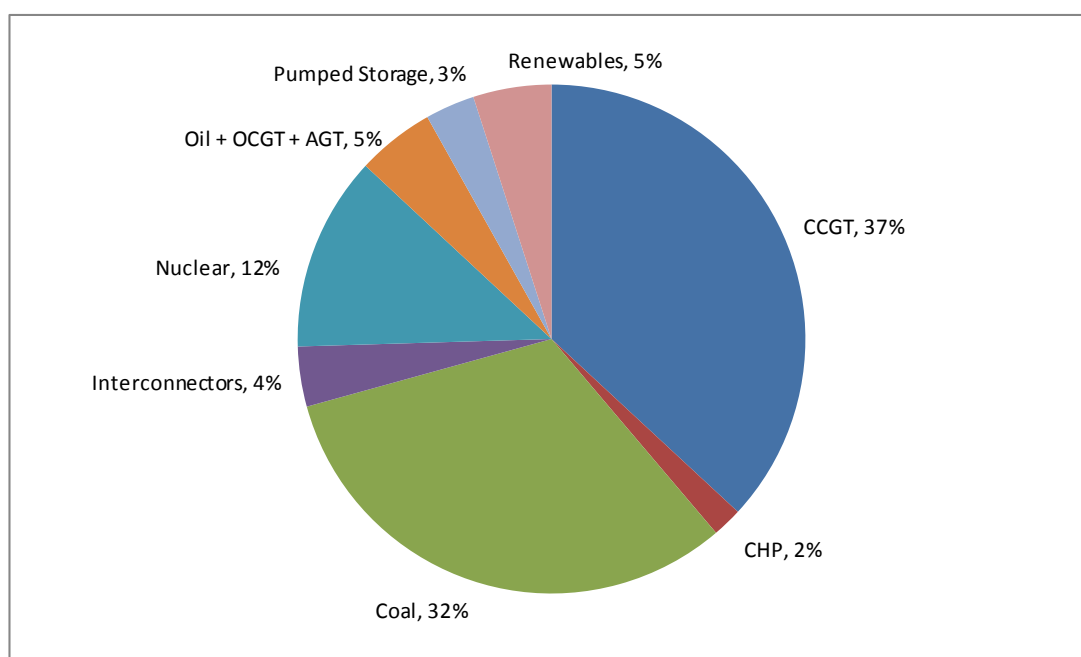
## Generation fuel mix

361. NGET developed four different generation backgrounds for the SYS. These are outlined below in order of certainty, starting with the most certain:

- 'Existing Background' (E) – Current contracted generation either to the transmission or distribution network;
- 'Existing or Under Construction Background' (E+UC) – Includes existing category plus all future generation plants under construction;
- 'Consents Background' (C) – Includes all existing plants, plants with relevant consents, and planned future plants also with relevant consents; and
- 'SYS Background' (SYS) - Includes existing generation and proposed new generation for which an appropriate Bilateral Agreement is in place.

362. A breakdown of current (2010/11) generation capacity against all NGET's generation backgrounds, with exception of SYS background, is presented in figure 26. This shows that, similar to previous years the majority of GB transmission entry capacity comes from CCGT and coal fired plants (37 and 32 percent of total generation capacity<sup>143</sup>).

**Figure 26: Generation Capacity by plant type 2010/11 (Source: NG)**



363. There has been an increase of Total Transmission Entry Capacity (TEC) from plant under construction by 3.9 GW in 2010/11, based on information provided in the SYS. This is due to an increase in wind and CCGT power generation.

364. The table below shows expected changes in TEC from 2009/10 to 2016/17. This shows that the GB electricity market is set to become increasingly dependent on gas and renewable capacity. As part of Project Discovery, in Ofgem's Green Scenarios renewable generation comprised of 17.7% of demand and 10.8% in the non-green scenarios.

<sup>143</sup> Transmission entry capacity by generation type

**Table 27: Growth in Generation Capacity; Change in TEC (MW) between 2010/11 to 2016/17 by fuel type, NGET SYS**

Fuel type	Growth in Generation Capacity (MW)
Clean coal	0
Other coal	-8214
Gas	16136
Oil	-3636
Renewables	22917
Nuclear	1950
Interconnector	0 <sup>144</sup>
Biomass	1685

*Generation Investment*

365. The SYS 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 considered<sup>145</sup>. Currently 6.5GW of new generation projects is under construction (the table below outlines the projects)<sup>146</sup>. A further 11.7GW has received Section 36 consent. Wind farms (both onshore and offshore) account for 10.6 GW of the capacity which has received consent or is awaiting consent but is not currently under construction, whilst for CCGT's this figure is 7.7GW.

**Table 28: Forthcoming generation projects under construction, source: NGET Seven Year Statement<sup>147</sup>**

Plant Type	Power Station	New Capacity (MW)	Year
CCGT	Staythorpe C Stage 4	425	2010
CCGT	Pembroke Stage 1	840	2011
CCGT	Pembroke Stage 2	510	2011
CCGT	West Burton B	1370	2011
CCGT	Grain Stage 3	430	2011
CCGT	Pembroke Stage 3	750	2012
Interconnector	Britned Stage 2	0	2010
Interconnector	Britned Stage 3	0	2010
Wind Offshore	Walney Offshore Windfarm Stage 1	182	2010
Wind Offshore	Thanet Offshore Windfarm	201	2010
Wind Offshore	Ormonde	150	2011
Wind Offshore	Gwynt Y Mor Offshore Wind Farm Stage 1	147	2012
Wind Offshore	Gwynt Y Mor Offshore Wind Farm Stage 2	285	2013
Wind Offshore	Gwynt Y Mor Offshore Wind Farm Stage 3	142	2014
Wind Onshore	An Suidhe Wind Farm, Argyll (SRO)	20.7	2010
Wind Onshore	Beinn an Tuirc 2	38	2010
Wind Onshore	Hill of Towie	48.3	2011
Wind Onshore	Gordonbush Wind	70	2012
Wind Onshore	AChruach Wind Farm	49.9	2013
Wind Onshore	Mark Hill Wind Farm	56	2010
Wind Onshore	Clyde North & South	519	2011

<sup>144</sup> This figure is based on currently secured transmission entry capacity only. It is likely to increase over the coming years.

<sup>145</sup> These are section 36 consents of the Electricity Act 1989 and section 14 consents of the Energy Act, which authorise new generation projects.

<sup>146</sup> NG SYS, Table 3.2

<sup>147</sup> 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.



## Generation commissions/retirements

366. 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 2016/17 inclusive<sup>148</sup>.

### 5.3 Gas

367. For their 2010 gas supply and demand forecasts National Grid Gas (NGG) developed two scenarios – Gone Green and Slow Progression. The Slow Progression scenario uses NGG’s ‘Business As Usual’ profile, taking into account forecasts of fuel prices, the economy, the impact of government energy policy and other relevant indicators. The Gone Green scenario depicts NGG’s views of the plausible energy mix under the assumption that the 2020 environmental targets are met.

368. We have focussed on NGG’s slow progression scenario in this chapter because it is produced in a manner consistent with their ‘business as usual’ forecasts depicted in last year’s National Report. However, for more details about NGG’s Gone Green scenario and ways in which it differs from the Slow Progression scenario, please refer to National Grid’s Ten Year Statement (TYS)<sup>149</sup>.

#### *Gas demand*

369. The table below outlines NGG’s forecast gas demand in their 2010 TYS. In the short term, NGG forecast gas demand to increase. This is driven by a combination of economic recovery, increased exports to Europe and increased gas-fired power generation. The longer-term fall in gas demand is due to a fall in the gas share of power generation. Peak gas demand is forecast to follow a similar underlying pattern over the period, although the impact of Exit Reform results in a step change in the level of peak demand in 2012/13.

**Table 29: Annual and Peak Gas Demand Forecast<sup>150</sup>**

TWh	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Annual demand (TWh)	1099	1120	1128	1105	1098	1077	1086	1082	1067	1069	1049
Peak demand (GWh)	5,513	5,619	5,629	6,303	6,372	6,339	6,398	6,430	6,409	6,559	6,527

#### *Gas Supply*

#### *Storage*

370. Information relating to existing storage facilities is provided in the Market Concentration section<sup>151</sup>; please refer to this section for further information. The key changes in storage capacity compared with our previous report submission are that four projects have started construction. When completed these projects will have a total of

<sup>148</sup> NG SYS

<sup>149</sup> Available at the following link <http://www.nationalgrid.com/NR/rdonlyres/E60C7955-5495-4A8A-8E80-8BB4002F602F/44779/TenYearStatement2010.pdf>

<sup>150</sup> Source: NGG 2009 TYS. Peak data is based on gas supply year.

