

2009 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 2009 National Report to the European Commission

Date of submission: 31 July 2009

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). This report covers only Great Britain (GB) and not Northern Ireland. The Northern Ireland report is found in the other section of this UK response.

In terms of content, the GB report covers:

- The organisation and structure of the Gas and Electricity Market Authority (GEMA)
- Developments in the GB energy markets in the last 12 months
- 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 and 2008. Much of the information remains unchanged, although latest data is supplied where relevant. Where background on particular issues is not included, please see the 2008 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 **2007/08 Annual Report**. The Ofgem Annual Report 2007-08 is available at the link below. The 2008-09 annual report will also be available shortly.

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

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1. Ofgem Foreword

Just as most of us have started to learn to live with the cost of beginning to tackle climate change and big rises in commodity fuel prices we have had to watch a global financial crisis add to the risks faced by the energy industry and the pressures felt by householders and businesses.

The scale and character of the challenges faced by the energy industry and its stakeholders demand innovation and determination in equal measure from the entire sector including the industry regulator. While the implications of these challenges are here and now, they are also global and stretch far into the future.

The pages of this report show how Ofgem has responded to new challenges with an open mind and a clear focus on the consumer. We have been guided too by the distress voiced by consumers and, looking ahead, we will continue to follow that guide. Our commitment to understand and act on consumers' concerns is perhaps best exemplified by our appointment under our Consumer First programme, of a panel of domestic consumers to advise our thinking on the issues that most exercise them.

Consumer anxiety grew as prices kept on climbing after last summer. With the need to address that anxiety in mind, we took unprecedented measures in our energy market probe to identify and then to deal with instances of unfair pricing. This focus on the protection of customers will endure in our work for the future.

The 'Third Package' of European energy legislation and the 'Green Package' addressing carbon emissions and renewables, will have profound implications for British energy consumers in the future. They lay the ground for a more competitive and sustainable European energy market. We will continue to make a major contribution to the work of the European energy regulators, through my continuing chairmanship of ERGEG and through significant engagement at all levels of the organisation. We are also now working with Government on transposition of the Third Package into national law.

Ofgem has started up a series of projects that together seek to ensure that it is best positioned to continue protecting consumer interests. The urgency to do this long-term work arises from the mix of inevitabilities and uncertainties that the future holds. Key among these are the impact of the global credit crisis on the British energy sector coupled with Government support for a low-carbon economy by 2050, building on the EU's 20-20-20 targets, and the closure, under European environmental legislation, of much of Britain's coal- and oil-fired power stations by 2016.

Ofgem has already begun to respond to these developments. We have launched, in Project Discovery, an analysis of the energy markets to test their capacity to cope with the fallout from the credit crisis and Britain's shifting reliance on imported gas. Its findings will provide a full appraisal of the situation that will be impartial and independent, taking account of developments in European markets and the forthcoming proposals for a gas security of supply Regulation.

Ofgem's two-year review of the 20-year old regime for regulation of the pipes and wires operators (RPI-X@20) will make sure any future regime keeps up the value for money and reliable networks Britain's consumers expect. This work has been informed by our report on long-term electricity network scenarios (LENS) which highlights the challenges anticipated from possible developments in renewable generation out to 2050.

Meanwhile we are advancing the next review of revenue controls for the electricity distribution industry that will introduce a greater focus on consumers and new incentives for innovation to help make the transition to a low-carbon economy.

A huge programme of investment is needed to build the networks that will carry the power from planned onshore and offshore wind farms. We have launched a new regulatory regime developed in partnership with the Department of Energy and Climate Change and in the summer of 2009 we expect to see the significant interest shown to date translate to commitment to invest.

Our review of the arrangements for connecting renewable generation to the national grid – the Transmission Access Review (TAR) - aims to step up the pace at which green energy comes on line. We have worked hard toward enduring measures to ensure national networks are available to carry the output of new, low-carbon generation needed over the next two decades. The scope for reform has however been frustrated by industry process such that we have now recommended that the Government use its powers to avoid further delay.

Aligned with TAR is our Codes Governance Review - our overhaul of the rule-making process that underpins the entire industry. Benefits to customers from removing red tape in the rules governing many aspects of the industry – including renewable development will emerge in the coming year. We will look to bring some of the lessons from our extensive experience of network and market codes into the European discussions on the new Framework Guidelines and network codes.

As we take on these major responsibilities we are also being asked to do much more in the coming year. The government has handed us greater responsibilities to administer environmental programmes. This raises naturally an issue over resources as we approach the end of our self-imposed five-year cap on expenditure.

Meanwhile our role was expanded and reinforced during 2008. Parliament has enacted changes to our statutory duties to increase our focus on sustainability and future consumers. We welcome this. It has been more than a year since our chief executive Alistair Buchanan declared that "Sustainability is in Ofgem's DNA." And I believe our launch now of key, long-term strategic reviews is timely and will define our forward-thinking to protect and promote customers' interests today and for the future.



Lord Mogg
Chairman

2. Summary \ Major Developments in the last year

1. The European Commission Directives on gas and electricity liberalisation stipulate a monitoring and reporting obligation for Member States, as well as for regulators. Therefore, in accordance with Directives 2003/54/EC (Electricity) and 2003/55/EC (Gas), Ofgem has produced a National Report to account for the main changes in the Electricity and Gas markets over calendar-year 2008. Relevant changes in the first part of 2009 are also briefly covered where necessary. The GB report forms one part of the two-section UK response – the Northern Ireland report is found in the other section of this UK response.

2. In this first section, we will summarise the major developments in the Great Britain electricity and gas markets over 2008. The summary will include:

- Energy Markets
- Network developments
- Consumer-related issues
- Security of supply and infrastructure developments
- Sanctions
- Other policy actions

Energy markets

3. The discussion of the GB electricity and gas markets have been split into two parts for this report – the domestic and small business sector and the wholesale sector. There have been important changes in both of these areas over 2008 and the main ones are covered below.

Domestic and Small business sector

4. In February 2008, Ofgem launched a study of the state of the GB energy supply markets ('the Probe')¹ in response to large increases in the retail electricity and gas prices for domestic customers by all major suppliers in 2008. This investigation focussed on:

- the customer's perspective and experience of the market including access to information and barriers to switching supplier;
- suppliers' market shares, switching rates for different groups of customers (such as online, dual fuel, single fuel and pre-payment);
- the competitiveness of suppliers' pricing in the different market segments and customer movement between payment types as well as suppliers;
- the relationship between retail and wholesale energy prices; and
- the economics of new entry and the experience of companies trying to enter the energy market.

5. The investigation covered markets serving domestic customers and small businesses. We found that overall, the transition from monopoly gas and electricity supply ten years ago to competitive markets is well advanced and continuing to develop. Many customers have benefited from lower prices, better service and a wider range of deals on offer. Domestic electricity and gas suppliers offer a wide range of tariffs to domestic customers by offering fixed or variable prices, green energy deals and social tariffs and a wide range of incentive and reward deals. Customer service is improving as suppliers invest in their systems and cut the number of complaints. Switching levels among

¹ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=4&refer=Markets/RetMkts/ensuppro>

domestic gas and electricity customers in 2008 exceeded that seen in 2007. The six largest suppliers are acting competitively and we have found no evidence of a cartel.

6. The report on the Probe found some important areas where the transition to competitive markets now needs to be accelerated. Many customers are not yet benefiting fully from the competitive market and vulnerable consumer groups are disproportionately affected. In responding to these concerns, we proposed a package of measures which is designed to improve the functioning of the market for all customers, particularly vulnerable households and small businesses. This package is currently being consulted on and will be covered in more detail in next year's GB National Report.

Wholesale markets

7. In the GB wholesale gas market, Winter 2008/09 was the coldest since 1993. Despite this, demand (excluding IUK exports) was lower than that in Winter 2007/08. On a weather-corrected basis, demand in all market sectors was lower with an overall reduction of six per cent. This reduction was attributed to a combination of the effects of the recession and to some extent improving energy efficiency measures². Indigenous supplies met 55 per cent of demand. Norwegian supplies to the UK met nearly 30 per cent of demand and the remainder from LNG, other imports and storage withdrawals.

8. For wholesale electricity, the total installed capacity on the GB system at the beginning of 2008/09 was 79.9 GW and increased by 3.7 GW to 83.6 GW by the start of 2009/10³. A combination of very high commodity prices (coal, oil and gas) and a higher number of planned and unplanned outages at generation plants in the summer (compared to 2007) contributed to higher electricity prices in GB during 2008. However, as the full impact of the recession took hold towards the end of 2008, global commodity prices fell, reducing GB electricity prices. In addition, the recession reduced demand from I&C customers adding further downward pressure on electricity prices. The Winter 08/09 saw weekly peak demands over the winter period of around 2 GW lower on a weather corrected basis than we would have seen in the absence of the recession. The winter peak demand was met successfully by the market through its normal function together with residual System Operator actions⁴.

9. The information requirements with regards to the operation of the gas and electricity markets were enhanced during 2008. These requirements include requiring the Transmission Company to provide information on electricity demand forecast and demand out-turn data to be published on Balancing Mechanism Reporting Site website. Further changes include a requirement on National Grid Gas (NGG) to publish on its website the daily volume (in TWh) of all total matched trades in respect of that Day (before the Day & within Day).

10. In April 2008 Ofgem launched an investigation into Scottish Power Limited and Scottish and Southern Energy plc, under section 18 of the Competition Act 1998 (the Chapter II prohibition) and Article 82 of the EC Treaty. In January 2009 we announced the decision to close the Competition Act investigation, noting that the likelihood of making an infringement finding under CA98 was low, and that other actions were available which could be more effective in addressing the issues raised on a forward-looking basis.

² National Grid 2009/10 Winter Outlook Report.

³ NGET May 2009 Seven Year Statement

⁴ National Grid 2009/10 Winter Outlook Report

11. Ofgem has recently published a discussion document on the issue of wholesale market liquidity in GB⁵. This document investigates the level of liquidity in the GB wholesale energy markets and examines concerns raised by the market participants as to why liquidity, particularly in the GB electricity market, is low. It outlines a range of possible measures to improve GB electricity market liquidity. The report found that whilst liquidity in the GB gas market compared well to other wholesale gas markets, liquidity in the GB electricity market was significantly lower than other markets (despite some improvement in recent years). We intend to publish a consultation document later in the year outlining in more detail measures to improve the level of liquidity in the GB wholesale electricity market.

Network developments

12. Some of the key areas of development related to the regulation of the GB electricity and gas networks over 2008 are covered below. Over 2008, Ofgem has been working on projects that can be seen as the bread-and-butter duties of a regulator, such as the fifth Distribution Price Control Review. We have also undertaken a number of more forward-looking projects, such as the Transmission Access Review that deals with future transmission network access arrangements and the RPI-X@20 review that deals with the future model for network regulation.

RPI-X@20

13. In March 2008, Ofgem opened a review of the 20-year-old regime governing its regulation of gas and electricity networks. The two-year review will seek to establish whether the existing approach - based on pegging increases below the retail price index (RPI) - is still the best way to ensure that networks are well-run and provide good value to customers. The need for the review arises out of the new challenges faced by the energy network companies in financing and running their networks. The challenges for the future include ambitious new renewable targets for 2020, proposals for greater power network interconnection in Europe, a greater emphasis on small-scale distributed generation and a growth in gas imports.

14. We are running the review in two parts. In the first 'visionary' phase we aim to understand all the issues affecting energy networks and network regulation, and to identify areas where change may be needed. The second phase will involve narrowing the scope of the project and a detailed analysis of identified key issues and potential options for change. Conclusions and recommendations will be made to the Gas and Electricity Markets Authority (GEMA) in summer 2010, with recommendations potentially being implemented in the next transmission price review (TPCR5).

Long term Energy Network Scenarios (LENS)

15. The main objective of the LENS project is to facilitate the development of a range of plausible electricity network scenarios for Great Britain for 2050, around which industry participants, government, Ofgem and other stakeholders can discuss longer term network issues. The final report contained five electricity network scenarios for Great Britain in 2050. The report also drew comparisons between the scenarios, and set out our academic partner's views on the scenarios' implications. Since the final scenarios report was published on 7 November 2008, the findings from the LENS project have been further reviewed and considered within the context of a number of other Ofgem projects and

⁵<http://www.ofgem.gov.uk/Markets/WhIMkts/CompanEff/Documents1/Liquidity%20in%20the%20GB%20wholesale%20energy%20markets.pdf>

areas of work, including the fifth Distribution Price Control Review, the RPI-X@20 project and our work on future consumers.

Transmission Access Review

16. Anticipated growth in renewable energy will place new demands on the electricity transmission grids. In Scotland alone there is 12GW of mostly wind plant awaiting connection to the networks. In conjunction with government and industry, 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.

17. The June 2008 TAR Final Report⁶ recommended that access rights should to be more clearly defined and generators needed to be offered choice about how to access the system. In order to make more efficient use of existing and new capacity, it was concluded that better arrangements to share and trade access rights were required. Over the last 12 months, the industry has developed alternative models that would deliver the enduring reform of grid access arrangements. Ofgem has recently published a progress report setting out its concerns that despite these efforts industry has not developed a holistic access model that meets the agreed principles of access reform. As a result, Ofgem has written to the Secretary of State recommending that he uses his powers under the Energy Act 2008 to implement new transmission access arrangements. Ofgem is of the opinion that this approach will significantly increase the possibility of an enduring access solution that is fair to existing generation and new generation without exposing customers to excessive and unnecessary cost.

18. It is expected that the changes proposed by the Secretary of State for enduring access reform, consistent with the principles of access reform agreed in 2008, will be facilitated by industry and in place by 1 April 2011.

Offshore Transmission regime

19. Ofgem has continued to work towards facilitating the connection of increased amounts of renewable generation to the transmission networks, in particular the development of an offshore transmission licensing and charging regime. This will facilitate the development of a sustainable and competitive offshore wind industry. These offshore transmission networks are pivotal to the UK's objectives for renewable energy and will add to the security of UK energy supplies. The final consultation on proposals for a regulatory framework for offshore electricity transmission networks before implementation begins was published in March 2009. In May 2009, the Secretary of State commenced primary statutory provisions⁷ that enabled the Authority with the approval of the Secretary of State, to make regulations to enable the first round of tenders to begin after 'Go-Active' (24 June). The regulations were made on 1 June and took effect on 2 June. The new regime is expected to 'Go Live' in June 2010.

Electricity Distribution Price Control Review

⁶ Available from the Ofgem website, reference number 89/08:
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=84&refer=Networks/Trans/ElecTransPolicy/tar>

⁷ Section 92 of the Energy Act 2004 and section 44 of the Energy Act 2008

20. Ofgem launched its fifth electricity distribution price control review with an initial consultation in March 2008. The price control will set the revenues that distribution network operators are allowed to recover from users between 2010 and 2015. The consultation document focussed on three key themes: giving DNOs strong incentives to help tackle climate change; encouraging DNOs to be more responsive to the needs of customers; and delivering good value for consumers by ensuring that DNOs provide secure and more sustainable networks. This review is taking place against a background of an economic downturn and great financial uncertainty. We are aware that the initial and final proposals in 2009 will need to take account of these issues and any further developments. In December 2008 we published the price control review policy paper, setting out Ofgem's views on the overall approach to the control, proposed methodologies, the structure of incentives and appropriate new regulatory arrangements.

Consumer-related issues

21. During 2008, Parliament enacted changes to Ofgem's statutory duties to make it clearer that we must protect the interests of future as well as existing customers and to increase our focus on sustainable development. 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 help the government in meeting its targets to eliminate fuel poverty. Government consulted on revised guidance in 2008 and this should be published shortly.

Social programmes

In the 2008 Budget, the Chancellor announced an increase in suppliers' collective expenditure on their social programmes of £225 million over the period 2008 to 2011. Government requested that Ofgem lead a process to set the parameters for what can be included as part of this spend and the associated reporting arrangements. Ofgem published a final decision and guidance document in July 2008 which included the full range of initiatives of suppliers' social programmes such as discounted tariffs, rebates, trust funds and partnership schemes, as well as energy efficiency and joint industry initiatives.

Fuel poverty and vulnerable customers

22. Ofgem also convened an Energy Summit on Fuel Poverty in April 2008 that brought together Ministers, Government officials, energy suppliers and consumer organisations. Its objective was to agree a programme of practical action to improve the targeting of existing help to those in fuel poverty and help more vulnerable customers participate more effectively in the energy market. As a result of the Summit, Ofgem published a Fuel Poverty Action Programme to improve the identification and targeting of existing help to fuel poor customers.

23. In addition, Ofgem published a report in December 2008 on the range of measures suppliers undertook to assist their vulnerable and fuel poor customers throughout 2007-2008. This included a new definition of a "social tariff" which must be at least as good as the lowest tariff offered by that supplier to a customer in that region on an enduring basis. This is regardless of that customer's payment method and includes online tariffs.

Security of supply

24. The impact of the Ukraine and Russia dispute on EU gas supplies has highlighted the importance of security of supply as an issue for European energy regulators. Ofgem has been working on many different projects in the area, both related to internal arrangements and our level of interconnection with other member states.

Project Discovery and Energy Markets Outlook

25. The Discovery project (launched in March 2009) will assess whether or not future security of supply can be delivered by the existing market arrangements over the coming decade. Britain's energy market has delivered secure supplies for some 20 years. But there have been changes in the energy sector in recent years, some of them quite profound, with still more testing challenges to come, including:

- GB has demanding new carbon targets;
- Britain's exposure to global gas markets is increasing;
- GB is experiencing a worldwide financial crisis which threatens investment and highlights the risk that existing market arrangements may not be sufficient to protect consumers' interests;
- the amount of investment needed to hit environmental targets leaves no room for delay in medium term expenditure;
- at the same time, the economic slowdown has hit gas demand and prices, and has shrunk the price of permits in the EU Emissions Trading Scheme; and
- on the supply side, there are concerns regarding whether investment in additional capacity and infrastructure in Russia and elsewhere will be sufficient and timely enough to meet the increasing demand for imports to the EU.

26. In the autumn Ofgem will publish and invite views from all our stakeholders on a number of security of supply scenarios and the possible implications of these. At the turn of the year Ofgem will produce a further report. This will set out possible policy options for debate and development, providing plenty of time to implement solutions should they be needed.

27. The second Energy Markets Outlook report was published by Ofgem and the Department for Energy and Climate Change (DECC) in December 2008. The report provides a discussion of the risks and drivers associated with future energy security of supply.

