2010 GREAT BRITAIN AND NORTHERN IRELAND NATIONAL REPORTS TO THE EUROPEAN COMMISSION

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

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Ofgem 2010 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 GB report covers:

- Developments in the GB energy markets in 2009
- 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 and 2009. Much of the information remains unchanged, although latest data is supplied where relevant. Where background on particular issues is not included, please see the 2009 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 2009-10 is available at the link below.

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

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1. Ofgem Foreword

The past year has been one of the most challenging in Ofgem's history. Essential and radical internal reorganisation has been carried through against the backdrop of an industry confronting a fundamental dilemma: the need for massive investment to secure low carbon energy and market stability, at a time of acute fragility in the global financial system and economic weakness.

In the face of such external turbulence Ofgem has taken a series of difficult decisions and set in train a number of initiatives. The findings of our earlier in-depth investigation into the workings of the retail energy market, for example, demonstrated that there were a number of areas where action was required to benefit and protect consumers.

The Authority decided that it would use its existing powers to deliver the reforms needed without incurring potentially long delays and uncertainty. Over the last year a number of beneficial changes for customers have been introduced – with others following in the next few months – so that consumers now enjoy better protection and a stronger voice.

Other reforms launched by Ofgem last year included our review of Codes Governance, the industry's rules making process; and RPI-X@20, a root and branch analysis of the regime which has determined the revenues and expenditure of Britain's energy networks for the past 20 years to determine whether it will remain fit for purpose in the future.

A major inquiry, Project Discovery was also completed, this was a comprehensive analysis of the challenges facing Britain's energy supplies as the country becomes more reliant on imports, and an indication of the scale of the investment that is likely to be required to enable Britain to secure its energy supplies and meet its climate change targets over the coming decade.

It is increasingly evident that continental Europe exerts a growing influence on Britain's energy policies and energy markets. With the negotiation and the implementation of the European Third Energy Package, the ground is laid for a more competitive European energy market and the establishment of the Agency for the Co-operation of Energy Regulators (ACER). Ofgem welcomes the implementation of the European Third Energy Package as a major milestone in the development of a more open European energy market.

The challenges posed by the need to tackle climate change and deliver secure energy supplies are not, however, confined to one country or one continent but are truly global in scale. The year has seen the establishment of the International Confederation of Energy Regulators (ICER) at the World Energy Forum in Athens. ICER's purpose is to review key energy issues from a global perspective and report to the next World Energy Forum in Quebec in 2012.

Closer to home, Ofgem substantially reorganised in 2009, to create a separate business unit, Ofgem E-Serve to administer government environmental programmes and vital projects, such as the roll out of smart meters and the offshore transmission regime, and new policy divisions including one on sustainable development.

Amid the many changes, both internal and external, one factor has remained constant: Ofgem's determination to meet its responsibilities to existing and future consumers promptly and efficiently while keeping its costs under tight control. Over each of the last five years Ofgem has met our self-imposed and demanding target of keeping cost

increases to three percentage points below the rate of inflation – saving consumers some £11.9 million to date.

Lord Mogg
Chairman

Major Developments in the Last Year

2.1 Energy markets

Domestic and Small business sector

1. The Energy Supply Probe initial report[1] (the Probe) which investigated the state of competition in the GB energy supply markets covering both domestic and non domestic consumers was published in October 2008. The Probe reported that the GB energy market had made a successful transition into a competitive market and showed signs of further competitive growth. The levels of domestic switching continued to reflect positive upward trend annually. There is evidence indicating that many consumers were availing the benefits of the competitive market, manifested through presence of competitively priced tariffs, better customer service and wide range of energy deals which match the needs and requirements of the consumer.

2. The Probe also identified key focus areas in the GB retail market for both domestic and non domestic segments where the benefits of competition were yet to be accessed by consumers, particularly those who are vulnerable. It was revealed that in general there is a need for improved market transparency and better customer engagement, particularly to improve the ease with which consumers can compare deals and thus make good quality decisions when switching.

3. Consequent to the findings of the Probe a retail remedies package[2] was announced to improve the functioning of the market for all consumers including non-domestic consumers. Some of these remedies are licence backed wherein suitable amendments have been made to the existing standard supply licence conditions[3] or new licence conditions have been introduced. These remedies cover areas relating to continuity of supply, unilateral contract variations; consumer protection including conduct of sales/marketing activities by suppliers and improved customer information for the domestic customer segment. In case of non domestic consumers the new licence condition protects micro-business customers through better provision of information and limiting length of automatic contract rollovers. Further, with a view to improve market transparency Ofgem has introduced licence conditions requiring the vertically integrated major energy suppliers (Big Six) to publish financial information on segmental basis, annually. In order to monitor the effectiveness of the introduced remedies Ofgem plans to enhance its market monitoring activities, through collection of detailed switching and customer number information on a monthly basis. Additionally, certain non licence backed measures were also put in place such as the *"overarching standards of conduct"* which emphasise the need for providing appropriate and easy to understand information while marketing a product or service to the consumer.

4. The focus in the coming months will be on monitoring the post Probe remedies and improving customer engagement for both domestic and non-domestic consumers. We also aim to bring out quarterly publications reporting on key retail issues identified through the Probe. The first such quarterly publication will focus on undue price

[1] Energy Supply Probe - Initial Findings Report, (Ref 140/08)
http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=4&refer=Markets/RetMkts/ensuppro
[2] Energy Supply Probe - Retail Market Remedies (Ref 99/09)
http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=199&refer=Markets/RetMkts/ensuppro
[3] Factsheet on Probe Remedies package (Ref 82)
http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=probefs.pdf&refer=Media/FactSheets

discrimination. We will report in more detail about the on-going remedial measures in subsequent National Reports.

Wholesale markets

5. In June 2009 Ofgem published a discussion document[4] examining the issue of liquidity in the GB wholesale energy markets. The report found that levels of liquidity, particularly in the GB wholesale electricity market, were significantly lower than levels observed in other energy and commodity markets and particularly low further along the curve. The report found that low liquidity may be acting as a barrier to entry and growth for small / independent market participants. The report includes analysis on bid/offer spread, churn rates, market share and international comparisons.

6. In January 2010, a new power exchange, Nasdaq OMX N2EX, started to operate in the GB wholesale market. The exchange has attracted around 14 members with a large number waiting to join. The exchange currently operates a day-ahead continuous market, a day-ahead auction and is planning to launch a derivatives and within-day continuous market during 2010.

2.2 Smart metering

7. In October 2008 the Government announced its intention to mandate a roll out of electricity and gas smart meters to all homes in Great Britain, with the aim of completing the roll out by the end 2020.

8. Following a consultation exercise, the Government announced in December 2009 its decision on a preferred delivery model for the smart metering roll out: a Central Communications Model, under which energy suppliers will be responsible for purchasing and installing meters, and communications are organised centrally. The Government also set high-level smart functionality requirements for domestic electricity and gas meters, and announced the initiation of a central Smart Metering Implementation Programme.

9. The Implementation Programme's work will build on the platform provided by the decisions in the Government response, and will prepare the way for the start of the mass roll out of smart meters. The first phase of this work will be concerned with defining the scope and key principles of the smart metering solution, placing consumers at the heart of the programme. These principles will form design parameters which will guide the preparation of detailed specifications and commercial and regulatory arrangements. Work on phase one will be led by Ofgem E-Serve and will culminate in a Prospectus, to be decided by Government and Ofgem E-Serve, taking into account the views of stakeholders.

4

http://www.ofgem.gov.uk/Markets/WhlMkts/CompandEff/Documents1/Liquidity%20Proposals%20for%20the%20GB%20wholesale%20electricity%20market.pdf

2.3 Network developments

RPI-X@20

10. We have continued to progress our RPI-X@20 project, launched in March 2008, which is reviewing the 20-year-old framework governing the regulation of gas and electricity networks. We have engaged with a broad range of stakeholders throughout the process which has provided us with valuable insights and ideas on the benefits of the existing framework and the need for change to meet the challenges of the future.

11. In January 2010, we published our Emerging Thinking consultation on a potential new regulatory framework for GB energy network companies. The suite of consultation papers suggest that while RPI-X regulation has served energy consumers well since privatisation, the current price control arrangements were not designed to deliver a sustainable energy sector.

12. Emerging Thinking puts forward a number of proposals which, if introduced, would change significantly the way Ofgem regulates network companies. The proposals include:

- Putting much greater focus on the delivery of outcomes and outputs related to safe, secure, high quality and sustainable network services at value for money;

- Retaining and, where appropriate, strengthening incentives on network companies to constrain costs but with much greater focus on the long-term cost of delivery and considering different (and new) approaches;

- Encouraging a longer term focus by extending some elements of the price control to greater than the current five years;

- Providing a separate time-limited innovation stimulus common to all the energy networks and open to a range of parties, including non-networks;

- Focusing regulatory effort where it will be most beneficial. This will involve streamlining the regulatory process for the most efficient companies, while maintaining regulatory scrutiny over those who perform poorly;

- Setting clear principles for ensuring network companies earn appropriate returns (on a defined regulatory asset value) for their performance and the level of risk they face, but not bailing out inefficient companies.

- Opening up certain large scale projects to competition where this does not jeopardise timely delivery. For example, through the use of tendering.

- All aspects of the proposed new framework would be informed and enhanced by network companies and Ofgem engaging even more effectively with consumers, network users and other stakeholders. We are considering the case for providing third parties with a route to challenge our decisions on their merits at the Competition Commission (an independent public body which conducts in-depth inquiries into the regulation of the major regulated industries).

13. Ofgem will make its final recommendations to the Gas and Electricity Markets Authority (GEMA) in summer 2010. These will reflect responses to our Emerging Thinking consultation and further analysis on the detail of how a new regulatory framework might be implemented in the electricity and gas transmission and distribution sectors. The

recommendations will be consulted on and a final decision reached in autumn 2010. Any new regulatory framework will be first implemented at the next Transmission Price Control Review and the next Gas Distribution Price control (GDPCR2) with price controls due to be implemented in April 2013.

Transmission Price Control Rollover

14. The current transmission price controls expire on 31 March 2012. On 21 December 2009 we published an open letter providing notification of the Authority's decision to implement the next price control (TPCR5) from 1 April 2013, while allowing for a one year "adapted roll-over" of the current price control (TPCR4) for the period from 1 April 2012 to 31 March 2013. This will enable TPCR5 to reflect fully the conclusions of the RPI-X@20 project and other relevant developments in the transmission sector.

Transmission Access Review (TAR)

15. Ofgem commenced a major project in July 2007 looking at the possible reform of transmission access arrangements to identify areas for improvement. The reform of the electricity transmission access arrangements is vital if we are to ensure that access to the grid does not undermine the achievement of the EU's renewable and climate change targets.

16. Following a lengthy consultation process, during which Ofgem and the Department for Energy and Climate Change (DECC) held several industry seminars and bilateral meetings, the project led to the publication of the TAR Final Report[5], which identified the following guiding principles that DECC and Ofgem considered should underpin an enduring transmission access framework:

- New electricity generation projects should be offered firm connection dates, reasonably consistent with the development time of the project.

- Generators wanting long term, financially firm access to the transmission system need to make long term financial commitments.

- Transmission companies need to have appropriate incentives to respond to the long term demand for access signalled by generators and the freedom and incentives to invest ahead of full user commitment.

- Access rights need to be more clearly defined and all generators need to be offered choice of terms of access to the transmission system.

- Efficient use of existing and new capacity needs to be maximised.

17. The TAR Final Report introduced a number of models for transmission access reform, which the industry then sought to develop in accordance with the prescribed governance arrangements. However, the industry ultimately failed to come up with a workable set of reforms to the current arrangements.

[5] www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=84&refer=Networks/Trans/ElecTransPolicy/tar

18. As a consequence, Lord Mogg wrote to the Secretary of State in June 2009 recommending that the Secretary of State took on powers under the Energy Act 2008, to facilitate enduring transmission access reform. The Secretary of State signalled his intention to take on these powers.

19. On 25 August 2009, DECC published a suite of consultation documents, entitled "Improving Grid Access", which set out its anticipated approach to using powers under the Energy Act 2008, to facilitate access to the transmission network. Although the industry considered and explored a number of different grid access models, DECC is proposing to introduce a variation of only one of these models - the Connect & Manage approach. The scope of the changes will be focused primarily on access rights for new entrants. It is expected that the changes proposed by the Secretary of State for enduring access reform to codes and licences will be facilitated by industry and in place by June 2010. These changes need to be consistent with the legal basis of the Energy Act 2008.

20. Ahead of the enduring access reforms, Ofgem has taken urgent steps with National Grid Electricity Transmission (NGET) and the industry to make sure that projects that are ready to go can connect as soon as possible. In May 2009, we approved a new interim regime that allows NGET to offer earlier grid access to a significant number of generators. Based on this regime, around 1 GW of renewable projects in Scotland have now been offered the opportunity for earlier connection. The regime means that projects are able to advance connection to the grid by a number of years.

Transmission Investment

21. Our work on transmission investment consists of two major work strands:

- The 2020 Transmission System Study, which was produced by the Transmission Operators (TOs) and published under the auspices of the Electricity Networks Strategy Group (the "ENSG study"); and

- Our work on enhanced transmission investment incentives ("TO incentives") which provide an appropriate funding framework for anticipatory investment.

22. Following the completion of the ENSG study, the TOs have requested funding for a substantial programme of investment, including links to the Scottish Islands, with a combined cost of some £5 billion (including both pre-construction and construction activities). The TOs consider this programme is required to accommodate new generation connections in the period up to 2020. This is in addition to the £4 billion of investment in new capacity and asset replacement allowed in the current electricity transmission price control (TPCR4), which runs from 2007 to 2012. For a significant proportion of the investment put forward by the TOs, construction is currently proposed to commence within TPCR4.

23. Our work on TO incentives aims to develop appropriate funding arrangements for the projects identified by the TOs, as enhancements to the arrangements under TPCR4. A key aim is to ensure that funding arrangements do not create a barrier to the investment needed to accommodate future generation, whilst ensuring adequate protection to consumers where that investment is undertaken on an anticipatory basis.

24. In April 2009 we provided a total of £12.5m of funding for initial pre-construction work in 2009/10 on specific projects which were not already funded during TPCR4. By providing this funding we kept options open, ensuring that critical projects would not be

delayed. Work is ongoing to provide initial funding for construction spend incurred up to the end of 2011/12, when the current price control expires.

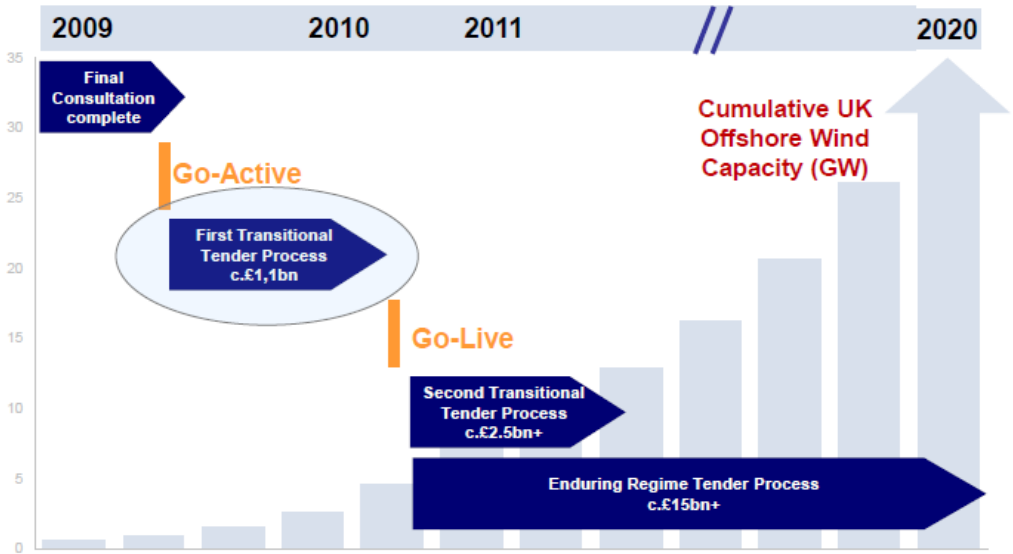
Offshore Transmission Regime

25. Offshore wind will play an important part in meeting the Government's ambitious renewable energy targets. Ofgem worked with DECC to introduce an offshore transmission regime, which came into effect in June 2009. The regime, designed to deliver the required offshore transmission investment in an efficient and timely manner, competitively grants new licences to companies through a tender process run by Ofgem. In return, transmission companies receive a 20 year regulated income, based on their competitive bids, for owning and operating offshore transmission assets[6].

26. The first round of tenders began in July 2009 for nine qualifying offshore projects. The tender process has triggered significant response from the market, and appealed to incumbent players as well as new market entrants, with both taking part in the competitive process. We expect to grant licences following an announcement of Preferred Bidders in the summer 2010.

27. In terms of investment, Ofgem is currently tendering for transmission assets worth £1.1bn, and future tender rounds will require upwards of an estimated £20bn (see figure 2.1 for an illustration of the required investment). During the current tender round the EIB (European Investment Bank) has announced the provision of significant funding to investors in this first tender round of opportunities. The funding, which was approved in December 2009, would be available for those seeking licences for six of the nine first round projects.

Figure 2.1: Expected investment in offshore transmission



[6] Later projects will remunerate developers for designing and constructing offshore transmission assets where bidders will bid to undertake construction as well as operation, maintenance and financing.

Electricity Distribution Price Control Review[7]

28. Ofgem set a tough investment-led price controls on regional electricity networks. Investment for the DNOs is up 40 per cent on the last five years' spending to £7.2 billion, largely due to the need to replace ageing infrastructure. The £7.2bn also comprises a new £500m fund to pave the way for large-scale trials of smart grids and other technology required in a low carbon economy. Ofgem set the companies tougher targets for network reliability, and customer service.

29. The final proposals will govern the revenue of the 14 Distribution Network operators (DNOs) for five years from April 2010. With an average increase in electricity bills of £4.30 a year, householders will get better customer service, improved reliability and a greener electricity supply. The new controls will also open the way for much-needed local power generation and other developments to help tackle climate change.

30. As part of the price control Ofgem set the cost of capital which is the benchmark return on investment for each DNO. Ofgem has set a 4.7 per cent actual (called vanilla) weighted average cost of capital (using a pre-tax cost of debt and a post-tax cost of equity). Our assessment, assisted by Price Waterhouse Coopers, is that low risk utilities like the DNOs can adequately finance themselves at this rate.

31. The DNOs will have an opportunity to bid for cash from a new £500 million fund earmarked for innovative projects that will combat climate change. This Low-Carbon Fund (LCF) will be available to DNOs and partner companies to use over the next five years to help to pave the way for local generation, growth in electric vehicle use and other projects that will be needed to meet our climate change targets. This fund breaks new ground in regulation. Its objective is to encourage the companies to be more innovative with new technologies and commercial arrangements. It will allow companies to play a full part in combating climate change.

2.4. Consumer-related issues

32. The package of probe remedies described above, and the roll out of smart metering, are two major developments this year in our work on behalf of consumers.

33. Our Consumer First initiative has also seen us continue to improve our understanding of the issues that really matter to consumers and to ensure that consumer views inform our policy work. We have a panel of 100 domestic consumers who we meet with on a regular basis and have also carried out a number of pieces of ad-hoc research including work with customers new to debt.