<sup>151</sup> Please see pp.57-59.

one bcm of capacity. However, the current investment climate is such that the construction of Aldbrough 2 and the Deborah storage facility remain under review.

### *Importance of LNG*

371. At present, LNG meets around 17% of annual GB demand<sup>152</sup> and is still expected to become an increasingly important supply source for meeting peak demand. This continues to reflect a combination of declining UKCS production and Norwegian and Continental pipelines moving closer to full capacity utilisation.

372. There continues to be significant uncertainty about LNG imports due to the exposure to global conditions. This is namely LNG production and demand in alternative markets, notably Asia, and to a lesser extent Europe and the Americas, as well as unconventional gas production in countries outside the US.

373. GB currently has three main LNG importation terminals: the Isle of Grain, South Hook and Dragon. The Isle of Grain terminal opened in 2005, with further expansions in 2008 and early 2010 giving the terminal a total capacity of 21bcm/year. In December 2010, further expansion provided an additional five million tonnes of capacity through an additional storage tank and second jetty, able to take the world's largest LNG carrier - the Q-Max. This latest expansion takes the total GB LNG importation capacity to around 51bcm/year. There are also a number of proposed LNG projects, which may be constructed during the next decade.

### *Import investment*

374. NGG's TYS provides information relating to proposed import and storage projects<sup>153</sup>. Table 30 outlines proposed projects expected online over the next five years.

**Table 30: Proposed import projects expected over next five years**

<b>Import Project</b>	<b>Operator / Developer</b>	<b>Type</b>	<b>Location</b>	<b>Date</b>	<b>Capacity (bcm/yr)</b>	<b>Status</b>
Dragon 2	BG Group / Petronas	LNG	Milford Haven	2015+	6.0	Planning granted, no FID <sup>154</sup>
Isle of Grain 4	Isle of Grain LNG	LNG	Isle of Grain	n/a	n/a	Open season in progress
Medway LNG	Peel Energy / Single Buoy Moorings	LNG	River Medway	2015+	8.7	Conceptual
Norsea LNG	Partners	LNG	Teesside	2015+	6.8-20.5	Most planning granted, no FID
Port Meridian	Hoegh LNG	LNG	Barrow	2013+	5-6	Planning granted, no FID
				<b>Total</b>	<b>27-41</b>	

<sup>152</sup> NGG TYS 2010.

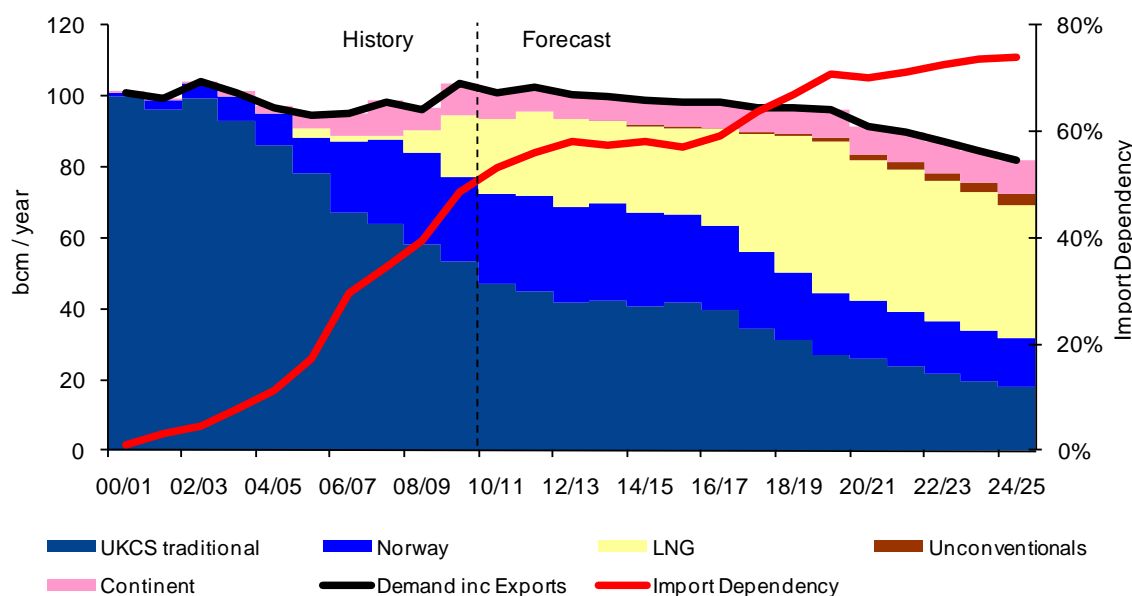
<sup>153</sup> NGG TYS 2010

<sup>154</sup> Final Investment Decision

*Ongoing supply-demand situation*

375. NGG’s annual supply and demand forecast is presented below. The chart shows a decline in UKCS production, relatively high levels of Norwegian imports with only modest growth from current import levels followed by subsequent decline post 2015. There are also significant LNG imports, with LNG becoming the primary import source post 2015 with a small contribution in terms of Continental imports.

**Figure 31: NGG’s Slow Progression Annual Supply Forecast<sup>155</sup>**



376. NGG’s<sup>156</sup> Slow Progression flow forecast considers assumptions about a number of key developments in global gas supply. NGG forecasts import dependency to increase to 71 per cent in 2020, which is significant when compared with 49 per cent of GB demand met by imports in 2010. By 2020, LNG supplies are forecast to meet most of UK demand, contributing around 40 bcm per year.

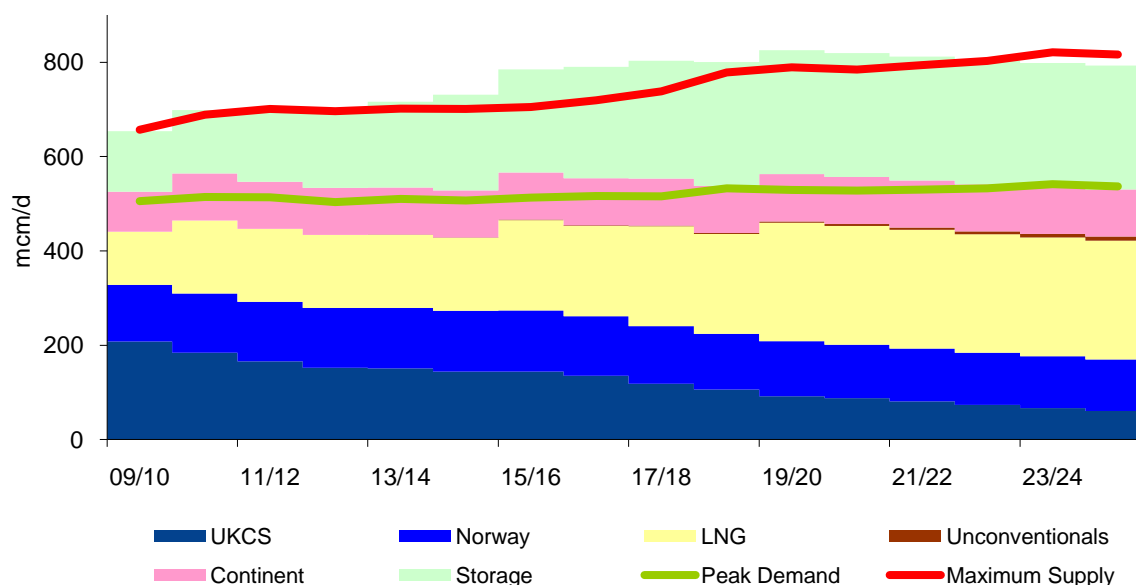
377. The chart below outlines NGG’s Slow Progression peak supply and demand forecast<sup>157</sup>. Given declining UK Continental Shelf (UKCS) supplies, NG forecasts demand to be met by a growth in LNG supplies and storage capacity. However, this is based on the assumptions of new storage developments coming about.

<sup>155</sup> Source: National Grid 2010 Ten Year Gas Statement available at: <http://www.nationalgrid.com/NR/rdonlyres/E60C7955-5495-4A8A-8E80-8BB4002F602F/44779/TenYearStatement2010.pdf>

<sup>156</sup> As outlined in NGG’s TYS.

<sup>157</sup> Based on 1:20 peak demand.