Infrastructure developments

Electricity

28. For electricity, it is planned that a 1000 MW GB to Netherlands interconnector will become operational in 2010. A 500 MW line is also expected to become operational between GB and the Republic of Ireland during 2012, built by the Irish TSO, Eirgrid. Over the course of 2008, Ofgem also accepted an application from Imera for an exemption from licence conditions covering a proposed 700MW GB-Ireland interconnection project.

29. In addition, Regional TSOs also performed a consultation on interest in further interconnection between GB and the continent during the second half of the year. This consultation found that there was interest in additional interconnection and TSOs now plan to take this forward.

Gas

30. The Isle of Grain Liquefied Natural Gas (LNG) terminal expanded at the end of 2008 increasing its capacity to 13.5 bcm per year. In early 2009 the South Hook terminal was completed and has a capacity of 10.5 bcm per year. Three further LNG importation projects are currently under construction; the Dragon terminal in Milford Haven, and expansions of the South Hook and Isle of Grain terminals. When completed, these projects will add a further 23.5 bcm per year of capacity to the GB market, taking the total to 51.5 bcm per year.

31. As gas production from the North Sea declines there will be greater incentives to build new storage facilities. A new facility at Aldbrough in Yorkshire is in the final stages of commissioning. Planning consent has been given to expand or enhance two facilities and six new facilities have planning permission. Furthermore, a number of proposals have been made for building new storage facilities both onshore and offshore.

32. Obtaining consents has been an obstacle to development given the timescales involved. However, it is expected that the Planning Act 2008 will help resolve this issue through the establishment of the Infrastructure Planning Commission to determine nationally significant projects.

Sanctions

33. In April 2008, Ofgem launched an investigation into Scottish Power Limited and Scottish and Southern Energy plc, under section 18 of the Competition Act 1998 (the Chapter II prohibition) and Article 82 of the EC Treaty. This investigation was based on a formal complaint alleging abuse of a dominant position in the electricity generation sector arising from constrained capacity on the transmission network, as well as informal enquiries.

34. In January 2009, we announced the decision to close the Competition Act investigation, noting that the likelihood of making an infringement finding under CA98 was low, and that other actions were available which could be more effective in addressing the issues raised on a forward-looking basis.

35. There were sanctions imposed by Ofgem on licensed companies during 2007/2008, the major one being a £41.6 million (€60.8million)⁸ fine imposed on National Grid for a breach of competition law that restricted the development of competition in the market for installed domestic-sized gas meters.

36. This decision was later upheld by the Competition Appeal Tribunal. In its decision the CAT has ruled that National Grid should instead face a £30 million fine –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.

Governance Review

37. Ofgem has initiated a major overhaul of the rules governing participation in the gas and electricity markets. The review comprises six work-strands which (among other things) aim to facilitate the delivery of major policy changes, reduce Ofgem's role in

⁸ Using the Bank of England's 2007 average annual exchange rate of £1 to €1.4619

routine amendments and minimise complexities that may create obstacles for small participants and new entrants.

Other policy actions

38. In addition, Ofgem carried out a significant amount of policy groundwork in 2008. Some of the areas where we have carried out such work include:

- In Europe, we continue to play a proactive role alongside our European colleagues in CEER and ERGEG, including through Lord Mogg's chairmanship.
- We continue to manage the government's energy demand reduction project. This is co-funded by government and industry participants and involves several energy saving trials with about 50,000 households participating. The trials will compare the efficiency of smart meters, clip on real time display units and other ways of information provision to save energy use. The trials will end in 2010.
- We have introduced new complaint handling standards for suppliers and network companies and have approved a statutory redress scheme which the companies must be members of under new Government legislation. These new arrangements came into force from 1 October 2008.

39. Further information on recent activities in GB energy markets, and on the activities of Ofgem can be found in the Ofgem Annual Report 2007-08, which is available at:

http://www.ofgem.gov.uk/About_us/annlrprt/Pages/AnnualReport.aspx

3. Regulation and Performance of the Electricity Market

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

General

40. The electricity market in Great Britain is fully liberalised.

Management of congestion on interconnectors

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

42. Some congestion does exist on the IFA electricity interconnector and this congestion is physical rather than financial in nature. This physical congestion has provided a signal to potential interconnector investors, with some interest in building future lines from GB to both France and Ireland over 2008.

43. Development continued in 2008 on the new Capacity Management System for IFA which will see Congestion Management arrangements on the GB-France interconnector be brought into line the Electricity Regulation (1228/2003) and its appended Congestion Management Guidelines. The main improvements of the IFA access rules, that underpin the new system, are the implementation of hourly products during daily allocation; the implementation of a firm nomination stage, enabling the use of netting; introduction of a mechanism for automatic resale of long-term capacities at the daily auction; and the introducing of two sets of intraday explicit auctions for hourly products throughout the day.

44. Ofgem expects that a 1000 MW line running between GB and the Netherlands will become operational in 2010. A 500 MW line is also expected to become operational between GB and the Republic of Ireland during 2012. Over the course of 2008, Ofgem also accepted an application from Imera for an exemption from licence conditions covering third party access, the need to gain regulatory approval for charging methodologies and to the use of interconnector revenues regarding a proposed 700MW GB-Ireland interconnection project. The first 350MW line in this project is due to go-live in 2010.

45. In addition, Regional TSOs also performed a consultation on interest in further interconnection between GB and the continent during the second half of the year. This consultation found that there was interest in additional interconnection and TSOs now plan to take this forward.

46. The GB market is linked with the Single Electricity Market (SEM) that operates in Northern Ireland and the Republic of Ireland, through the 500MW Moyle DC line. Moyle is a member of the FUI region of the Electricity Regional Initiative despite being an internal UK line (and hence not an interconnector under EU law). To recognise this, the last Stakeholder Group meeting of the FUI region was held in the Moyle offices in December 2008, where issues relevant to both the GB and SEM markets were discussed.

Management of congestion on national networks

47. The Energy White Paper⁹ published in May 2007 announced a joint review by Ofgem and Department of Business, Enterprise and Regulatory Reform of the transmission access regime for electricity transmission networks in Great Britain (GB) – the Transmission Access Review (TAR).

48. The TAR process highlighted that the “first come first served” allocation method is perceived as inefficient because it does not necessarily allocate capacity to those that value it most. It also indicated that the present “invest and connect” principle has meant that many projects require significant reinforcements to the network before they can connect, resulting in the ‘GB connection queue’, and indicated that the existing arrangements act as a significant barrier preventing new renewable and low carbon generation accessing the generation market.

49. In response, the June 2008 joint TAR Final Report¹⁰ recommended that short and long access rights should be more clearly defined and generators needed to be offered choice about how to access the system. In order to make more efficient use of existing and new capacity, it was concluded that better arrangements to share and trade access rights were required.

50. The TAR report identified key strands of work required: to develop enduring access arrangements, to facilitate timely and efficient transmission investment for a system fit for the achievement of the 2020 goals, and to develop short term measures to facilitate earlier connection in the interim period.

51. Over the last 12 months, the industry has developed alternative models that would deliver the enduring reform of grid access arrangements. Following concerns about the ability of the industry codes process to deliver the necessary reforms, Ofgem has recently recommended that the Government exercises its powers to bring about reform of the transmission access arrangements. We await a response from Government on our recommendation. This is because we think that this approach will significantly increase the possibility of an enduring access solution that is fair to existing generation and new generation without exposing customers to excessive and unnecessary cost.

The regulation of the tasks of transmission and distribution companies

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

Transmission

Network Tariffs - structure of charges

53. TNUoS charges have four component parts (reflecting the decision by the Authority on 15 December 2008¹¹):

- **‘Local’ circuit charge.** This is allocationally 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

⁹ Available from DECC’s website: <http://www.berr.gov.uk/energy/whitepaper/page39534.html>

¹⁰ Available from the Ofgem website, reference number 89/08:
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=84&refer=Networks/Trans/ElecTransPolicy/tar>

¹¹ <http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/Charging/Documents1/151208%20ECM-11%20decision%20letter.pdf>

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. There are 21 charging zones for generation and 14 for demand. For 2008/09 the demand charge varies between €3.84/kW and €29.12/kW whereas the 'wider' locational generation charge varies between €-7.59/kW and €24.53/kW. Five generation zones have a negative TNUoS charge. This means that generators in these zones are paid by the SO for using the transmission system. Connection charges enable National Grid to recover, with a reasonable rate of return, the costs involved in providing the assets that afford connection to the GB transmission system.

Balancing of the transmission system

55. There were no major changes to this area over 2008 - please see last year's GB National Report for background.

Independence from network companies

56. There were no major changes to this area over 2008 - please see last year's GB National Report for background.

Distribution

Structure of charges

57. Please see last year's GB National Report for background on this area.

58. Ofgem launched the structure of charges project in 2000, with the aim of reviewing the basis upon which DNOs calculate their 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.

59. 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

separate connection and use of system charging methodologies to be approved by Ofgem. Each methodology must meet four relevant objectives:

- 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.

60. There is a formal process for DNOs to modify their approved charging methodologies where the modifications can be demonstrated to better achieve the relevant objectives. DNOs 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'.

61. 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 and connection charging statement will 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.

62. Following consultation, in July 2008 the Authority issued a decision that a licence obligation to deliver a common use of system charging methodology should be placed on the DNOs. Unfortunately the statutory consultation to modify the licence failed to obtain the required support from the DNOs. In March 2009 Ofgem issued a further decision to introduce a licence condition to oblige DNOs to bring forward a common use of system charging methodology for the high and low voltage (HV/LV) parts of the networks. The DNOs accepted the statutory licence modification and are working towards bringing forward a common HV/LV methodology to the Authority for approval by 1 September 2009. Ofgem is now also working with the DNOs to introduce common use of system methodologies for the extra high voltage parts of the networks by 1 April 2009

Assistance for high cost distribution areas

63. The Energy Act 2004 established statutory provisions that enable the Secretary of State to make orders that charges levied by the SO shall be set to recover an amount of money from all suppliers that will be passed on to consumers connected to a distribution system on which the costs of distributing electricity are relatively high. These arrangements were focused largely at those customers connected to rural networks to ensure that they are not unduly disadvantaged by high electricity costs. These arrangements are established by the Secretary of State independently of Ofgem. The charges levied in 2007/08 are set out below.

Table 1: Average distribution network charge payable by different customer groups in Great Britain in 2007/08¹²:

Customer type	Distribution charges (c/kWh)
Domestic customer ¹	1.87 – 3.73
Small industrial customer ²	1.18 – 2.58 (E&W) 2.94 – 4.84 (Scot)
Large industrial customer ³	0.14 – 0.91

Outputs reporting framework

64. No major changes in this area – please see last year’s GB National Report.

Quality of service incentives

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

66. Since the introduction of the interruptions incentive scheme in April 2002 the underlying number of customer interruptions per 100 customers has fallen by 15% (2002/3 to 2007/8) (excluding the impact of exceptional events). Figures for 2007/8 show a downturn in both customer interruptions and customer minutes lost compared to the previous year. On average a customer experienced 0.71 interruptions per year and is interrupted for approximately 68 minutes excluding exceptional events.

67. 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 2007/8 there was a moderate amount of exceptional event claims. Storms were less prevalent than in 2006/7 but there were a number of floods in June 2007 resulting in several large claims.

68. In 2008 Ofgem consulted on potential changes to the quality of service arrangements from 2010 until 2015. These include:

- Introducing incentives around a broader measure of customer satisfaction;
- Improved incentives on customer interruptions;
- Measures to ensure better service for customers seeking a new connection;
- Measures to ensure better service for worst served customers;
- Refinements to the guaranteed standards;
- Streamlining and amending the telephony scheme; and
- Refocusing the customer service reward scheme.

¹² Notes: Distribution network charges change once or twice a year: the table above represents 2007/8 charges at an exchange rate appropriate at that time. The differential in tariffs between customer types is expected to be broadly the same year on year within the same price control period.

1) Domestic customer – is a household customer with annual consumption of 3500 KWh/year

2) Small industrial customer – is a commercial customer with annual consumption of 50 MWh / year, subscribed maximum power 50 KW

3) Large industrial customer – is an industrial customer with annual consumption of 24 GWh/ year, subscribed maximum power 4000 KW, assumed to be connected at 11kV

4) Exchange rate of £1 = €1.42

Standards of Performance

69. The latest GSOPs for DNOs came into effect from 1 April 2005 as part of the current electricity distribution price control. These standards were detailed in the 2008 Ofgem National Report.

Quality of service reports

70. To date, Ofgem has published seven 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

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.

Competition Issues [Article 23(8) and 23(1)(h)]

Description of the wholesale market

72. Information on the structure of the wholesale electricity market was provided in Ofgem's 2008 submission of the National Report and we have no significant developments to report. In brief, the GB wholesale market is based on bilateral trading between generators, suppliers, traders and customers across a series of markets. Broadly speaking, the wholesale market can mainly be divided into over the counter trading and power exchange trading, followed by Balancing Mechanism (BM) activity and imbalance settlement.

Over the counter trading (OTC)

73. Over the counter trading (i.e. bilateral trading between two market participants or where an intermediary (the broker) brings together a buyer and seller) typically operates from a year or more ahead of real time up until 24 hours ahead of real-time. The vast majority of trading in the GB wholesale electricity market takes place in the OTC market. Exchange based trading is very limited although the volume of OTC trades cleared through exchanges has increased slightly over the past year.

74. Another mechanism for trading energy is through structured contracts where energy is purchased directly from generators or producers using contracts that are arranged bilaterally, often on a long-term basis (structured contracts are often considered as a subset of the OTC market). Structured contracts may not enhance liquidity as the energy is not sold via the wholesale markets (OTC platforms or exchanges), although volumes sold using structured contracts may be subsequently traded in the GB wholesale markets (contributing to liquidity).

75. On the basis of analysis undertaken by the Financial Services Authority (FSA) total OTC trading (excluding exchange based trading) in 2007/8 (Aug 07 to Jul 08) was around

1104TWh¹³ (or around 3.2 times generated output). This is around 12 per cent higher than total OTC traded volume for the previous year. Despite the recent financial turmoil the impact on traded volumes appears to be limited, with OTC monthly traded volumes increasing to March 2009.

Power exchanges

76. Trading on power exchanges is via a set of standardised contracts on a spot, prompt and forwards basis: this includes half-hour to four-hour contracts; base load and peak load contracts; weekly, monthly and seasonal contracts. The key exchange provider in the GB electricity market is the APX Group, which provides platforms offering a range of products including half-hourly, peak and base-load and day-ahead contracts. The other main energy exchange in GB is the Intercontinental Exchange (ICE) that offers electricity futures, although volumes traded in these products are relatively low when compared to OTC volumes.

77. Total traded volume on the APX Power UK Exchange in 2008 was 11.5TWh, an increase of 0.7TWh on the calendar year 2007. In addition, APX Power UK's OTC Clearing product commenced trading in February 2008, with a total of 0.2TWh being traded in the calendar year 2008. Traded volume on the Intercontinental Exchange (ICE) UK Power Futures exchange totalled 14.6TWh in 2008, an increase of 5.2TWh on the calendar year 2007.

Balancing mechanism (BM)

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

79. Total trading on the Balancing Mechanism in 2008 amounted to around 43TWh of offers to increase generation, and around 50TWh of bids to reduce generation. Around 0.23TWh of offers and 0.45TWh of bids were accepted in 2008.

Generation Capacity

80. The total installed capacity on the GB system at the beginning of 2008/09 was 79.9 GW and this rose to 83.6 GW by the start of 2009/10

Market integration

Market integration

81. GB typically imports from France, through the IFA interconnector, and exports to Northern Ireland via the Moyle interconnector¹⁴. Total imports through IFA were 11,671 GWh and exports through IFA were 481 GWh in 2008. Historically, across the winter there has been an export from GB to NI of around 60-400 MW. However, for the first

¹³ http://www.fsa.gov.uk/pubs/other/analysis_energy_2008.pdf

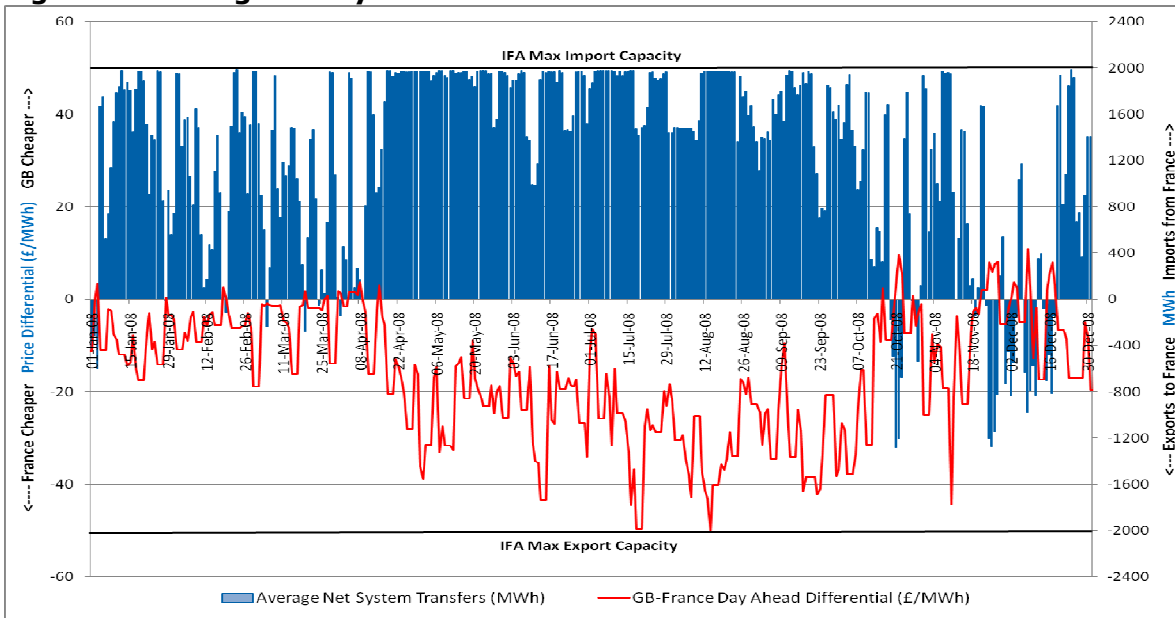
¹⁴ Moyle is a 500MW interconnector between Scotland and Northern Ireland. It is Capable of exporting 500MW to Northern Ireland and importing at 80MW. It is owned by Moyle Interconnector Ltd.

time, GB imported 16MW from Northern Ireland at last year’s system peak demand period instead of exporting as in previous years¹⁵. Prices for access to interconnectors reflect the market dynamics, with non-discriminatory auctions regularly held for daily, weekend, monthly, quarterly, seasonally and annual capacity.