34. In addition to licence conditions designed to improve the conduct of marketing/sales activities by suppliers and improve customer information, our consumer protection work this year has seen new licence conditions coming into force in January 2010 in order to protect the interests of consumers paying by direct debit. According to the new obligations gas and electricity suppliers should ensure that domestic customers' direct debit payment levels are based on the best available information and are clearly

[7] For the complete report on the Price Control, see http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=FP_3_Cost%20Assessment%20with%20SS%20comments.pdf&refer=Networks/ElecDist/PriceCntrls/DPCR5

explained. Suppliers must also ensure that any credits built up on a customer's balance must not be unreasonably withheld. We have also thoroughly reviewed the way suppliers treat customers in debt and as a result suppliers are adopting new principles for the way they consider customers' ability to pay.
35.
36. 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. The strategy is updated annually to review progress over the past year and identify areas of work for the coming year; this will be available in July 2010.

2.5. Security of supply

37. In Ofgem's 2009 National Report submission, we reported on the launch of Project Discovery. This was a year-long study of whether the current market arrangements in GB are capable of delivering secure and sustainable energy supplies over the next 10-15 years. As part of this project, Ofgem developed four energy market scenarios examining the risks and uncertainties facing GB gas and electricity industries over the next decade. In October 2009[8], we published an interim consultation document outlining the scenario results, the key determinants of which are the pace of global economic recovery and global commitment to environmental action.

38. Examination of consultation responses and updates to the Discovery scenarios confirmed there are still risks to future gas and electricity security of supply. In February 2010[9], we consulted on possible policy measures to address the risks and issues we identified. These, and security of supply issues more generally, are discussed at greater length in the Security of Supply chapter of this Report.

2.6 Sanctions

39. In November 2009 the Authority confirmed the imposition of a £2million penalty upon EDF Energy Networks (EDFE) for breaches of its electricity distribution licence. The breaches relate to EDFE's failure to provide offers for connection as soon as practicable and in any event within three months of receipt of an application which contains all such information as EDFE may reasonably require for the purpose of formulating the terms of the offer.

40. In June 2010 the Authority decided EDFE had failed to record complaints adequately infringing Regulation 4(1) of the Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008. The Authority decided not to impose a financial penalty upon EDFE considering the nature of the breach, EDFE's acceptance of the problem and the actions taken by EDFE to resolve the issue (such as additional payments to two consumer funds to demonstrate its ongoing commitment).

2.7 Code Governance Review

41. Many of the technical and commercial rules and obligations that govern participation in Great Britain's gas and electricity sector are set out in a series of multilateral codes. The codes significantly impact on the shape and development of the

[8] 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
[9] 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

gas and electricity sectors and, by extension, Ofgem's ability to deliver competitive markets that best protect the interests of consumers.

42. Each code is designed to be capable of modification with the network operators, the signatories to the code and, in some cases, Consumer Focus (the National Consumer Advocacy Body) able to propose such modifications.

43. Ofgem has initiated a major overhaul of these rules with the aim of speeding up the delivery of major policy changes and reducing Ofgem's role in routine amendments. It will take out complexities that create obstacles for small players and new entrants.

44. In summer 2009, we consulted separately on our initial proposals for each of the Code Governance Review work strands. A wide range of industry code modifications will be necessary to bring effect to the proposals. We expect these to be raised in summer 2010 with full effect to be given to these proposals by autumn 2010.

Regulation and Performance of the Electricity Market

3.1. Regulatory Issues

Management of congestion on interconnectors

45. Ofgem has a separate licensing regime for interconnectors.

46. The England-France Interconnector (IFA) connects the electricity market in Great Britain with the continent. 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.

47. 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.

48. It is anticipated that the 1000MW BritNed[10] HVDC cable between Netherlands will commence operations at the end of 2010. BritNed will allocate capacity on its cable through a mixture of explicit and implicit auctions. The introduction of implicit auctions is a requirement of BritNed's exemption from the relevant European rules on electricity interconnectors[11].

49. Ofgem recently concluded a consultation on GB Electricity Interconnector Policy. The conclusions of the consultation, which support the development of further interconnection and the removal of barriers to cross-border trade, will inform our policy priorities over the coming year. In addition, a group of ten Member States and the European Commission have established a group to promote the development of a North Sea offshore grid. Ofgem will work with other relevant National Regulatory Authorities to support Member States in this important work.

Management of congestion on national networks

50. Ofgem commenced a major project in July 2007 looking at the possible reform of transmission access arrangements to identify areas for improvement. The reform of the electricity transmission access arrangements is vital if we are to ensure that access to the grid does not undermine the achievement of the EU's renewable and climate change targets.

51. The industry failed to come up with a workable set of reforms to the current arrangements that would facilitate the connection of new low carbon generators without resulting in large and unnecessary bills for customers. As a consequence, Lord Mogg wrote in June 2009 recommending that the Secretary of State took on powers under the Energy Act 2008, to facilitate enduring access reform. The Secretary of State signalled his intention to take on these powers.

[10] A joint venture between TenneT (the Dutch TSO) and National Grid (the GB TSO)
[11] Under Article 7 of Regulation 1228/2003 and Article 17 of Regulation 714/2009.

52. On 25 August 2009, DECC published a suite of consultation documents, entitled "Improving Grid Access", which set out its anticipated approach to using powers under the Energy Act 2008 (EA2008), to facilitate access to the transmission network. Although the industry considered and explored a number of different grid access models, DECC is proposing to introduce a variation of only one of these models - the Connect & Manage approach. The scope of the changes will be focused primarily on access rights for new entrants. It is expected that the changes proposed by the Secretary of State for enduring access reform to codes and licences will be facilitated by industry and in place by August 2010. These changes need to be consistent with the legal basis of the Energy Act 2008.

The regulation of the tasks of transmission and distribution companies

Transmission

Network Tariffs - structure of charges

53. Transmission Network Use of System (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.

- **'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.

54. Under the powers conferred by the Energy Act 2004, the Government has been developing its policy to establish a regulatory regime for offshore transmission. It has concluded that a non-exclusive, price-controlled approach was the most appropriate licensing and regulating model and that the current transmission licence and industry code arrangements, wherever possible, should be extended to offshore. National Grid Electricity Transmission plc (NGET) has been appointed as the system operator offshore designate.

55. In this designate role, NGET proposed a modification to incorporate offshore electricity transmission charging arrangements as part of an integrated regime following the commencement of the forthcoming regulatory regime for offshore transmission. On the 30th of March 2009, we published our decision not to veto NGET's proposals.

The key features of these proposals included:

- The extension of the concept of transmission 'local' and 'wider system' infrastructure assets, the costs of which are recovered under the TNUoS charging methodology.

- The extension of the application of existing principles in defining the boundary between 'local' and 'wider' infrastructure assets for the purposes of TNUoS charges.

- The majority of assets forming part of the offshore transmission network will be categorised as 'local' and recovered from the local circuit and local substation elements of the tariff. These will be derived using the same principles as under the onshore arrangements whilst including the introduction of specific details necessary for calculating offshore tariffs.[12]

56. There are 20 charging zones for generation and 14 for demand. For 2009/10 the demand charge varies between £3.38/kW and £25.90/kW whereas the 'wider' locational generation charge varies between £-6.98/kW and £21.59/kW.

Balancing of the transmission system

57. There were no major changes to this area over 2009 - please see last year's GB National Report for background.

Independence from network companies

58. There were no major changes to this area over 2009 - please see last year's GB National Report for background.

Distribution

Structure of charges

59. Ofgem launched the structure of charges project in 2000, with the aim of reviewing the basis upon which DNOs calculate their electricity distribution network charges. Ofgem was concerned that existing charging structures did not properly reflect the impact and benefits from generation connected to the networks and could be a barrier to the connection of small scale low carbon generation.

60. In July 2004, following the introduction of the Directive, Ofgem implemented changes to the regulatory framework to establish an obligation on all DNOs to produce

[12] To include: (a) Local circuit expansion factors and local circuit security factors will be defined for each OFTO, b) The local substation tariff would be based on both assets located on each OFTO platform and the offshore platform itself, but will contain a discount to reflect the fact that the onshore substation tariff does not include civil costs, and c) The wider locational and residual tariffs are based on the existing calculation method.

separate connection and use of system charging methodologies to be approved by Ofgem. In 2009 DNOs accepted licence changes that mean that from 1 April 2010 there is a common charging method across DNOs in respect of their use of system charging methodologies at lower voltages (HV and LV) and common methods are required at the higher voltages (EHV) from 1 April 2011. DNOs are also progressing a more harmonised connection charging methodology. 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; and

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

61. There is a formal process for DNOs to modify their approved charging methodologies where the modifications can be demonstrated to better achieve the relevant charging objectives. DNOs own their methodologies and they often consult with interested parties on proposed modifications and consider the views expressed. Once the consultation process has been concluded, the proposed modification of the methodology is submitted to the Authority, which decides whether or not to veto the proposal. The Authority also has the option of consulting where it considers the proposal to be 'important'. A change from April 2010 is that the new common use of system methodologies at lower voltage levels are subject to new open governance arrangements whereby the methodologies have been incorporated in to an industry code which is a multi-party contract between the licensed electricity distributors, suppliers and generators. This incorporation allows users the opportunity to propose change. The same arrangements are expected to apply at the higher voltages from April 2011.

62. Each DNO must comply with its approved charging methodologies 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 and made available to interested parties and any other person that requests the information. The use of system statement at lower voltages is now essentially common. 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.

Table 3.1 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				Note 2
E&W	0.942	-	2.055	
Scot	2.149	-	2.203	
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 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 definitions of time bands vary across different network areas.

Quality of service incentives for DNOs

63. Please see last year's GB National Report for background on quality of service indicators.

64. Since the introduction of the interruptions incentive scheme in April 2002 the underlying number of customer interruptions per 100 customers has fallen by 18 per cent (2002/3 to 2008/9) (excluding the impact of exceptional events). Figures for 2008/9 show a downturn in both customer interruptions and customer minutes lost compared to the previous year. On average each customer experienced 0.67 interruptions per year, with the average duration of interruptions approximately 46 minutes excluding exceptional events.

65. With exceptional events included the picture is less clear, as changes are far more variable depending on the year chosen 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 2008/9 there were a moderate amount of successful exceptional event claims. Storms were less prevalent than in the previous two years which saw a number of sizeable successful claims as a result of storms and floods.

66. A number of amendments to Quality of Service and customer themed arrangements have come into force on April 1 2010 as the next Price Control period (2010 – 2015) begun. For further details of these arrangements, please refer to chapters 10- 18 of the DPCR5 Final Proposals document[13].

Standards of Performance for DNOs

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

DNO Quality of service reports

68. To date, Ofgem has published eight reports on the quality of service in electricity distribution. These reports set out information on how the DNOs have performed against their targets for the number and duration of supply interruptions and against other performance benchmarks that Ofgem has calculated. They also set out information on fault rates and the quality of telephone response. Ofgem will continue to publish annual reports on the quality of service in future.

Effective unbundling

Transmission

69. All electricity transmission licensees (i.e. Scottish Power Transmission ltd, Scottish Hydro Electric Transmission ltd, National Grid Electricity Transmission ltd 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.

70. Requirements for greater structural separation of transmission interests from generation, production and supply interests is 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, assuming we will be designated as the regulatory authority for GB, 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). As part of the certification decision, we have committed to consult in order to seek views on the ownership arrangements of the transmission system operators and their compliance with the unbundling provisions.

[13]http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Documents1/FP_2_Incentives%20and%20Obligations%20FINAL.pdf

Distribution

71. 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 and for the ownership structure of DNO companies in GB.

72. The ownership structure of the DNO companies in Great Britain is listed in the table below. The only changes from 2008 are for: Northern Electric Distribution Ltd, Yorkshire Electricity Distribution Ltd and The Energy Network Company Ltd.

Table 3.2 Ownership Structure of DNO Companies in Great Britain

Network Company	Activity	Owner
Northern Electric Distribution Ltd	Electricity Distribution	Berkshire Hathaway Inc
Yorkshire Electricity Distribution Ltd	Electricity Distribution	Berkshire Hathaway Inc
Central Networks East Plc	Electricity Distribution	E.ON AG plc
Central Networks West Plc	Electricity Distribution	E.ON AG plc
EDF Energy Networks (EPN) Plc	Electricity Distribution	Electricite de France S.A.
EDF Energy Networks (LPN) Plc	Electricity Distribution	Electricite de France S.A.
EDF Energy Networks (SPN) Plc	Electricity Distribution	Electricite de France S.A.
SP Manweb Plc	Electricity Distribution	Iberdrola S.A.
SP Distribution Ltd	Electricity Distribution	Iberdrola S.A.
Western Power Distribution (South Wales) Plc	Electricity Distribution	PPL Corporation
Western Power Distribution (South West) Plc	Electricity Distribution	PPL Corporation
Electricity North West	Electricity Distribution	North West Electricity Networks (Jersey) Ltd
Scottish Hydro Electric Power Distribution Plc	Electricity Distribution	Scottish and Southern Energy Plc
Southern Electric Power Distribution	Electricity Distribution	Scottish and Southern Energy Plc
Energetic Electricity Ltd	Electricity Distribution	Energetics Networked Energy Ltd
ESP Electricity Limited	Electricity Distribution	ABN Amro - Infrastructure Capital Equity Fund
Independent Power Networks Ltd	Electricity Distribution	Inexus Group Ltd
The Energy Network Company Ltd	Electricity Distribution	Prime Infrastructure Ltd
ECG (Distribution) Ltd	Electricity Distribution	Ecocentrogen Ltd

3.2. Competition Issues

Description of the wholesale market

73. 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 trading (OTC)

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

75. On the basis of analysis undertaken by the Financial Services Authority (FSA), total OTC trading (excluding exchange based trading) in 2008/9 (Aug 08 to Jul 09) was around 1129TWh[14] (or around 3.2 times generated output). This is around 2 per cent higher than total OTC traded volume for the previous year. Of this around 51% of traded volumes were electronically brokered whilst 49% was voice brokered. Despite the recent financial turmoil and the recession, the impact on traded volumes appears to be limited, with OTC monthly traded volumes increasing to March 2010.

Power exchanges

76. The key exchange providers in the GB electricity market are the APX Group and the Intercontinental Exchange (ICE)[15]. Total traded volume on the APX Power UK Exchange in 2009 was around 12.63TWh, an increase of 1.1TWh on the calendar year 2008. Traded volume on the Intercontinental Exchange (ICE) UK Power Futures exchange totalled 76.8TWh in 2009, a significant increase on volumes traded in calendar year 2008. A more recent development was the opening of a new power exchange, Nasdaq OMX N2EX, which started to operate in the GB wholesale market in January 2010. The exchange has attracted around 14 members with a large number waiting to join. The exchange currently operates a day-ahead continuous market, a day-ahead auction and is planning to launch a derivatives and within-day continuous market during 2010. Currently, traded volumes to date (Jan 2010 - April 2010) on both platforms are around 1.4TWh. Prompt volumes have increased significantly during May following an initiative by market participants to support the platform.

Liquidity

77. In June 2009 Ofgem published a discussion document[16] examining the issue of liquidity in the GB wholesale energy markets. The report found that levels of liquidity, particularly in the GB wholesale electricity market, were significantly lower than levels observed in other energy and commodity markets and particularly low further along the curve. The report found that low liquidity may be acting as a barrier to entry and growth

[14] http://www.fsa.gov.uk/pubs/other/analysis_energy_2009.pdf
[15] A description of these exchanges was provided in Ofgem's 2009 National Report.
[16] http://www.ofgem.gov.uk/Markets/WhlMkts/CompandEff/Documents1/Liquidity%20Proposals%20for%20the%20GB%20wholesale%20electricity%20market.pdf

for small / independent market participants. The report includes analysis on bid/offer spread, churn rates, market share and international comparisons.

78. In February 2010 we published a consultation document outlining in more detail the issue of low liquidity in the GB wholesale electricity market and exploring a number of options to address these concerns.

Balancing mechanism (BM)

79. A description of the GB BM was outlined in Ofgem's 2009 National Report. Average daily volumes traded on the BM in 2009 amounted to around 52GWh of offers to increase generation, and around 59GWh of bids to reduce generation, for each half hour. Around 5TWh of offers and 8.1TWh of bids were accepted in 2009 – this represents around 4% of total consumption in GB in 2009.

Generation Capacity

80. The total transmission entry capacity on the GB system at the beginning of 2009/10 was 82.6. A number of new gas fired power stations have come online during 2009 or are due to come online shortly including Langage (Centrica) a 900MW CCGT, Marchwood (842MW) and Immingham (ConocoPhillips) 450MW.

Market integration

81. 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[17]. However, as we highlighted in last year's submission, this does not mean that there are not issues or impediments to address and this may be reflected in circumstances where IFA flows may not reflect market fundamentals.

82. The GB electricity market currently has around 2.5GW of interconnection (to France and Northern Ireland) which is expected to increase to around 4GW by 2012 with the development of the 1GW BritNed interconnector plus a new interconnector between GB and Ireland. Total interconnector capacity could potentially reach around 8GW in 2020.

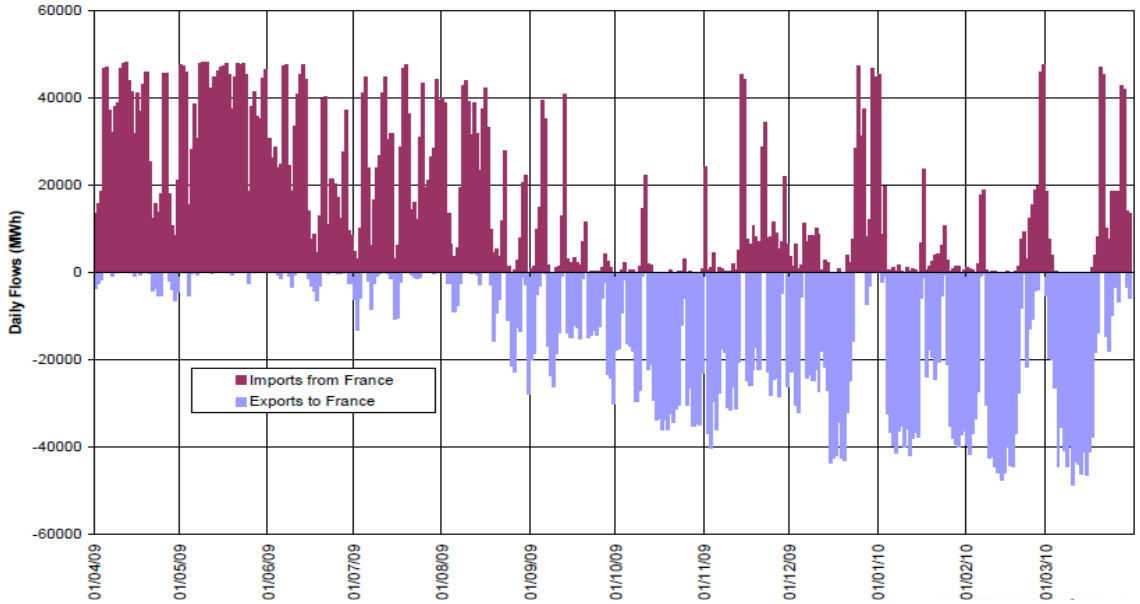
83. GB typically imports from France, through the IFA interconnector, and exports to Northern Ireland via the Moyle interconnector[18]. However Figure 3.3, below, shows significant volumes were exported to France during winter 2009/10 due to a high volume of nuclear outages in France. More recently there has also been a trend of low imports into GB due to increased reliability of GB nuclear generation. Prices for access to interconnectors reflect the market dynamics, with non-discriminatory auctions regularly held for daily, weekend, monthly, quarterly, seasonally and annual capacity.