**Figure 32: NGG’s Slow Progression peak supply and demand forecast**



*Forthcoming production capacity investment for the next three years*

378. The oil and gas resource in the UK Continental Shelf (UKCS) is in decline. The UK Oil and Gas Activity survey for 2010<sup>158</sup> showed that the UKCS production decline rate is likely to remain at 6% in the year. This reflects the slowdown in capital investment since 2006 and will continue to accelerate if investment is not sustained. However, if investment can be sustained above £5 billion per year, the UKCS could still be delivering 1.5 million barrels of oil and gas per day in 2020, enough to satisfy half of total UK demand. Current plans could result in investment of £25 billion over the next five years. Delivering all sanctioned projects, potential new fields and incremental developments identified in the survey will require capital expenditure of up to £60 billion.

379. Ofgem does not currently hold information relating to long-term gas import contracts.

**Public Service Issues**

**Vulnerable consumers**

380. Ofgem’s principal statutory objective is to protect the interests of present and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. We do this by promoting competition, wherever appropriate, and regulating the monopoly companies which run the gas and electricity networks in Great Britain.

<sup>158</sup> Information relating to future production and capital investment in the UKCS is taken from the 2010 Oil and Gas Activity survey by the Oil and Gas UK. A copy can be found at the following address <http://www.oilandgasuk.co.uk/cmsfiles/modules/publications/pdfs/EC020.pdf>.

381. In performing our duties, we must have regard to the interests of gas and electricity consumers who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas. We must also have regard to the need to contribute to the achievement of sustainable development and to secure a diverse and viable long-term energy supply.

382. We are also obliged to have regard to statutory guidance issued by government on social and environmental matters which, amongst other things, requires us to make an appropriate contribution to the achievement of government in meeting its targets to eliminate fuel poverty. Our consumer policy work supports these objectives through a number of initiatives and cross-divisional working. The following sets out our work in this area during 2010.

#### *Social Action Strategy*

383. In October 2005, Ofgem launched its Social Action Strategy which describes how it seeks to meet the abovementioned social responsibilities and help the government to meet its targets for eradicating fuel poverty. The strategy has been updated annually to review progress over the past year and identify areas of work for the coming year. The 2010 update was published in July 2010. Going forward we intend to update our work in this area through our Sustainable Development Focus report<sup>159</sup>. The latest of these was published in November 2010.

#### *Helping vulnerable consumers through regulation of network companies*

384. As part of the Gas Distribution Price Control (2008 – 2013), an incentive mechanism (the Gas Discretionary Reward Scheme) was introduced to encourage gas transporters to extend their gas networks to help tackle fuel poverty in communities not connected to the gas network. We have continued to work with the gas distribution networks to ensure that the gas network extensions scheme is successful in delivering cheaper connections to fuel poor households and providing grants to eligible households for central heating and gas appliances. A total reward fund of £4 million is available each year for the scheme.

385. We administer a Customer Service Reward Scheme which is used to promote good practice among companies, who operate the electricity network, when serving vulnerable customers. The 2009/10 scheme focused, among others, on proactively engaging and serving disadvantaged groups within the community; tackling social and environmental issues linked to the network companies' customers such as unemployment, fuel poverty and carbon reduction.

#### *Understanding vulnerable consumers' experience of the market*

386. In 2007 we launched "Consumer First", a programme designed to ensure that consumers remain at the heart of everything we do and help us improve our understanding of the things that really matter to consumers. We have built up a wealth of knowledge and insight into consumers' attitudes, behaviours and needs. Continually developing and evolving, the programme has four main pillars: consumer research; the Consumer Challenge Group; the Consumer First Panel and Demand Side Insight.

387. The Consumer Challenge Group was set up in July 2008 to assist the Electricity Distribution Price Control team in ensuring that the consumer view was fully considered during the fifth Electricity Distribution Price Control Review. The Group's input was so valued that in 2010 we asked them to participate in our transmission and gas

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<sup>159</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Sustainability/SDR>

distribution price controls (RIIO-T1 and RIIO-GD1). We expanded the group from six to eight consumer experts, who act in an advisory capacity giving consumer insight into some of the more complex issues, complementing the research we undertake.

388. Our Consumer First Panel is a group of 100 domestic energy consumers from a wide range of backgrounds and a variety of locations across Great Britain. Panel members meet regularly to give us the 'ordinary consumers' perspective on topical and challenging energy issues. They have proved to be a powerful resource in our drive to fully engage with consumer issues and concerns. The Panel has been so successful that we have now been running it for three years. Membership and locations are refreshed each year to ensure that the views put forward come from people with an 'everyday consumer' understanding of the energy industry.

389. Our Demand Side Insight function was established to help us understand how, when and why consumers use energy. Energy demand is driven by a huge range of factors, not just price. Lifestyle choices, society, the range and efficiency of technology available and government policy all influence the way we use energy. Saving energy can help consumers lower their bills and help contribute towards our climate change goals. There are a number of policies being established with the potential to change how consumers manage their energy. The smart meter roll out aims to put consumers in control of their energy use and the Feed-in Tariff scheme enables consumers to become generators. The Green Deal aims to insulate every home in Great Britain with a range of private sector companies, not just suppliers, innovating in this area. Given these emerging initiatives, we are developing our understanding of current and future consumers' energy needs, and the drivers of change and how this relates to our work.

390. Building on the findings of our 2008 Energy Supply Probe, in November 2010 Ofgem announced the Retail Market Review<sup>160</sup> - an investigation into the markets for electricity and gas for households and small businesses in Great Britain. We carried out research to feed into the review and findings indicated that the energy market is still not operating as well as it could do and this is particularly true for vulnerable consumers. Prepayment meter consumers are particularly dissatisfied and it needs to be publicised more widely the fact that these consumers pay similar prices to other non-prepayment meter consumers. We also found that a common method of presenting prices was widely viewed as a good idea and would help many potential switchers identify better deals, although this change would not, in itself, encourage many vulnerable customers to switch supplier. People reacted positively to the idea of Ofgem controlling prices because they believed prices would be fairer and more stable. But part of the appeal of this proposition was that vulnerable customers would feel less need to attempt to engage actively with the energy market once on a controlled tariff.

#### *Protecting vulnerable consumers from debt and disconnection*

391. Ofgem continues to encourage energy suppliers to take a proactive approach to helping their fuel poor and vulnerable consumers, in particular by developing their social programmes and through the promotion of best practice in the area of debt and disconnection. We monitor and report on supplier progress and practices in preventing and managing household consumer debt, encouraging best practice and using enforcement powers when necessary.

392. We carried out a review<sup>161</sup> of energy suppliers' approaches to debt management and prevention jointly with Consumer Focus<sup>162</sup>, as part of our wider project looking at

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<sup>160</sup> <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Pages/rmr.aspx>

<sup>161</sup> <http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Debt%20Review%20Report.pdf>

debt and disconnection. We found many examples of good practice amongst energy suppliers and welcomed their efforts to assist their customers in the current challenging economic times. However, we also found a number of areas of concern, particularly regarding the extent to which energy suppliers take customers' individual circumstances into account when determining their ability to repay debt. We developed some key Principles for assessing ability to pay which suppliers should use to address these problems and we will take application of these Principles into account when considering suppliers' adherence to their licence obligations in this area and stand ready to take enforcement action where suppliers are in breach.

393. In July 2010 we published a report<sup>163</sup> providing a summary of domestic energy suppliers' performance for the calendar year 2009 in relation to debt and disconnection, prepayment meters and services for vulnerable customers. The key findings were:

- Disconnections continued to decrease in 2009, particularly for gas;
- The number of people repaying a debt remained broadly static, however there was a significant increase in people entering debt repayment arrangements for the first time and in people with bigger debts. Average weekly repayment amounts have generally increased;
- There was an overall rise in the number of prepayment meter (PPM) customers, largely due to a rise in the installation of PPMs to recover debt;
- There was a substantial increase in the number of customers on Fuel Direct<sup>164</sup>;
- The number of customers on suppliers' Priority Services Registers has increased, as has the number of customers receiving general energy efficiency information and more specialist energy efficiency advice.

394. We also identified that two suppliers had relatively high disconnection rates and, as a result of discussions with these suppliers, were successful in getting them to take action aimed at reducing their disconnections. Ofgem will continue to closely monitor suppliers' performance in these areas, intervening where we identify issues.

395. We introduced a modification<sup>165</sup> to gas and electricity suppliers' Standard Licence Conditions in September 2010 obliging energy suppliers to take all reasonable steps to ascertain the status of a customer and the occupants of any affected domestic premises before disconnection. This modification was aimed at ensuring vulnerable consumers are not disconnected in error.

396. The number of disconnections for non-payment of debt fell again in 2010, following the trend seen from 2007 onwards. In 2010 there were 2,801 disconnections - a 34% reduction compared to 2009. Of these, 813 (a decrease of 55% compared to 2009) were for non-payment of gas and 1,988 (a decrease of 15%) were for non-payment of electricity.