82. 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 methods¹⁶. 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.

83. Figure 2 shows average net system transfers across the GB-France interconnector. A combination of high commodity prices and a higher number of planned and unplanned outages at generation plants (compared to 2007) contributed to higher than usual electricity prices in GB. The winter saw more generation plant return to the system and the graph shows that flows across the interconnector broadly followed the price differential between GB and Europe.

Figure 2: Average net system transfers for IFA in 2008¹⁷



84. Going forward, GB expects to continue to analyse and address further the possibilities for enhanced cross border trade and market integration. In the first instance this will be through ERGEG’s “Electricity Regional Initiative”. Under this, Ofgem is working with regulators in Republic of Ireland, Northern Ireland, and France to improve cross-border trade arrangements. The process is designed to involve TSOs, stakeholders, the European Commission, and national governments.

¹⁵ National Grid Winter Consultation Report 2009/10.
¹⁶ The Interconnector arrangements were outlined in Ofgem’s submission last year. These arrangements have remained unchanged and so for further information on these arrangements please see this report.
¹⁷ This based on information from National Grid and Bloomberg.

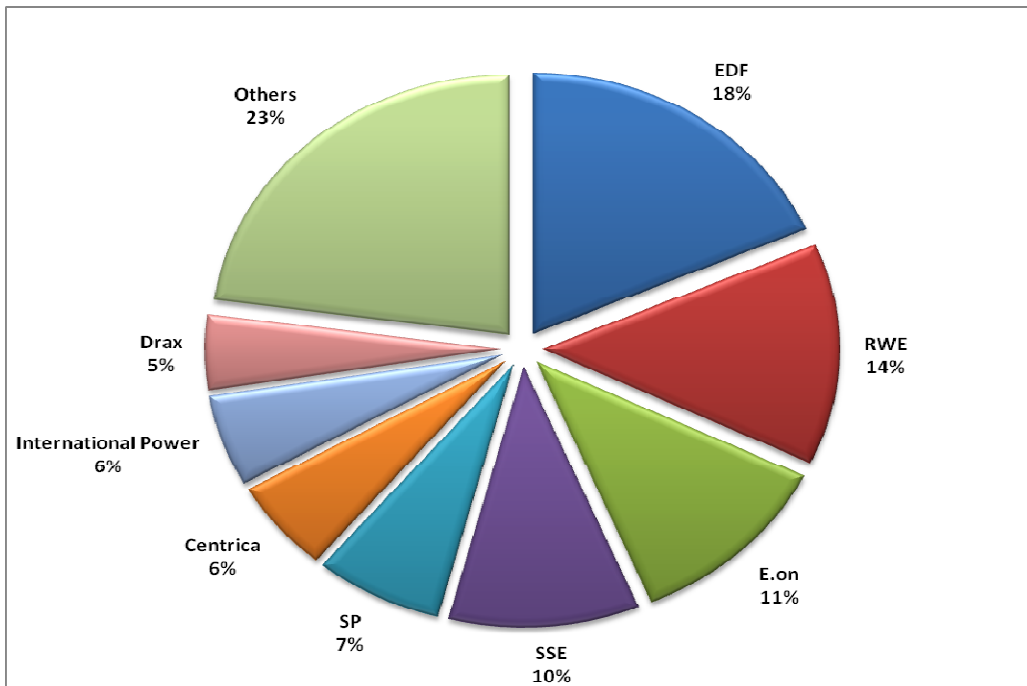
85. In this area, progress was made on the new TSO-TSO model of balancing exchange on IFA throughout 2008. The model has the aim of improving the efficiency of balancing trade on the interconnector. The new model achieves this in a number of ways, such as increasing the number of opportunities TSOs get to exchange prices for potential balancing trades throughout the day and also through a significant increase in functionality. The "interim" stage of implementation of this new model became operational in April 2009.

86. Significant progress was also made on the new Capacity Management System on IFA. This system aims to improve Congestion Management arrangements on the interconnector by bringing these arrangements in line with the European Congestion Management Guidelines and promoting harmonisation with other European borders. The access rules that underpin this new system were made available to regulators in the early part of 2009 and suggest important improvements such as intraday trading and capacity netting.

Market Concentration

87. As illustrated in figure 3 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.

Figure 3: 2009/10- Percentage of capacity (based on Transmission Entry Capacity (TEC) Values) by Generation Owner¹⁸



¹⁸ This is taken from NG Seven Year Statement, table 3.5. 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.

HHI by capacity

88. In November 2008, EDF notified the European Commission (EC) of their proposal to acquire British Energy. This represented an increase in concentration in the electricity generation and non-domestic electricity supply sectors. Ofgem provided views to the EC on the effects on competition of the proposed transaction. The EC cleared the merger with a number of remedies that the parties had proposed, including divestment of two power stations, an auction of a volume of output and disposal of two sites suitable for the development of new nuclear power stations.

89. Table 4 provides Herfindahl-Hirschman Index (HHI) analysis based on capacity owned by different companies in GB in 2008. 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 4: Herfindahl-Hirschman Index (HHI) based upon capacity (source: NG Seven Year Statement, table 3.5)

Company	Capacity (HHI)
EDF	339
RWE	190
E.on	132
SSE	108
SP	48
Centrica	33
International Power	33
Drax	22
Others	523

Measures to avoid abuses of dominance

90. Information provision is a key component of transparency and the effective and efficient operation of the GB electricity markets.

91. 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)¹⁹. The information requirements with regards to participating in the BM have been enhanced in this last reporting year. Overall, there have been three main changes in 2008:

- a. Demand forecast and outturn data provided by the Transmission Company is now required to be published on the BMRS website²⁰. This includes Interconnectors, Demand from station transformers and pumped storage as well as forecast and outturn data that excludes Interconnectors, Demand from station transformers and pumped storage.

¹⁹ Further information relating to the operation of the MRS and the information available on this website can be found in Ofgem's 2008 National Report submission and at the following link: www.elexon.co.uk

²⁰ This change was brought into place by modification 'P219 consistency between forecast and outturn demand'. Further information on this modification can be found at this link: www.elexon.co.uk

- b. The Transmission Company was also required to provide further information to the BMRA for publication on the BMRS website. This information included trend data for daily energy volumes transported across the transmission system; real time transmission system frequency data; daily energy volumes which would be based on initial national demand out-turn; non-Balancing Mechanism (BM) short term operating reserve (STOR) instructed volumes; information on instantaneous and half-hourly generation by fuel type (including 'real-time' total demand outturn data and half-hourly Interconnector flows); out-turn and reference temperatures; and wind generation forecast.²¹;
- c. An obligation was placed on those responsible for registering BM units associated with Large Combustion Plants (LCPs) (under the terms of the LCPD) to report different types of data for publication on the BMRS website²².

92. 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

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

94. For example in April 2008 Ofgem launched an investigation into Scottish Power Limited and Scottish and Southern Energy plc, under section 18 of the Competition Act 1998 (the Chapter II prohibition) and Article 82 of the EC Treaty. This decision was based on a formal complaint alleging abuse of a dominant position in the electricity generation sector arising from constrained capacity on the transmission network, as well as informal enquiries.

95. In January 2009, we announced the decision to close the Competition Act investigation, noting that the likelihood of making an infringement finding under CA98 was low, and that other actions were available which could be more effective in addressing the issues raised on a forward-looking basis.

96. In March 2009 we published a consultation on options for other powers to address concerns about market power in the electricity wholesale sector . The document sets out a number of options for tackling the issue of undue exploitation of market power in the GB wholesale electricity sector, categorised into three broad approaches: changes to existing market arrangements, changes to existing assets and specific mechanisms for addressing market power concerns. Ofgem is concerned that the sector is vulnerable to such exploitation, both when there is congestion on the electricity transmission system and more generally at times of system tightness. Any undue exploitation of market power will make wholesale electricity more expensive and have a detrimental effect on the competitiveness of the wholesale market. The resultant costs are likely to be borne by consumers in terms of increased retail bills. In light of these concerns, we believe there is a case for developing proposals to address market power issues.

²¹ This change was brought into place by modification 'P220 Provision of new data items for improving market information'. Further information on this modification can be found at this link: www.elexon.co.uk

²² This change was brought into place by a modification 'P226: Improving large combustion plant directive information disclosure'. Further information on this modification can be found at this link: www.elexon.co.uk .

97. We are currently considering responses to the consultation and are likely to publish a follow-up document later in the summer.

Balancing

98. In October 2008, Ofgem approved a modification proposal which aims to ensure the main Energy Imbalance Price that Parties are liable to pay when their physical and contractual positions are out of balance reflects the costs of energy balancing actions taken by NGET to balance the system in its role as System Operator ("SO"), instead of system balancing actions²³. The proposal will be implemented by 5 November 2009.

Market surveillance

99. Please refer to Ofgem's 2008 National Report submission for information relating to our wholesale market surveillance activities that have remained broadly unchanged.

100. As outlined in last year's report responsibility for the operation of the financial markets, including power exchanges, such as IPE sits with the Financial Services Authority (FSA)²⁴. The FSA has the power to fine persons who have abused the market, where 'market abuse' is defined under the Financial Services Market Act 2000.

Experience with virtual power plant auctions or other capacity release measures

101. There have been no virtual power plant auctions or other capacity release measures in 2008.

Description of the retail market

102. The GB retail electricity supply market has been open to competition since the late 1990's. All price controls were removed by April 2002. Today, the market is characterised by the existence of six large suppliers ('Big 6') that evolved from the fifteen former incumbent electricity and gas suppliers over the 1998-2003 period. They are: E.ON UK (formerly Powergen), RWE npower (owned by RWE AG), EDF Energy (owned by Electricité de France), Scottish and Southern Energy (SSE), Scottish Power (owned by Iberdrola) and British Gas (owned by Centrica). At the end of 2008, there were also five active domestic and eleven non-domestic electricity suppliers who are not former incumbents.

Price developments

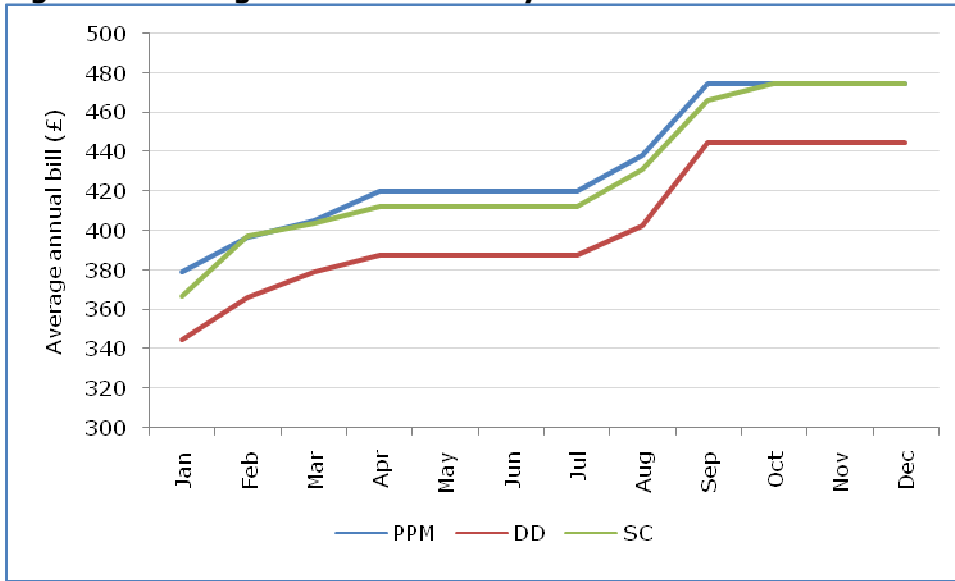
103. Ofgem monitors domestic suppliers' prices across GB. All final prices in the GB wide retail energy markets are determined by market forces as all price controls on final prices were lifted by April 2002. However, there are elements of the final price which are attributable to the regulated aspects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

²³ 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.

²⁴ www.fsa.gov.uk

104. There have been increases in the retail electricity prices for domestic customers by all major suppliers in 2008. Figure 6 shows the impact of 2008 price changes across the three main payment methods: direct debit, standard credit and prepayment. During the first few months of 2008, all Big 6 suppliers raised prices. Over the Aug - Sep 2008 period another round of price rises were implemented by the Big 6. The overall electricity price increases in 2008 were 25% for prepayment and 30% for direct debit and standard credit customers.

Figure 6: Average annual electricity bills Jan – Dec 2008²⁵



Source: Ofgem

105. Wholesale energy costs were cited by suppliers as being one of the primary reasons for these increases. They account for over 60% of a domestic customer's electricity bill and are a major consideration in supplier's retail pricing decision. Wholesale energy costs depend on range of factors. A key factor is price of oil which rose to a peak of \$147 a barrel in 2008. Oil prices feed through to gas prices with a lag of around six to nine months. Oil prices have a major impact on GB's wholesale gas prices which in turn have an impact on wholesale electricity prices as gas is used to generate around 40 per cent of GB's electricity.

106. As a part of the probe into the energy supply market we examined the relationship between wholesale and retail prices. We 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. We now publish a quarterly report into the relationship between wholesale and retail prices.

107. In addition to the wholesale energy costs, environmental programmes and network investment 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, connect more renewable electricity and import more gas also adds costs to customer bills.

²⁵ Bills are based on an average annual consumption of 3,300 kWh.

108. The breakdown of the average domestic electricity bill consists of the following components: distribution and metering costs (where metering is a very small proportion), transmission costs, environmental costs (which include the Carbon Emissions Reducing Target²⁶ and the Renewables Obligation²⁷), and Value Added Tax (VAT). Generation costs, retail costs (including, for example, marketing, billing and call centres) and margin make up the remainder of the bill. Table 7 provides the estimated breakdown of the domestic bill into these components.

Table 7: Estimated breakdown of domestic electricity bill as of December 2008 (with estimated annual average consumption of 3300kWh)

Components of electricity bill	Proportion of bill
Energy, supply costs and margin	71%
Distribution and metering costs	15%
Transmission costs	3%
Environment	6%
VAT	5%

Source: Ofgem

109. Ofgem does not at present actively collect data on prices in the non-domestic sector; therefore we are unable to provide up-to-date data on prices. BERR publish a digest of non-domestic prices on their website. The most recent publication is for March 2009 which is available at:

<http://www.BERR.gov.uk/energy/statistics/publications/prices/index.html>

Market shares and concentration

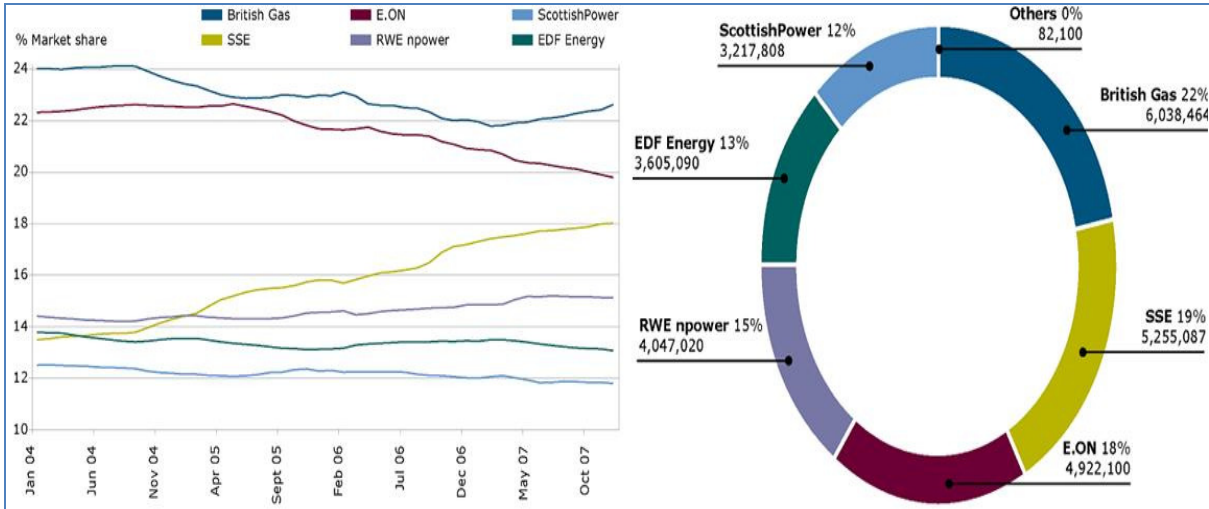
110. In June 2008, there were approximately 27.2 million customers in the domestic electricity sector of which the six large supply companies accounted for over 99% of the market. Figure 8 shows the national market shares of the six large supplier groups in the domestic electricity market.

Figure 8: National GB domestic electricity market shares (January 2004 to December 2007) & snapshot (June 2008)

²⁶ The Carbon Emissions Reducing Target (CERT) is a Government policy that sets energy suppliers targets for reducing carbon emissions by providing energy efficient measures to domestic customers. Suppliers pass on the costs to domestic customers.

²⁷ The Renewables Obligation is the government's main mechanism for supporting renewable energy. It aims to provide a substantial market incentive for all eligible forms of renewable energy.

Ofgem & NIAUR 2009 Submission to the European Commission
(under 2003/54/EC and 2003/55/EC)



Source: Ofgem

111. In the domestic electricity market, these six main supplier groups all have a market share of above 5%. The three suppliers with the highest domestic national market shares are British Gas, Scottish and Southern Energy and E.ON UK, who together have 60% of the market.

112. 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 22%. It has gained its customers mostly through organic growth. Entry by independent suppliers has been on a less significant scale. Five smaller suppliers in the market (Ecotricity, First Utility, Good Energy, Utilita and Spark Energy) account for less than 1% of the national market.

113. National market shares do not reveal certain 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 of around 48%. The market shares of these suppliers in their former monopoly markets continue to fall year-on-year (at a rate of around 2% per year) as they 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.

114. Within the non-domestic customer group, there are both small and medium enterprises (SME) and industrial and commercial (I&C) customers. The information Ofgem collects on market shares in the non-domestic markets (Non HH and HH) is acquired from a third party, who collects the data from suppliers. This data is presented in Table 9 below. In addition to this data, Table 9 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 2007.