84. Figure 3.3 shows flows across the GB-France interconnector. A combination of low coal and gas prices and a higher number of planned and unplanned outages at nuclear generation plants in France (compared to 2008) contributed to higher than usual exports of electricity to France during winter 2009/10.

[17] The Interconnector arrangements were outlined in Ofgem's 2009 National Report. These arrangements remain unchanged.

[18] Moyle is a 500MW interconnector between Scotland and Northern Ireland. It is Capable of exporting 500MW to Northern Ireland and importing at 80MW. It is owned by Moyle Interconnector Ltd.

Figure 3.3: Average net system transfers for IFA in 2009[19]



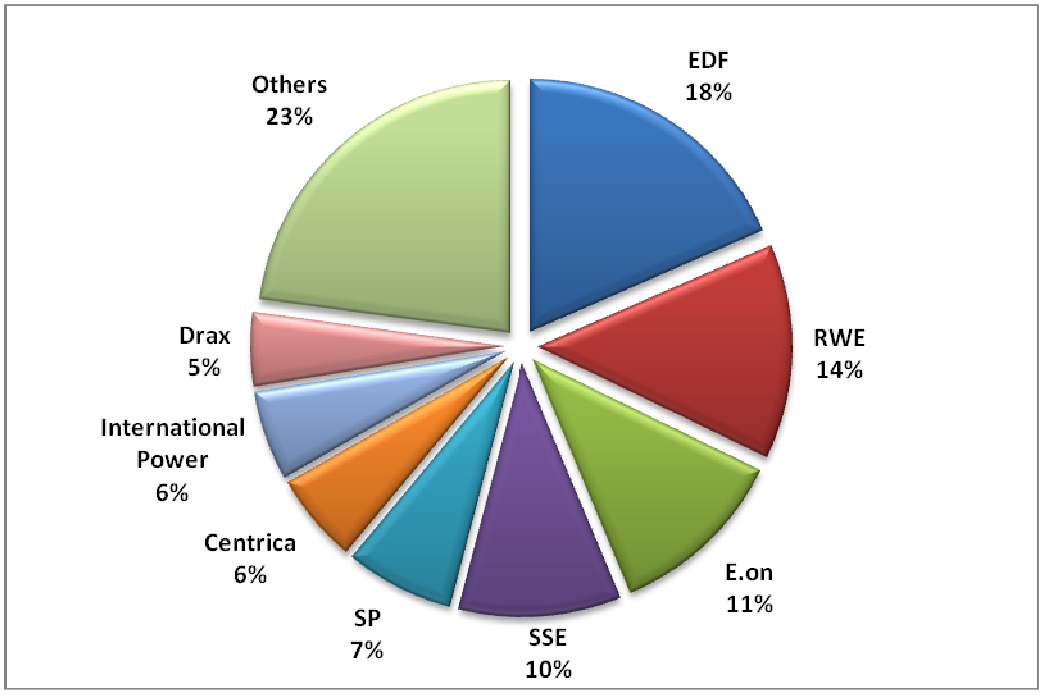
85. In January 2010 Ofgem published a consultation document on electricity interconnector policy[20]. The consultation described proposed models for the allocation of capacity on interconnectors, including market coupling, and for regulation of new investment. The aim of the consultation was to seek views on how Ofgem's electricity interconnector policy should develop going forward.

Market Concentration

86. As illustrated in figure 3.4 below, eight companies have market shares exceeding five per cent and, of these, the largest three companies held 43 per cent of transmission entry capacity. It is worth noting that contractual arrangements are important, as ownership of capacity does not necessarily equate fully with the dispatch rights, which depend on the contractual arrangements in place.

[19] This based on information from National Grid and Bloomberg.
[20] http://www.ofgem.gov.uk/Europe/Documents1/Interconnector%20policy%20consultation.pdf

Figure 3.4: 2010/11- Percentage of capacity (based on Transmission Entry Capacity (TEC) Values) by Generation Owner[21].



87. In May 2009, Centrica announced its intention to buy a 20% stake in British Energy (BE) from its new owners EDF (who had purchased BE in 2008). This transaction was cleared by the Office of Fair Trading (OFT) in August 2009. Under the terms of the transaction EDF and Centrica will form a joint venture (with 80% and 20% respective shares) through which they intend to construct four nuclear power stations. This transaction represents an increase in concentration in the wholesale electricity generation market.

88. Table 3.5 provides Herfindahl-Hirschman Index (HHI) analysis based on capacity owned by different companies in GB in 2009. The largest individual HHI by capacity is EDF (HHI of 339) which acquired British Energy in late 2008 and now owns and operates a number of nuclear plants in GB.

Table 3.5: Herfindahl-Hirschman Index (HHI) based upon capacity (source: NG Seven Year Statement)

Company	Capacity (HHI)
EDF	**339**
RWE	**190**
Eon	**132**
SSE	**108**
SP	**48**
Centrica	**33**

[21] This is taken from NG Seven Year Statement, table 3.4. Where the station capacity is owned by a number of equity owners, capacity has not been allocated to each party based on their equity holding.

International Power	**33**
Drax	**22**
Others	**523**
Total	**1428**

Measures to avoid abuses of dominance

89. 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)[22]. In January 2010 Ofgem approved a modification to improve the granularity of available generation information. Therefore, from November 2010 forecast generation capacity information from generators will be published by Balancing Mechanism Unit (BMU) and by fuel type (previously it was only published on an aggregated basis).

90. 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

91. In cases where Ofgem considered that generators' bidding strategies suggested market manipulation may be occurring, Ofgem would seek to investigate and where appropriate, take enforcement action under its Competition Act 1998 powers.

92. In Ofgem's 2009 National Report, we outlined our decision to close our Competition Act investigation into Scottish Power Limited and Scottish and Southern Energy plc in January 2009[23]. Following this, Ofgem consulted on other potential options to address market power concerns in the electricity wholesale sector and the Government's Department for Energy and Climate Change decided to take forward Ofgem's preferred option to introduce a new market power licence condition (MPLC) into the licences of electricity generators. The Energy Act 2010 now enables the Secretary of State to introduce such a licence condition.

Balancing

93. In November 2009, a modification[24] was implemented which aims to ensure the main Energy Imbalance Price that Parties are liable to pay[25] reflects the costs of only energy balancing actions taken by NGET to balance the system in its role as System Operator ("SO"), and not of system balancing actions[26].

[22] 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
[23] This investigation examined a formal complaint alleging abuse of a dominant position arising from constrained capacity on the transmission network.
[24] This relates to modification proposal P217A 'Revised Tagging Process and Calculation of Cash Out Prices' Further information can be found on Ofgem's website at www.ofgem.gov.uk.
[25] Parties are liable to pay the main imbalance price when their physical and contractual positions are out of balance
[26] Energy balancing actions are taken to resolve an overall supply-demand imbalance. System balancing actions are taken for more specific reasons, such as to resolve transmission constraints.

Market surveillance

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

95. 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)[27].

Experience with virtual power plant auctions or other capacity release measures

96. There have been no virtual power plant auctions or other capacity release measures in 2009.

Description of the Retail Market

Price developments

97. The GB retail electricity supply market has been open to competition since 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 Six) 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) Scottish Power: A wholly-owned subsidiary of the Spanish energy group, Iberdrola.

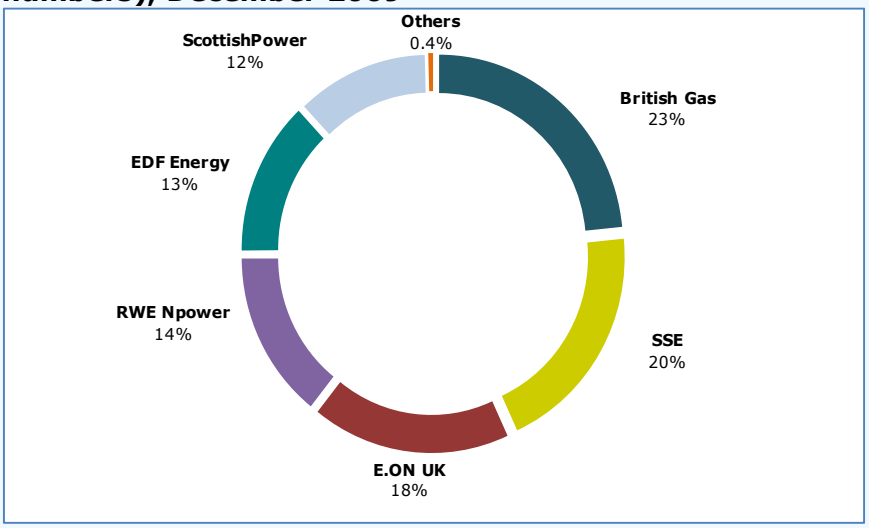
98. At the end of 2009, there were six active domestic and thirteen non-domestic electricity suppliers in addition to the former incumbents.

Market shares

99. In December 2009 there were approximately 27.3 million customers in the domestic electricity market. As shown in Figure 3.6 below, the Big Six suppliers accounted for over 99% of this market in the same month.

[27] www.fsa.gov.uk

Figure 3.6: National GB domestic electricity market shares (by customer numbers), December 2009



Source: Ofgem

100. In the domestic electricity market, all of Big Six suppliers have a market share of above 10%. British Gas, the former gas monopoly supplier is the largest entrant in the electricity market and has a significant presence with a national market share of 23%. The three suppliers with the highest domestic national market shares are British Gas, Scottish and Southern Energy and E.ON UK, who together account for 61% of the market.

101. In the domestic electricity sector entry by small/ independent suppliers has been on a less significant scale. 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 2009, the customer numbers for small suppliers grew by 60% compared to January 2009, albeit from a small customer base. In September 2009, we saw a new energy supplier (OVO Energy) enter the domestic market. Their first tariff offering was the cheapest in the market. The fact that small suppliers are currently offering some of the most competitively priced offers in the market, may result in increased market share of the non Big Six energy suppliers further over the next year.

102. 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 incumbent in each region typically has a market share ranging from 34% to 76%. However, this continues to fall year-on-year at a rate of around 2% per annum as these 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.

103. 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 3.7 below. In addition, Table 3.7 also shows electricity

market shares for small business customers (defined as customers with an annual spend of less than £10,000) based on Datamonitor's "SME Market Analysis Survey" from December 2008.

Table 3.7: 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 2009)	**Non HH** (sub 100 KW, Nov 2009)	**Small business customers** (2008)
British Energy	4%		
Centrica	8%	26%	26%
E.ON Energy	12%	17%	21%
EDF Energy	22%	18%	13%
GDF Suez	3%		
Opus Energy		2%	
RWE npower	22%	12%	14%
ScottishPower	6%	10%	11%
SSE	19%	14%	11%
Total Gas and Power	1%		
Others	2%	0%	6%

Source: Datamonitor

104. The non-domestic market is supplied by the Big Six and a group of smaller new entrants. The individual segments of the non-domestic market are dominated by the Big Six, as shown in Table 3.7, who individually have a market share greater than 5% but who together supply between 89-97% of each segment. However, the smaller suppliers have made significant in-roads into the non-domestic market, supplying between 3-11% 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.

105. 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 EDF Energy, RWE npower and SSE, which together have a 63% share of the sector. In the small business sector Centrica, E.ON Energy and RWE npower are the three largest suppliers together capturing 60% market share in this segment.

Market concentration[28]

106. Herfindal-Hirschman Indices (HHI) 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.

107. In December 2009, the HHI for national domestic electricity market was 1,751. On account of presence of electricity incumbent suppliers, regional markets are more significantly concentrated for electricity supply and HHIs are higher than the national average. The GB regional HHI average in the electricity domestic retail supply market in December 2009 was 3,084.

[28] 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.

108. HHI index for small business customers in 2008 was 1,708. In 2009 HHI for HH market segment was 1,599 and for Non HH it was 1,753.

109. Both domestic and small business electricity supply markets are "concentrated" while regional electricity domestic market is "highly concentrated" according to the threshold HHI levels used by the OFT.

Vertical integration

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

111. However, in contrast to the domestic supply markets, where the independent sector accounts for less than 1% of the market, non-Big Six generators accounted for around 28% of generation capacity and around 32% of generation output in 2009[29]. Although this appears 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. Overall, the GB generation market is not highly concentrated with an HHI of 1195 (based on generation output in 2009).

112. In addition, some investment is being undertaken by non-utility participants and non-vertically integrated new entrants. Recent examples include the 470 MW expansion of ConocoPhillips Immingham CHP and the acquisition by DONG Energy of the 800MW Severn Power Combined Cycle Gas Turbines (CCGT). Conversely, some independent generators have also entered the supply market, albeit on a small scale and focusing on non-domestic sector as evidenced by the takeover of Haven Power by Drax and International Power's stake in Opus' supply business.

113. Arguably one of the key concerns is that 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. In 2009 the Big Six's own generation exceeded the demand from their domestic customer base and generated more than half the level of their total customer requirements (i.e. domestic, small businesses and demand from large industrial and commercial customers), with the exception of Centrica.

114. The Probe highlighted a lack of liquidity in GB wholesale electricity markets as one of key barriers to entry into supply market. Ofgem investigated this further[30] and presented a range of policy options, in its report on Liquidity, which can be considered if the market does not deliver[31].

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[29] Ofgem's calculations Based on Elexon's data

[30] Liquidity in the GB wholesale energy markets, (62/09) http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=58&refer=Markets/WhlMkts/CompandEff

[31] Liquidity proposals for the GB wholesale electricity market (22/10) http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=95&refer=Markets/WhlMkts/CompandEff

Switching

115. In 2009, more than 5 million domestic electricity customers changed their supplier (on average around 418,000 each month). This is equivalent to a switching rate of 18%. There has been a small decrease in the level of switching among domestic electricity customers in 2009 compared with the level seen in 2008. Table 3.8 below shows the number of annual switchers of domestic electricity customers and annual switching rate.

Table 3.8: Domestic customers' annual switching in electricity

	Jan – Dec 05	Jan – Dec 06	Jan – Dec 07	Jan – Dec 08	Jan – Dec 09
Total switchers	4,316,401	4,820,756	5,157,028	5,419,334	5,025,210
Switching rate	16%	18%	19%	20%	18%

Source: Ofgem

116. Both domestic and small business electricity supply markets are "concentrated" while regional electricity domestic market is "highly concentrated" according to the threshold HHI levels used by the OFT. 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 we intend to develop 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 will be collecting data from suppliers on customer gains and losses, which will indicate switching, and data on number of objections to customer transfer.

117. However, according to Datamonitor's SME Gas and Power Survey (2008) over half of SME respondents have switched their electricity supplier at least once, compared to 38% of who have never switched.

Switching procedure

118. For the switching procedure for domestic electricity customers, please refer to the 2007 GB National Report, pages 37-38. The procedure remains unchanged.

Factors which influence switching

119. For factors that influence switching, please refer to 2008 GB National Report, pages 31-32 for the most recently available data.

Difficulties in switching

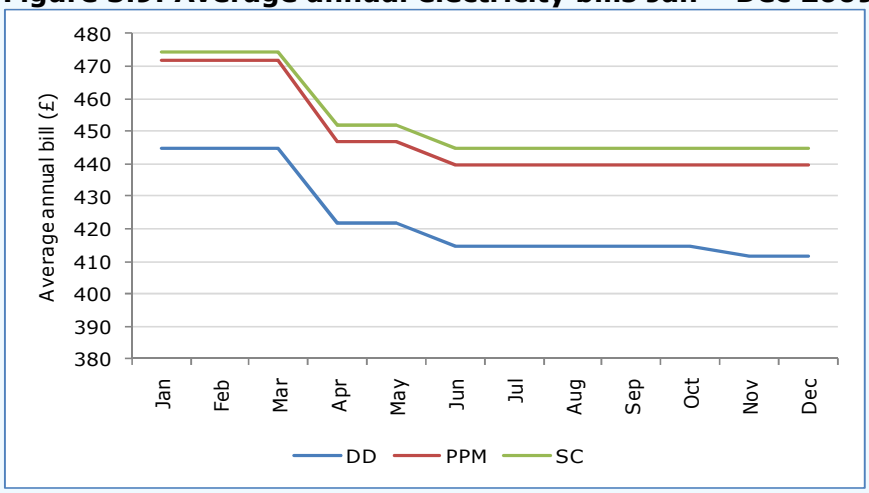
120. For the difficulties in switching, please refer to 2008 GB National Report, page 32. As with above, for the most recently available data.

Price developments

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

122. On account of reduction of prices by all major energy suppliers, the retail electricity prices for domestic customers fell in 2009 (most of these decreases occurred in the early part of the year). Figure 3.9 shows the impact of 2009 price changes across the three main payment methods: direct debit (DD)[32], standard credit (SC)[33] and prepayment (PPM)[34]. The overall electricity price decreases in 2009 were 7% for prepayment and direct debit and 6% for standard credit customers.

Figure 3.9: Average annual electricity bills Jan – Dec 2009[35]



Source: Ofgem

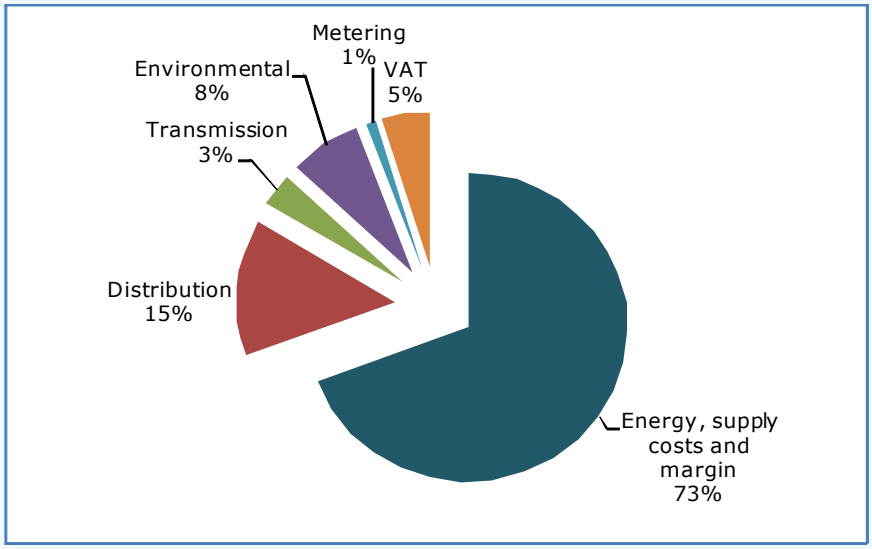
123. Wholesale energy costs were cited by suppliers as being one of the primary reasons for these changes as they are a major consideration in supplier's retail pricing decision. Wholesale energy prices (both spot and forward) have fallen in 2009. As part of the Probe we examined the relationship between wholesale and retail prices and found no evidence to suggest that increases in wholesale costs have been passed through to customers to a greater extent when wholesale prices rise compared to when they fall. To provide ongoing information on the relationship between retail energy prices and wholesale costs Ofgem is publishing quarterly reports[36].