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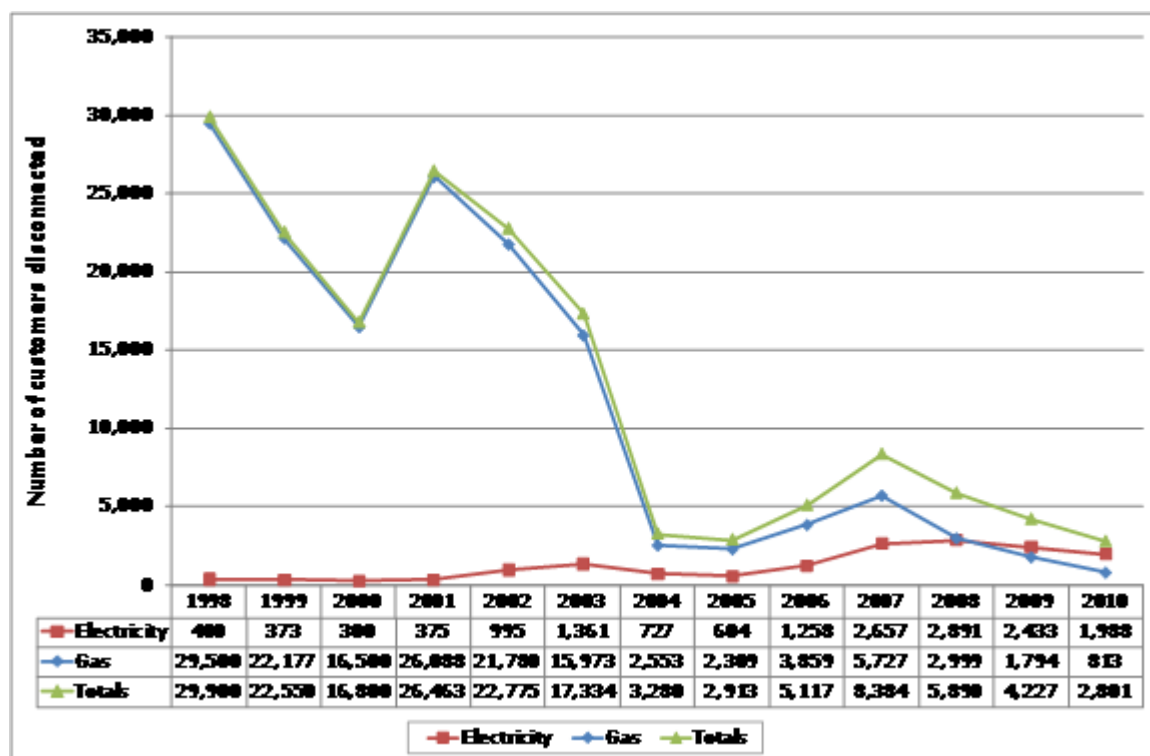
<sup>162</sup> Consumer Focus is the statutory consumer champion for England, Wales and Scotland

<sup>163</sup> <http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Documents1/Social%20obligations%202009%20annual%20report.pdf>

<sup>164</sup> Scheme whereby eligible consumers have a fixed sum automatically deducted every week from their social benefits and paid directly to their energy supplier which covers their current fuel use and also pay off their debt.

<sup>165</sup> [http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Modification%20Direction%20of%20insertion%20of%20Standard%20Licence%20Condition%2027.11\(A\)%20in%20the%20gas%20and%20electricity%20supply%20licences.pdf](http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Modification%20Direction%20of%20insertion%20of%20Standard%20Licence%20Condition%2027.11(A)%20in%20the%20gas%20and%20electricity%20supply%20licences.pdf)

**Figure 33: Number of disconnections for non-payment of debt over time**



Source: Ofgem, supplier data

*Working in partnership to tackle fuel poverty*

397. In September 2010 we published a report<sup>166</sup> on the range of measures energy suppliers undertook to assist their vulnerable and fuel poor consumers in the second year of suppliers’ voluntary commitment (April 2009 to March 2010). This showed that at the end of March 2010 there were approximately 1.6 million consumer accounts benefiting from social tariffs and rebates, compared to 1.3 million the previous year. This highlights the significant and growing contribution that energy suppliers are making to support fuel poor households.

398. New GB legislation (Energy Act 2010) has replaced the voluntary social programmes commitment with a mandatory scheme called “Warm Home Discount” (which came into force on 1 April 2011). The scheme requires suppliers to provide £1.13 billion (over four years) of direct and indirect support to fuel poor and vulnerable consumers and is projected to help around two million households per year, with the majority of financial help delivered by energy suppliers in the winter months. Potential benefits to consumers include rebates on energy bills, discounted tariffs, debt relief assistance and energy efficiency advice and measures. The Department for Energy and Climate Change (DECC) is responsible for the overall Warm Home Discount policy and target framework, whereas Ofgem is responsible for administering the scheme.

399. As the government takes forward its strategic plans for changing the consumer representation landscape and empowering consumers, Ofgem continues to work hard to deliver its primary objective of ensuring that energy consumers are protected. As part of

<sup>166</sup> <http://www.ofgem.gov.uk/Sustainability/SocAction/Suppliers/CSR/Documents1/Monitoring%20Suppliers%20Social%20Spend%202009-10.pdf>



this work we have now entered the third year of a very successful partnership with Citizens Advice (a registered charity that provides free and independent advice to consumers) delivering the Energy Best Deal consumer advice campaign, with funding support from some of Great Britain's energy suppliers. For many consumers, and particularly those who are vulnerable, the energy market can be complex. 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. Since 2008 the Energy Best Deal campaign has reached more than 60,000 consumers and the feedback we have received from evaluations over this period has shown high levels of consumer satisfaction. To broaden the campaign, and to take it to the next level, we have recently launched a series of seven short online videos<sup>167</sup>. These will deliver the key messages on an effective new platform providing the advice that consumers require to engage effectively with the market. We feel that 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.

400. For a number of years, Ofgem has run a Social Action Strategy Review Group to gather information on prevalent issues affecting vulnerable energy customers and to provide early input into Ofgem's work regarding vulnerable consumers to inform strategic direction. Membership of the group includes individuals from suppliers, consumer groups and fuel poverty action groups that are experts on energy issues affecting vulnerable consumers. We held two meetings of the group in 2010, covering how the fuel poor can be better identified and what measures are being taken to help vulnerable customers benefit from feed-in tariffs.

401. In line with our duties under the Equality Act 2010, Ofgem has a Disability Equality Scheme<sup>168</sup>. We encourage energy suppliers to exercise good practice and adherence to licence conditions relating to vulnerability, and we support people with disabilities to better engage with, and exercise choice within the energy market. We set up a Disability Advisory Forum including a number of external stakeholders representing people with a range of physical and mental impairments. We met with the Forum throughout 2010 to better understand the real issues facing disabled consumers and to use this information to inform our ongoing policy thinking, in particular on a range of smart metering issues as part of the design phase of GB's smart metering programme. Areas of interest have included the design of in-home displays to ensure that they are able to be used by these groups of consumers.

### **Energy efficiency to reduce vulnerable consumers' bills**

402. The Carbon Emissions Reduction Target (CERT) 2008 – 2012 requires energy suppliers to achieve targets for a reduction in carbon emissions generated by domestic consumers. The Department for Energy and Climate Change (DECC) is responsible for the overall CERT policy and target framework and Ofgem is responsible for administering the programme. DECC has committed to the continuous delivery of carbon savings from the domestic sector using some form of supplier obligation until at least 2020. CERT is part of this and will contribute to the government's overall Climate Change Programme by cutting carbon emissions in the domestic sector. 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

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<sup>167</sup> <http://www.ofgem.gov.uk/Consumers/smebd/Pages/smebd.aspx>

<sup>168</sup> The scheme was originally developed under the Disability Discrimination Act 1995. Requirements under the Equality Act 2010 have recently come into force.

people claiming specific social benefits. The programme also contributes to the government's Fuel Poverty Strategy.

403. The Community Energy Saving Programme (CESP) has been created as part of the government's Home Energy Saving Programme. It requires energy suppliers and electricity generators to 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). DECC is responsible for setting the overall CESP target and policy framework and Ofgem is responsible for administering the programme. CESP contributes to the government's Fuel Poverty Strategy by requiring measures to be delivered in areas selected according to the level of poverty in England, Scotland and Wales.

### ***Implementation of labelling of primary energy source (electricity)***

404. Since March 18th 2005 all electricity suppliers have been required to provide customers on (or with) their bill with details of the mix of fuels used to produce the electricity supplied to them along with certain environmental information. As a minimum, each energy supplier must provide the mix of fuels used to produce the electricity it supplies in percentage terms for coal, natural gas, nuclear, and renewable, as well as the remainder that is produced from any other sources. This information must be provided with other environmental information related to the CO<sub>2</sub> emissions and levels of radioactive waste generated.