Table 9: GB non-domestic electricity retail market shares by volume of supplied electricity for Non-HH, HH and by number of small business customers

	Non HH²⁸ (sub 100kW, Nov 2008)	HH²⁹ (100 kW-1MW, Nov 2008)	Small businesses customers (Dec 2007)
British Gas	31%	6%	26%
RWE npower	11%	18%	13%
E.ON Energy	15%	11%	18%
SSE	18%	16%	11%
EDF Energy	16%	18%	11%
ScottishPower	6%	5%	12%
British Energy	-	15%	1%
GDF Suez	-	6%	-
Bizz Energy	-	-	2%
Electricity4 Business	-	-	2%
Opus Energy	2%	-	1%
Total Gas and Power	-	2%	-
Other suppliers	0%	3%	1%

Source: Datamonitor

115. In each of the sectors of the non-domestic market there are at least six suppliers with a market share above 5%, as shown in Table 2.1. The three suppliers with the highest market shares in the non-half hourly sector are British Gas, EDF Energy and E.ON UK who together have a 55% share of the sector. In the half hourly sector EDF Energy, British Energy and RWE npower are the three suppliers with the highest market shares, which together have a 54% share of the sector. In the small business sector British Gas is market leader with 26% share. British Gas, RWE npower and E.ON UK together as three largest small business suppliers have 57% market share in this sector.

116. However, the Table 2.1 demonstrates that a number of new entrant suppliers have made some inroads into the non-domestic market. Some of these suppliers focus on a specific market niche, such as renewable energy, while others choose to compete more broadly. Note, however, that in October 2008 Bizz Energy was acquired by British Gas. In the same month Electricity 4 Business went into administration and British Gas was appointed as a supplier of last resort for its customers.

Market concentration

117. In June 2008, the HHI for the national domestic electricity market was 1,735. As a result of the existence of electricity incumbent suppliers, regional markets are significantly more 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 June 2008 was 3,356.

²⁸ Non HH represents customers that are not metered on a half hourly basis. This group can be categorised as all those with a consumption below 100kW.

²⁹ HH represents customers that are metered on a half hourly basis. This group can be categorised as all those with consumption above 100kW.

118. The HHI index for small business customers in December 2007 was 1,575. 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

119. The 6 large supplier groups 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. Between them, the six supplier groups account for 54% of generation capacity (this figure does not include contractual arrangements between generators and suppliers).

120. The independent domestic suppliers are not generally vertically integrated. In addition to the six large supplier groups, other non-domestic suppliers are also vertically-integrated (such as British Energy). About 70% of generation output is accounted for by vertically-integrated suppliers in the non-domestic markets.

Switching

121. Between Jan and Dec 2008, 5,419,334 domestic electricity customers changed their supplier (on average, 451,611 each month). This is equivalent to a switching rate of 20%.

122. There has been a steady increase in the level of switching among domestic electricity customers, with the level in 2008 exceeding that seen in 2007. Table 10 below shows the number of annual switchers of domestic electricity customers and annual switching rate.

Table 10: Domestic customers’ annual switching in electricity

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

Source: Ofgem

123. Ofgem primarily collects data on the number of customers switching between suppliers in the domestic electricity retail market. It therefore does not have switching data for the non-domestic markets.

124. However, research conducted by Accent in 2007 suggests that switching rates among small business consumers (defined as having fewer than 10 full time equivalent employees) are less than those in domestic sector. The research found that 13% of small business customers switched their electricity supplier in the previous twelve months. The research also suggests that just over half of SME customers had switched electricity supplier.

Switching procedure

125. For the switching procedures for domestic electricity customers, please refer to the last year's report. The procedure remains unchanged from last year.

126. There is good evidence from qualitative work we commissioned that the switching process is now working well³⁰. Just over three-quarters of those customers who had switched said the switching process had gone smoothly for them and this is borne out by falling complaint levels related to them switching process. In addition, an external survey conducted in July 2008 showed that, with the exception of the car insurance market, more gas and electricity customers have switched their supplier than in any other major customer services sector in GB over the past five years - many of which have had a far longer history of customer choice.

127. Difficulties with the switching process were much more prevalent in the early days of the competitive retail market, and the majority of switches now go through smoothly. The fear that something might go wrong is still strong, however. Almost half of consumers worry that service may be worse as a result of the switch. Memories of issues such as double billing remain large in the public memory, and bad switching experiences attract adverse publicity.

Factors which influence switching

128. A survey done by FDS International confirmed that a number of conditions need to be met for customers to engage successfully in the energy markets. Customers must:

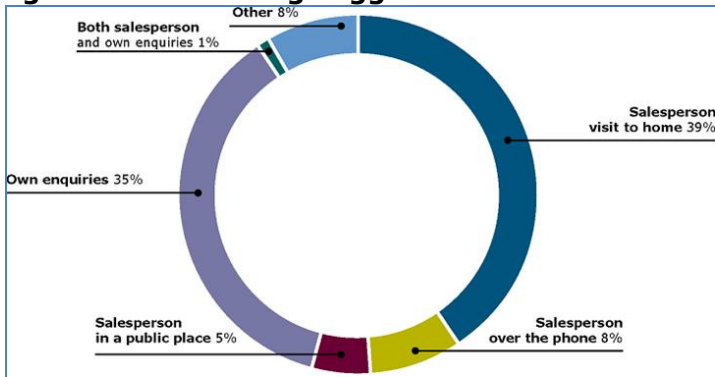
- be aware that they can switch energy supplier;
- know how to switch, or be willing to have the process explained to them;
- be convinced that there are benefits to switching; and
- be confident that the switching process itself is not difficult or risky, and that they are unlikely to encounter problems (particularly billing errors, subsequent price increases or poor service) after the switch has been completed.

129. Over half of customers who switched in the past year did so in reaction to a direct approach by a sales person from one of the supply companies. Vulnerable and PPM customers are more likely to switch via this route³¹.

³⁰ Over the Jan-May 2008 period, Ofgem commissioned qualitative research, using focus groups and individual interviews with a range of domestic vulnerable and non-vulnerable consumers, to understand consumers' attitudes and experiences of GB domestic energy supply markets. This was undertaken by FDS International.

³¹ Ofgem also commissioned quantitative research among domestic consumers to investigate their awareness, experience and satisfaction with switching suppliers. This was undertaken by Ipsos MORI ("Ofgem Customer Engagement Survey July 2008").

Figure 11: Switching triggers



Source: Ipsos-MORI Ofgem Customer Engagement Survey July 2008, in response to Question: "On the last occasion you switched, would you say you switched as a direct result of a visit or telephone call from a supplier's salesperson or was it from making your own enquiries?"

130. The predominant reason given for switching in response to a direct sales approach was that the customer was told that the supplier that approached them was cheaper than their current supplier (82%). 18% reported that the salesperson had told them they were the cheapest on the market. Saving money is also the main trigger for those who switch as a result of their own enquiries, although some do switch as a result of having received poor service from their current supplier.

131. Just under a third of customers in the survey said that they check regularly to see if it is worth switching.

Difficulties in switching

132. The main barrier to switching is that customers appear unsure or sceptical about the savings to expect. A majority believe the savings are not worth the hassle of switching or that the savings will only last a short time. Many customers tend to think in terms of weekly or monthly savings and even a quite substantial yearly saving may not seem sufficient when considered on this basis. However, when shown price comparisons during our qualitative work many were surprised at the amount they could save. A large number of customers (70%) also find the number of tariffs on offer confusing and just over half find it too hard to work out whether they would save anything if they did switch. In addition, many people feel they are simply too busy, with just over a third feeling that they have no time to think about switching.

133. Finally, almost half of customers – and 58% of non-switchers - say that they worry that if they switch things will go wrong or service may be worse as a result of the switch. Low-income groups tend to be particularly worried as they are less easily able to recover from unexpected debts or expenses.

Assessment of competition

General assessment

134. In February 2008, Ofgem launched an investigation into the markets in electricity and gas supply for households and small businesses. We published our initial findings in

October 2008³² and reported that the market is working well in important respects. The fundamental structures of a competitive market are in place, and the transition to effective competitive markets is well advanced and continuing. We haven't found evidence of cartel-like behaviour or evidence that retail prices are rising by more than can be justified by wholesale costs.

135. Our investigation did, however, identify a number of important areas where consumers are not yet benefiting fully from the competitive market and vulnerable consumer groups are disproportionately affected. We are currently finalising a number of remedies for these issues.

Development of choice competition has brought for customers

136. Competition in the retail energy markets has brought considerable benefits to industrial, commercial and domestic customers since it was introduced. Allowing customers to choose their supplier keeps pressure on costs and promotes greater choice of tariffs and services for customers, such as the fixed price and capped price offers now available to domestic customers.

137. Before market opening, customers were supplied by regulated monopoly suppliers and had limited choice over their form of tariff or supply arrangement beyond the three main payment methods.

138. Since market opening, energy suppliers have also widened considerably the range of tariffs available to domestic consumers. They offer fixed or variable prices, green energy deals and social tariffs that offer cheaper deals for vulnerable customers, energy service packages, a wide range of incentive and reward deals and online tariffs. Suppliers have also responded in recent years to customer demand for greater certainty by offering a range of fixed or capped price tariffs. Over 1 in 7 households are on a price guarantee tariff of some form. We see this as a positive indication of competition at work; of suppliers responding to customer needs and tailoring their offerings accordingly.

139. Competition in metering services also helps suppliers to deliver more innovative products to customers.

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

140. As mentioned above, the Probe found that competition is not yet fully effective in all segments of the domestic market and identified a number of issues in the non-domestic market, particularly in relation to the ability of small business customers to engage effectively in the market.

141. In responding to the concerns raised during the Probe, we proposed a package of measures that are designed to improve the functioning of the market for all customers, particularly vulnerable households and small businesses. One of the key objectives of the package is to improve the quality and accessibility of the information available to customers so that they can make well-informed decisions about their energy supply.

³² <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=4&refer=Markets/RetMkts/ensupro>

142. We are proposing that suppliers active in the domestic market should:

- improve the information they give to their customers by: stating on each bill the name of the customer's tariff and their annual consumption; and sending each customer an annual statement;
- reduce confusion surrounding their tariffs and improve how tariff information is presented; and
- provide customers with confidence about the switching process by introducing a guarantee that changing supplier will be a safe process.

143. We are also proposing that suppliers active in the small business sector should introduce a range of informational remedies aimed at improving small business customers' ability to engage with the energy market. Our proposals have been out to consultation and we are in the process of finalising our decision and considering any licence changes needed.

Price comparison service

144. Customers can obtain information on prices from Consumer Focus (the consumer advocacy body), price comparison websites and by contacting the energy suppliers directly to check their current energy prices. Consumer Focus provides energy supplier price comparison factsheets and a calculator. The calculator uses simple calculations to show the average prices based on the information customers have entered. It does not display the kWh unit rates and discount information used to calculate these prices.

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

146. The use of comparison and switching sites is an important part of customer engagement with the market. The Initial Findings Report proposed that a programme to promote confidence in price comparison and switching sites was needed. We 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.

Customer complaints

147. Ofgem does not deal directly with customer complaints or enquiries. From 1 October 2008 the Government introduced new arrangements for consumer representation in the energy sector. The new arrangements replaced energywatch with two new bodies: Consumer Focus and Consumer Direct. They also created a package of support and protection for customers who have complaints against their energy supplier.

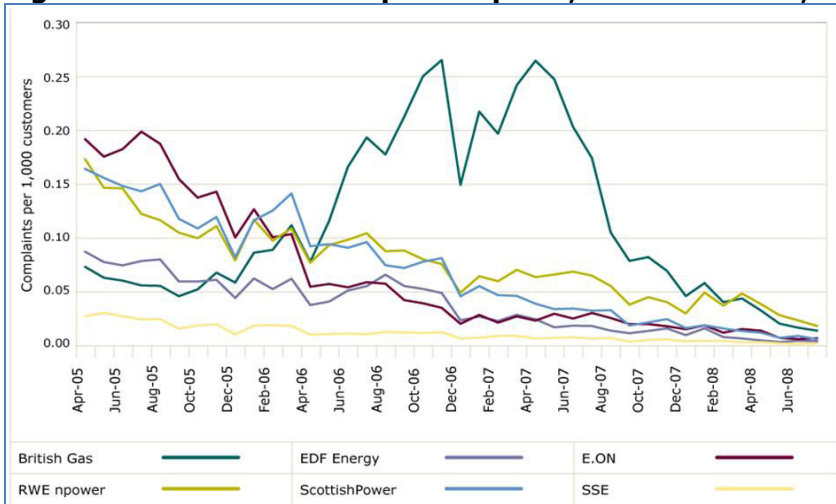
148. Where a domestic or a small business energy customer has a complaint or enquiry relating to their energy supplier, they have to contact their energy supplier in the first instance. Under the new arrangements energy suppliers have committed to keep to a new and stringent set of complaints handling standards set by Ofgem³³. If they fail to meet these they face the prospect of heavy fines. Suppliers have set a time limit during which in most cases they will resolve the complaint. The time limit is currently eight weeks for the six major suppliers and twelve weeks for smaller suppliers.

149. At any point while making a complaint, a customer can go to Consumer Direct for independent advice and information. Consumer Direct can also signpost them to the appropriate body for further action. It will also identify vulnerable customers and those threatened with disconnection or who have been disconnected. These customers will be directly referred to Consumer Focus³⁴.

150. If during the course of investigation a point is reached where a supplier says it can do no more about the complaint and the customer is still not satisfied or the time limit has expired, the customer can move on to seek redress through the Energy Ombudsman. The Energy Ombudsman will try to settle the dispute between energy suppliers and customers. It can ask the energy supplier to apologise, take practical action to resolve a dispute and has the power to make a financial award to the customer (of up to £5000).

151. There is evidence that customer service standards have improved markedly over the period since market opening, although British Gas's customer complaints rose sharply in 2006 and 2007 as a result of significant customer service issues with the implementation of a new customer billing system, as shown in Figure 12. The levels of all customer complaints, which include transfer, direct sales and billing complaints, have fallen steadily over the April 2005 – August 2008 period.

Figure 12: Customer complaints per 1,000 customers, April 2005 – August 2008



Source: Energywatch

³³ 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

³⁴ Consumer Focus, as well as dealing with vulnerable customers and disconnection cases is also the customer advocacy body, concerned with customer issues.

3.4 Measures to avoid abuse of dominance

Rules governing conduct of supply companies

152. 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.

Market monitoring

153. Please see the earlier "Description of the Retail Market" section of this year's report for more on the Retail Market Probe.

Enforcement actions

154. In December 2008 Ofgem fined RWE npower £1.8 million after the supplier failed to take sufficient action to prevent mis-selling of energy contracts to customers³⁵. Ofgem found that RWE npower breached a supply licence condition by failing to take adequate steps following complaints from customers about visits by the company's doorstep salespeople.

155. While RWE npower had procedures in place to follow up complaints, Ofgem judged that company managers had not been proactive enough in applying and improving them. This allowed incidents of mis-selling to proceed unchecked. As a result Ofgem concluded that RWE npower had failed in its duty to ensure that it had taken all reasonable steps to remedy the matter. The level of penalty reflects the nature of the licence breach and the prompt action taken by RWE npower. In other circumstances, it could have been much higher.

³⁵ Ofgem has powers under the Gas and Electricity Acts to take action if there is a breach of a licence obligation. Penalties have to be paid to The Treasury via the consolidated fund.

4. Regulation and Performance of the Natural Gas Market

Regulatory Issues [Article 25(1)]

General

156. The gas market in Great Britain is fully liberalised.

Management of congestion on interconnectors capacity

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

158. The GB gas system is interconnected with Belgium, Northern Ireland, the Republic of Ireland and the Netherlands. The interconnector with Belgium 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 per year. The interconnector with the Netherlands 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.

159. 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.

Management of congestion on national networks

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

161. 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.

162. 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 £21m per annum for capacity congestion management associated with existing

entry capacity (net of certain revenues³⁶ 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 £18m (or -£18m) per annum. The operational incentive scheme is being reviewed in 2009 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

163. 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)³⁷ 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).

164. 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

165. 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

³⁶ 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.

³⁷ In gas distribution, there is no distinction between asset owners and system operators. DN owners both own and operate the system.

be adjusted automatically as the requirements of network users become known. Ofgem sets price controls which are typically five years long.

Balgzand-Bacton Line (BBL) gas interconnector expansion

166. In May 2007, the BBL company began investigating market interest for increased capacity through its Balgzand to Bacton interconnector. This resulted in the decision to install a fourth compressor station in The Netherlands that would make around 3 bcm/year of additional capacity available.

167. An “approval by approval” process approved the tariff structure for the additional capacity resulting from the fourth compressor station. This allowed another regulatory agency to approve the tariff structure and charging methodology. If satisfied that this approval met all relevant UK licence conditions, Ofgem would then issue a notice stating its approval.

168. The Dutch Ministry for Economic Affairs was the regulatory authority that assessed the tariff structure. It approved the tariffs proposed at the interconnector on April 2008. As this was the first time the approval by approval process had been used, Ofgem undertook a short consultation seeking views on the process before issuing an approval notice on June 2008.

Exit Reform

169. In 2005 National Grid completed the sale of four of its Gas Distribution Networks (GDNs)³⁸. This resulted in an interface between separately owned transmission and distribution businesses which could potentially lead to inefficient investment or operational decisions. In light of this concern, Ofgem placed a condition on its consent to the sale of the GDNs. This condition was that an enduring framework for taking gas off the transmission system was implemented.

170. The industry developed a number of proposals for the enduring exit regime and on 5 April 2007 Ofgem made its decision to implement one of the proposals³⁹. This decision was appealed and in July 2007 the Competition Commission upheld part of the appeal and quashed the April 2007 decision⁴⁰.

171. The Competition Commission’s decision resulted in a review group being set up to consider exit reforms. This led to a number of proposals in early 2008. On 19 January 2009 Ofgem made its decision to implement the proposal UNC195AV⁴¹. UNC195AV implemented enduring exit reform arrangements from 1 April 2009 but for the release of exit capacity from 1 October 2012⁴². In the enduring period NGG will have obligations on it to make fixed amounts of firm exit (flat) capacity available at each exit point, known as baselines.

³⁸ Four of the eight GDNs were sold by National Grid to third parties in 2005.