[32] Fixed or variable amount is taken from a customer's bank account each month, quarter or year.
[33] Customer pays on receipt of bill (payment mechanisms include cash, cheque, credit card and standing order).
[34] Customer pays for energy in advance by inserting electronic tokens, keys or cards into the prepayment meter.
[35] Based on average annual consumption of 3300 kWh
[36] These reports are available at the Energy Supply Probe's section of the Ofgem's website: http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Pages/Energysupplyprobe.aspx

124. In addition to the wholesale costs, suppliers also face a wide range of other costs such as the cost of environmental commitments and network charges, which are passed on directly to consumers' bills. There are some other costs which increase pressure on domestic energy bills. These include environmental costs, such as the Renewables Obligation (RO) [37], the cost of which increases each year, and the Carbon Emissions Reduction Target (CERT) [38]. 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) in September 2009 has also contributed to increasing the domestic energy bill.

125. Figure 3.10 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 3.10: Illustrative breakdown of typical domestic electricity customer bill, December 2009 (based on estimated annual average consumption of 3300kWh)



Source: Ofgem

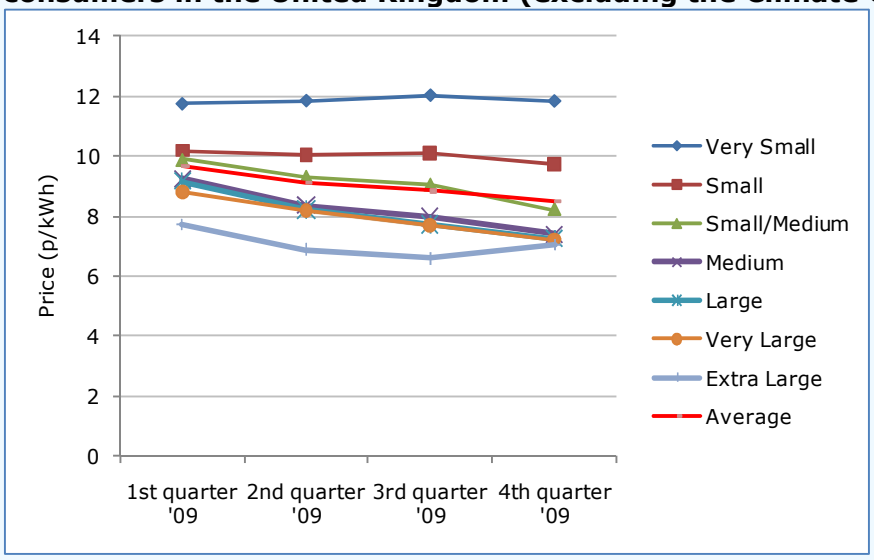
126. At present Ofgem does not actively collect our own data on prices in the non-domestic sector. However, DECC published a digest of non-domestic prices on their website[39].

[37] 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.
[38] 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.

[39] http://www.decc.gov.uk/en/content/cms/statistics/publications/prices/prices.aspx

127. Figure 3.11 below shows prices based on the most recent publication which is for March 2010.

Figure 3.11: Quarterly prices of electricity purchased by non-domestic consumers in the United Kingdom (excluding the Climate Change Levy)



Source: Quarterly Energy Prices: March 2010, DECC

128. In 2009 the electricity prices in the non domestic sector have fallen on average 2.5%[40], 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 (6.2%), whilst the prices for the very small consumers actually have increased by 1.2%.

Assessment of competition

General assessment

129. In October 2008 we published our initial findings from the investigation into retail energy markets[41] and reported that the market is working well in many important respects with the fundamental competitive market structure in place and continuing to advance. Further, there was no evidence found of cartel-like behaviour. However, the investigation did highlight a number of key areas where consumers including vulnerable consumers are not yet fully accessing the benefits of the competitive market.

130. Subsequently, in August 2009 we announced a detailed package of remedies to promote competition and consumer engagement in the retail energy supply market[42]. These measures were approved by our Authority and licensees and are being implemented in a phased manner from September 2009 to July 2010.

[40] These figures are calculated as an average of the quarterly percentage change for the last four quarters.
[41] Energy Supply Probe - Initial Findings Report, (140/08) http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=4&refer=Markets/RetMkts/ensuppro
[42] For further details please refer to the Energy Supply Probe – Proposed Retail Market Remedies, (99/09) http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=199&refer=Markets/RetMkts/ensuppro

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

131. 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' licence conditions and cover broadly the following aspects[43]:

- 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.

132. 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 to customers through competition

133. The introduction of competition in the retail energy markets has brought significant benefits to all stakeholders. 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.

134. The smart meter rollout has brought 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.

135. Non-standard offers also provide a range of benefits to 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

[43] Please refer to the same document as above.

require on-line registration or account management are currently cheaper than or of equal price 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. However, we note that exit penalties may apply to current offers if a customer wishes to leave before the end of the agreed fixed term period.

136. 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 currently be able to access all of these options, such as online or direct debit offers.

Price comparison service

137. 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.

138. 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. Consumer Focus's 'Confidence Code' sets out the minimum requirements that a provider of an online domestic gas and electricity Price Comparison Service (Service Provider) must meet in order to be, and remain, accredited.

139. The use of comparison and switching sites is an important part of customer engagement with the market. The Probe-Initial Findings Report[44] 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 also working with Consumer Focus towards extending its accreditation scheme (the Confidence Code) to include internet price comparison and switching sites for non-domestic customers.

Customer complaints

140. Ofgem does not deal directly with customer complaints or enquiries where a domestic or micro business energy customer has a complaint or enquiry relating to their energy supplier or network business; customers 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[45]; the companies have up to eight weeks to resolve a complaint.

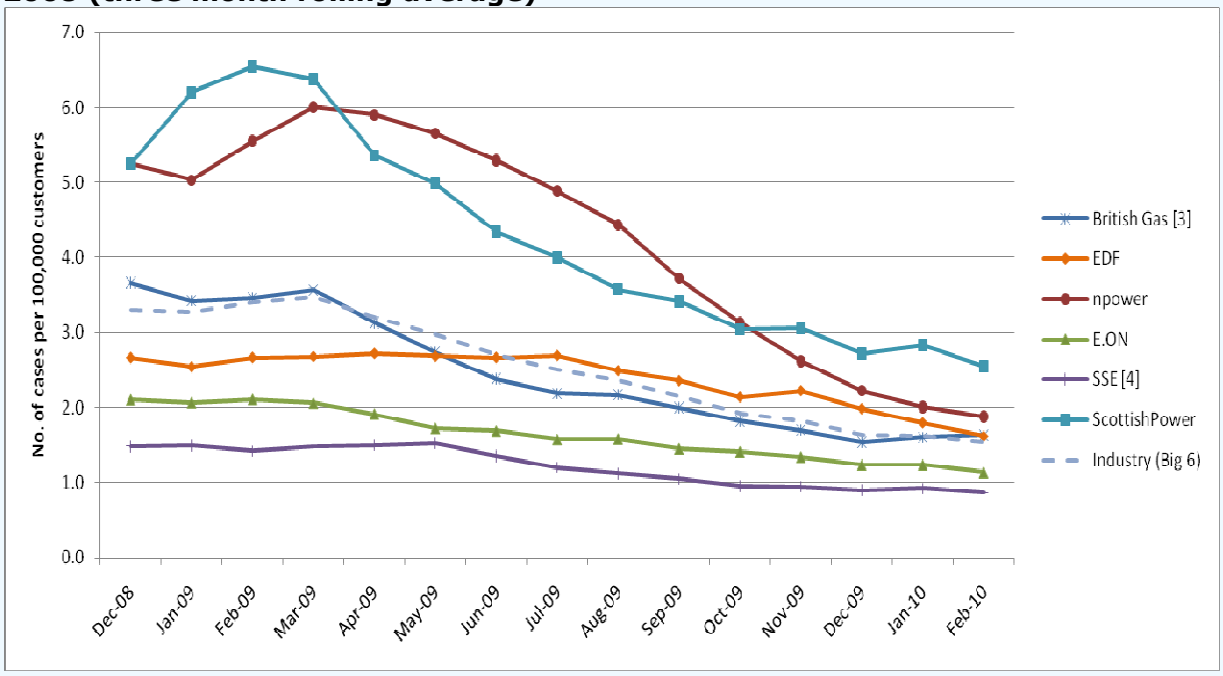
[44] Probe- Initial findings report
http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=4&refer=Markets/RetMkts/ensuppro
[45] The complaint standards are prescribed by "The Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008" which come into force on 1 October 2008 and are published at: http://www.opsi.gov.uk/si/si2008/uksi_20081898_en_2#pt2-l1g3

141. If a customer requires assistance with their complaint, they can go to Consumer Direct[46] for independent advice and information. Consumer Direct will assess whether they are dealing with vulnerable customers or customers threatened with disconnection, and where applicable, refer them directly to Consumer Focus. Consumer Focus has a dedicated Extra Help Unit to deal with vulnerable customers' complaints[47].

142. If, at any point before the eight week time prescribed in the complaints handling standards, the energy company says it can do no more to resolve a customer's complaint or the eight week time limit has expired, it must advise the customer that they can seek redress through the Energy Ombudsman. The Energy Ombudsman, approved by Ofgem, is independent and free of charge to the consumer. It will settle disputes between the energy company and the customer and has the power to make a financial award to the customer of up to £5000. Its decisions are binding on the energy company but not the customer.

143. Figure 3.12 shows the number of cases per 100,000 customers for each of the Big Six suppliers received by Consumer Direct and referred onto the suppliers' dedicated handling teams or Consumer Focus's Extra Help Unit.

Figure 3.12: Historical domestic supplier performance on company referrals from Consumer Direct and cases received by its Extra Help Unit since October 2008 (three month rolling average)



Notes:
[1] All Big Six suppliers improved their performance over the period shown
[2] The data is provided on a 3-month rolling average basis e.g. Oct 09 denotes the period Aug – Oct 09
[3] Includes Scottish Gas
[4] Includes Atlantic, Scottish Hydro Electric, Southern Electric, SWALEC
Source: Consumer Focus

[46] More information on Consumer Direct is available here http://www.consumerdirect.gov.uk/
[47] More information on the Consumer Focus Extra Help Unit is here http://www.consumerfocus.org.uk/about-us/extra-help-unit

Measures to avoid abuses of dominance

Rules governing conduct of supply companies

144. 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.

Market monitoring

145. Subsequent to the Energy Supply Probe, we have stepped up our ongoing monitoring of the retail market. This includes gathering additional data from suppliers and conducting analyses 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.

146. We also committed to setting out in more detail how we plan to monitor supplier performance against the post probe remedies. We intend to publish quarterly reports in the coming months focusing on particular aspects of the Probe remedies. The first of these publications will focus on undue price discrimination.

Enforcement actions

Customers in debt

147. In November 2009 Ofgem launched an investigation into the approach taken by British Gas towards customers in debt, and particularly the approach adopted when setting instalment payments to recover accrued debt. This is an investigation into compliance with obligations under the gas supply licence and the electricity supply licence (Standard Licence Condition 27.8). Standard Licence Condition 27.8 requires suppliers to take all reasonable steps to ascertain the Domestic Customer's ability to pay and take this into account when calculating instalments. The investigation is ongoing.

Connections

148. Standard licence condition 4D (since 1 June 2008, standard licence condition 12) of the distribution licence requires Distribution Network Operators (DNOs) to provide offers for connection as soon as reasonable practicable and in any event within three months of receipt of an application which contains all such information as a DNO may reasonably require for the purpose of formulating the terms of the offer.

149. In July 2009, the Authority issued an infringement decision finding that EDFE had failed to comply with this obligation and announced it intended to impose a financial penalty of £2million on EDFE. Ofgem's investigation concerned applications and offers for connections made between April 2006 and 21 November 2008. EDFE accepted that there were 108 instances of it breaching condition 4D /12 and that it did not have appropriate resources, systems and processes in place to monitor and ensure compliance.

150. In November 2009, following representations from EDFE, the Authority issued a penalty decision confirming the £2million penalty. The Authority considered that there were a number of aggravating factors, notably that the infringement had occurred repeatedly, which outweighed the mitigating actions taken by EDFE in this case.

151. Ofgem has also opened three other investigations relating to alleged breaches of obligations established within the electricity distribution licence. The entities under investigation are Electricity North West (since January 2010), Central Networks plc (since December 2009) and Scottish Hydro-Electric Power Distribution (since July 2009). All three investigations relate to the obligation to respond to requests from customers for connection offers, and to having sufficient resources available at all times to secure compliance with its obligations. All three investigations are ongoing.

Complaints handling standards

152. In July 2009 Ofgem launched an investigation into EDFE's compliance with the Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008, in particular whether complaints have been recorded correctly. In June 2010 EDFE was found to have breached its obligations under foresaid Regulations between October 2008 and March 2009. It was decided that the actions taken by EDFE to resolve the issue, such as additional payments to two consumer funds to demonstrate its commitment to its customers, obviated the need for a financial penalty.

Competition policy actions

153. In January 2009, Ofgem launched an investigation into Electricity North West Limited (ENW), under section 18 of the Competition Act 1998 (the Chapter II prohibition). The investigation was initiated after a formal complaint alleging abuse of a dominant position, and is based upon the terms imposed by ENW on independent distribution network operators (IDNOs) connecting to ENW's pre-existing network. The investigation, which is ongoing, is seeking to establish whether those terms foreclose the market to competitors in the area where ENW is the incumbent network operator.

4. Regulation and Performance of the Natural Gas Market

4.1. Regulatory Issues

Management of congestion on interconnectors capacity

154. Please refer to previous GB National Report for background.

155. The GB gas system is interconnected with Belgium, Northern Ireland, the Republic of Ireland and the Netherlands. 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. 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 will result in the construction of a fourth compressor station in the Netherlands to increase import capacity by 3bcm/year from 1 December 2010.

156. 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-Wes 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. This information provides a clear 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 Dutch interconnector BBL publish information on an hourly basis.

157. 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.

158. BBL is currently exempt from Standard Licence Conditions 11 and 12 regarding Third Party Access provision and the publication of a charging methodology to facilitate the latter. For IUK, the agreements related to the operation of the pipeline and its marketing arrangements were notified to the Commission in 1995 and cleared by way of a 'comfort letter' (administrative approval).

Management of congestion on national networks

159. Please refer to previous GB National Report for background.

160. Transmission system operators are responsible for managing congestion on their networks. Both gas and electricity system operators are under a statutory obligation to

develop and maintain economic and efficient systems, as are gas and electricity distributors.

161. The gas national transmission system operator 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.

- Under the operational incentive scheme, the SO has an implicit target allowance of £19m per annum for capacity congestion management associated with existing entry capacity (net of certain revenues[48] it earns). 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 (or loss) from this incentive scheme is capped at £16.8m (or -£16m) per annum. The operational incentive scheme is being reviewed in 2010 which may potentially reset these figures.

- Under the incremental incentive scheme, the SO 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 the SO from this scheme. In addition, there is an "entry permits" scheme whereby the SO can vary the lead time for delivery of any new capacity (around a default lead time of 42 months). Through this scheme, the SO 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 the SO are capped at £36m.

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

The regulation of the tasks of transmission and distribution companies

162. There is one gas transmission network, the National Transmission System (NTS), which is owned and operated by National Grid Gas plc (NGG). There are eight gas distribution networks (GDNs)[49] 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 Independent Gas Transporters (IGTs).

[48] These include revenues from sales of interruptible capacity, "non-obligated" capacity and on the day sales of firm capacity. If the SO earns revenues from the sales of non-obligated capacity because of earlier than planned delivery of new (incremental) capacity, then it is allowed to retain all of these revenues as additional revenues. All other revenues are treated as described in the main text.

[49] In gas distribution, there is no distinction between asset owners and system operators. DN owners both own and operate the system.

163. 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 sixteen licensed IGT's organised in ten groups.

Gas Transmission price controls and tariff information

164. Ofgem regulates the level of charges NGG can levy through the Transmission Price Control Review (TPCR). The most recent TPCR sets out proposals to apply from April 2007 onwards for each of the transmission licensees in their role as transmission owners (TOs). These comprise a set of fixed revenue allowances for the period until March 2012, supplemented by additional mechanisms (revenue drivers) which will allow revenues to be adjusted automatically as the requirements of network users become known. Ofgem sets price controls which are typically five years long.

165. As stated above, in 2009 we announced a one year rollover of the current TPCR until 2013. This will allow any outcomes from the RPI-X@20 review to be included in the next price control period starting in 2013.

Balgzand-Bacton Line (BBL) gas interconnector expansion

166. Under the terms set by the EU Commission in relation to the exemption from certain requirements for third party access to the interconnector, BBL has an obligation to introduce a product to flow gas from GB to the Netherlands (hereafter referred to as "reverse flow"). However, as it does not have the necessary compressor set-up to allow a physical flow of gas in the reverse direction, it has proposed to meet the requirements of the exemption by providing a non-physical reverse flow product.
During 2009, BBL has been in discussions with the GB and Dutch regulatory authorities on how it can best meet the requirements of this exemption. At the back end of 2009, BBL agreed in principle to the provision of the reverse flow product through a series of auctions. It conducted a series of consultations at the start of 2010, and submitted a charging methodology proposal to Ofgem on 26 April 2010. This now has to be considered by Ofgem, and if it is approved, will subsequently need to be approved by the Dutch authorities before it can be implemented. It is anticipated that, subject to approvals, the service should be in place by September 2010.

Entry charging review

167. A fundamental review of the gas entry charging regime was started in 2009 to investigate concerns that increasing amounts of Transmission Owner (TO) allowed revenue is collected by the application of the TO commodity charge with a corresponding decrease in revenue collected through capacity charges.

168. National Grid collects TO allowed revenue by levying charges on capacity sold at gas entry auctions. If the revenue collected from these auctions falls short of allowed revenue, National Grid makes up the difference by application of a commodity charge based on Shippers capacity holdings.

169. The review group, led by National Grid, was established to investigate why capacity charges levied on entry capacity auctions are accounting for lower amounts of TO allowed revenue collection and what mitigation actions could be taken. The group is made up of industry stakeholders and the regulatory authority.

170. In 2009, the group identified several mitigating actions which could increase the amount of revenue National Grid raise from capacity charges. These measures will be considered by the regulatory authority in greater detail during 2010.

Entry capacity substitution

171. Ofgem placed an obligation on National Grid to introduce entry capacity substitution at the time of the last transmission price control review (TPCR4). Entry capacity substitution is a mechanism which facilitates the permanent transfer of unsold entry capacity at one or more entry points to meet the demands for capacity elsewhere.

172. National Grid submitted their proposed methodology to implement entry capacity substitution on September 2009. After a two month assessment of the methodology Ofgem approved its implementation during December 2009.

Maximum technical capacity

173. Gas entry baselines are set out in NGG transmission licence and reflect Ofgem's assessment of the existing capability of the NTS at the various entry points where gas can be landed or imported under a range of supply scenarios. Please see last year's report for more background.

Distribution

174. Ofgem regulates the level and structure of charges levied for using the monopoly 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 IGTs, is regulated using price controls and various incentive regimes[50].

175. 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 2005-06 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

176. Unless stated, there are no changes in this area from the situation as described in the last GB National Report.

177. In 2008, drawing on the precedents set in the transmission and electricity distribution sectors, Ofgem produced its first annual report on the gas distribution networks, based on the regulatory reporting process introduced as part of the Gas Distribution Price Control Review for 2008-2013. The report sets out the revenue earned by each of the networks as well as expenditure and returns on regulatory equity for the eight licensed gas distribution networks. It also updates the benchmarking information produced for the price control review, summarises quality of service information, and gives Ofgem's provisional assessment of Regulatory Asset Value (RAV) for each licensee.