405. The publication of such information is a mandatory requirement under the electricity standard licence condition 21 ('Fuel mix disclosure arrangements') which was introduced into electricity supply licences by The Electricity (Fuel Mix Disclosure) Regulations 2005 (Si No. 391) on 18th March 2005. If a supplier provides information that is not prepared in accordance with the requirements of the licence condition, it will become an enforcement matter for Ofgem.

### **Smart Metering**

406. The government mandated rollout of smart meters to all homes and smaller businesses in Great Britain will deliver significant benefits to consumers. As part of the smart metering implementation programme, Ofgem published a supporting document<sup>169</sup> in July 2010 relating to consumer protection issues. It focussed on the domestic consumer and considered issues around prepayment, disconnection, marketing, new tariffs, switching, vulnerable consumers and cost recovery and set out our proposed approach for ensuring that protections are fit for purpose going forward.

407. Ofgem published a consultation document "Smart Metering Spring Package – Addressing Consumer Protection Issues" in February 2011<sup>170</sup> setting out our proposals for how we will ensure consumer interests remain protected in response to early moves by suppliers to install smart meters ahead of the government's mandated rollout. The document proposed updating some of the important protections around prepayment and disconnection which could in future be done remotely and proposed obligations to help ensure consumers do not face barriers to switching supplier where they have a smart meter. We are currently reviewing the responses.

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<sup>169</sup> <http://www.ofgem.gov.uk/e-serve/sm/Documentation/Documents1/Smart%20metering%20-%20Consumer%20Protection.pdf>

<sup>170</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=186&refer=Sustainability/SocAction/Publications>

408. As part of the Smart Metering Spring Package<sup>171</sup> we commissioned consumer research into innovations such as: load limiting (which limits the amount of electricity a consumer can use while covering basic needs such as lighting) and credit limiting/managed credit (where consumers are automatically cut off if they owe more than a pre-determined amount). We found those consumers not struggling to pay considered these alternative types of disconnection to be preferable to total disconnection. However, those struggling to pay had a number of concerns over their ability to do activities such as cooking. Our research showed that while we must ensure that consumers, particularly the vulnerable, continue to be appropriately protected from actions which amount to disconnection, we need to also ensure, that we do not limit suppliers' ability to genuinely innovate and provide benefits in the tariffs they offer and their approaches to debt management.

### ***Supplier of last resort arrangements***

409. For the relevant statutory requirements and licence conditions on supply activities which Ofgem oversees please refer to 2007 National report, pages 102-105. In this section we only report on supplier of last resort (SoLR) arrangements and implementation of labelling of primary energy source (electricity).

410. Like any other market, companies within the gas and electricity supply market have the potential to fail as a consequence of market forces. However, unlike most other markets the services these companies provide are generally regarded as essential. Hence, it is important that Ofgem, in conjunction with other bodies where appropriate, takes all reasonable steps to address the consequences of gas and electricity suppliers failing to secure continuity of supply for all customers. It is to be noted that not every failure will require regulatory intervention – the business may be sold in a trade sale. However, it is for Ofgem to take all reasonable steps within its available powers to secure continuity of supply for all customers.

411. Although Ofgem's preference is for a trade sale this is not always possible given the urgency of the situation and the subsequent time frames involved. Given this, where a trade sale is not possible Ofgem must consider the balance between the interests of the failed supplier's customers against the risk to other industry parties (and, ultimately, all other customers) of exposure to the increasing bad debt of the failed supplier by pass through.

412. Therefore, once a supplier has become insolvent Ofgem has special powers to revoke the supply licence and subsequently appoint a 'Supplier of Last Resort' (SoLR)<sup>172</sup>, directing it to assume responsibility for the failed suppliers supply portfolio. Such powers have been granted under the Utilities Act 2000 licensing schemes and standard licence conditions (SLC 29 of the Gas and Electricity Supply Licence). However, until insolvency occurs, Ofgem's scope to deal with a failing company is limited.

413. So far, Ofgem has been able to appoint SoLRs within hours of revoking the supply licence, thereby minimising smeared costs to the industry. When appointing a SoLR, Ofgem takes into account issues including the licensee's ability to comply with the direction without significantly prejudicing its ability to continue to supply its own existing customers, the speed at which customers can be transferred in order to minimise disruption to the failed supplier's customers, and the contracted rates that the supplier is willing to offer to these customers. Under this process, each supplier provides

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<sup>171</sup> <http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Smart%20Metering%20Spring%20Package%20-%20Addressing%20Consumer%20Protection%20Issues.pdf>

<sup>172</sup> Ofgem has the power to appoint a SoLR for all customers – domestic and non-domestic.

information that indicates that it would be able to perform the role of SoLR, alongside deemed contract prices for Ofgem's consideration.

414. Ofgem would always prefer to be able to appoint a SoLR that had consented to the role. However, if no suitable supplier wants to be a SoLR, we will consider using our powers to direct a supplier without its consent. We will therefore send high-level, aggregated information about the failed supplier's portfolio to those licensees that we consider are most likely to be able to fulfil the role of SoLR, whether voluntarily or otherwise.

## Appendix 1 – The Authority’s Powers and Duties

1.1. 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. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Acts of 2004, 2008 and 2010, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.<sup>173</sup>

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly<sup>174</sup>.

1.4. The Authority’s principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. The interests of consumers are their interests taken as a whole, including their interests in the reduction of greenhouse gases and in the security of the supply of gas and electricity to them.

1.5. The Authority is generally required to carry out its functions in the manner it considers is best calculated to further the principal objective, whenever appropriate by promoting effective competition between persons engaged in, or commercial activities connected with:

the shipping, transportation or supply of gas conveyed through pipes;  
the generation, transmission, distribution or supply of electricity;  
the provision or use of electricity interconnectors.

1.6. Before deciding to carry out its functions in a particular manner with a view to promoting competition, the Authority will have to consider the extent to which the interests of consumers would be protected by that manner of carrying out those functions and whether there is any other manner (whether or not it would promote competition) in which the Authority could carry out those functions which would better protect those interests.

1.7. In performing these duties, the Authority must have regard to:

0. the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
1. the need to secure that all reasonable demands for electricity are met;
2. the need to secure that licence holders are able to finance the activities which are the subject of obligations on them<sup>175</sup>; and

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<sup>173</sup> Entitled “Gas Supply” and “Electricity Supply” respectively.

<sup>174</sup> However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

<sup>175</sup> Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Acts in the case of Electricity Act functions.

3. the need to contribute to the achievement of sustainable development.

1.8. In performing these duties, the Authority must have regard to the interests of individuals who are disabled or chronically sick, or of pensionable age, with low incomes, or residing in rural areas.<sup>176</sup>

1.9. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

4. promote efficiency and economy on the part of those licensed<sup>177</sup> under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
5. protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
6. secure a diverse and viable long-term energy supply,

and shall, in carrying out those functions, have regard to the effect on the environment.

1.10. In carrying out the functions referred to, the Authority must also have regard to:

the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and certain statutory guidance on social and environmental matters issued by the Secretary of State.

The Authority may, in carrying out a function under the Gas Act and the Electricity Act, have regard to any interests of consumers in relation to communications services and electronic communications apparatus or to water or sewerage services (within the meaning of the Water Industry Act 1991), which are affected by the carrying out of that function.

1.11. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation<sup>178</sup> and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

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<sup>176</sup> The Authority may have regard to other descriptions of consumers.

<sup>177</sup> Or persons authorised by exemptions to carry on any activity.

<sup>178</sup> Council Regulation (EC) 1/2003

# Northern Ireland Authority for Utility Regulation 2010 National Report to the European Commission

**Date of Submission: 11 July 2011**

## **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 2010 was the third 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 first Annual Energy Retail Report is available at:

[http://www.uregni.gov.uk/uploads/publications/2nd\\_ERR\\_20101109.pdf](http://www.uregni.gov.uk/uploads/publications/2nd_ERR_20101109.pdf)

The SEM Annual report for 2010 is due to be published by Quarter 3 2011. However the SEM Annual Report for 2009 is available at:

[http://www.allislandproject.org/en/wholesale\\_overview.aspx?article=9fe266b6-27a8-4692-909e-217048f9791d&mode=author](http://www.allislandproject.org/en/wholesale_overview.aspx?article=9fe266b6-27a8-4692-909e-217048f9791d&mode=author)

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## **1. Foreword**

2010 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. There has also been further progress on the Common Arrangements for Gas (CAG).