³⁹ Ofgem’s April 2007 decision can be read online at http://www.gasgovernance.com/NR/rdonlyres/32E065A3-5364-4E93-87ED-11E440FC7518/16281/116_Decision.pdf

⁴⁰ The Competition Commission’s July 2007 decision can be read online at http://www.competition-commission.org.uk/appeals/energy/eon_final_decision.pdf

⁴¹ Ofgem’s January 2009 decision can be read online at <http://www.gasgovernance.com/NR/rdonlyres/052FB1D6-FB0D-4943-B6EC-9826C5BCB81A/31289/0195AVOfgemDecisionLetter.pdf>

⁴² Between 1 October 2008 and 30 September 2012 transitional exit arrangements are in place.

172. UNC195AV will introduce a number of exit capacity products, these are:

- A. Exit (flat) capacity – this gives a right to the holder to take a daily quantity of gas off the transmission system at the specific exit point. The implied obligations are to offtake gas at an even flow across the day.
- a. Enduring exit (flat) capacity – this is firm capacity to offtake gas from an exit point for each day in that and each following gas year unless the user gives NGG notice of a reduction in these enduring rights
 - b. Annual exit (flat) capacity – this is firm capacity to offtake gas at an exit point for each day in the gas year
 - c. Daily exit (flat) capacity – this is firm capacity to offtake gas from an exit point for one day only
 - d. Daily off-peak exit (flat) capacity – this is an interruptible product the amount of which is made up of three components (i) Use-It-Or-Lose-It (UIOLI) this is the 30 day average of unutilised bookings (ii) discretionary releases (iii) where forecast demand on the day ahead is less than 80% of the 1-in-20 peak day demand then NGG will release in addition to components (i) and (ii) an additional amount of capacity. This is equal to:
*Maximum Supply Point Offtake Rate * 24 – Aggregate Firm Holdings*
- B. Exit (flexibility) capacity – this product allows users to vary their offtake of gas from the transmission system throughout the day relative to the constant rate implied by flat capacity. This can be acquired by GDN users to fulfil their licence obligations and demonstrate their provision of sufficient flexibility to meet requirements of consumers connecting to their network.

173. One new feature of the enduring regime will be that all types of exit users (e.g. GDNs or direct connected customers) will use the same mechanisms to book the exit capacity products. Currently there are different booking mechanisms for different types of exit users. The booking mechanisms in the enduring regime, however, differ for each type of exit product as follows:

- Enduring exit (flat) capacity – can be booked for 4 to 6 gas years in advance via the annual application window held each July. This product can also be booked for 6 months to 3 gas years in advance for new exit sites or significant increases to existing exit sites in ad-hoc applications between October and June. Users do not submit a price but make applications based on indicative prices, actual prices will be published before the relevant gas year. There is also a process for users to notify reductions in their enduring exit (flat) capacity holdings.
- Annual exit (flat) capacity – can be booked for 1 to 3 gas years in advance in annual application windows to be held each July.
- Daily exit (flat) capacity – can be bought on the day-ahead and on-the-day via pay-as-bid auctions.
- Daily off-peak exit (flat) capacity – can be bought via pay-as-bid auctions

174. The Enduring exit (flat) capacity and Annual exit (flat) capacity charges will be based on the same model which currently generates the exit capacity charges, with a few changes to the source of demand data. Reserve prices for the Daily exit (flat) capacity auctions will be set based on the Enduring Annual/Annual exit (flat) capacity charge which is in place for that gas day. The reserve price will be zero for Daily off-peak exit (flat) capacity auctions.

Maximum technical capacity

175. 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

176. 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 regimes⁴³.

177. 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

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

179. 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.

180. 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.

181. 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.

182. Ofgem also published a sixth annual report on quality of service in the gas distribution sector⁴⁴. 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.

⁴³ Transmission Price Control Review: Final Proposals, Ofgem, 4 December 2006 206/06.

⁴⁴ Link : http://www.ofgem.gov.uk/Networks/GasDistr/GDPCR7-13/Documents1/Gas%20Distribution%20Annual%20Report%202007_8.pdf

Network tariffs

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

Balancing

184. 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

185. 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.

Legal ownership for DSOs and TSOs

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

Ownership structure of TSOs and DSOs

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

Independence of production and supply affiliates

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

Role of the compliance officer

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

Shared costs and outsourcing

190. There were no major changes in this area over 2008 – please see last year's National Report for more.

Competition Issues [Article 25(1)(h)]

Description of the wholesale market⁴⁵

191. Ofgem provided a description of the structure of the wholesale gas market in its 2008 National Report submission. The structure of the gas market has remained broadly unchanged since this submission⁴⁶. 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 trading⁴⁷.

Over the counter trading (OTC)

192. Over the counter trading (i.e. bilateral deals between two market participants, including via an intermediary (the broker) brings together a buyer and seller) typically operates from a year or more ahead of real time up until 24 hours ahead of real-time. As in electricity, the majority of gas trading occurs on the OTC market, although exchange based traded volumes are higher than in the GB wholesale electricity market.

193. The key exchange provider in the GB gas market is the APX Group which operates the OCM which is used by parties (including National Grid) for balancing and hedging purposes. The other main energy exchange in GB is the ICE, which offers a range of monthly, quarterly and seasonal gas futures products.

194. The Financial Services Authority (FSA) conducts an annual survey to determine total OTC traded volumes, which are traded through brokers in the UK. These are reported below.

Table 13: Estimated value of UK Gas market

	Volume traded (billion therms)	Est. value of market (£ billion)	Churn Ratio (volume traded/ throughput)
2007/08	338	176	8.7
2006/07	437	134	11.6
Decrease on 2006/07	-99	42	

Source: Financial Services Authority⁴⁸

195. According to the FSA, the total volume of forward traded gas through electronic or voice brokered services year from 1 August 2006 to 31 July 2007 was 338 billion therms, down from 437 billion the previous year.

⁴⁵ Defined as covering any transaction of gas between market participants other than final end use customers.

⁴⁶ Therefore, for further information on the structure of the gas market please refer to last year's report.

⁴⁷ For further information relating to OTC and power exchange trading can be found in Ofgem's 2008 National Report submission.

⁴⁸ http://www.fsa.gov.uk/pubs/other/analysis_energy_2008.pdf

Exchanges, including the OCM

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

197. Total traded volume on the APX Gas UK (OCM) and APX Gas UK (NBP) exchanges in the calendar year 2008 was 3.7 billion therms (0.09 times total throughput), a decrease from 4.5 billion therms in the calendar year 2007. Traded volume on the Intercontinental Exchange (ICE) UK Gas Futures exchange totalled 86 billion therms (2.2 times total throughput in 2008) in 2008, an increase from 60 billion therms on the calendar year 2007.

Market integration

Table 14 – UKCS Forecast and Import Requirements⁴⁹

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	64.2	61.7	58.3	52.9	47.3	46.4	43.9	41.9	37.9	35.7	30.6
Demand	99.4	98.7	99.2	99.2	100.4	102.2	103.4	104.2	106.3	108.9	110.3
% import requirement	35	37	41	47	53	55	58	60	64	67	72

198. Table 14 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 BBL and Langede came on line, as previously GB prices could de-couple from those elsewhere in Europe when the IUK was full or not operational.

199. In terms of the IUK, each shipper has a share of the Forward Flow and Reverse Flow Standard Capacity. Originally, nine Shippers acquired Capacity Rights in the UK/Zeebrugge interconnector for a period of 20 years from 1 October 1998 through to 30 September 2018. Currently 17 Shippers hold primary capacity rights. The utilisation of these capacity rights has remained unchanged since Ofgem’s 2008 National Report submission⁵⁰.

200. The BBL commenced operation in December 2006 and has three foundation shippers with contracted capacity for periods of up to 15 years. Use it or lose it provisions are applied to capacity allocations and temporary capacity is advertised and traded if and when available through mechanisms established by BBL. BBL is installing a

⁴⁹ Source: National Grid Ten Year Statement Table 4.7A. Available at: <http://www.nationalgrid.com/uk/Gas/TYS/archive/tys08/tys08chart.htm>

⁵⁰ For further information please see Ofgem 2008 National Report submission and please refer to IUK website available at the following link: www.interconnector.com.

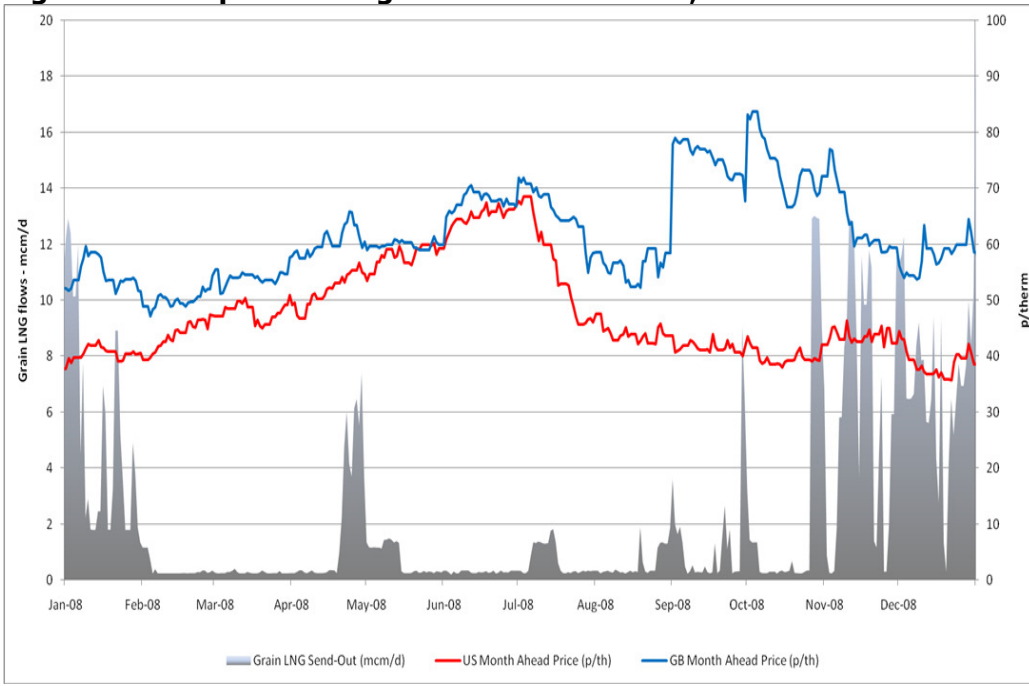
fourth compressor to upgrade capacity by 3 bcm and is currently developing new commercial arrangements for interruptible non-physical reverse flow.

Interactions via Global LNG markets

201. The 2008 expansion of Isle of Grain LNG importation terminal (operational since 2005) and the recent commissioning (early 2009) of the South Hook terminal have increased the interaction of the GB with the global market, from a number of global sources (for example the US, Middle East and Asia). Going forward, the impact of global supply and demand conditions on the GB gas market will continue to increase as the proportion of supplies accounted for by LNG imports rises over time.

202. As an illustration of this effect, figure 15 below compares the GB and US month-ahead prices with flows at the Isle of Grain over the 2008 calendar year. It can be seen that, whilst GB prices were higher than those in the US throughout almost all of the year, the differential was highest in January and the September to October period, making GB a much more attractive market for cargoes during these periods. Correspondingly, these periods also saw the highest volume of LNG deliveries.

Figure 15: Graph Showing Grain flows and GB, US Gas Prices⁵¹



203. It is important to note that the relevant market for LNG is increasingly a global one, with supply and demand conditions in regions such as Asia impacting the volume of LNG deliveries available to GB. This was evident in the early months of 2008, when deliveries into the Isle of Grain 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.

204. There have been no mergers and acquisitions in the gas market for this reporting year.

⁵¹ 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/>

Market Concentration

205. 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 LNG importation terminal.

206. In terms of gas from the UKCS, there are five companies whose market share of production exceeds five per cent⁵². 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, when BBL became operational (since 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. South Hook LNG, part of a fully integrated LNG venture chain, is expected to bring significant amounts of Qatari gas to the market.

207. 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, as with last year 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)). However, market share figures are liable to change as capacity can be traded on a secondary market.

Storage services

208. 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. With declining UKCS supplies and GB growing import requirement gas from storage is expected to play an increasingly important role in meeting winter demand⁵³.

209. 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 16 presents details on the size and scope of existing storage facilities in GB.

Table 16: Information on GB storage facilities and TPA⁵⁴ status

Facility	Space (mcm)	Deliv. (mcm/d)	Durat'n (Days)	Owner	Status
Operate under nTPA (negotiated third-party access)					
Rough	3300	45	71	Centrica Storage	Operational (in accordance with

⁵² <http://www.nationalgrid.com/uk/GrainLNG/background/>

⁵³ Energy Markets Outlook report, December 2008

⁵⁴ Space is working gas capacity and deliverability is withdrawal capacity

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				Limited	merger undertakings)
Hornsea	316	18	18	SSE Hornsea Limited	Operational
<i>Total nTPA</i>	<i>3616</i>	<i>63</i>			
<i>% of total storage</i>	<i>78%</i>	<i>39%</i>			
LNG storage facilities, offers TPA under section Z of Unified Network Code					
Avonmouth	81	13.5	6	National Grid Gas	Operational
Glenmavis	51	8.7	5.9	National Grid LNG	Operational
Partington	53.4	15	3.7	National Grid LNG	Operational, capacity reduced for storage year 2009 onwards
<i>Total TPA under UNC</i>	<i>185</i>	<i>37.2</i>			
<i>% of total storage</i>	<i>4</i>	<i>23</i>			
Other non TPA storage					
Hatfield Moor	120	2.4	50	Scottish Power	Operational
Humbly Grove	280	7.5	37	Petronas	Operational
Hole House Farm	60	10	6	EDF Trading	Operational
Aldbrough	246	27	9	SSE Hornsea Limited	Commenced operations in part during 2009
Aldbrough	123	13	9	Statoil- Hydro	Commenced operations in part during 2009
<i>Total non TPA storage</i>	<i>829</i>	<i>60</i>			
<i>% of total</i>	<i>18</i>	<i>37</i>			
Total	4630	160			

storage			
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Table 17: The storage levels on 2007-2009⁵⁵(%)

	1 Oct 2007	28 Feb 2008	1 Oct 2008	28 Feb 2009
LRS	92	33	99	23
MRS	65	59	93	51
SRS	78	60	93	28

210. 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.

211. Rough, operated by Centrica Storage Limited (CSL), is the largest facility and makes up around 70 per cent of GB storage space. Under terms of undertakings⁵⁶ Centrica Plc (Centrica) is allowed to hold up to 15 per cent of capacity. Moreover, CSL is required to sell a minimum 85 per cent of capacity available to third parties. Capacity is sold on an annual basis in three stages. First, minimum capacity is sold on a bilateral basis. Second, any unsold minimum capacity is sold at a zero reserve price auction at least 30 days before the start of the storage year. Third, any capacity in excess of the minimum capacity is sold. The undertakings require CSL to sell all capacity at Rough on non-discriminatory terms.

212. The undertakings also require CSL to offer at least 20 per cent of minimum capacity on annual contracts and offer the rest of the capacity for a range of contract durations (a range of 1 to 5 years is suggested). In addition, CSL is required to give customers the option of either fixed or indexed contract prices. Indexed prices are indexed to the difference between forward prices and spot prices for gas.

213. The combination of the requirement to sell all minimum capacity, the zero reserve price auction and the cap on capacity which Centrica can procure effectively prevent Centrica and CSL from using Rough's strong market position. This serves to promote competition and reduces barriers to entry in the downstream gas market.

214. 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. SSEHL does not publish prices at the Hornsea facility; it auctions one year capacity on an annual basis and has in the past auctioned five year capacity contracts. 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.

215. Ofgem understands that all the non-exempt storage facility owners sell capacity in a non discriminatory fashion and Ofgem has not received any complaints to indicate otherwise. In the case of Rough, 25-30 parties currently hold capacity including a number of new entrants to both the gas and electricity markets.

216. 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

⁵⁵ Source: NG storage monitors: <http://www.nationalgrid.com/uk/Gas/Data/storage/>

⁵⁶ Undertakings were provided by Centrica 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.

up to the storage operators and other parties to decide to participate in the tender. Currently the TSO requirements for operating margins are around 126mcm⁵⁷.

Measures to avoid abuses of dominance

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

218. There have been changes to the information GB gas market participants are required to make available. There have been two main changes in this regard:

- a. National Grid Gas (NGG) are required to publish on its website the daily volume (in TWh) of all total matched trades in respect of that Day (before the Day & within Day); the volume (in TWh) of all total daily input nominations in respect of that Day; the total number of matched trades to which the volume of all 'total matched trades' applies; the total number of Users who have registered a Trade Nomination for the relevant Gas Day⁵⁸.
- b. NGG are required to publish information on nominations for any Aggregated System Entry Point (ASEP) capable of flowing more than 10 mcm per day. For each ASEP which does not have an associated system exit point, NGG will publish aggregate prevailing Input Nominations. Where there are no nominations at one of these points, a zero figure will be published. For each ASEP which has an associated System Exit Point, NGG will publish the net prevailing Input Nominations. Net prevailing Input Nominations will be defined as aggregate prevailing Input Nominations less aggregate prevailing Output Nominations. This figure may be positive, negative or zero⁵⁹.

Transparency

219. 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.