178. 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.

[50] Transmission Price Control Review: Final Proposals, Ofgem, 4 December 2006 206/06.

179. The work done on the annual reports on the gas distribution sector will provide the basis for developing the annual reporting process over the next four years leading up to the next Price Control Review for the gas distribution networks.

180. Ofgem also published a sixth annual report on quality of service in the gas distribution sector[51]. We expect this to be the final report of this type, as quality of service information will be covered under the broader annual report mentioned above.

Network tariffs

181. There are no significant changes in this area from the last GB National Report.

Balancing

182. Ofgem's submission to the European Commission (DGTREN) Report in 2005 contained a detailed explanation of the balancing market arrangements. These have not changed significantly over the past three years and so please see last year's GB National Report for more.

Effective Unbundling

Unbundling requirements on the network companies

183. The National Transmission System (NTS), Distribution Network (DN) and Independent Gas Transporters (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; and
- 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.

184. National Grid Gas (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.

Legal ownership for DSOs and TSOs

185. There were no major changes in this area during the reporting year – please see 2008's National Report for more.

Ownership structure of TSOs and DSOs

186. There were no major changes in this area during the reporting year – please see 2008's National Report for more.

[51] Link : http://www.ofgem.gov.uk/Networks/GasDistr/GDPCR7-13/Documents1/Gas%20Distribution%20Annual%20Report%202007_8.pdf

Independence of production and supply affiliates

187. There were no major changes in this area during the reporting year – please see 2008's National Report for more.

Role of the compliance officer

188. There were no major changes in this area during the reporting year – please see 2008's National Report for more.

Shared costs and outsourcing

189. There were no major changes in this area during the reporting year – please see 2008's National Report for more.

4.2 Competition Issues

Description of the wholesale market[52]

190. 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[53].

191. Further analysis of the GB wholesale gas market was presented in a Liquidity Discussion document published in June 2009. This includes comparisons of churn rates between a number of European countries and analysis of distance of forward trading.

Over the counter trading (OTC)

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

193. 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.

[52] Defined as covering any transaction of gas between market participants other than final end use customers.
[53] 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.

Table 4.1: Estimated value of UK Gas market

	Volume traded (billion therms)	Est. value of market (£ billion)	Churn Ratio (volume traded/ throughput)
2008/09	329	157	
2007/08	338	176	8.7
2006/07	437	134	11.6
Decrease on 2007/08	-9	19	10.3

Source: Financial Services Authority[54]

Exchanges, including the OCM (On the day Commodity Market)

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

195. Total traded volume on the APX Gas UK (OCM) and APX Gas UK (NBP) exchanges in calendar year 2009 was 148 TWh (0.15 times total throughput), an increase from 108.4 TWh in calendar year 2008. Traded volume on the Intercontinental Exchange (ICE) UK Gas Futures exchange totalled around 637bcm in 2009, an increase from on the calendar year 2008.

Market integration

Table 4.2 – UKCS Forecast and Import Requirements[55]

Bcm	07/08	08/09	09/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18
2007 UKCS Forecast	64	58	53	52	50	46	43	40	38	38	34
Demand	98	97	95	95	95	95	96	97	97	97	96
% import requirement	35 %	40 %	44 %	46 %	47 %	52%	55%	59%	61%	61%	65%

196. Table 4.2 shows the decline in production from the UK Continental Shelf (UKCS) and the associated increase in the import requirements. Increasing import requirements has 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.

[54] http://www.fsa.gov.uk/pubs/other/energy_2009.pdf. The data covers the period August to July and excludes exchange trading.
[55] Source: National Grid Ten Year Statement Table 4.7A. Available at: http://www.nationalgrid.com/uk/Gas/TYS/archive/tys08/tys08chart.htm

197. 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[56].

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

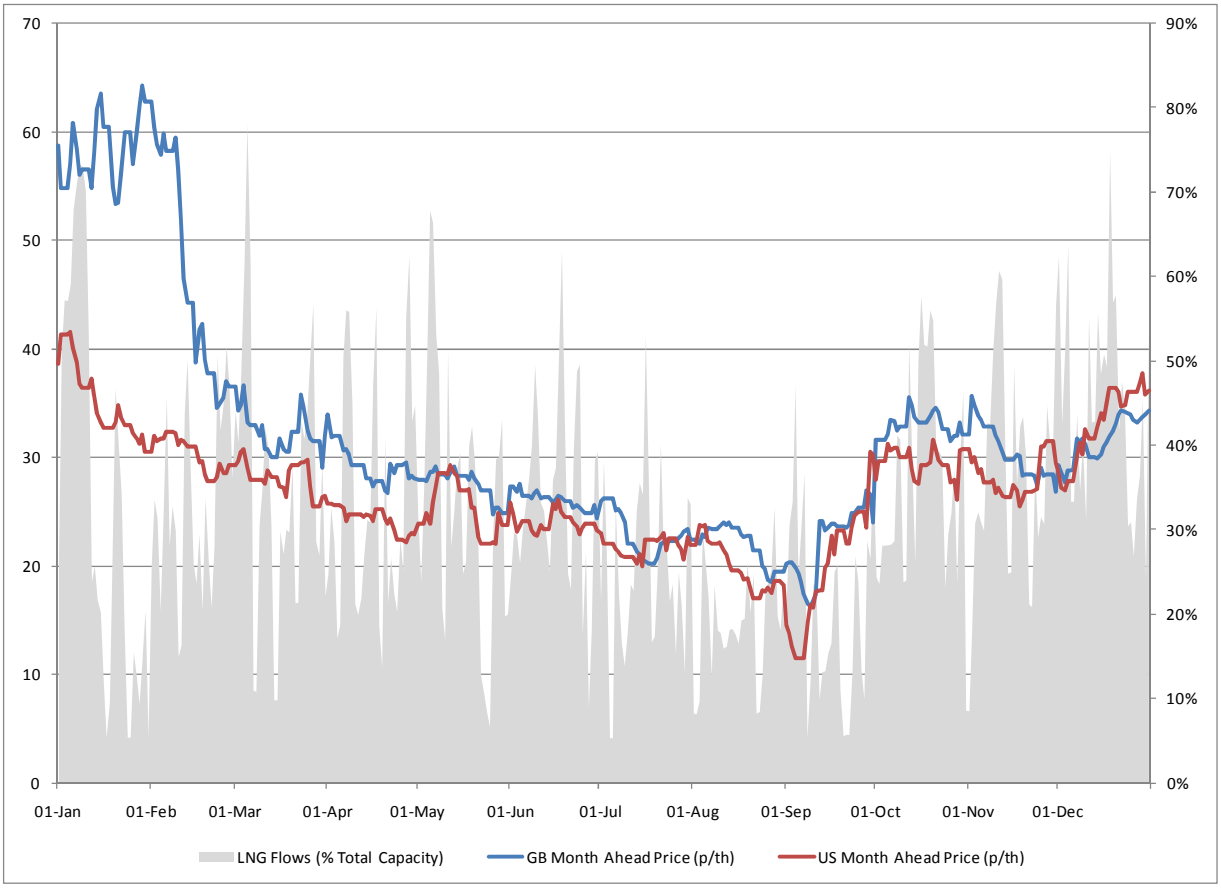
Interactions with Global LNG markets

199. 2009 saw the completion of two new LNG importation terminals in GB (South Hook and Dragon), taking the country's total LNG importation capacity to 44bcm/year. The rapid expansion of LNG importation capacity in GB over the past five years has increased interaction with the global market, including regions such as the US, the Middle East and Asia.

200. 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 were substantially higher as economic conditions suppressed LNG demand in competing markets, and US domestic production was boosted by high volumes of unconventional gas. This LNG trend seen in 2009 can be seen in figure 4.3 below.

[56] For further information please see Ofgem 2008 National Report and please refer to IUK website available at the following link: www.interconnector.com.

Figure 4.3: Graph Showing Grain flows and GB, US Gas Prices for 2009[57]



Market Concentration

201. 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.

202. In terms of gas from the UKCS, there are five companies whose market share of production exceeds five per cent[58]. 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. In contrast, since BBL became operational (December 2006), it has typically been used by two to three shippers. There are also four shippers (BP, Centrica, GDF Suez and Sonatrach) who import gas through the Isle of Grain and this will increase to six when the third phase of the terminal opens later this year. Now fully commissioned, the South Hook Terminal is capable of delivering up to 21 billion cubic metres (bcm) per annum of gas into the National Transmission System. The South Hook Terminal is owned by a UK joint venture of Qatar Petroleum (QP) (67.5%), ExxonMobil

[57] The information is sourced from National Grid LNG send-out data and Bloomberg. An archive of send-out data is available here: http://www.nationalgrid.com/uk/GrainLNG/data
[58] http://www.nationalgrid.com/uk/GrainLNG/background/

(24.15%) and Total (8.35%). Also commissioned last year, Dragon LNG has three shareholders: BG Group (50%), Petronas (30%) and 4Gas (20%).

203. 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, around 50 per cent of capacity in Rough, the largest gas storage facility in GB, was held by four parties (Rough has a capacity of around 3.2bcm (42mcm/d)), similar to last year. However, market share figures are liable to change as capacity can be traded on a secondary market.

Storage services

204. 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.

205. 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 4.4 presents details on the size and scope of existing storage facilities in GB.

Table 4.4: Information on GB storage facilities and TPA[59] status

Facility	**Space (mcm)**	**Deliv. (mcm/d)**	**Durat'n (Days)**	**Owner**	**Status**
Operate under nTPA (negotiated third-party access)					
Rough	3,300	45	71	Centrica Storage	Operational (In addition to the nTPA regime, Rough operates in accordance with undertakings)
Hornsea	316	18	18	SSE Hornsea	Operational
Total nTPA	*3,616*	*63*			
% of total storage	*79*	*39*			
LNG storage facilities, offers TPA under section Z of Unified Network Code[60]					
Avonmouth	63	13.5	4.6	National Grid LNG	Operational
Glenmavis	36	8.8	4.2	National Grid LNG	Operational

[59] Space is working gas capacity and deliverability is withdrawal capacity
[60] http://www.nationalgrid.com/uk/Gas/lngstorage/Capacity/

Partington	18	14.6	1.2	National Grid LNG	Operational
Total TPA under UNC	*117*	*36.8*			
% of total storage	*3*	*23*			
Non TPA storage					
Hatfield Moor	120	2.4	50	Scottish Power / Iberdrola	Operational
Humbly Grove	280	7.5	37	Star Energy / Petronas	Operational
Hole House Farm	60	10	6	EDF Trading	Operational
Aldbrough	246	27	9	SSE Hornsea	Commenced operations in part during 2009
Aldbrough	123	13	9	Statoil-Hydro	Commenced operations in part during 2009
Total non TPA storage	*829*	*60*			
% of total	*18*	*38*			
Total storage	**4,562**	**160**			

206. The main change in Table 4.4 from last year relates National Grid LNG decision to scale back the capabilities of its three facilities. National Grid have stated that this is due to the age of the facilities and shippers not placing sufficient value on the services offered to justify the required investment to maintain their performance, A review is ongoing which could lead to further reductions in the capability of the three facilities[61].

207. 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.

208. 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 of its purchase of Dyengy, the owner of the Rough facility. Information on these undertaking were provided in Ofgem's 2009 National Report and these have remained unchanged.

[61] http://www.nationalgrid.com/NR/rdonlyres/5B984301-324E-4556-9343-9B1D04367745/38978/LNGStorage18December2009.pdf

209. 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.

210. 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. Currently the TSO requirements for operating margins are around 114mcm[62].

Measures to avoid abuses of dominance

Transparency

211. Information provision is a key component in the effective and efficient operation of the GB gas markets.

212. Parties that hold gas licences are able to propose further modifications to the type of information the Transmission Company is required to make publicly available. There have been no major developments to the information GB gas market participants are required to make available since Ofgem's 2009 National Report.

Availability of gas to non-incumbents, and new entrants' access to the swaps market

213. Ofgem does not currently hold information relating to the gas swaps market.

Market Surveillance

214. Ofgem's market surveillance activities were outlined in its 2008 National Report and this has broadly remained unchanged.

[62] http://www.nationalgrid.com/NR/rdonlyres/51971797-6CE0-4368-ABEB-CB80C7D1E36C/40049/Operating_Margins_Statement_2010_11.pdf

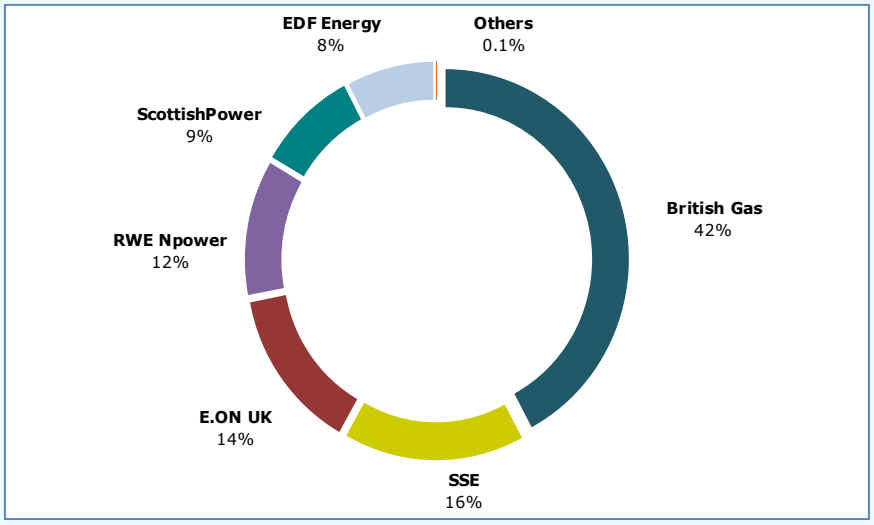
Description of the Retail Market

215. As with electricity retail market, the GB retail gas supply market is characterised by the existence of Big Six 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). At the end of 2009, there were also five active domestic and twenty one non-domestic independent gas suppliers who are not former incumbents.

Market shares and concentration

216. In December 2009, there were approximately 22.2 million domestic customers in the gas market, 99.9% of which were supplied by the Big Six as presented in Figure 4.5.

Figure 4.5: National GB domestic gas market shares (by customer numbers), December 2009



Source: Ofgem

217. The Big Six 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 Six, 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 five smaller suppliers active in the domestic gas supply market (First Utility, Good Energy, Utilita, Spark Energy and OVO Energy) accounting for just 0.1% of the market.

218. 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 2009 data is presented in Table 4.6 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 "SME Market Analysis Survey" from December 2008.

Table 4.6: 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	NDM	Small business customers (2008)
Centrica	5%	39%	38%
Corona Energy	5%	10%	
EDF Energy		1%	
E.ON Energy	10%	23%	29%
ENI	17%		
Gazprom	5%	3%	
GDF Suez	14%	2%	
RWE npower	5%	3%	4%
ScottishPower		1%	
Shell Gas Direct	16%	3%	
SSE		7%	12%
Statoil UK	8%		
Total Gas and Power	11%	7%	5%
Wingas	5%		
Others		0%	12%

Source: Datamonitor

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

220. The DM segment is by far the most fragmented of the three segments, with the top three suppliers holding 47% of the market share. It is also the segment that the non-Big Six 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 Suez. The three suppliers with the highest market shares in the Non-DM segment are Centrica, E.ON Energy and Corona Energy, who together capture 72% of this segment. Whilst the small business segment is dominated by Centrica with 38% market share, who jointly with E.ON Energy and SSE capture 79% market share in this segment.

Market concentration

221. Herfindal-Hirschman Indices (HHI)[63] 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.

222. In December 2009, the national gas HHI in domestic market was 2,496 while HHI index for small business customers in 2008 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 2009 data the HHI for the Non-DM segment was 2,314 and for DM it was 1,173.

[63] 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.

Vertical integration

223. 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

224. In 2009, more than 3.8 million domestic gas customers changed their supplier (on average more than 318,000 each month). The switching rate for the year was 17%.

225. There has been a slight decrease in the level of switching among domestic gas customers, with the level in 2009 lower that seen in 2008. Table 4.7 below shows the number of annual switchers of domestic gas customers and the annual switching rate.

Table 4.7: Domestic customers' annual switching in gas

	Jan – Dec 05	Jan – Dec 06	Jan – Dec 07	Jan – Dec 08	Jan – Dec 09
Total switchers	3,510,976	3,915,480	3,982,225	4,155,953	3,824,337
Switching rate	17%	18%	18%	19%	17%

Source: Ofgem

226. Historically Ofgem has not looked into switching data for the non-domestic gas market. However, as stated in the Energy Supply Probe decision document[64] published in August 2009, we intend to develop our market monitoring activities to provide us with better information on the non-domestic market, particularly on the small business sector, to enable us to monitor the effectiveness of the Probe remedies. Consequently, from April 2010 we will be collecting data from suppliers on customer gains and losses (which will indicate switching) and on number of objections to customer transfer.

227. However, according to Datamonitor's SME Gas and Power Survey (2008) gas customers are less likely to switch supplier than electricity customers. Based on this survey, while many gas customers have yet to switch, nearly a quarter of respondents have switched at least once.

Switching procedure

228. For the switching procedure for domestic gas customers, please refer to the 2007 GB National Report, page 74. The procedure remains unchanged.

Factors which influence switching

229. For the factors which influence switching please refer to the electricity retail market section of 2008 GB National report, pages 31-32.

[64] Energy Supply Probe - Retail Market Remedies (Ref 99/09)
http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=199&refer=Markets/RetMkts/ensuppro

Difficulties in switching

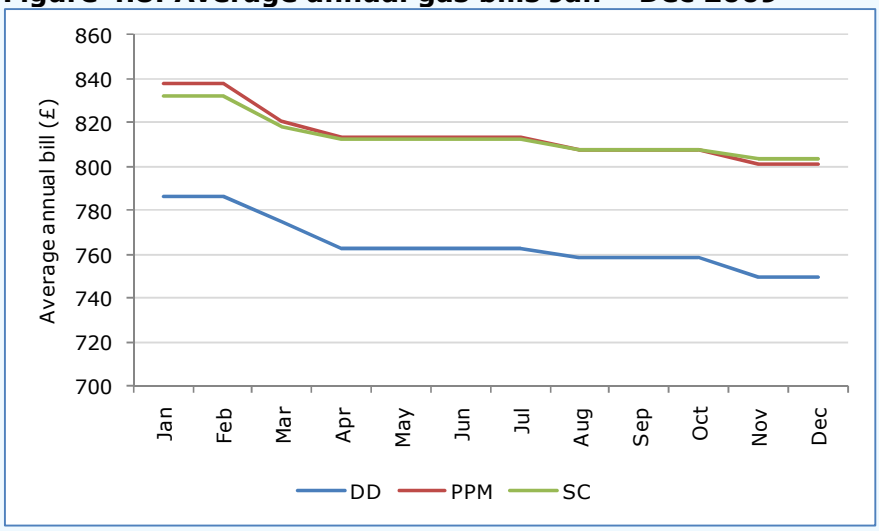
230. For difficulties in switching please refer to the electricity retail market section of 2008 GB National report, page 32.

Price developments

231. 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, which continue to be price controlled.

232. As with electricity prices, there has been a small decrease in the retail gas prices for domestic customers of all major suppliers in 2009. Figure 4.8 shows the impact of 2009 price changes across the three main payment methods: direct debit (DD), standard credit (SC) and prepayment (PPM). The overall decreases in 2009 were 5% for direct debit 4% for prepayment and 3% for standard credit customers.