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**

### **Electricity**

The year 2010 was the third 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.

Work is ongoing with respect to the development of fully harmonised arrangements for ancillary services, generator use of system charging, the treatment of losses and the treatment of intermittent generation in dispatch and in the market schedule.

During 2010 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 mid 2012) and emerging EU blueprint for a single European electricity market. The SEM Committee issued a Decision Paper (SEM-10-11)<sup>179</sup> in March 2010 on the approach for integrating the SEM into the wider regional and European electricity markets

### **Gas**

#### **Transmission**

##### **Common Arrangements for Gas (CAG)**

The Northern Ireland Authority for Utility Regulation and the Commission for Energy Regulation (CER) continue to progress the Common Arrangements for Gas (CAG) project. The CAG project aims to operate the gas transmission network on a single all-island basis - (Northern Ireland (NI) and Republic of Ireland (RoI)).

Both regulatory authorities continue to work with their respective transmission system operators on two key workstreams under the CAG project: single system operation and harmonisation of tariff arrangements between the two jurisdictions. Operations under CAG are expected to 'go live' in October 2012.

#### **Gas Storage**

Two industry ventures are exploring the possibility of developing gas storage facilities within salt layers in the Larne area. One industry venture applied for planning permission in 2010, which is viewed as a key milestone in the development process.

The Northern Ireland Authority for Utility Regulation continues to work with industry and other government stakeholders to determine an appropriate regulatory framework for

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<sup>179</sup> <http://www.allislandproject.org/GetAttachment.aspx?id=8dd9e94f-8330-46ce-81b3-ad9ea360ea18>

gas storage facilities. To date the regulator has published a draft gas storage licence and is developing transmission tariff arrangements for storage facilities under the CAG project.

## **Retail**

Phoenix Natural Gas Ltd. (the distribution network operator for the Greater Belfast gas market in NI), implemented a semi-automated customer switching system on November 2010 to facilitate domestic customer switching. In parallel with this the suppliers put in place the necessary processes and procedures as part of a Supplier Meter Point Agreement. These arrangements have allowed a new entry supplier to make a competitive offering to domestic customers. Work will commence on facilitating the switching of customers with prepayment meters.

### **3. Regulation and Performance of the Electricity Market**

#### **3.1 Regulatory Issues [Article 23(1) except "h"]**

##### **3.1.1 Management and allocation of interconnection capacity and mechanisms to deal with congestion**

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.

During 2010 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 co-incide 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.

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.

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.

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 latest.

##### **3.1.2 The regulation of the tasks of transmission and distribution companies**

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. Its 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.

System Operator for Northern Ireland (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.

### **3.1.3 Effective unbundling**

During 2010 NIE has been acquired by ESB, the state owned Vertically Integrated Undertaking (VIU) in Ireland. In July 2010 the owner of NIE plc announced its intention to sell the business to ESB. This was conditional on financing arrangements for the parent company and approval of the competition authorities. The sale was completed on 21 December 2010. As such NIE has no generation affiliates in NI, although the ESB Group does have generation assets and supply interests in Northern Ireland through its subsidiary ESBI.

System operation has previously been divested, although NIE still have responsibility for planning, maintenance and development of the high voltage transmission system. With the third package coming into effect from 3 September 2009 work commenced in NI by government, the Regulator and the industry to establish whether current arrangements in NI are compliant with the directive, to develop alternatives if required, and for the Regulator to certify these.

## **3.2 Competition Issues**

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

2010 was the third full year of operation of the 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.

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. During 2009 a programme by the regulators to identify and remove short and long term barriers to trading commenced. Other workstreams and consultations during 2009 aimed to develop all island harmonised arrangements for ancillary services and performance charges; all island harmonised arrangements for generator use of system charging and treatment of losses; the treatment of intermittent generation in dispatch and scheduling; options for increased response and demand side involvement in the SEM.

### **3.2.2 Description of the retail market**

In 1999 industrial electricity consumers became eligible to change supplier; consequently the structures to manage legacy generation contracts and levies were altered so these applied across incumbent and competitor customers. Since 2005 small and medium business electricity customers have been able to change supplier and, in November 2007, household electricity customers became eligible too.

The Utility Regulator *Energy Retail Report* (2010) provides relevant information relating to the state of evolution of the retail market in Northern Ireland, along with background information. Section two of the report relates specifically to the retail market.

The *Transparency Reports*<sup>180</sup> provide quarterly information on a specific set of data for the energy sectors (i.e. market shares, switching, etc).

Data in the mentioned reports indicates that there is active competition in the industrial and commercial (I&C) sector, where a significant share of non-domestic consumption is now supplied by non-NIE Energy Supply (NIEES) suppliers. For 2010 there were seven suppliers in the business markets; three of which were also active in the domestic credit market segment<sup>181</sup>.

## Switching

At the end of 2010, 45% of the business (industrial and commercial) customers (81% by volume) were with non-incumbent suppliers. In the domestic sector, competition started in June 2010 among those customers with no keypad meter. At the end of 2010, 4% of the domestic credit market segment had switched to the new supplier. This figure becomes 2.61% when referring to the total number of domestic customers. .

There is unlimited switching for non-regulated customers, large energy users and higher consuming small and medium businesses; the process currently takes 4 to 6 weeks. In implementing the EU Third Package, we will be working to reduce the switching time to three weeks for all domestic and small business customers and for larger business customers where possible.

Switching in the domestic sector is limited by the IT systems. The Utility Regulator has been working with the industry to increase the switching capacity, and since October 2010 the limit is 7,500 switches per month. There is more work to be done to implement an unlimited switching system by early 2012.

Our most recent research on customers attitudes to competition was conducted among Northern Ireland domestic customers in 2011 [http://www.uregni.gov.uk/uploads/publications/SMR\\_Customer\\_Research.pdf](http://www.uregni.gov.uk/uploads/publications/SMR_Customer_Research.pdf). It showed that 60% of respondents are aware that it is possible to switch electricity supplier in Northern Ireland. Also, it stated that saving money (85% of responses related to electricity) was the most important reason for switching main energy supplier. Feedback from domestic consumers suggested that the switching procedure is working fine. 45% of those domestic customers who have already switched electricity supplier said that they would consider switching supplier again, they found the process being easy and 83% of those switchers found the experience positive.

In 2010 NIAUR and CER conducted research into business and domestic customer switching. The full findings are set out in the following paper: [http://www.uregni.gov.uk/uploads/publications/140610\\_Consumer\\_research\\_report\\_on\\_electricity\\_supply\\_companies\\_-\\_Retail.pdf](http://www.uregni.gov.uk/uploads/publications/140610_Consumer_research_report_on_electricity_supply_companies_-_Retail.pdf).

This study showed that almost nine in ten businesses surveyed (89% of Small and Medium Enterprises and 88% of Large Energy Users) who had switched in the previous 12 months identified cost as a driver for changing supplier; around half (45% of SMEs and 50% of LEUs) stated good service as the reason they decided to stay with their current supplier.

## Customer Information

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<sup>180</sup> [http://www.uregni.gov.uk/news/view/utility\\_regulator\\_publishes\\_retail\\_energy\\_market\\_monitoring\\_report/](http://www.uregni.gov.uk/news/view/utility_regulator_publishes_retail_energy_market_monitoring_report/)

<sup>181</sup> For further information see "Energy Retail Report" 2010 (page 41): [http://www.uregni.gov.uk/news/view/the\\_utility\\_regulator\\_publishes\\_its\\_second\\_annual\\_energy\\_retail\\_report/](http://www.uregni.gov.uk/news/view/the_utility_regulator_publishes_its_second_annual_energy_retail_report/)

The Utility Regulator has provided a list of frequently asked questions for domestic consumers which can be found in the following publication  
<http://www.uregni.gov.uk/uploads/publications/DomesticConsumerFAQJune2010.pdf>

A new supplier entered the NI domestic market in June 2010 and so, the Consumer Council for Northern Ireland provides a leaflet explaining how to switch supplier available [http://www.uregni.gov.uk/uploads/publications/CCNI\\_Switching\\_Domestic\\_Electricity\\_Supplier\\_Guide.pdf](http://www.uregni.gov.uk/uploads/publications/CCNI_Switching_Domestic_Electricity_Supplier_Guide.pdf) as well as a price comparison tool <http://www.consumercouncil.org.uk/energy/price-comparison-/>. There is also information on this on our website [http://www.uregni.gov.uk/customer\\_information/](http://www.uregni.gov.uk/customer_information/)

## **Complaints**

The customer complaints procedure in Northern Ireland is detailed [http://www.uregni.gov.uk/customer\\_information](http://www.uregni.gov.uk/customer_information) In the first instance customers are asked to resolve any difficulty with their supplier. All domestic suppliers are required by licence to have a Code of Practice on complaint handling 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.