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

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

Market Surveillance

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

⁵⁷ http://www.nationalgrid.com/NR/rdonlyres/AD4B4AD6-B80F-48CF-A6FA-C587D867A617/34216/OM_Tender_Information_Report.pdf

⁵⁸ This change was brought into place by Uniform Network Code modification '219 Publication of UK wholesale gas market liquidity data'. Further information on this modification can be found here: www.jointoffice.co.uk

⁵⁹ This change was brought into place by Uniform Network Code modification '223 provision of day ahead Gas Flow Nomination data at major Aggregated System Entry Points'. Further information on this modification can be found here: www.jointoffice.co.uk

Description of the retail market

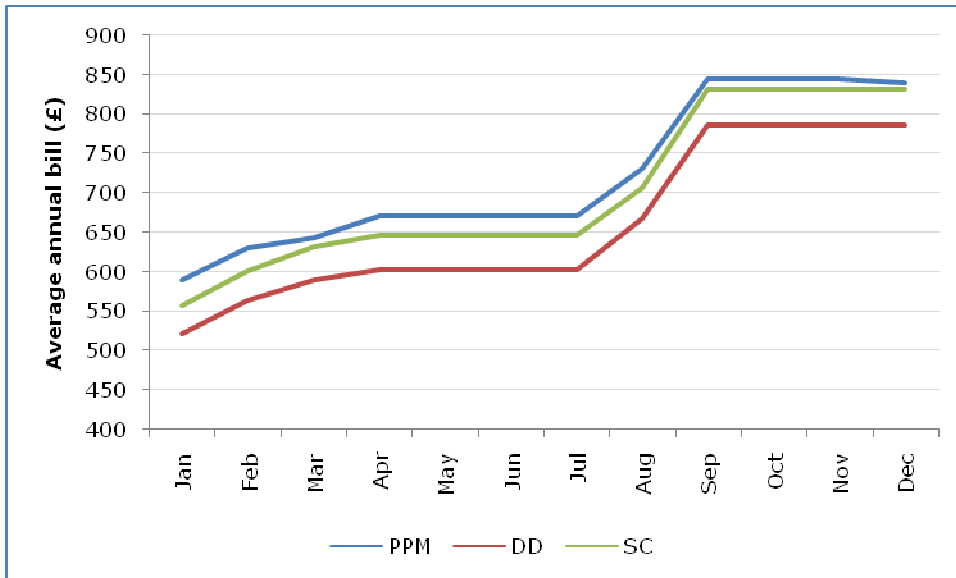
222. The GB retail gas supply market is characterised by the existence of six large supply groups that evolved from the fifteen former incumbent electricity and gas suppliers over the 1998-2003 period. They are: E.ON UK (formerly Powergen), RWE npower (owned by RWE AG), EDF Energy (owned by Electricité de France), Scottish and Southern Energy (SSE), Scottish Power (owned by Iberdrola) and British Gas (owned by Centrica). At the end of 2008, there were also three active domestic and sixteen non-domestic independent gas suppliers who are not former incumbents.

Price developments

223. 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 (partially), and as such continues to be price controlled.

224. As with electricity, there has been a large increase in the retail gas prices for domestic customers by all major suppliers in 2008. Figure 19 shows the impact of 2008 price changes across the three main payment methods: direct debit, standard credit and prepayment. During the first few months of 2008, all Big 6 suppliers raised prices in quick succession. Over the Aug - Sep 2008 period another round of price rises were implemented by the Big 6. The overall increases in 2008 were 43% for prepayment and 51% for direct debit and 50% for standard credit customers.

Figure 18: Average annual gas bills Jan – Dec 2008⁶⁰



Source: Ofgem

⁶⁰ Bills are based on an average annual consumption of 20,500 kWh.

225. Wholesale energy costs were cited by suppliers as being one of the primary reasons for these increases. They account for around 60% of a domestic customer's gas bill and are a major consideration in supplier's retail pricing decision. Wholesale energy costs depend on range of factors. A key factor is price of oil which rose to a peak of \$147 a barrel in 2008. Oil prices have a major impact on GB's wholesale gas prices, and feeds through to gas and power prices with about a six to nine month lag.

226. As a part of the probe into the energy supply market we examined the relationship between wholesale and retail prices. We 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. We now publish a quarterly report into the relationship between wholesale and retail prices.

227. In addition to the wholesale energy costs, environmental programmes and network investment 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 costs to customer bills.

228. The breakdown of the average domestic gas bill consists of the following components: distribution and metering costs (where metering is a very small proportion), transmission costs, environmental costs (which include the Carbon Emissions Reducing Target⁶¹), and Value Added Tax (VAT). Generation costs, retail costs (including, for example, marketing, billing and call centres) and margin make up the remainder of the bill. Table 20 provides the estimated breakdown of the domestic bill into these components.

Table 19: Estimated breakdown of domestic gas bill as of December 2008 (with estimated annual average consumption of 20,500 kWh)

Components of gas bill	Proportion of bill
Energy, supply costs and margin	74%
Distribution and metering costs	18%
Transmission costs	2%
Environment	2%
VAT	5%

Source: Ofgem

229. Ofgem does not actively collect data on prices in the non-domestic sector; therefore we are unable to provide up-to-date data on prices. BERR publish a digest of non-domestic prices on their website. The most recent publication is for March 2009 which is available at:

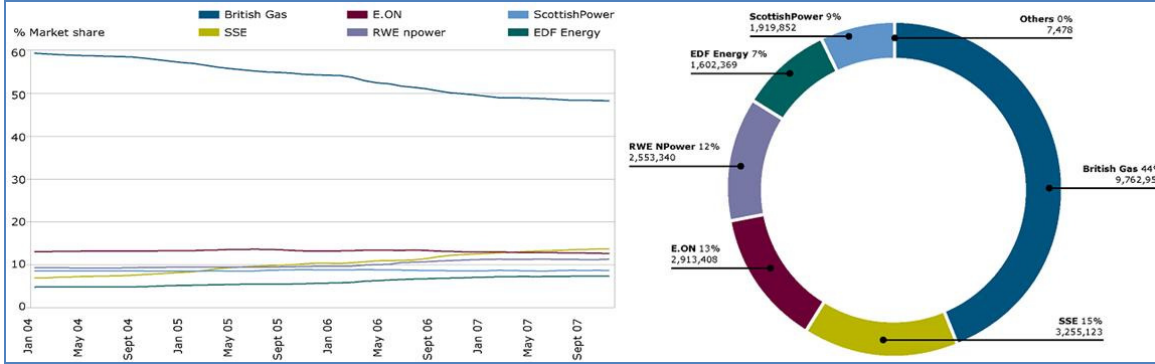
<http://www.BERR.gov.uk/energy/statistics/publications/prices/index.html>

⁶¹ The Carbon Emissions Reducing Target (CERT) is a Government policy that sets energy suppliers targets for reducing carbon emissions by providing energy efficient measures to domestic customers. Suppliers pass on the costs to domestic customers.

Market shares and concentration

230. In June 2008, there were approximately 22 million customers in the domestic gas sector of which the six large supply companies accounted for 99.95% of the market as presented in Figure 21.

Figure 20: National GB domestic gas market shares (January 2004 to December 2007) & snapshot (June 2008)



Source: Ofgem

231. In the domestic gas market, these six main supplier groups all have a market share of above 5%. The three suppliers with the highest domestic national market shares are British Gas, Scottish and Southern Energy and E.ON UK, who together have 72% of the market.

232. British Gas, the former gas monopoly supplier has the largest market share of 44%. The other Big 6, all of whom are new entrants into gas supply since liberalisation, have market share ranging from 7% for the smallest (RWE npower) and 15% for the largest (SSE) of these. There were also three smaller suppliers active in the domestic gas supply market, accounting for just 0.05 per cent of the market.

233. Within the non-domestic customer group, there are both non daily metered (NDM) and daily metered⁶² (DM) gas customers. The information Ofgem collects on market shares in the non-domestic markets is acquired from a third party, who collects the data from suppliers. This data is presented in Table 22 below which also shows 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 2007.

Table 21: GB non-domestic gas retail market shares by volume of gas supplied for NDM and DM supply points and by number of small business customers

	NDM (Nov 2008)	DM (Nov 2008)	Small business customers (Dec 2007)
British Gas	21%	7%	48%
RWE npower	5%	2%	8%
E.ON Energy	19%	5%	21%

⁶² Daily Metered – A supply point with an annual consumption greater than 58,600,000 kWh

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SSE	5%	-	7%
EDF Energy	2%	-	3%
ScottishPower	1%	-	7%
GDF Suez	7%	13%	-
Total Gas and Power	17%	17%	4%
Corona	12%	1%	1%
ENI	-	9%	-
Statoil UK	-	20%	-
BP Gas	-	3%	-
Shell Gas Direct	5%	15%	-
Gazprom	4%	1%	-
Wingas	-	6%	-
Other suppliers	2%	0%	1%

Source: Datamonitor

234. In NDM and DM sectors of the non-domestic gas market there are 8 suppliers while in the small business customer market there are 5 suppliers with a market share above 5%. The three suppliers with the highest market shares in the NDM sector are British Gas, E.ON Energy and Total Gas and Power who together have a 57% share of the sector. In the DM sector Statoil UK, Total Gas and Power and Shell Gas Direct are the three suppliers with the highest market shares, which together have a 52% share of the sector. In the small business customers sector British Gas is market leader with 48% share. British Gas, E.ON Energy and RWE npower together as three largest small business suppliers have 77% market share in this sector. However, the table also demonstrates that a number of new entrant suppliers have made some inroads into the non-domestic market, especially in NDM and DM sectors.

Market concentration

235. In June 2008, the national gas HHI in domestic market was 2,625. HHI index for small business customers in December 2007 was 2,896. Both domestic and small business gas supply markets are "highly concentrated" according to the threshold HHI levels used by the OFT.

Vertical integration

236. Five of the six large gas suppliers in the domestic retail market have gas production interests; either contractually or by equity. In the non domestic market, all the large suppliers are gas producers. However, most accept that the GB gas sector is not vertically integrated.

Switching

237. Between Jan and Dec 2008, 4,155,953 domestic gas customers changed their supplier (on average 346,329 each month). The switching rate for the year was 20%.

238. There has been a steady increase in the level of switching among domestic gas customers, with the level in 2008 exceeding that seen in 2007. Table 23 below shows the number of annual switchers of domestic electricity customers and the annual switching rate.

Table 22: Domestic customers' annual switching in gas

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

Source: Ofgem

239. Ofgem primarily collects data on the number of customers switching between suppliers in the domestic gas retail market. It therefore does not have switching data for the non-domestic gas markets. However, a research conducted by Accent in 2007 suggests that just over one third of small business customers changed their gas supplier.

Switching procedure

240. For the switching procedures, for domestic gas customers, please refer to the last year's report as the procedure remains unchanged.

Factors which influence switching

241. For the factors which influence switching please refer to the electricity retail market section of this report.

Difficulties in switching

242. For difficulties in switching please refer to the electricity retail market section of this report.

Assessment of competition

General assessment

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

Development of choice competition has brought for customers

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

Measures to promote market transparency

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

Price comparison service

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

Consumer complaints

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

Measures to avoid abuse of dominance

Rules governing conduct of supply companies

Competition law

248. For the general competition law framework please refer to the last year's report.

Transparency

249. 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.

Contract structure

250. Please refer to last year's 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.

Competition policy actions

252. On 21 February 2008, the Authority issued an infringement decision under the Competition Act 1998. The Authority found that National Grid had abused a position of dominance in the market for domestic-sized gas meters. The Authority directed that National Grid must bring the breach to an end and has imposed a penalty of £41.6 million. National Grid has entered into long-term exclusive contracts for the provision of domestic gas meters with energy suppliers. The contracts are considered to lock suppliers into National Grid for a significant share of their gas meter requirements and thereby restrict the development of competition.

253. National Grid launched an appeal against the Authority's decision 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, restricting the development of competition in the domestic gas meter market. In its decision the CAT has ruled that National Grid should face a £30 million financial penalty –although lower than the £41.6 million fine imposed by Ofgem it is the highest penalty for abuse of dominance imposed to date in the UK. In its judgment the CAT has also upheld Ofgem's directions which require National Grid to bring these multi-million pound contracts into compliance with competition law.

254. On 30 June 2009 the CAT refused National Grid permission to appeal against the CAT decision ([2009] CAT 21). On 14 July 2009 Ofgem were informed that National Grid intended to apply to the Court of Appeal for permission to appeal against the decision of

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the CAT. At the time of writing, any such permission had yet to be granted by the Court of Appeal.

5. Security of Supply

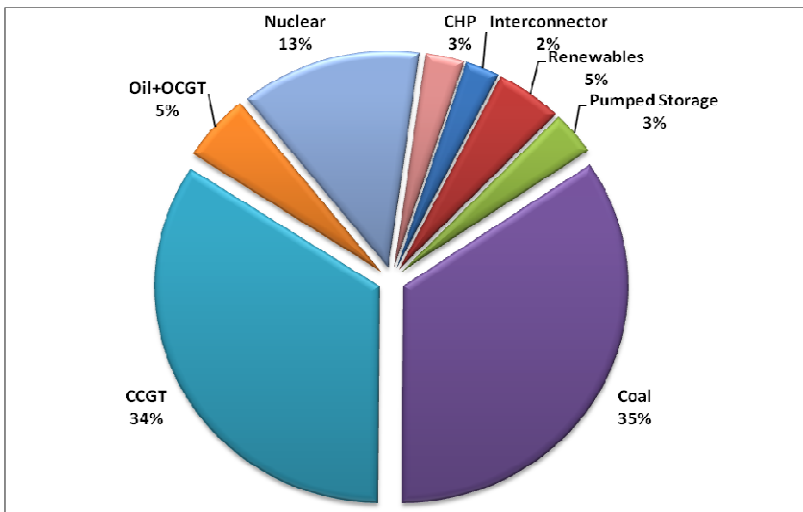
255. The Discovery project (launched in March 2009) will assess whether or not future security of supply can be delivered by the existing market arrangements over the coming decade. Britain's energy market has delivered secure supplies for some 20 years. But there have been changes in the energy sector in recent years, that include demanding new carbon targets; exposure to global gas markets is increasing; also the worldwide financial crisis threatens investment and highlights the risk that existing market arrangements may not be sufficient to protect consumers' interests. The economic slowdown has additionally hit gas demand and prices. On the supply side, there are concerns regarding whether investment in additional capacity and infrastructure in Russia and elsewhere will be sufficient and timely enough to meet the increasing demand for imports to the EU.

256. In the autumn Ofgem will publish and invite views from all our stakeholders on a number of security of supply scenarios and the possible implications of these. At the turn of the year Ofgem will produce a further report. This will set out possible policy options for debate and development, providing plenty of time to implement solutions should they be needed.

Electricity [Article 4]

257. A breakdown of the current generation fuel mix by source is provided in Figure 24 and is based upon generation plants' transmission entry capacity.⁶³ This shows that similar to previous years the majority of GB transmission entry capacity comes from gas and coal fired plants.

Figure 23: 2009/10 Transmission Entry Capacity (TEC) values by fuel type (Source: NG Seven Year Statement (May 2009))⁶⁴



⁶³ It is important to note that contractual arrangements may mean that entry capacity rights may not equate fully with dispatch rights.

⁶⁴National Grid's Seven Year Statement can be found here;
http://www.nationalgrid.com/uk/sys_09/

258. The NGET Seven Year Statement also provides information in relation to forthcoming generation projects which are actually in the process of construction. Table 25 below outlines changes in power station capacity (TEC) over the next three years. A total of 18.4 GW of new generation capacity is scheduled to be completed in that time. It is important to note that TEC (Transmission Entry Capacity) may not fully equate with dispatch rights and that an increase TEC is not necessarily indicative of a generation plant becoming available to the system for commercial use.

Table 24: Forthcoming generation projects, source: NGET Seven Year Statement

2009		2010		2011	
Plant	MW Change	Plant	MW Change	Plant	MW Change
Wilton	10	Pembroke Stage 1, 2	2000	Drakelow D	1320
Staythorpe C Stage 1, 2, 3	1700	Grain Stage 2	860	Hatfield	800
Greater Gabbard	500	Netherlands Interconnector Stage 2, 3	1200	London Array Stage 1	630
West Burton B Stage 1	435	Clyde	519	Doacking Shoal Wind Farm Ltd	500
Severn Power Stage 1	425	West Burton Stage 2, 3	870	East-West Interconnector 1, 2	875
Thanet	300	Severn Power Stage 2	425	Partington Stage 1	430
Crystal Rig 2	200	Sheringham Shoal	315	Grain Stage 3	430
Gordonbush Wind	70	Lincs Offshore Wind Farm	250	Port Talbot	350
Lairg - Achray Wind Farm	50	Griffin Wind Farm	204	Kyle	300
Edinbane Wind, Skye	42	Arcleloch	150	Humber Gateway	300
Fairburn Wind Farm	40	Heysham Offshore Wind Farm	140	Gwynt Y Mor Stage 1	294
Longpark	38	Mark's Hill	99	Fallago	144
Toddleburn	36	Carraug Gheal (Fernoch)	60	Harestanes	140
Dun Law Extension	30	Roths Biopower Plant	52	Earlshaugh	108
Whitlee Stage 3	29	Auchencorth	45	Waterhead Moor	72
Kilbraur (Strath Brora) Wind Farm Stage 2	20	Andershaw	45	Dersalloch	69

Millenium Wind, Ceannacroc Stage 3	15	Beinn an Turic 2	38	Ewe Hill	66
Tullo Wind Farm, Laurencekirk	14	Drone Hill	38	Newfield	60
Netherlands Interconnector Stage 1	0	Tormywheel	32	Harrows Law	55
		Barmoor	30	Bellindalloch Muir Wind Farm	21
		Kingsburn Wind Farm, Fintry, Stirling	20	Causeymire Phase 2	7
Total Increase in TEC (MW)	4013	Total Increase in TEC (MW)	7392	Total Increase in TEC (MW)	6971

Generation Investment

259. The Seven Year Statement prepared by NGET provides details of those 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 17.6 GW⁶⁵ of new generating capacity has been proposed and is awaiting Section 36 consent. A further 5.7 GW has received Section 36 consent but is not yet under construction⁶⁶. Wind farms (both onshore and offshore) account for 10.6 GW of the capacity which has received consent or is awaiting consent but is not currently under construction, whilst for CCGT's this figure is 7.7GW⁶⁷.

Table 25: Change in TEC (MW) in 2008 by fuel type

Fuel type	Change in TEC (MW)
Coal/Oil	0
Gas	2406
Renewables	377
Other	0
CHP as part of above mentioned categories	601

Peak electricity demand conditions

260. NGET's Seven Year Statement⁶⁸ provides information in relation to outturn and forecast peak electricity demand levels. In its latest statement, NGET outlines that actual GB peak demand in the winter of 2008/9 at 59.2 GW was 1.5 GW lower than in the previous winter. A major factor in the significant peak demand drop seen between 2007/08 and 2008/09 was the economic downturn.