Figure 4.8: Average annual gas bills Jan – Dec 2009



Source: Ofgem

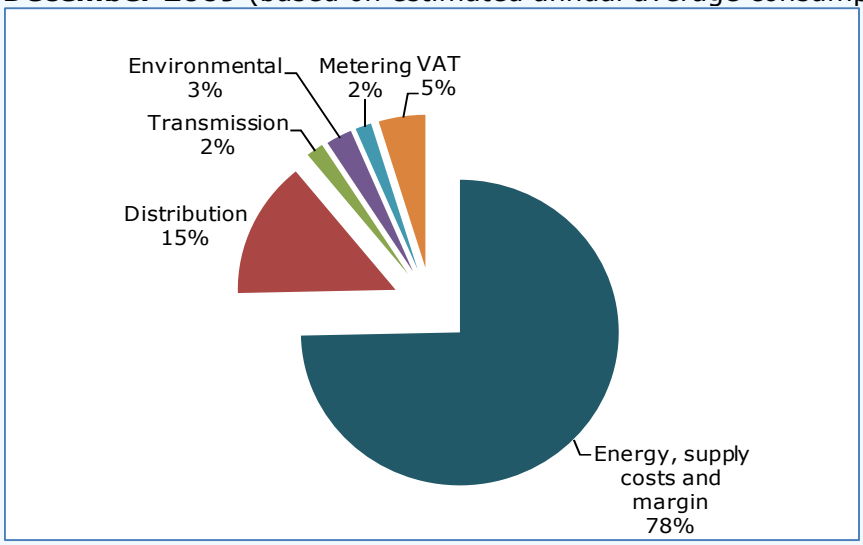
233. Wholesale energy costs were cited by suppliers as being one of the primary reasons for these changes which are a major consideration in suppliers' retail pricing decisions. Wholesale energy prices (both spot and forward) have fallen in 2009.

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

235. The breakdown of the average domestic gas bill consists of: distribution and metering costs, transmission costs, environmental costs (including the Carbon Emissions

Reducing Target), and Value Added Tax (VAT). Generation costs and retail costs (e.g. costs on marketing, billing, call centres and margin) make up the remainder of the bill. Figure 4.9 illustrates the estimated breakdown of a typical domestic gas bill.

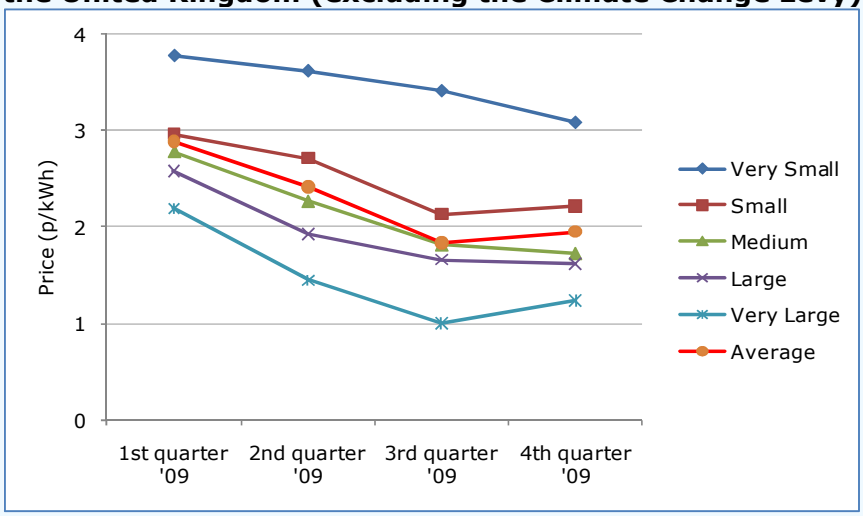
Figure 4.9: Illustrative breakdown of typical domestic gas customer bill, December 2009 (based on estimated annual average consumption of 20500kWh)



Source: Ofgem

236. 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[65]. Figure 4.10 below shows prices based on the most recent publication which is for March 2010.

Figure 4.10: Quarterly prices of gas purchased by non-domestic consumers in the United Kingdom (excluding the Climate Change Levy)



Source: Quarterly Energy Prices: March 2010, DECC

[65] www.decc.gov.uk/en/content/cms/statistics/publications/prices/prices.aspx

237. In 2009 the gas prices in the non domestic sector have fallen on average by 7.6%[66], 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 (11.3%), whilst very small consumers saw prices declining by a lesser extent (3.2%).

Assessment of competition

General assessment

238. Please refer to the electricity retail market section of this report.

Development of choice competition has brought for customers

239. Please refer to the electricity retail market section of this report.

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

240. Please refer to the electricity retail market section of this report.

Price comparison service

241. Please refer to the electricity retail market section of this report.

Consumer complaints

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

Measures to avoid abuses of dominance

Competition law

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

Transparency

244. 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.

[66] These figures are calculated as an average of the quarterly percentage change for the last four quarters.

245. 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.

246. 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.

247. 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 the their needs, does not mislead the customer and is otherwise fair in terms of content and presentation.

248. 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.

249. Please note that the same standards of information provision, transparency and domestic customer protection exist for electricity customers.

Contract structure

250. Please refer to the 2008 GB National Report.

Market monitoring

251. 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

RWE npower

252. On 13 February 2009 Ofgem completed its investigation into RWE Npower's changes to its gas tariffs in 2007. There were concerns about RWE Npower's approach to notifying its customers of the changes to tariffs which resulted in financial loss to some households whose consumption was low. Following the investigation, the company has agreed to rectify matters and will be making payments totalling £1.2 million to 200,000 customers approximately who were affected. RWE Npower has also pledged to write to existing and past customers adversely affected by the changes in the tariff.

253. The investigation was in relation to so-called two-tier tariffs which have two payment levels. The amount of gas consumed during the tariff year that is subject to the higher charge varies according to season. Every time RWE npower altered its charges it started a new tariff year on which charges are based. So some consumers whose consumption had taken them into the lower level charges were placed back on the higher

level when new charges were introduced, although the vast majority of customers benefitted from the reduction in prices also made at that time. RWE npower has now revised the wording of its contract information in order to clarify the period over which the higher tariffs are calculated.

Customers in debt and complaints handling standards

254. Please refer the electricity section for details on enforcement action against BG and EDFE.

Other

255. There is an ongoing investigation into National Grid Gas plc. The investigation, initiated on November 2008, is based on the alleged failure of NG to comply with its Retained Distribution Network ("RDN") gas transporter licence obligations regarding accurate reporting of regulatory information.

Competition policy actions

National Grid

256. National Grid appealed against the Authority's decision of February 2008 under the Competition Act 1998 to the Competition Appeal Tribunal (CAT). The main hearing of this appeal took place in January 2009.

257. As reported in last year's report, the Authority found National Grid abusing a position of dominance in the market for domestic-sized gas meters. National Grid entered into long-term exclusive contracts for the provision of domestic gas meters with energy suppliers. The contracts were considered to lock suppliers into National Grid for a significant share of their gas meter requirements and thereby restrict the development of competition. The Authority directed that National Grid must bring the breach to an end and imposed a penalty of £41.6 million.

258. 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 substantially upheld Ofgem's directions requiring National Grid to bring these multi-million pound contracts into compliance with competition law.

259. On 30 June 2009 the CAT refused National Grid permission to appeal against its decision ([2009] CAT 21)[67]. However permission to appeal was granted by the Court of Appeal under section 49 of the Competition Act 1998.

[67] Decisions associated with the case can be found at http://www.catribunal.org.uk/238-661/1099-1-2-08-National-Grid-PLC.html

260. On 23rd February 2010, the Court of Appeal dismissed National Grid's appeal against the CAT's decision on abuse, but allowed the appeal on the penalty issue. The Court of Appeal considered that the £30m imposed by the CAT placed insufficient weight on relevant factors (such as the Authority's involvement in the history of the case), adding that a penalty of £15m should be substituted for the £30m imposed by the CAT.

261. National Grid has since sought leave to appeal to the Supreme Court, but at the time of writing no such permission has yet been granted.

5. Security of Supply

General

Project Discovery

262. In Ofgem's 2009 National Report submission, we reported on the launch of Project Discovery. This was a year-long study of whether current market arrangements in GB are capable of delivering secure and sustainable energy supplies over the next 10-15 years. As part of this project, Ofgem developed four energy market scenarios examining the risks and uncertainties facing GB gas and electricity industries over the next decade. In October 2009[68], we published an interim consultation document outlining the scenario results, the key determinants of which are the pace of global economic recovery and global commitment to environmental action.

263. Each scenario shows that gas and electricity supplies can be maintained to customers, but the analysis exposes real risks and uncertainties to GB energy security of supply. For example, in the Green Transition scenario, rapid economic recovery combined with concerted environmental action delivers a significant shift towards renewable generation over the next decade and stable gas import dependency. The Dash for Energy scenario, however, implies growing gas demand as fossil-fuelled generation continues to play a significant role.

264. Further examination of consultation responses and updates to the Discovery scenarios confirmed there are still risk to future gas and electricity security of supply. In February 2010[69], we consulted on possible policy measures to address the risks and issues we identified.

Discovery Policy measures

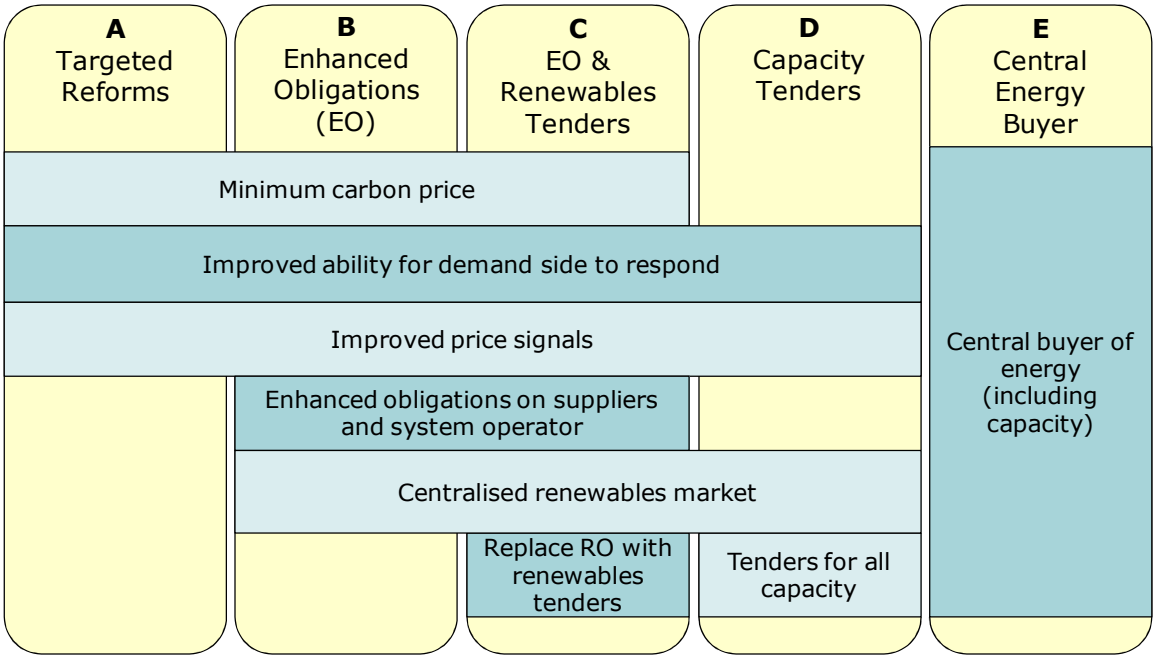
265. Ofgem grouped the policy measures into five packages designed to help ensure current arrangements are resilient to a number of future security of supply outcomes. These included measures to address risks which are internal to the GB market (for example strengthening price signals within industry codes), and measures to mitigate the impact of external risks, principally at international level (for example measures to increase GB storage capacity to help manage future gas supply shocks).

266. Figure 5.1 summarises the packages starting with those involving the least reform and intervention in the market on the left (although even this package involves significant changes) and moving to the most dramatic move away from competitive markets on the right. However, we recognise that there may be other policy measures and other combinations that could address the risks and issues identified.

[68] 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

[69] A copy fo '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

Figure 5.1 – Possible policy packages



5.1 Electricity

Peak electricity demand conditions

267. National Grid Electricity Transmission's (NGET) Seven Year Statement[70] (SYS) provides information on outturn and forecast peak electricity demand. Actual peak electricity demand fell in winter 2008/09 due to the impact of the recession and increased use of energy efficiency measures. In its latest statement, NGET outlines actual peak demand outturn in winter of 2009/10 was 59.1 GW, 0.1 GW lower than in the previous winter[71].

268. 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 2009/10 yields a provisional 'unrestricted' peak of 58.2 GW, which is 0.8 GW lower than previous winter's ACS peak[72].

269. NGET's ACS Peak Electricity Demand Outlook is outlined in table 5.2 and is based on a number of factors including the weather, economic activity, energy prices and energy efficiency/conservation.

[70] References to NGET's Seven Year Statement refer to the version published in May 2010, which is available at http://www.nationalgrid.com/uk/Electricity/SYS/
[71] NG SYS
[72] NG SYS

Table 5.2: NGET base ACS Peak Electricity Demand Forecast[73]

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
ACS Peak incl Station Demand and Exports to External Systems	58.2	58.3	58.4	58.5	58.6	59.0	59.1	59.0
ACS Peak excl Station Demand and Exports to External Systems	57.6	57.7	57.8	57.9	58.0	58.4	58.5	58.4

270. NGET also provide scenario forecasts based on more optimistic and pessimistic assumptions about factors that affect peak electricity demand - high growth and low growth scenarios. NGET forecast ACS peak demand in these scenarios range from 57.6GW to 63.3GW and 57.6GW to 53.9GW respectively. Ofgem also considers a similar range of factors, such as economic growth and energy efficiency, in its Project Discovery peak electricity demand assumptions. Taking this into account peak electricity demand[74], for these scenarios, range from 58GW to 67GW in 2015 and from 57GW to 70GW in 2020.

Generation fuel mix

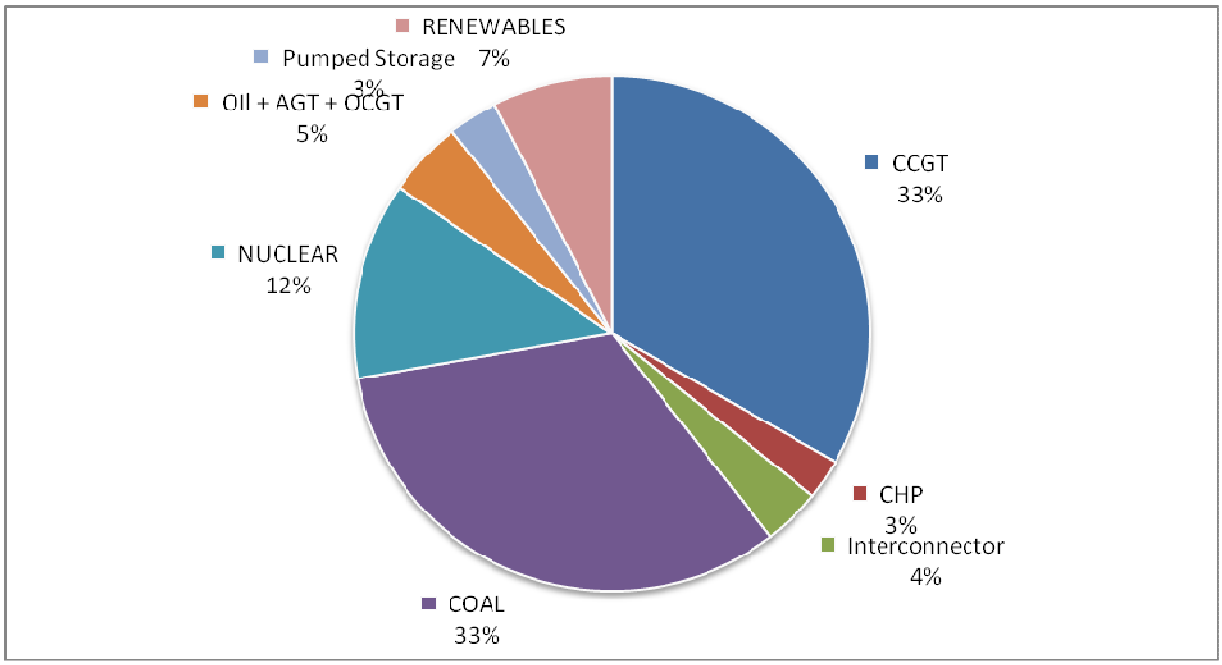
271. NGET developed four different generation backgrounds for the 2009/10 SYS. These are outlined below in order of level of pessimism (starting with least pessimistic):

- '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 consents75, 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.

272. A breakdown of current (2010/11) generation capacity against all NGET's generation backgrounds, with exception of SYS background, is presented in figure 5.3. This shows that similar to previous years the majority of GB transmission entry capacity comes from gas and coal fired plants (34% and 35% respectively).

[73] NGET SYS table 2.1
[74] 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
[75] These are section 36 consents of the Electricity Act 1989 and section 14 consents of the Energy Act

Figure 5.3: Generation Capacity by plant type (Source: NG SYS)



273. Total Transmission Entry Capacity (TEC) has increased by 5.4 GW since 2005, based on information provided in the SYS. This is predominantly due to an increase in wind and CCGT power generation.

274. 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. In Ofgem's Green Scenarios renewable generation comprise of 17.7% of demand and 10.8% in the non-green scenarios.

Table 5.4: Growth in Generation Capacity; Change in TEC (MW) between 2009/10 to 2016/17 by fuel type, NGET SYS

Fuel type	Growth in Generation Capacity (MW)
Clean Coal	0
Other Coal	-3568
Gas	17075
Oil	-3636
Renewables	13462
Nuclear	1850
Interconnector	1700
CHP as part of above mentioned categories	0

Generation Investment

275. 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. Currently 8145.9 MW of new generation projects is under construction (the

table below outlines the projects)[76]. A further 11729.4 MW has received Section 36 consent[77]. 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, whist for CCGT's this figure is 7.7GW[78].

Table 5.5: Forthcoming generation projects under construction, source: NGET Seven Year Statement[79]

Plant Type	Power Station	New Capacity (MW)	Year
CCGT	Severn Power Stage 1	425	2009
CCGT	Staythorpe C (Stage 1)	0	2009
CCGT	Staythorpe C (Stage 2)	425	2009
CCGT	Staythorpe C (Stage 3)	850	2009
CCGT	Severn Power Stage 2	425	2010
CCGT	Staythorpe C (Stage 4)	425	2010
CCGT	Grain (Stage 2)	860	2010
CCGT	Grain (Stage 3)	430	2011
CCGT	West Burton B - Stage 1	435	2011
CCGT	West Burton B - Stage 2	435	2011
CCGT	West Burton B - Stage 3	435	2011
CHP	Immingham Stage 3	0	2010
Interconnector	Britned Stage 1	0	2009
Interconnector	Britned Stage 3	400	2010
Interconnector	Britned Stage 2	800	2010

[76] NG SYS, Table 3.2
[77] NGET SYS
[78] NGET SYS
[79] 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.