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) and its process is outlined <http://www.consumercouncil.org.uk/complaints/what-happens/>

Statistics for 2006 – 2009 are contained within Complain, campaign and gain - the Consumer Council's complaints report 2006-2009

The Utility Regulator deals directly with complaints and disputes with regard to the transmission and distribution operator and certain issues concerning Northern Ireland's Public Electricity Supplier (NIEES).

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.

## **Facilitating Competition**

Since the advent of the Single Electricity (wholesale) market, the Utility Regulator committed to working with the regulator in the Republic of Ireland (CER) to facilitate an all-island retail space to create scale for suppliers and encourage market entry into retail markets north and south.

The Retail Unit continues to work on reducing or eliminating barriers and potential barriers to entry including incumbent regulation issues such as transparency of K factors and flexible price controls for a changing market environment and appropriate data transparency, systems and processes.

We are currently working on implementation of the third package of EU energy legislation dealing with customer protection including information and data to be provided to consumers (including the European Consumers' Checklist), dispute settlement, contract terms and conditions and ensuring adequate protection for vulnerable customers.

## Assessing Progress

We have developed a short term Retail Market Monitoring project, based on a series of quarterly transparency reports. Also, we aim to develop a long term Market Monitoring Framework, building on the first Annual Retail Report, to measure contestability and competitiveness and customer impact within our retail markets including market concentration, pricing, tariff options, switching, complaints and enquiries and consumer engagement and outcomes. We intend to measure sub-sectors of the domestic market to evaluate the experience of more vulnerable customers and ensure they secure the benefits of a competitive market or are appropriately protected where this is not possible.

### 3.2.3 Measures to avoid abuse of dominance

ESB is the single biggest generator on the island owning over 40% of all-island generation. Endesa and Veridian own slightly over 8.5% of all-island generation<sup>182</sup>.

There are a number of measures in the SEM to mitigate the potential abuse of market power. These include:

- a. A bidding Code of Practice (BCOP) which requires generators to bid their short run marginal costs in the wholesale market
- b. A Market Monitoring Unit (MMU) which ensures that generators comply with the BCOP
- c. Ring fencing arrangements between affiliated businesses which are dominant as a group, including both generation and supply businesses
- d. An economic purchasing obligation (EPO) on dominant suppliers

## 4. Regulation and Performance of the Natural Gas market

### 4.1 Regulatory issues

Currently capacity on the Scotland to NI Pipeline (SNIP) is only available on an annual basis. However it is envisaged that this will change under CAG and that a full range of daily and monthly products will become available.

#### 4.1.1 The regulation of the tasks of transmission and distribution companies

##### Network Tariffs

##### Distribution

In NI for gas distribution the entry exit tariff model is applied. Information is collected in relation to volumes, revenues and costs, split across relevant customer categories, which are then used to calculate appropriate tariffs. A combination of incentive-based regulation, along with performance based outputs is implemented for distribution companies. The standard RPI-X price control is applied, alongside a performance based system, which is retrospectively adjusted based on actual performance, with incentives included to encourage efficiency and network growth. The standard duration of revenue or price caps is usually 5 years. 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.

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<sup>182</sup> % of generation capacity

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 Rate of Return 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.

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.

In terms of access to the grid in Northern Ireland there have been no cases of refusal of access to the grid, for instance because of insufficient capacity.

## **Transmission**

At the transmission level, 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.

The postalised methodology will be replaced by an entry exit regime under CAG.

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.

Where the TSO's financing is based upon a mutualised model, a shadow price control is adopted. This allows the Northern Ireland Authority for Utility Regulation to review the level of operating expenditure forecast by the relevant TSOs.

Additionally a 'pain-gain' mechanism is applied at the transmission level where TSOs can share in any capex efficiencies gained.

### **4.1.2 Effective Unbundling**

NI has two DSOs and both DSOs operate distribution and supply businesses. One DSO has more than 100,000 customers, and has therefore spun-out the supply business. This has been completed. The other DSO does not have, and does not expect to ever have, more than 100,000 customers. It remains an integrated Distribution and Supply business.

The arrangements for unbundling at the transmission level are being examined as necessary as part of the certification process required under the third energy package.

## **4.2 Competition Issues**

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

The CAG project aims to operate the gas transmission network on a single all-island basis - (Northern Ireland (NI) and Republic of Ireland (RoI)).

Both regulatory authorities continue to work with their respective transmission system operators on two key workstreams under the CAG project: single system operation and harmonisation of tariff arrangements between the two jurisdictions. Operations under CAG are expected to 'go live' in October 2012.

#### **4.2.2 Description of the retail market**

In NI there are currently 160,000 gas customers of which 12,000 are non-household customers.

The gas market consists of the Greater Belfast area which is open to competition and the ten towns' development area where one gas supply company firmus energy Ltd. has exclusivity of supply for industrial, commercial and domestic customers. A review of the supply exclusivity arrangements in the ten towns area by the Northern Ireland Authority for Utility Regulation has resulted in a better coordinated timetable for market opening across the ten towns area. The new arrangements will see the market sector for customers expected to exceed 732,500 kilowatt hours in any period of 12 months opening on October 2012 and the market sector for customers not expected to exceed 732,500 kilowatt hours in any period of 12 months opening on April 2015.

In the Greater Belfast area, four companies Phoenix Supply Ltd., firmus energy Ltd., Energia and VAYU currently supply gas to industrial and commercial customers. As of November 2010 firmus energy Ltd. made a competitive offering to the incumbent gas supply company Phoenix Supply Ltd. to domestic customers.

In 2009, 365 industrial and commercial customers switched gas supplier in the Greater Belfast area.

#### **Measures to promote competition**

The Gas Market Opening Group (GMOG) has been established by the Northern Ireland Authority for Utility Regulation to address any operational barriers to entry into the gas supply market in NI. The group includes representation from license holders, the Department of Enterprise, Trade and Investment in NI, the Consumer Council in NI and the Commission for Energy Regulation in the Republic of Ireland. The GMOG is examining each of the barriers to entry into the gas market in NI (which have been identified by the GMOG members), with a view to making a decision on the best way to address each issue.

To facilitate a greater number of standard credit customers to switch supplier per week Phoenix Natural Gas Ltd. (the distribution network operator for the Greater Belfast gas market which is open to competition) has implemented a semi-automated customer switching system from November 2010. Based on Phoenix Natural Gas Ltd.'s existing resources the semi-automated customer switching system would enable Phoenix Natural Gas Ltd. to switch up to 500 customers per week. The semi-automated customer switching system has the potential to switch an additional 350 customers per week for every additional transportation officer Phoenix Natural Gas Ltd. employ. The ability of customers to switch supplier is also dependent upon gas suppliers having their customer switching arrangements in place. By September 2011 Phoenix Natural Gas Ltd. also plan to put in place a new prepayment customer switching system to facilitate the switching of customers using all types of prepayment meters.

#### **Price Regulation**

In the Greater Belfast gas market Phoenix Supply Ltd. is price regulated for customers using less than 25,000 therms per annum. The current price control will last for three



calendar years from 1 January 2009 to 31 December 2011. The price control sets out a level of operating expenditure for Phoenix Supply Ltd. for each year of the control, contained within this amount are some costs which will be retrospectively adjusted to account for a movement in the driver. The treatment of these retrospective items will be subject to review during the period of the control and the determination will be subject to a re-opener pending the outcome of this review. Gas costs are treated as pass through in this determination, however the treatment of gas costs will also be subject to review during the period of the control and the determination will be subject to a re-opener pending the outcome of this review.

In determining the allowable supply business costs the Northern Ireland Authority for Utility Regulation has applied a cash flow methodology, which allows Phoenix to earn a margin on turnover, in addition to operating and capital costs being financed on a pay as you go basis. The margin remains at 1.5%, this too will be subject to review and a re-opener applied to the determination pending the outcome of the review.

A new Price Control on Phoenix Supply Ltd. for the period from 1 January 2012 will be considered and consulted on in the next period.

### **Measures to promote market transparency**

Regulations have been passed by local government (the Northern Ireland Assembly) as part of an Energy Bill. The Energy Bill includes legislation to facilitate the implementation of guaranteed standards of service in the gas industry. Guaranteed standards of service will ensure that gas consumers are aware of the level of service they should receive and gas licence holders are committed to providing a guaranteed level of performance.