⁶⁵ Source: NGET Seven Year Statement Table 3.8

⁶⁶ Source: NGET Seven Year Statement Table 3.3

⁶⁷ Source: NGET Seven Year Statement Table 3.8

⁶⁸ References to NGET's Seven Year Statement refer to the version published in May 2009, which is available at <http://www.nationalgrid.com/uk/Electricity/SYS/>

261. Correcting historical actual demands to Average Cold Spell (ACS) conditions eliminates the weather effects and gives a better indication of the underlying pattern of annual peak demand. Correcting winter weekday peak demands in 2008/09 to ACS conditions yields a provisional 'unrestricted' peak of 59.0 GW, which is 2.4 GW lower than previous winter's ACS peak. NGET explain the main difference of this to be the impact of recession in 2008/09, and general energy efficiency measures such as energy saving light bulbs. On the basis of the information provided in NGET's Seven Year Statement, current levels of peak electricity demand and expectations up until 2015/16 are shown in Table 27 below.

Table 26: ACS peak demand forecasts, source: NGET Seven Year Statement

Forecast (GW)	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
ACS Peak Demand incl. Station Demand	59	60.2	60.8	62	62.7	63.2	63.7	64.1
ACS Peak Demand excl. Station Demand	58.4	59.6	60.2	61.4	62.1	62.6	63.1	63.5

Evaluation of operational network security

262. Network security in its simplest terms is ensured by the obligation on the transmission operators to ensure all reasonable demands for electricity are met. For more background, see last year's GB National Report.

Generation mix

263. The generation fuel mix in 2009/10 across a total TEC of 83.6GW, based on information provided in NGET's Seven Year Statement, is displayed in Table 28 below.

Table 27: 2009/10 Generation mix by plant type (source: NGET Seven Year Statement, table 3.14)

Plant type	TEC MW	% of total TEC
Biomass	45	0.1
CCGT	28428	34
CHP	2326	2.8
Hydro	1070	1.3
ICGCCT	0	0
IGC with CCS	0	0
Interconnector	2068	2.5
Large unit coal	4413	5.3
Large Unit Coal + AGT	21467	25.7
Medium Unit Coal	1102	1.3
Medium Unit Coal + AGT	1131	1.4
Nuclear AGR	8244	9.9
Nuclear Magnox	1450	1.7
Nuclear PWR	1200	1.4
OCGT	589	0.7

Offshore Wind	800	1.0
Oil + AGT	3636	4.3
Pumped Storage	2744	3.3
Small Unit Coal	783	0.9
Onshore Wind	2096	2.5
Total MW	83,592	100

264. The table shows that the power station entry capacities for 2009/10 is predominantly gas fired CCGTs. This combined with scheduled nuclear retirements and possible coal-fired retirements, will make the GB electricity market increasingly dependent on gas and renewables.

Generation commissions/retirements

265. On the basis of information in NGET's Seven Year Statement⁶⁹, of the 35.2GW of additional transmission contracted capacity since 2005/06, 14.7GW or 41.7% is CCGT plant and 13.5GW or 38.4% is due to wind farms (both onshore and offshore). Similarly, of the 11.9GW of new contracted capacity either existing or under construction, 7.0GW or 59% is CCGT plant and 2.9GW or 24.6% is due to wind farms.

266. In terms of plant closures, NGET's Seven Year Statement states that a total of 2.5GW of generation disconnections (closures) have been notified since the year 2005 inclusive. Due to the Large Combustion Plant Directive opted-out plant, comprising of 8.5GW of coal and 3.5GW of oil, NGET highlight that some 12GW of closures will take place by January 1st 2016; however, due to the uncertainty of the closure dates and whether any TEC would be terminated no allowance has been made for these closures over the seven years. For the 2010 GB SYS this situation will need to be addressed.

Infrastructure projects

267. The GB electricity system is connected with France and Northern Ireland via the IFA⁷⁰ and Moyle⁷¹ interconnectors respectively. The existence of these interconnectors and the current proposals for new interconnectors suggests that new interconnection capacity will be provided to the market when it is economic to do so. One new interconnector link to the Netherlands (BritNed⁷²) is under construction. Ofgem has also granted licences for the construction of three interconnectors with the Republic of Ireland, one interconnection with Belgium and two with France although none of these are yet under construction. We have also spoken with parties regarding the potential construction of two further interconnectors with Europe.

The Netherlands

268. National Grid Interconnector Ltd and NLink - a subsidiary of TenneT, the transmission SO in the Netherlands - are constructing a 1000MW interconnector (BritNed) between Britain and the Netherlands. On 12 July 2007, Ofgem issued an electricity interconnector licence to BritNed and an exemption order stating that the third party access and use of revenue requirements should not apply for a period of 25 years. The

⁶⁹ Source: Table 3.7 of NGET's Seven Year Statement.

⁷⁰ Interconnexion France Angleterre (IFA) is a 2,000MW HVDC interconnector link between France and GB. It is jointly owned by National Grid Interconnector Limited (NGIL) and RTE.

⁷¹ Moyle is a 500MW interconnector between Scotland and Northern Ireland. Capable of exporting at 500MW to Northern Ireland and importing at 80MW. It is owned by Moyle Interconnector Ltd.

⁷² BritNed is a 1,000MW interconnector jointly owned by NGIL and TenneT.

exemption order was amended by the European Commission in order to take on board its further concerns.

Ireland

269. There are two proposed interconnector projects between GB and Ireland. One 500MW interconnector has been proposed by the Irish TSO Eirgrid, and East West Cable One Limited (EWC) has proposed to build two 350MW links on a merchant basis. EWC has been granted two electricity interconnector licences by the Gas and Electricity Markets Authority. EWC has applied for a full exemption from the application of rules relating to third party access and use of revenue requirements for each interconnector. On 2 July 2008, Ofgem issued a consultation document⁷³ requesting views on the assessment of EWC's reasons for requesting an exemption and our initial view that EWC should be granted an exemption from the application of rules relating to third party access and use of revenue requirements for each licensed interconnector. The exemption has since been granted.

Regulatory framework for interconnectors

270. The EU Electricity and Gas Directives and Electricity Regulation introduce, amongst other things, the requirement for a regulated third party access (RTPA) regime for interconnectors. These requirements were implemented in Great Britain via the Energy Act 2004. The Energy Act 2004 introduced a licensing regime for all gas and electricity interconnectors, which is administered by Ofgem.

271. The requirements of the EU legislation concerning third party access and, where appropriate, exemptions from these requirements are given effect via this licensing route. Where exemption from these requirements is granted, this is done by "switching off" certain of the interconnector licence conditions via an exemption order. BERR has now issued licences to all relevant interconnectors to GB.

⁷³ Available at: www.ofgem.gov.uk

Gas [Article 5] and 2004/67/EC [Article 5]

Ongoing supply-demand situation

272. NGG's Ten Year Statement⁷⁴ provides information in relation to forecast gas demand that is outlined in table 29. This table shows that NG forecasts a steady increase in gas demand of around one bcm per year up to 2023. It should be noted that this information was published in 2008 and given the current economic climate this forecast should be treated with caution. Recent data published by National Grid suggest that weather-corrected gas demand for the first five months of 2009 was 9.5% lower than for the corresponding period in 2008 as a result of the recession⁷⁵, suggesting that the out-turn value for 2009 may be considerably lower than that suggested below.

Table 28: Base Case Gas Demand Forecast⁷⁶

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Bcm	102	103	102	101	102	103	105	106	107	110	112	113	114	115	116	117	118
Mtoe	92	93	92	91	92	93	95	96	96	99	101	102	102	103	104	105	106

273. The table shows the increasing level of imports that NGG expects to see as a result of the decline in the UKCS. Similar to last year's report, this shows that a decreasing amount of UK demand is expected to be met by domestic gas production in the UKCS and so import requirements are expected to increase by 35 per cent between 2008/09 to 2017/18.

Figure 29: National Grid Base Case Annual Supply Forecast⁷⁷

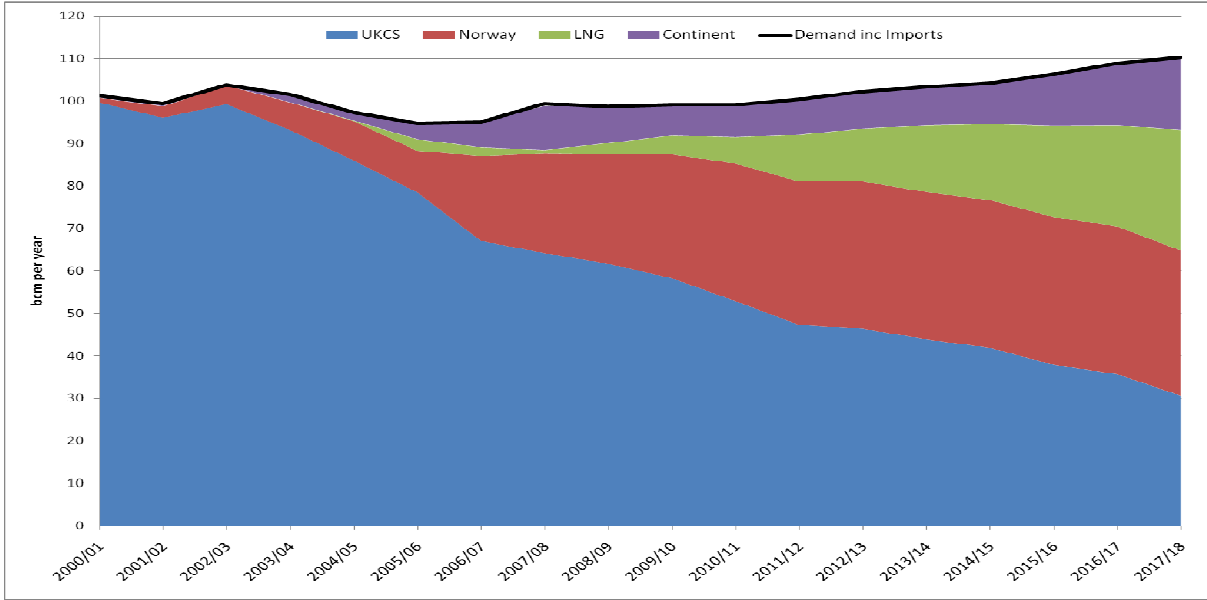
⁷⁴ References to NGG's Ten Year Statement refer to the version published in December 2008, which is available at: <http://www.nationalgrid.com/uk/Gas/TYS/>

⁷⁵ Source: National Grid Transporting Britain's Energy 2009 – Development of Scenarios. Available at: <http://www.nationalgrid.com/NR/rdonlyres/3FCF87F1-6CB4-4B42-A185-AED337453821/35677/TBE2009DevelopmentofEnergyScenarios.pdf>

⁷⁶ Source: National Grid Ten Year Statement Table 3.8A. Available at: <http://www.nationalgrid.com/uk/Gas/TYS/archive/tys08/tys08chart.htm>

⁷⁷ Source: National Grid Ten Year Gas Statement Figure 4.7E available at: <http://www.nationalgrid.com/uk/Gas/TYS/archive/tys08/tys08chart.htm>

Ofgem & NIAUR 2009 Submission to the European Commission
(under 2003/54/EC and 2003/55/EC)



274. It outlines the main sources of gas supply for the UK market and their diversification. In terms of annual supplies, for 2008/09, National Grid anticipated supply capacity of 60bcm could be provided by UK Continental Shelf (UKCS) production and 49bcm could be provided by imports. In general it is difficult to determine the future source of the GB’s continental imports through IUK and BBL as gas arrives at Zeebrugge and Balgzand from different locations. However, NGG⁷⁸ projected that imports from Norway could be up to 31bcm for 2008/09 and Isle of Grain LNG import capacity is increased to 13.5bcm per year in 2008. In addition, there are two further LNG terminals due to come online during 2009, which will add 27bcm of capacity per year.

Existing sources of gas for GB market

275. Table 31 indicates existing and near completion import facilities in GB. Since Ofgem’s 2008 National Report submission, the second phase of the Isle of Grain LNG terminal has been completed, and the first phase of the South Hook LNG terminal entered commissioning in early 2009 and Dragon LNG is nearing completion. These projects, together with existing import facilities mean that the UK now has around 123bcm per year of importation capacity. Table 31 below shows existing UK Import Capacity.

⁷⁸ As outlined in NGG’s Ten Year Statement.

Table 30: UK Import Capacity

Import Project	Operator/Developer	Type	Location	Capacity (bcm/yr)
Interconnector	IUK	Pipe	Bacton	25.5
BBL Pipeline	BBL	Pipe	Bacton	~15
South Hook 1	QP/ ExxonMobil	LNG	Milford Haven	10.5
Dragon	BG/Petronas	LNG	Milford Haven	6
Isle of Grain Phase 1	National Grid	LNG	Isle of Grain	4.5
Isle of Grain Phase 2	National Grid	LNG	Isle of Grain	9
Langeded	Gassco	Pipe	Easington	25
Tampen ⁷	Gassco	Pipe	St Fergus	10
Vesterled	Gassco	Pipe	St Fergus	13
GasPort	Excelerate	LNG	Teesside	~4
			Total	123

⁷ Limited by available capacity in FLAGS

276. The table above from the NGG Ten Year Statement shows that GB has 4.4bcm of gas storage space with total deliverability of 122.3bcm per day. It is worth noting that in 2008 National Grid completed a review of its LNG storage business and it was decided that one facility would have reduced capacity and another would be sold (however, there was little commercial interest in the site so National Grid decided to close the it). Table 32 below shows existing UK Storage.

Table 31: Existing UK Storage

Storage Project	Operator	Location	Space (bcm)
Rough	Centrica Storage	Southern North Sea	3.3
Hornsea	SSE Hornsea	Yorkshire	0.3
Hatfield Moor	Scottish Power	Yorkshire	0.1
Holehouse Farm	Energy Merchants Gas Storage	Cheshire	0.04
Humbly Grove	Star Energy	Hampshire	0.3
LNG Storage	National Grid LNG Storage	Various	0.3
		Total	4.4

Production and import investment

277. NGG's Ten Year Statement provides information in relation to proposed import and storage projects. Table⁷⁹ 33 outlines proposed projects that are expected over the course of the next five years.

Table 32: Proposed import projects expected over next five years

Project	Developer	Type	Location	Date	Capacity	Status
Aldbrough I	SSE/Statoil	Storage	East Yorkshire	2009	0.37bcm	Due to commission
South Hook 2	Qatar Petroleum/ ExxonMobil	LNG	Milford Haven	2009/10	10.5bcm/y	Under Construction
BBL Expansion	BBL	Pipe	Bacton	2010+	~3bcm/y	Investment Decision Taken
Isle of Grain 3	Isle of Grain LNG	LNG	Isle of Grain	2010/11	7bcm/y	Under Construction
Holford	E.ON	Storage	Cheshire	2010/11	0.16bcm	Under development
Caythorpe	Centrica	Storage	East Yorkshire	2011/12	0.2bcm	Under development
Dragon 2	BG Group/ Petronas	LNG	Milford Haven	2012	6bcm/y	Planning Received
Stublach	GDF Storage	Storage	Cheshire	2013/14	0.4bcm	Under development
ConocoPhillips	Partners	LNG	Teesside	2012+		Most planning granted
Canvey LNG	Partners	LNG	Canvey Island	2012+	5.4bcm/y	Planning rejected
Other LNG	Various	LNG	n/a	2012+		Conceptual
Aldbrough II	SSE/Statoil	Storage	Yorkshire		0.4bcm	Planning Granted
Portland	SSE/Statoil	Storage	Dorset		~1bcm	Planning granted
White Hill Farm	E.ON	Storage	Yorkshire		~0.4bcm	Planning granted
Gateway Storage	Stag Energy	Storage	Offshore Barrow		~1bcm	Planning granted
Albury I	Star Energy	Storage	Surrey		~0.2bcm	Applied for planning
British Salt	British Salt	Storage	Cheshire		~0.3bcm	Applied for planning

⁷⁹ Source: NGG Ten Year Statement, table 4.6B

Saltfleetby	Wingas	Storage	Lincolnshire		~0.7bcm	Applied for planning
Welton	Star Energy	Storage	Lincolnshire		0.4bcm	Planning not yet applied for
Albury II	Star Energy	Storage	Lincolnshire		~0.7bcm	Planning not yet applied for
Esmond Gordon	Star Energy	Storage	Offshore		~4bcm	Planning not yet applied for
Fleetwood	Cantaxx	Storage	Lincolnshire		~1bcm	Planning not yet applied for
Bains	Centrica	Storage	Off-shore Barrow		0.5bcm	Planning not yet applied for
Hewett	Eni	Storage	Offshore Bacton		5bcm	Planning not yet applied for

278. Regarding the quality and level of maintenance of the networks NG has a duty as a licensed gas transporter under section 9(1)(a) of the Gas Act (1986) to develop and maintain an efficient and economical pipeline system. This duty to maintain an efficient and economical network should ensure NG maintains the network at a sufficient level of quality.

Importance of LNG

279. LNG will play an increasingly important role in the GB gas market over the next decade. At present, around 2-3% of annual GB gas demand is met by LNG imports, but NG forecast that this proportion will increase to around 25% by 2017/18 as UKCS production declines, and pipelines from Norway and the Continent move closer to full capacity utilisation though there is significant uncertainty surrounding these numbers. The importance of LNG imports in meeting peak demand also increases significantly over the same period, with NG estimating its potential contribution rising to 82mcm/day (14%) by 2016/17, compared to 42mcm per day (8%) at present.

280. However, it should also be noted that out of all the supply components, LNG imports provide the greatest level of uncertainty due to the option to deliver gas to a number of alternative markets and the limited number of contracted supplies.

281. At present, GB has two main LNG importation terminals; the Isle of Grain and South Hook. The Isle of Grain terminal opened in 2005, with an expansion completed at the end of 2008 increasing its capacity to 13.5bcm per year. The South Hook terminal was completed in early 2009 and has a capacity of 10.5 bcm per year. A third facility, an on-board re-gasification facility located off Teesside (that came online in January 2007) has a maximum annual capacity of four bcm per year.

282. As noted, three further LNG importation projects are currently under construction; the Dragon terminal in Milford Haven, and expansions of the South Hook and Isle of Grain terminals. When completed, these projects will add a further 23.5bcm per year of capacity to the GB market, taking the total to 51.5bcm per year.

Forthcoming production capacity investment for the next three years

283. The annual UKCS Activity Survey conducted by the Oil & Gas UK association show that in 2008 £5billion⁸⁰ was spent on total development capital expenditure⁸¹ in relation to oil and gas fields and associated infrastructure. This figure is down slightly from 2007 development capital expenditure, which totalled £5.3billion. The survey implied that lower product prices, more difficulty in obtaining funding and a slow fall in input costs levels means that the development capital expenditure in 2009 will fall short of £5billion and may fall below £4billion in 2010. 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.