Wind Offshore	Greater Gabbard Offshore Wind Farm	500	2009
Wind Offshore	Thanet Offshore Windfarm	300	2009
Wind Offshore	Walney I Offshore Windfarm	31	2010
Wind Onshore	Millennium Wind (Stage 2), Ceannacroc	10	2008
Wind Onshore	Fairburn Wind Farm	40	2009
Wind Onshore	Gordonbush Wind	70	2009
Wind Onshore	An Suidhe Wind Farm, Argyll (SRO)	20.7	2010
Wind Onshore	Beinn an Tuirc 2	38	2010
Wind Onshore	Drummuir Wind	48.3	2011
Wind Onshore	AChruach Wind Farm	49.9	2013
Wind Onshore	Toddleburn Wind Farm	36	2009
Wind Onshore	Crystal Rig 2	138	2009
Wind Onshore	Clyde Wind Farm (Scotland) Ltd	519	2010

Generation commissions/retirements

276. Information on generation projects with consents and under construction is provided in the previous section. In terms of plant closures, NGET's Seven Year Statement states that 582MW fall in power station capacity since 2005/06 inclusive due to the closure of two nuclear power stations in 2007. Due to the Large Combustion Plant Directive (LCPD) opted-out plant, comprising of 12 GW of coal and oil capacity. NGET

highlight that some closures will take place by the end of 2015. Including nuclear closures, 13.4GW of plant is due to be disconnected by 2016/17 inclusive[80].

5.2 Gas

Gas demand

277. Table 5.6 below outlines National Grid Gas' (NGG) forecast gas demand in their 2009 Ten Year Statement (TYS)[81]. The ongoing impact of the recession in 2009 has contributed significantly to a drop in annual and peak demand of around 5 bcm and 13 mcm respectively. Table 5.6 also shows that in the longer term NG forecasts a flat increase in annual demand up to 2012, a two bcm increase after 2012 before remaining relatively flat up to 2018. In the longer term NG predict that demand will start bouncing back from the recession in 2010 due to an improved economic outlook. However, NG believe this is offset by rising end user prices and energy efficiency measures and so demand is not projected to return to 2008 levels during NGG's forecast period. National Grid forecast peak gas demand to rise by 0.3% per annum up to 2018, driven by growth in the power generation sector. Ofgem's Project Discovery scenarios assume peak demand to range from 469 mcm/day to 551 mcm/day in 2018, in the Green Stimulus and Dash for Energy scenarios respectively[82].

Table 5.6: Base Case Annual and 1in20 Peak Gas Demand Forecast[83]

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Annual demand (TWh)	1039	1041	1041	1037	1055	1061	1058	1073	1066	1062
Peak demand (GWh)	5582	5526	5445	5510	5546	5630	5552	5690	5716	5709

Gas Supply

Existing and future sources of gas for GB market

278. Information relating to existing storage facilities is provided in the Market Concentration section and so please refer to this section for further information. The key changes compared with 2008 is that the Aldbrough storage facility started commercial operation in July 2009 with an initial space of 60 mcm. Additional capacity is expected to become available in 2010 with full completion by 2012. When completed, 370 mcm of capacity will be available and deliverability from the site will be approximately 40 mcm/d, placing Aldbrough second only to Rough in terms of deliverability[84].

[80] NG SYS
[81] NGG 2009 TYS. This is available at: http://www.nationalgrid.com/uk/Gas/TYS/
[82] This information is based on the February 2010 Ofgem publication 'Project Discovery: Energy market Scenarios Update'.
[83] Source: NGG 2009 TYS. Peak data is based on gas supply year.
[84] NGG 2009 TYS

279. The main development in the sources of GB gas supply since 2009 have been the completion of LNG import terminals at Isle of Grain (Phase 2) and South Hook and Dragon at Milford Haven. This takes GB's total LNG import capacity has now risen to 44bcm/year.

Importance of LNG

280. At present, around 6% of annual GB demand is met by LNG[85]. Ofgem's Project Discovery scenarios assume that up to 40% of annual supplies could come from LNG by 2020. It is also expected to become more important for meeting peak demand, with Project Discovery estimating that supplies could account for 25-30% of peak day supply by 2020, compared to 20% at present. This increased importance reflects a combination of declining UKCS production and Norwegian and Continental pipelines moving closer to full capacity utilisation.

281. However, LNG imports also provide the greatest level of uncertainty of all the supply components. This is due to the fact that at present, GB has a limited number of firm contracted supplies, and the fact that unlike pipelines, producers have the option to deliver gas to a wide range of alternative markets.

282. 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 an expansion completed at the end of 2008 increasing its capacity to 13.5bcm/year. The South Hook terminal commenced commercial operations in October 2009, with an expansion completed in early 2010 giving the terminal a total capacity of 21bcm/year. The Dragon LNG terminal provides capacity of 6bcm/year and was completed in September 2009. A fourth facility, an on-board re-gasification facility located off Teesside (that came online in January 2007) has a maximum annual capacity of 4bcm/year. National Grid reported that by the end of November 2009, over 8 bcm has been imported thought the Milford Haven and Grain terminals in 2009.

283. In addition to these existing terminals, a further phase of expansion at the Isle of Grain terminal is currently under construction, and is due for completion in Winter 2010/11. When completed, this expansion will add a further 7bcm/year of capacity to the terminal, taking total GB LNG importation capacity to 51bcm/year. There are also a number of proposed LNG projects which may be constructed during the next decade.

Import investment

284. NGG's TYS provides information relating to proposed import and storage projects[86]. Table 5.7 outlines proposed projects that are expected over the course of the next five years.

[85] NGG TYS 2009 - calculated from Figure 4.2A
[86] NGG TYS, table 4.7B

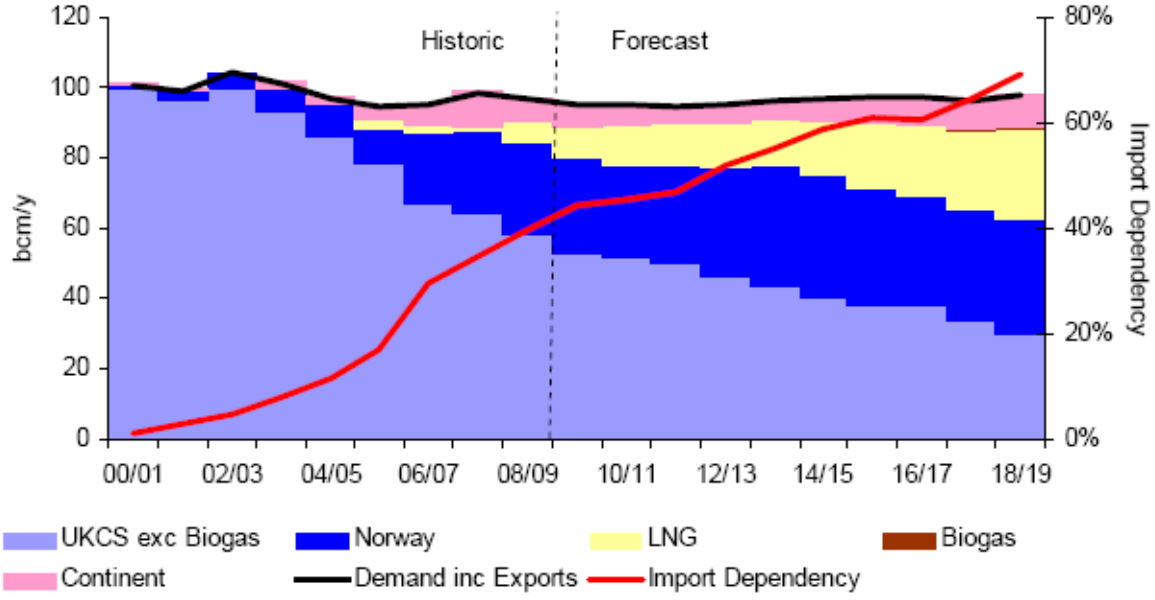
Table 5.7: Proposed import projects expected over next five years

Import Project	Developer	Type	Location	Date	Capacity (bcm/y)	Status
BBL Expansion	BBL	Pipe	Bacton	2010+	~3	FID[87] taken
Isle of Grain 4	Isle of Grain LNG	LNG	Isle of Grain			Open season underway
ConocoPhillips	Partners	LNG	Teesside	2014+	7+	Most planning granted, no FID
Canvey LNG	Partners	LNG	Canvey Island	2014+	5.4+	Planning rejected, potential resubmission
Port Meridian	Hoegh LNG	LNG	Offshore barrow	2013	4	Most planning granted, no FID
Other LNG	Various	LNG	n/a	2013+		Conceptual
	Total under construction (inc. proposed)				**19**	

Ongoing supply-demand situation

285. NGG's (base case) annual supply and demand forecast is presented in figure 5.8. This shows increasing levels of Norwegian imports, which is a modest compared with current levels. NGG also forecast a medium and long-term increase in continental import as well as an increasing role for LNG imports.

Figure 5.8: National Grid Base Case Annual Supply Forecast[88]

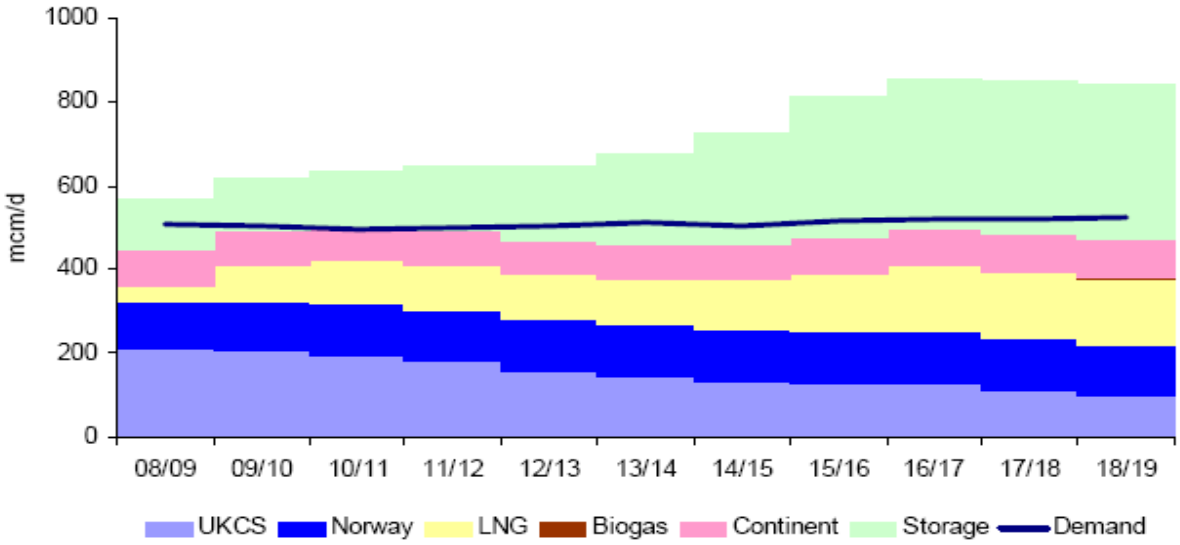


[87] FID - Final Investment Decision
[88] Source: National Grid 2009 Ten Year Gas Statement available at: http://www.nationalgrid.com/uk/Gas/TYS/archive/tys08/tys08pdf.htm

286. In general, it is difficult to determine the future source of the GB's continental imports as gas through some pipelines, such as IUK and BBL arrives from different locations. However, NGG's[89] (base case) flow forecast of Norwegian imports is27bcm/yr for 2009/10 and 5.8bcm/yr and 0.6bcm/yr from BBL and IUK respectively for the same year.

287. National Grid's (base case) peak supply and demand forecast[90] is outlined in figure 5.9. Given declining UKCS supplies, NG forecasts demand to be met by a growth in LNG supplies and storage capacity. However, this is based on the assumptions for new storage developments.

Figure 5.9: National Grid's (base case) peak supply and demand forecast



288. One of the areas that Ofgem looked at in Project Discovery is how demand can be met during a severe (1 in 20) winter, measured over the coldest 60 day period. The analysis shows that the Dash for Energy and Slow Growth scenarios would either require the interconnectors (continental imports) to operate at a higher level than the assumed annual average rate and/or balancing by way of demand reduction.

Forthcoming production capacity investment for the next three years

289. The annual UKCS Activity Survey conducted by the Oil & Gas UK association show that, similar to 2008, in 2009 £4.7 billion[91] was spent on total development capital expenditure[92] in relation to oil and gas fields and associated infrastructure. This figure follows the trend seen over the past three years, of decreasing capital investment. 2010 may fall below £4billion. The survey implied that short term investment commitments and the oil price recovery during the latter half of 2009 drilling and development costs beginning to fall, led to 2009 figures held up better than Oil and Gas UK expected. Lower

[89] As outlined in NGG's TYS.
[90] Based on 1:20 peak demand.
[91] UKCS Continental Shelf Survey 2008, BERR (2008); http://www.berr.gov.uk/files/file50677.pdf
[92] Does not include exploration, appraisal and decommissioning spending.

product prices, more difficulty in obtaining funding and a slow fall in input costs levels means that the development capital expenditure may continue to decrease. However, there is some uncertainty around future investment as this is dependent on a range of factors, including availability of capital, oil, and gas price movements.

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

Gas Emergency Measures

291. National Grid has been developing a potential modification to the gas emergency claims arrangements, which aims to provide greater incentives to balance and creates more cost reflective signals for gas to be provided to GB from non-UK sources during a GB gas deficit emergency[93].

[93] Further information on GB gas deficit emergencies can be found at the following link: http://www.cabinetoffice.gov.uk/ukresilience/response/recovery_guidance/infrastructure_issues/utilities.aspx

6. Public Service Issues

Appropriate treatment of vulnerable customers

292. Ofgem is obliged, through its statutory duties, to have regard to the interests of customers who are disabled, chronically sick, of pensionable age, on low incomes or living in rural areas, and to have regard to the need to contribute to the achievement of sustainable development and the need to secure a diverse and viable long-term energy supply.

293. During 2008, Parliament enacted changes to Ofgem's statutory duties clarifying that we must protect the interests of future as well as existing customers and to increase our focus on sustainability. In addition, in April 2010 parliament amended the general duties of Ofgem to make it clear that it should consider the interests of consumers as a whole, including their interests in the reduction of carbon emissions and their interests in secure energy supplies. The changes also made clear that Ofgem must step in proactively to protect consumers as well as considering longer term actions to promote competition.

294. Ofgem is also obliged to have regard to statutory guidance issued by government on social and environmental matters which, amongst other things, requires Ofgem to make an appropriate contribution to the achievement of government in meeting its targets to eliminate fuel poverty. Government issued revised guidance in January 2010 confirming the contribution it considers Ofgem should make towards the attainment of the Government's social and environmental policies.

295. In respect of social issues, Government expects Ofgem to take a strong lead in coordinating and ensuring that consumers on low incomes (or who are otherwise vulnerable to fuel poverty) are able to benefit from competitive markets. Ofgem should also promote transparency in charging, including the provision of information on comparative charges for different payment methods to help consumers take advantage of the best tariffs available. Ofgem should also ensure that there are no unnecessary barriers to switching.

Social Action Strategy

296. In October 2005, Ofgem launched its Social Action Strategy which describes how it seeks to meet these social responsibilities and help the government to meet its targets for eradicating fuel poverty. The strategy is updated annually to review progress over the past year and identify areas of work for the coming year. The 2010 update will be published in July 2010.

297. The Strategy supplements Ofgem's broad approach of promoting competitive energy markets and regulating network monopolies, by focusing on four key areas:

- securing compliance with regulatory obligations and effective monitoring and reporting by the companies;

- encouraging best practice among energy suppliers, using research to identify effective ways to address fuel poverty and help vulnerable customers;

- influencing the debate about measures to help tackle fuel poverty, working with other stakeholders, helping to promote a joined up and holistic approach; and

- informing consumers about ways to lower their energy bills.

Helping fuel poor and vulnerable customers

298. Ofgem continues to encourage suppliers to take a proactive approach to helping their fuel poor and vulnerable customers, in particular by developing their social programmes and through the promotion of best practice in the area of debt and disconnection. We have published reviews over the last 12 months in both of these areas.

299. As part of the 2008 Budget, Government agreed with energy suppliers an increase of at least £150 million a year by 2010-2011 in suppliers' collective expenditure on their voluntary social programmes. Ofgem published its report in August 2009 on the range of measures suppliers undertook to assist their vulnerable and fuel poor customers in the first year of the voluntary commitment (April 2008 to March 2009). This showed that at the end of March 2009 there were approximately 1 million customer accounts benefiting from social tariffs, compared to 460,000 the previous year - an increase of 118%. This highlights the significant and growing contribution that suppliers are making to support fuel poor households through their social and discounted tariffs.

300. Government is building on the success of this voluntary agreement and is developing plans to put new arrangements in place when the current voluntary agreement ends in March 2011. Legislation passed in April 2010 enables the Government to require energy suppliers to provide a specified level of social price support (direct assistance with energy bills) to the most vulnerable customers. As a precursor to these new arrangements, Government and energy suppliers are working together on the Energy Rebate Scheme which involves Government sharing data with suppliers to enable them to identify a particular group of Pension Credit recipients. This will result in energy suppliers giving these customers an automatic credit of £80 during 2010.

301. The Carbon Emissions Reduction Target (CERT) 2008 – 2011 follows on from the Energy Efficiency Commitment (EEC) 2005 – 2008. Revised in 2009, the CERT requires gas and electricity suppliers to achieve targets for a reduction in carbon emissions generated by the domestic sector. The programme itself is known as the CERT and the target for carbon emissions reduction as the CER target. Each supplier's individual target is known as its 'carbon obligation'. 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.

302. The Electricity and Gas (Carbon Emissions Reduction) Order 2008 and its amending order The Electricity and Gas (Carbon Emissions Reduction) (Amendment) Order 2009 (the Order) provides the statutory basis for the CERT. The Order sets out the overall carbon emissions reduction target to be collectively achieved by suppliers between 1 April 2008 and 31 March 2011. The target is 185 million tonnes of carbon dioxide (lifetime).

303. 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; hence the programme also contributes to the government's Fuel Poverty Strategy. Government announced in the 2009 "UK Low Carbon Transition Plan" that CERT would be extended to December 2012 and published a consultation in December 2009 which included a new Super Priority Group obligation to ensure that the most vulnerable householders who are

least able to afford energy saving measures are offered assistance. Government are currently considering the responses to the consultation.