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

##### **Gas supply**

The licences to supply gas in Northern Ireland outline the information which is required to be submitted by the gas supply company to the Utility Regulator in Northern Ireland on an annual basis. The gas licences also outline in general the conduct expected of the gas supply companies in operating their gas supply business.

In relation to monitoring market share the Utility Regulator has access to data on connections made, volumes supplied, and customer switches etc. and any other data considered necessary to regulate the gas supply market.

## **5. Security of Supply**

### **5.1 Electricity**

SONI prepare an annual Generation Capacity Statement which covers both demand predictions and the generation margins. The latest statement published in December 2010 shows:

- Current level of electricity peak demand is 1866 MW. This has been forecasted to reach 1917 MW by 2016. 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 from over the period 2011 to 2020 there is sufficient generation capacity to achieve compliance with the generation security standard. The report sets out that 2017 is likely to be the year Northern Ireland has the least surplus generation (circa 200MW) 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 generator unit sizes are large and there is a dependency on imports;
- The current available total fossil fuel net generating capacity is 2317 MW. This figure excludes available capacity via imports on interconnector and tie lines. There is also 403 MW of Partially dispatchable or non dispatchable generation capacity (including 380MW 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.

The most significant transmission project in NI is the second North-South interconnector. Preparatory work is ongoing for this; however the project is encountering significant opposition from residents along the route. Some delays are now expected due to other planning issues that have arisen in the Republic of Ireland. To view SONI's most recent Generation Adequacy Report see

<http://www.soni.ltd.uk/upload/All%20Island%20Generation%20Capacity%20Statement%202011%20to%202020.pdf>

## 5.2 Gas

The current levels of actual gas consumption (source: 2009/10 gas year Exit Volumes) are as follows:

<b>Actual gas volume 2009/10</b>		
<b>Sector</b>	<b>Volumes (bcm)</b>	<b>Volumes (Mtoe)</b>
Power	1.047	0.900
Distribution	0.417	0.359
<b>Total</b>	<b>1.464</b>	<b>1.259</b>

The forecast levels of total gas consumption (source 2011 Joint Gas Capacity Statement) are outlined in the following table. The forecasts have been supplied by power stations and distribution companies.

Forecast total volume										
	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2018/19
bcm	1.454	1.486	1.482	1.504	1.501	1.521	1.519	1.524	1.510	1.522
mtoe	1.206	1.233	1.230	1.248	1.246	1.262	1.261	1.265	1.254	1.263

Current levels of gas supply (Mtoe, bcm) and future expected and available supplies for the next ten years (i.e. 2010-20);

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 (as discussed above in section 2) 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 NI and reduce the level of dependence on supplies from Moffat.

### Emergency measures

The transmission companies in NI have emergency arrangements in place to deal with either a physical disruption to the network or a restriction in gas supplies. The arrangements are a legal requirement and are contained within each TSO's Safety Case. The safety case outlines the emergency stages and the actions that are to be undertaken at each stage.

Additionally power stations are required to hold reserves of alternative fuels to enable fuel switching in the event of a restriction to gas supplies. The emergency measures are tested annually alongside the Republic of Ireland and Great Britain exercises.

Supply licenses in NI also require that suppliers have access to gas supplies to meet peak demand during severe winter conditions.

Currently available production and import quantity (bcm and Mtoe):

100% of gas is supplied through the NTS exit point at Moffat. Import quantities are presented within the above table.

Forthcoming production capacity and import capacity investment for the next three years:

As discussed previously, there are currently no indigenous gas supplies in NI. However under the development of CAG, it is envisaged that NI will have access to alternative sources such as the Corrib gas field which is forecast to begin production in 2014.

### **Security of supply standards**

The Northern Ireland Authority for Utility Regulation and 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. This approach ensures that any areas requiring investment are identified and addressed so that future demands on the system can be met.

Security of supply standards are also contained within supply licences. As discussed above supply licences in NI require that suppliers have access to gas supplies that would meet peak demand during winter conditions.

The principle of protecting consumers is also contained within each TSO's safety case. For example load shedding arrangements are in place to ensure that domestic consumers are the last group to be taken off the system in the event of a restriction to gas supplies.

There is also significant interest in developing gas storage facilities in NI. The construction of gas storage facilities will significantly enhance NI's security of supply position.

Additionally the development of the CAG market will improve both NI and Ireland's security of supply position.

### **Security of Supply Regulation 994**

Regulation 994 concerning measures to safeguard security of gas supplies and repealing Directive 2004/67/EC was adopted in December 2010. Since Northern Ireland is part of the UK Member State, the Northern Ireland Authority for Utility Regulation is working with the relevant UK government authorities on meeting the requirements of this regulation.

The regulation also promotes regional co-operation between Member States. As such the Northern Ireland Authority for Utility Regulation is working closely with the relevant government departments and TSOs in Ireland and Great Britain to meet the requirements of the regulation.

### **Storage capacity**

Currently there are no gas storage facilities within Northern Ireland. Two industry ventures are exploring the possibility of developing gas storage facilities within salt layers in the Larne area of NI.

Islandmagee Storage Limited has completed their seismic testing and submitted a planning application in 2010 for their proposed facility. The planning application is viewed as a key milestone in the project plan. Operations are forecasted to start in 2015. Initial studies indicate that the facility could have a storage volume of up to 500 million cubic metres (18 billion cubic feet) of natural gas, with an injection rate of 12 million cubic metres per day and a withdrawal rate of 22 million cubic metres per day.

The second industry group, a joint venture between Bord Gais Energy (NI) and Storengy, have completing their seismic study and continue with data analysis. The venture intends to test drill in 2011 with planning applications to be submitted following the results of the test drill.

## **Incentives for new investments**

Companies currently have appropriate rates of return to encourage investment in their network.

## **Progress on major infrastructure projects**

As above, two industry ventures are exploring the possibility of developing gas storage facilities within salt layers in the Larne area of NI. The storage facilities will connect to the NI transmission system with the possibility of providing services to NI, Republic of Ireland and Great Britain.

The Northern Ireland Authority for Utility Regulation is working with industry to determine the regulatory framework for the proposed gas storage facilities. Work to date has included the development of a gas storage licence and publication of the criteria that will be used to determine the third party access regime.

## **6. Public Service Issues**

### **6.1 Implementation of labelling for electricity**

Article 3(6) of the Internal Market Directive (Directive 2003/54/EC) requires Member States to ensure that the contribution of each energy source to the overall fuel mix of the supplier over the preceding year and related environmental information are provided in or with bills sent by suppliers to final customers. This Article also stipulates that Member States must take the necessary steps to ensure that the above information provided by suppliers to customers is reliable.

Article 3(6) was transposed in Northern Ireland under the Electricity Order 1992 (Amendment) Regulations (Northern Ireland) 2005. Article 5 inserts a new Article 11A (8) in the Electricity (NI) Order 1992 under which electricity licenses, issued by the Utility Regulator, shall include conditions to ensure compliance with Article 3(6) of the Directive 2003/54/EC.

On Wednesday 20 May, 2009 the Regulatory Authorities in Northern Ireland and Ireland published a consultation paper outlining the options and preferred approach of the Regulatory Authorities to the interim fuel-mix disclosure arrangements. The preferred approach was for a methodology based on the average pool-mix and bi-lateral purchases. Having reviewed the responses the SEM Committee has decided to adopt this approach as the basis for the interim arrangements which are required in order to calculate suppliers' fuel mix until the enduring arrangements using Renewable Electricity Guarantees of Origin (REGOs) are fully implemented. The SEM Committee has issued a decision in March 2009 outlining the high level methodology for the new arrangements. However, the implementation of these arrangements will require additional consultation on the detail of the methodology, the establishment of a system for the administration of Guarantees of Origin and Generator Declarations, and the transposition of Directive 2009/28/EC. Accordingly the interim arrangements are likely to apply until at least 2011.

### **6.2 Vulnerable Customers**

Following an extensive consultation process carried out from January to June 2009, the Utility Regulator published a Social Action Plan 2009-2012 in October 2009. The Social Action Plan is a statement of how we intend to take forward our work in relation to social responsibilities and vulnerable customers and how we will ensure that we meet our statutory duty to protect customers in the present and in the future. The Social Action Plan was developed around two main themes: issues of financial vulnerability and issues of equal access to utility services. Planned activities for the three year period up to 2011/2012 are categorised under five themes:

- Reducing financial insecurity;

- Equal access to utility services for vulnerable groups;
- Energy and water efficiency;
- Working with others;
- Monitoring and review of Social Action Plan.

The Social Action Plan has now been implemented and progress will be monitored on an ongoing basis. There will be a review of the Social Action Plan in 2011, and a new Social Action Plan will be developed for 2012.