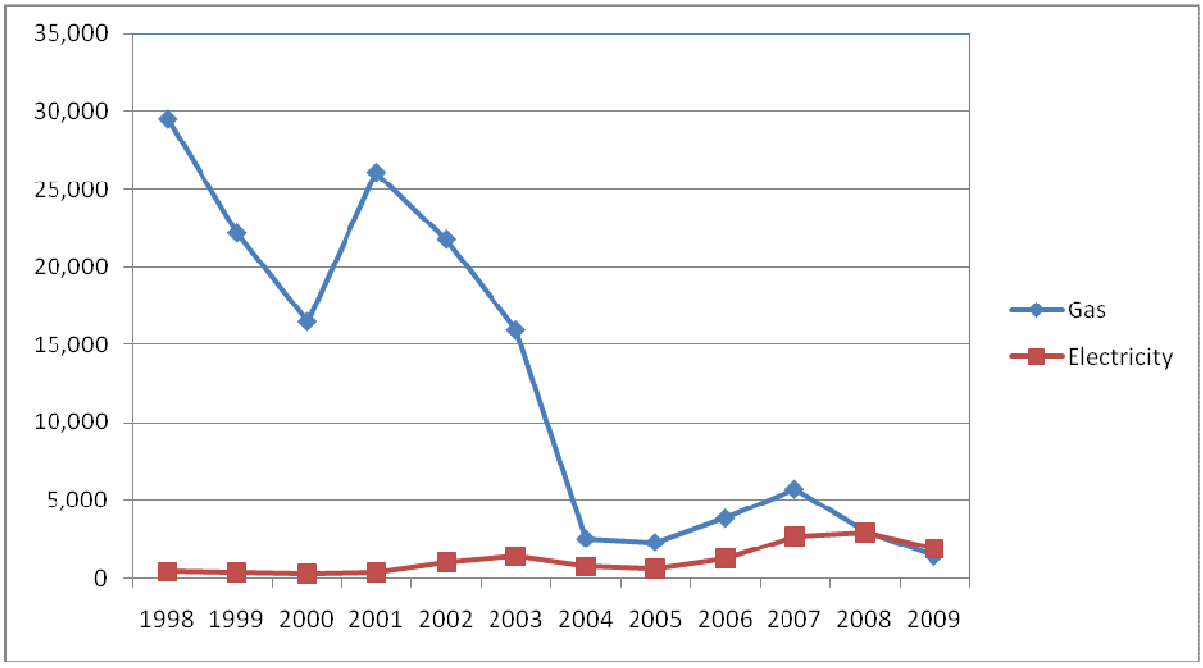
304. The Community Energy Saving Programme (CESP) has been created as part of the government's Home Energy Saving Programme. It requires gas and electricity suppliers and electricity generators to deliver energy saving measures to domestic consumers in specific low income areas of Great Britain. CESP has been designed to promote a 'whole house' approach and to treat as many properties as possible in defined areas. The CESP obligation period runs from 1 October 2009 to 31 December 2012. It requires certain gas and electricity suppliers and certain electricity generators to meet a carbon emissions reduction target. DECC is responsible for setting the overall CESP target and policy framework and Ofgem is responsible for administering the programme. CESP will also contribute to the government's Fuel Poverty Strategy by requiring actions to be delivered in geographical areas selected according to the level of deprivation in England, Scotland and Wales.

Disconnections for non-payment

305. See the 2008 GB National Report for background.

306. Under their licence, suppliers are prohibited from disconnecting customers in winter (October to March) where they know or have reason to believe that the customer is of pensionable age and lives alone, or lives only with persons who are of pensionable age or under the age of 18. Suppliers are also required under their licence to take all reasonable steps to avoid disconnecting customers in winter if the occupants of the premises include a person who is of pensionable age, disabled or chronically sick.

Chart 6.1: Total number of electricity and gas disconnections



307. As illustrated in Chart 6.1 above, disconnection levels continued to fall in 2009 in line with the trend seen since 2007. A total of 2,436 electricity customers and 1,794

gas customers were disconnected in 2009, representing a 16% decrease in electricity and 40% decrease in gas compared to the number of customers disconnected in 2008. One of the major suppliers ceased domestic gas and electricity disconnections from July 2008 until the end of 2009 and another major supplier suspended all domestic disconnections between October 2009 and the end of March 2010.

308. In October 2009, Ofgem and Consumer Focus carried out a joint review of the protection for vulnerable customers from disconnection. Whilst we found a large amount of good practice across suppliers and suppliers' policies and procedures to identify vulnerable customers and prevent them from being disconnected were largely satisfactory, we found some areas of weakness and inconsistencies between suppliers that need to be addressed. As a result of our review, Ofgem secured a number of commitments from suppliers to improve their code of practice relating to disconnection. Following the review, we have also consulted on amendments to suppliers' licence obligations clarifying that suppliers must take all reasonable steps to identify where a customer is vulnerable before disconnecting domestic premises.

309. Ofgem and Consumer Focus are also carrying out a joint review on the broader issues of suppliers' practices and approaches regarding debt prevention and management. Ahead of publication of the final report, we have held a roundtable discussion between suppliers, Citizens Advice Bureaux and other consumer advocates and advice agencies to discuss the draft recommendations and identify further steps that can be taken to help customers struggling to pay their energy bills.

Statutory requirements

310. 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).

Supplier of last resort arrangements

311. 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.

312. 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.

313. 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) [94], 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.

314. 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 and the speed at which customers can be transferred in order to minimise disruption to the failed supplier's customers.

315. Under this process, each supplier provides information that indicates that it would be able to perform the role of SoLR, alongside deemed contract prices for Ofgem's consideration.

316. 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.

Implementation of labelling of primary energy source (electricity)

317. 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 CO2 emissions and levels of radioactive waste generated.

318. 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.

[94] Ofgem has the power to appoint a SoLR for all customers – domestic and non-domestic.

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 Act 2004, 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.

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.

1.4 The Authority's principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5 The Authority must when carrying out those functions have regard to:

- 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;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them;
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.

1.6. 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:

- promote efficiency and economy on the part of those licensed under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;

- 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

- secure a diverse and viable long-term energy supply.

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

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;

- 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.

1.8. 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 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.

Appendix 2 – Changes to Consumer Representation

1.1. The Energy Supply Ombudsman (ESO), renamed the Energy Ombudsman, was established in July 2006 (at the request of Ofgem) by the six largest suppliers to resolve billing and transfer disputes and provide redress where domestic energy customer complaints had not been adequately addressed by suppliers. Since the establishment of the ESO, Parliament has introduced new measures through the Consumers, Estate Agents and Redress Act 2007 (the CEAR Act) to require energy suppliers and network operators to be a member of an Ofgem approved redress scheme to resolve the complaints of domestic and small business energy customers.

1.2. The CEAR Act saw energywatch – the existing energy consumer body - replaced with a single point of contact for consumers for information and advice covering all markets (Consumer Direct), the extension of redress schemes potentially to cover all energy complaints, and a new consumer advocacy body (Consumer Focus). The CEAR Act also provided for the same changes to apply to Postwatch, energywatch's equivalent in the postal market. These new arrangements took effect on 1 October 2008. The CEAR Act placed a statutory requirement on Ofgem to make regulations setting standards for complaint handling by the companies we regulate.

1.3. The Gas and Electricity (Consumer Complaints Handling Standards) Regulations were made on 16 July 2008 and came into force on 1 October 2008.

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

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 2009 was the second 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/EnergyRetailReport2009.pdf

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

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1. Foreword

2009 was a year which saw the 'bedding down' of the Single Electricity Market (SEM) and further progress on the Common Arrangements for Gas (CAG). With the economies of both jurisdictions struggling and uncertainty over fuel price trends, tariffs were under close scrutiny and the demand for regulatory transparency and effective action to protect customers was at the forefront of public energy policy and of public opinion.

2. Main Developments in the gas and electricity markets

The year 2009 was the second 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 progressed on 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. The development of a further interconnector between Ireland and GB was announced and the SEM Committee published its strategy for market integration. The divestment of the system operator SONI was completed and further progress made towards full retail market competition.

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

Two industry ventures are exploring the possibility of developing gas storage facilities within salt layers in the Larne area. The Utility Regulator continues to work with industry to determine an appropriate regulatory framework for gas storage facilities.

With respect to retail the Greater Belfast gas market has seen a significant increase in competition at the industrial and commercial level with large increases in the number of customers switching. On the retail side the Utility Regulator is continuing to work with industry and stakeholders to deliver competition at this level. Work is concentrating on improving switching capacity where Phoenix Natural Gas Ltd. (the distribution network operator for the Greater Belfast gas market in NI) is currently developing a semi-automated customer switching system to be put in place by November 2010 and suppliers are putting structures and processes in place to ensure the customer experience of switching is a smooth one. Once these measures are in place we anticipate competition at domestic level.

3. Regulation and Performance of the Electricity Market

3.1. Regulatory Issues

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 2009 capacity could only be auctioned on a monthly or annual basis and this was done manually (couriered bids opened under regulatory supervision). However work has been started to develop an electronic system which will support weekly, daily or even shorter auctions. This was due for delivery in 2009 however the project was delayed as the plan for a second interconnector between Ireland and GB (known as the East – West Interconnector), being developed by Eirgrid, the Transmission System Operator (TSO) for Ireland, plus Eirgrid's acquisition of SONI, the interconnector administrator for Moyle, resulted in the original project being delayed in favour of a single procurement exercise to cover trading platforms for both interconnectors. This is due for delivery during 2010 or 2011.

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. At present, options for intra-day trading are being developed.

Other issues related to Transmission Network Use of System charging (TNUoS) in GB will also need to be resolved before Moyle can be fully compliant.

In 2009 GB received an infringement notice from the Commission regarding the operation of Moyle, both the Utility Regulator and OFGEM contributed to the response. It is currently planned to make Moyle fully compliant with congestion management guidelines by 2012.

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.

SONI has a 3 year price control from 2007 – 2010. 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 2009 SONI was acquired by Eirgrid, the state-owned TSO in Ireland and work began on its next price control to run from October 2010.

3.1.3. Effective unbundling

NIE has no generation affiliates in NI although the Viridian Group does own generation in Ireland which is part of the SEM. The NIE Group still owns the main supplier in NI (NIE Energy Supply) but with strict ring-fencing applied. Although the system operator has been divested, 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

2009 was the second 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 on the day ahead. The ex-post market schedule sets the half hourly system marginal price. 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 opportunities 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 (SONI and EirGrid).

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 (Utility Regulator and CER) 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.

The Utility Regulators "Energy Retail Report" (2009) 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. Data in the report 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 (NIEES) suppliers. There are seven suppliers in the business markets; four of which are active across all use of system categories of customer and three of whom were active in specific customer categories[95].

Switching

At the end of 2009, 34% of business (industrial and commercial) customers (66% by volume) had switched away from the incumbent; in 2009 11% of business customers switched supplier, an improvement on 7% in 2008 and 3% in 2007. However, the majority of customers, particularly those in the small I&C sector, continue to be supplied by NIEES. At the end of 2009 no domestic customers had switched away from the

[95] For further information see "Energy Retail Report" 2009 (page 37)

incumbent as there were no other suppliers offering to supply the domestic market at that time, although the domestic market saw a new entrant supplier in June 2010.

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 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 and the Utility Regulator is working with the industry to implement an unlimited switching system by early 2012 for more information on limits on domestic electricity switching see

http://www.uregni.gov.uk/uploads/news/Interim_Market_Arrangements_250809.pdf

Our annual 'omnibus' surveys (unpublished) showed an increase in interest in switching between 2009 and 2010 of almost a quarter from 59% of customers surveyed to 73% in 2010; the proportion stating they are not interested in switching was static at around one in six over the two years with those unsure about switching declining from almost one in four (23%) in 2009 to one in ten (10%) in 2010.

Our most recent research on customers attitudes to competition http://www.uregni.gov.uk/uploads/publications/140610_Consumer_research_report_on_electricity_supply_companies_-_Retail.pdf

showed almost two thirds (60%) of domestic customers were interested to some degree in switching immediately a new supplier entered the market; almost nine in ten (89%) stated that cost would be the main driver for switching supplier with over half (54%) stating service as a main driver.

Almost nine in ten businesses surveyed (89% of SMEs and 88% of LEUs) who had switched in the previous 12 months identified cast 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.

Feedback from business consumers suggests that there are few problems with the switching procedure; 91% of SMEs said switching was easy, with just 3% stating they found the process difficult; 85% would consider switching again. Amongst LEUs, 87% found the process easy with no customers saying they had difficulty with the procedure; 86% said they would switch again.

Customer Information

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

There were no suppliers other than the incumbent in the NI domestic market during 2009 however another company entered the 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

as well as a price comparison tool

http://www.consumercouncil.org.uk/energy/price-comparison-/

Complaints

The customer complaints procedure in Northern Ireland is detailed

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); details of our process are given

http://www.uregni.gov.uk/uploads/publications/March_2010_Utility_Regulator_Dispute_Resolution_Procedure.pdf

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, branding separation 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 are currently developing a Retail 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 40% to 50% of generation. The next largest owner of generation is the Viridian Group.

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

1. A bidding Code of Practice (BCOP) which requires generators to bid their short run marginal costs in the wholesale market
2. A Market Monitoring Unit (MMU) which ensures that generators comply with the BCOP
3. Ring fencing arrangements between affiliated businesses which are dominant as a group, including both generation and supply businesses
4. An economic purchasing obligation (EPO) on dominant suppliers

4. Regulation and Performance of the Natural Gas market

4.1. Regulatory issues

4.1.1. Management and allocation of interconnector capacity and mechanisms to deal with congestion

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. Premier Transmission Limited (PTL) – the owner and operator of this pipeline operate a "use it or lose it" (UIOLI) mechanism – the annual review of firm capacity - which is based on a shipper's Maximum Daily Quantity (MDQ). PTL require the Regulator's consent however to reduce the shipper's MDQ.

4.1.2. 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. Incentive-based regulation is implemented

for distribution companies. The standard RPI-X price control is applied with incentives included to encourage efficiency and network growth. In NI no benchmarking has been used to date. The standard duration of revenue or price caps is 5 years.

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 applied (e.g. higher rate of return) the RoR for DSO is fixed and set "quite high" until 2016 (7.5 per cent), 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
A postalised tariff is currently used at the transmission level, however following consultation under the CAG project this is set to change to an Entry/Exit model.

With regards to transmission: volumes, capacity bookings and revenue requirements are collected from the power and distribution sectors. The individual submissions are then totalled and a single transmission tariff is calculated for all sectors.

TSOs are also price controlled. 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.

At transmission level, tariff methodology is set by the Regulator and tariff setting is overseen on an annual basis.

DSOs have licences extending 30 to 40 years.

Tariffs, connection charges, conditions etc are all available on the DSOs' websites. Similar information is published by TSOs

4.1.3. Effective Unbundling
NI has two DSOs and both 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 D&S business.

The arrangements for unbundling at the transmission level are being examined as necessary as part of the CAG project.

4.2. Competition Issues

4.2.1 Description of the retail market

In NI 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. In the ten towns' development area exclusivity of supply to customers whose consumption is not expected to exceed 732,500 kilowatt hours in any period of 12 months commenced on 1 April following the Start Date for that development area, and will expire on 31 March 8 years thereafter. For customers expected to exceed 732,500 kilowatt hours in any period of 12 months, exclusivity of supply to these customers shall commence on 1 April following the Start Date for that development area, and will expire on the 31 March 5 years thereafter. In the Greater Belfast area, four companies (Phoenix Supply Ltd., firmus energy Ltd., Energia and VAYU) currently supply gas to industrial and commercial customers, but only the incumbent supplier (Phoenix Supply Ltd.) currently offers gas supply to all domestic customers.

In NI there are currently 125,136 gas customers of which 10,916 are non-household customers. The total gas consumption of non-household customers in 2009 was 0.1617752 Mtoe, 0.18806 bcm (2,022,190 MwH) and the total consumption of household customers was 0.1008164 Mtoe, 0.1172 bcm (1,260,205 MwH). Based upon volumes supplied, Phoenix Supply Ltd. has approximately 68% of the market share for industrial and commercial customers in NI and approximately 81% of the market share for domestic customers in NI. firmus energy Ltd., the gas supply company with the second largest market share in NI, has approximately 19% of the market share for industrial and commercial customers and approximately 31% of the market share for 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) is currently arranging for a semi-automated customer switching system to be put in place by 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.

Measures to promote market transparency

To promote market transparency and the availability of information to consumers the Department of Enterprise, Trade and Investment are currently taking through the NI Assembly an Energy Bill which 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.

4.2.2 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 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 2009 shows:

- Current level of electricity peak demand is 1660 MW. This has been forecasted to reach 1786 MW by 2016. These forecasted peaks are less than predicted in previous years due to the affect of the global economic downturn;

- The large reduction in demand forecasts in NI and Ireland has led to a significant increase in generation adequacy;

- During the period from 2010 to 2016 there is sufficient generation capacity to achieve compliance with the generation security standard. 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 2286 MW. This figure excludes available capacity via imports on interconnector and tie lines. There is also 301.2 MW of wind capacity 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 which has the potential to impact on delivery of this project. To view SONI's most recent Generation Adequacy Report see

http://www.soni.ltd.uk/upload/Seven%20Year%20Generation%20Capacity%20Statement%202010-16.pdf

5.2. Gas

The current levels of actual gas consumption (source: 2008/09 gas year Exit Volumes) are as follows:

Actual gas volume 2008/09		
Sector	**Volumes (bcm)**	**Volumes (Mtoe)**
Power	1.164	1.001
Distribution	0.370	0.319
Total	**1.535**	**1.320**

The forecast levels of total gas consumption (source 2010 Joint Gas Capacity Statement) are outlined in the following table. The forecasts have been supplied by power stations and distribution companies.

Forecast total volume										
	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
bcm	1.501	1.473	1.540	1.596	1.591	1.611	1.629	1.646	1.657	1.668
mtoe	1.291	1.267	1.325	1.373	1.368	1.386	1.401	1.416	1.425	1.434

Current levels of gas supply (Mtoe, bcm) and future expected and available supplies for the next ten years (i.e. 2009-19);

100% of NI gas supplies are currently provided from Great Britain via the NTS Exit Point at Moffat. With the development of the CAG market it is envisaged that NI will have access to additional gas sources from the Republic of Ireland. It is expected that this will include access to indigenous supplies from the Corrib and Inch gas fields and through LNG imports from the planned facilities at Shannon. Additionally, there is significant industry interest in developing gas storage facilities in the Larne area of NI. Access to these sources will increase the level of diversification of gas supplies for NI and reduce the level of dependence on supplies from Moffat.

As previously discussed, all NI demand is currently met through supplies from Great Britain. However, the projected supply/demand balance is expected to change within the next ten years as new gas sources become available and the CAG market develops.

Gas is a relatively new industry in NI with first operations commencing in 1996. As such the networks are new and in good condition.

NTS Exit Substitution

National Grid is consulting on its proposed methodology for exit capacity substitution which will be applied at all of the exit points from the National Transmission System (NTS), including interconnectors, with effect from 1st April 2011. This mechanism will allow exit capacity to be transferred from exit points with unsold or unallocated capacity to exit points where incremental capacity is required. However, the mechanism proposed

may create uncertainty in the levels of available capacity at Moffat in Scotland, the NTS exit point for NI, Ireland and the Isle of Man. This uncertainty could result in security of supply issues to the three downstream jurisdictions.

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 2012.

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 adequacy 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 would 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.

Both regulators continue to monitor the progress of the proposed regulation concerning measures to safeguard security of gas supplies and repealing Directive 2004/67/EC.

Storage capacity
Currently, there are no gas storage facilities within NI. Two industry ventures are exploring the possibility of developing gas storage facilities within salt layers in the Larne area of NI.

Islandmagee Storage Limited have completed their seismic testing and have recently submitted a planning application 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 2010 with planning applications to be submitted early 2011.

Incentives for new investments
Companies currently have an appropriate RoR 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 Regulator 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.

A number of changes are required to the arrangements governing REGOs by 4 December 2010. These changes are required under Article 15 of the Renewable Energy Directive (RED). The changes include:

- changes to the definitions of "*energy from renewable sources*" and "*biomass"*;
- a change to the unit of measurement of a REGO from Kilowatt hour to Megawatt hour;
- an expiry date for a REGO of 12 months
- a requirement for REGOs to be cancelled once used;
- various changes to information to be recorded on the REGO itself.

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.

Implementation of the Social Action Plan is now underway and progress will be monitored on an ongoing basis.