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

Gas Emergency Measures

285. National Grid has been developing a potential modification to the gas emergency claims arrangements, which aims to provide greater incentives to balance and more cost reflective signals for gas to be provided to GB from non-UK sources during a GB gas deficit emergency⁸².

286. In addition, National Grid will be making changes to the information available to the market, which should provide an improved warning system for market participants when the supply-demand balance is becoming tight.

287. National Grid aims to have both changes in place before Winter 09/10.

Incentives for new investment

288. We would expect a properly functioning market to send price signals to investors encouraging them to build the capacity to meet required future demand.

Major Infrastructure developments

289. No major changes from last GB National Report.

⁸⁰ UKCS Continental Shelf Survey 2008, BERR (2008); Link:
<http://www.berr.gov.uk/files/file50677.pdf>

⁸¹ Does not include exploration, appraisal and decommissioning spending.

⁸² 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 [Article 3(9) electricity and 3(6) gas]

Appropriate treatment of vulnerable customers

290. 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.

291. 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. 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 consulted on revised guidance during 2008 and we are expecting this to be published shortly.

Social Action Strategy

292. 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 2009 annual update to the Strategy, reviewing progress over the past year and identifying areas for the coming year, has recently been published on the Ofgem website.

293. The Strategy supplements Ofgem's broad approach of promoting competitive energy markets and regulating network monopolies, by focussing 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

294. 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 in both of these areas. In the 2008 Budget, the Chancellor announced an increase in suppliers' collective expenditure on their social programmes of £225 million over the period 2008 to 2011. Government requested that Ofgem lead a process to set the parameters for what can be included as part of this spend and the associated reporting arrangements.

295. Ofgem published a final decision and guidance document in July 2008 which included the full range of initiatives of suppliers' social programmes such as discounted

tariffs, rebates, trust funds and partnership schemes, as well as energy efficiency and joint industry initiatives. This included a new definition of a "social tariff" which must be at least as good as the lowest tariff offered by that supplier to a customer in that region on an enduring basis. This is regardless of that customer's payment method and includes online tariffs.

296. Ofgem published a report in December 2008 on the range of measures suppliers undertook to assist their vulnerable and fuel poor customers throughout 2007-2008. This showed that at the end of March 2008, there were approximately 460,000 customer accounts benefiting from social tariffs – an increase of 25.5% from 365,000 customer accounts on social tariffs as at 31 August 2007. Estimates are that there were over 800,000 customer accounts benefiting from a social tariff at the end of October 2008.

297. The Government's Carbon Emissions Reduction Target (CERT) scheme which will run from 2008 to 2011, (previously the Energy Efficiency Commitment (EEC2)), is the Government's main policy instrument for reducing carbon emissions from existing households. Under EEC2, suppliers had to meet at least 50% of their target with a "Priority Group" of customers including those receiving income related benefits or tax credits. With CERT, the Priority Group was expanded to include those aged over 70 and now suppliers are required to meet at least 40% of their target from this group.

298. In September 2008, Government announced its £1 billion Home Energy Saving Program, which included a 20 per cent uplift to CERT. This is expected to boost supplier household energy efficiency investment by some £560m by 2011, and increase the scheme's lifetime carbon savings. It also included a new initiative, the Community Energy Saving Program (CESP), which aims to deliver around £350m of energy efficiency packages funded by energy suppliers and electricity generators.

Fuel Poverty Action Programme

299. In April 2008 Ofgem convened a Fuel Poverty Summit that brought together Ministers, Government officials, energy suppliers and consumer organisations. Its objective was to agree a programme of practical action to improve the targeting of existing help to those in fuel poverty and help more vulnerable customers participate more effectively in the energy market.

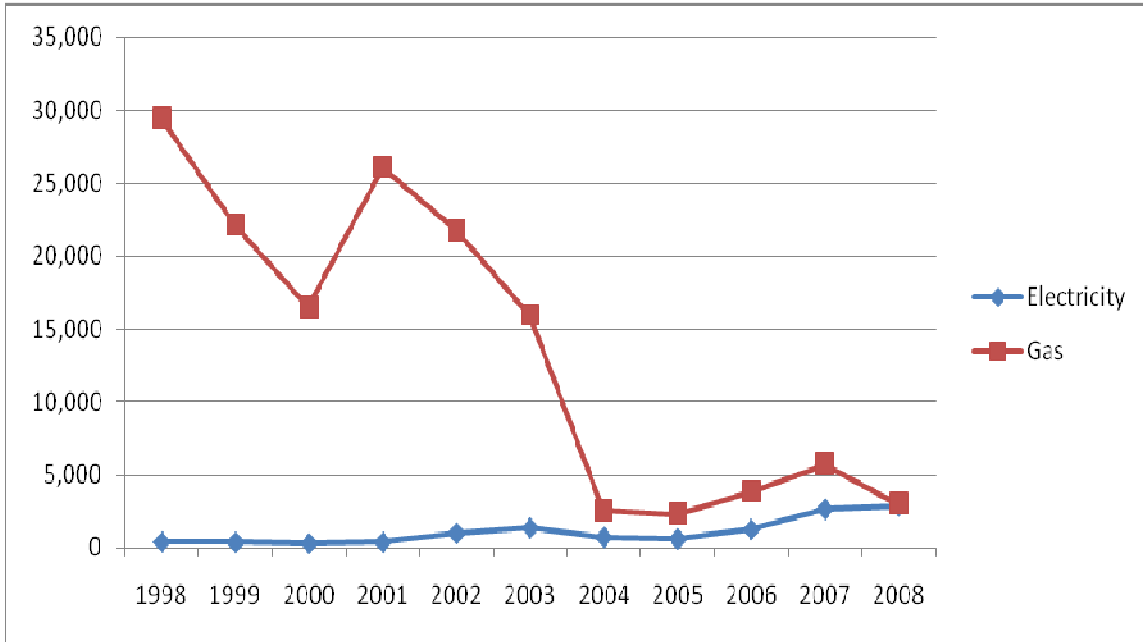
300. We subsequently published a Fuel Poverty Action Programme summarising the key commitments and outcomes that culminated from the Summit, including energy suppliers agreement to increase their collective expenditure on social programmes by £225 million over 2008-11, customers moved on to a cheaper tariff (including social tariffs) through a pilot scheme carried out by eaga and suppliers through the Government's Warm Front and Home Energy Efficiency Schemes and data sharing provisions now included in the Pensions Act 2008 to assist vulnerable energy consumers to receive assistance from energy suppliers.

Disconnections for non-payment

301. See previous GB National Report for background.

Total number of electricity and gas disconnections

Table 33: Total number of electricity and gas disconnections



302. In 2008, a total of 5890 customers were disconnected, representing a 30% decrease on the number of disconnections carried out in 2007. As illustrated in Chart 34 above, while electricity disconnections have increased overall in 2008, the rate of increase has dropped in relation to recent years. The number of customers disconnected for gas debt in 2008 reduced by 48%.

303. The overall reduction and the slowing of the rate of increase in electricity disconnections are largely attributable to a few key factors. E.ON continued its non-disconnection policy and British Gas only started reintroducing disconnections on a very small scale and on a trial basis towards the end of 2008. Some suppliers have reviewed their debt prevention and recovery processes in the light of Ofgem’s Debt and Disconnection Best Practice Review which has, in turn, enabled earlier proactive intervention. Although overall PPM installation rates came down in 2008 (significantly for electricity) some suppliers cite higher PPM installation (particularly for gas) as a reason for the reduction in the number of disconnections.

304. Following on from Ofgem’s Debt and Disconnection Best Practice Review published in January 2008, we are undertaking a further review of vulnerable customer disconnections jointly with Consumer Focus in 2009. The broader issues of suppliers’ practices and approaches regarding debt prevention and management will be taken forward separately by Ofgem and is scheduled to run until the end of 2009.

305. Under their licence, suppliers are prohibited from disconnecting customers in winter 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.

Transparent terms and conditions for supply contracts

306. There are no changes in this area since the last GB National Report.

Statutory requirements

307. For the relevant statutory requirements and licence conditions on supply activities which Ofgem oversees please refer to the last GB National Report. 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

308. 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. This is why 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. 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.

309. 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 smearing or pass through.

310. 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)⁸³, 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). But until insolvency occurs, Ofgem's scope to deal with a failing company is limited.

311. 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.

⁸³ Ofgem has the power to appoint a SoLR for all customers – domestic and non-domestic.

312. 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.

313. 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)

314. Since the March 18th 2005 all electricity suppliers have been required to provide customers on 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. This information must be provided with other environmental information related to the CO2 emissions and levels of radioactive waste generated.

315. 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.

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 (the new NCC). 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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NIAUR 2009 National Report to the European Commission

Date of Submission: 31 July 2009

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 2008 was the first 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. In this first year of contributing to the Regulator's National Report to the European Commission, NIAUR has provided high level descriptions only. It is intended to produce a full report from 2010 onwards. NIAUR will be providing data for the database indicators to accompany the text, as required by the Commission and by ERGEG.

The NIAUR Annual Report is available at:

http://www.niaur.gov.uk/uploads/publications/Annual_Report_2008-2009.pdf

The SEM Annual Report for 2008 is available at:

<http://www.allislandproject.org/en/sem-executive-overview.aspx?article=41798ae6-96da-4543-9ae1-660f1b1e2965>

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1. Foreword

2008 was a momentous year for gas and electricity regulation in Northern Ireland and was set in the context of the return of devolved government in Northern Ireland and new joint regulatory arrangements with the Commission for Energy Regulation (CER) the regulator in neighbouring Ireland.

2. Main Developments in the gas and electricity markets

The year 2008 was the first full year of operation of the Single Electricity Market, the first cross border market in Europe that embraces full integration of market operation and of regulation. It was also the first full year of operation of SEMO, the Single Electricity Market Operator whose second one year price control was carried out during the year. The process of divesting the system operator SONI also commenced and was concluded in 2009. 2008 also saw the first full year of a fully open retail market, although effective competition has yet to be achieved and is a high priority for NIAUR at present.

Work on the next phase of the All Island Project began with the development of Common Arrangements for Gas (CAG). A new price control was finalised for Phoenix Gas's distribution network and for Phoenix Supply.

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 been regarded as an interconnector for the purposes of the Electricity Directive. Nonetheless Moyle aims to comply with the requirements of the directive regarding congestion management. During 2008 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 is due for delivery later in 2009. The limit here is not the way in which Moyle is operated or capacity auctioned but the Single Electricity Market itself which is a day ahead gross mandatory pool i.e. no trading can occur after 10.00hrs on day -1. There is an 80MW limit on exports from NI into GB which is caused by a) TNUoS charging in GB and b) the network constraints from Scotland into the southern parts of GB.

3.1.2 The regulation of the tasks of transmission and distribution companies

The 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 DUoS tariffs are determined by the terms of this price control. It also receives a UoS allowance from the TSO. The allowed CAPEX is limited (mainly statutory maintenance etc.) with exceptional items individually approved and added via a Dt term.

The system operator in NI is SONI and it has a 3 year price control from 2007 – 2010. Its revenue is collected via TUoS and SSS tariffs. SONI is the interconnector administrator for the Moyle interconnector.

3.1.3 Effective unbundling

NIE has no generation affiliates in NI although the Viridien Group does own generation in Ireland which is part of the SEM. The NIE Group still owns the main supplier in NI but with strict ring-fencing applied.

During 2008 the process of divesting SONI from the NIE group was commenced. (This was completed in 2009).

3.2 Competition Issues

3.2.1 Description of the wholesale market

2008 was the first full year of operation of the SEM – it commenced operation on 1 November 2007. The SEM is a gross mandatory pool with gate closure at 10.00 hrs day ahead. The ex post market schedule sets the half hourly system marginal price and allocates infra marginal rent to those included in the schedule. Capacity payments are made to all available generators based on an annually calculated capacity pot. Regulated directed contracts and also non directed contracts provide hedging for market participants. The market is operated by SEMO – the Single Electricity Market Operator which is a joint venture between the system operators in NI and Ireland.

Further interconnection between Ireland and GB is planned however the very different market arrangements limit the extent of trading between BETTA and the SEM. During 2008 a programme by the regulators to identify and remove short and long term barriers to trading commenced.

3.2.2 Description of the retail market

At the end of 2008 the Utility Regulator made a commitment to deploy resources over the coming years to reduce barriers that currently hinder market entry and competition. A new Retail Unit was created to carry out the retail strategic intent of dealing with issues directly related to analysing and promoting competition in the energy retail sector (electricity and gas, e.g. k factors and margins, supply price controls, tariff structures, switching systems, branding separation and customers protection). Some of these projects are being undertaken in an all-island context with CER (the regulator in Ireland). Further details on specific current projects are as follows:

K factors and supply margins: In any given year, the revenues that the licensees earn from tariffs that they have to set in advance may differ from the allowable revenues. The k factor is a term in the price control formula that allows compensation for any under-recovery or over-recovery in any given year to be applied in the following year. A number of concerns have been raised over the continued use of k-factors in the price/revenue restrictions, suggesting that k-factors serve to undermine competition in supply. A consultation process has been opened welcoming views on several proposals on how to treat future developments in this area. This will have an impact on the incumbent Supply Price Control (NIE Energy Supply) and how the incumbent supplier is regulated.

Branding Separation: The Utility Regulator issued a decision paper on removing the barriers to competition in 2008 which concluded that one of the actions to be implemented would be branding separation between NIE PLC and NIE Energy Supply. The indicative timetable at this stage is Q3 of 09/10 to finalise plans to effect full branding separation in electricity, and then review policy in gas.

Suppliers Interface Group (SIG): SIG was established to deliver retail market opening to all classes of customer by November 2007. Since the market opened it has dealt with the day to day operational issues and will be responsible for implementing operational changes relating to the Enduring Solution.

Market Opening Senior Stakeholder Group (MOSSG): The main goal of the MOSSG is to act as a sounding board and policy advice forum on strategic/policy level issues that affect retail competition. The focus of the group will be largely in relation to NI retail markets. However, CER is participating on the group and part of the agenda will be to consider those issues which need to be debated in an all-island context.

Customer protection in a competitive environment: The Utility Regulator's new retail unit is leading a cross-utility group in a project to undertake a survey of electricity, gas and water customers in relation to Guaranteed Standards Schemes. In the coming months, supply marketing practices will be analysed.

3.2.3 Measures to avoid abuse of dominance

ESB is the single biggest generator on the island owning about 40% of generation. During 2007 the Irish government brokered an arrangement whereby generation in excess was sold. Endesa was the purchaser. The next largest owner of generation is the Viridien Group.

Generators in the SEM are required to comply with a bidding code of practice which limits their bid price to their short run marginal costs. This and other aspects of bidding are overseen by the Market Monitoring Unit which is part of the joint regulatory arrangements between NIAUR and CER for the SEM. Directed contracts also play an important role in preventing market dominance.

4. Regulation and Performance of the Natural Gas Market

4.1 Regulatory Issues

4.1.1 The regulation of the tasks of transmission and distribution companies

firmus energy Ltd. Distribution Price Control: The Utility Regulator carried out a price control on firmus energy Ltd. to last from 2009 to 2013. The price control limits the charge that can be made for using the firmus energy distribution network and relates to both capital and operating expenditure, achieving efficiencies to consumers of £6 million over the period.

Phoenix Supply Ltd. Price Control: The Utility Regulator carried out a price control on Phoenix Supply Ltd. determining the allowed operating expenditure and margin for the period 2009 to 2011. 25% of costs were removed from the original Phoenix Supply Ltd. submission, representing efficiencies to consumers of £5.1 million. These efficiencies will be passed on to consumers via savings in the tariff reviews for the Greater Belfast area.

4.1.1 Effective unbundling

The options for unbundling are being examined as part of the Common Arrangements for Gas (CAG) project.

4.2 Competition Issues

4.2.1 Description of the wholesale market

Common Arrangements for Gas (CAG) Project: The CAG project aims to operate the gas transmission network on a single all-island basis. To date, conclusions have been published on three key areas – operations, tariffs and gas quality. The next steps will be to determine the role of the proposed single system operator and the structure of the all-island tariff. This will require both Ministerial approval and supporting legislation.

A Cost Benefit Analysis (CBA) paper was jointly published with CER. The CBA identifies significant strategic benefits in addition to the quantitative benefits expected from streamlining the operation of the proposed CAG network. Both regulatory authorities take the view that the analysis provides a strong basis for pursuing the CAG project.

4.2.2 Description of the retail market

Gas Market Opening Group: The Gas Market Opening Group (GMOG) was established by the Utility Regulator to address any operational barriers to entry into the gas supply market in Northern Ireland. The group includes representation from license holders, the Department of Enterprise, Trade and Investment, the Consumer Council and the Commission. The GMOG is examining each of the barriers to entry raised by its members, with a view to making a decision on the best way to address each issue.

4.2.3 Measures to avoid abuse of dominance

Ring fencing of Phoenix Natural Gas Limited (PNGL): PNGL, the gas distribution company in the Greater Belfast area, have consented to proposed Licence modifications which require financial ring fencing arrangements to be put in place.

5. Security of Supply

5.1 Electricity

SONI prepare an annual Generation Capacity Statement which covers both demand predictions and the generation margins. The statement for 2008 shows:

- Current level of electricity peak demand is 1678 MW;
- The NI Generation Security Standard is met until 2012 based on the central scenario;
- NI and All Island generation adequacy analysis for beyond 2013, based on assumptions regarding plant retirements, has identified scenarios where there is a requirement for additional generation capacity;
- Currently available total net generating capacity is 2482 MW, of which 220 MW of wind is assumed to be available;
- 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 was ongoing during 2008, however the project is encountering significant opposition from residents along the route. This has not resulted in delays to date, however this may become an issue following submission of the planning application.

5.2 Gas

NTS Exit Reform: Ofgem have proposed changes to the process for allocating capacity at exit points from the National Transmission System (NTS). The intention of the reform is

to more accurately reflect the costs of NTS exit capacity. However the mechanism proposed will create uncertainty in the levels of available capacity at Moffat in Scotland, the NTS exit point for Northern Ireland, Ireland and the Isle of Man. This uncertainty could result in security of supply issues to the three downstream jurisdictions.

Gas Storage: Interest has been expressed in storing gas in underground salt caverns in the Larne area. Work is being done on the regulatory framework that will apply to gas storage facilities in Northern Ireland.

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 20th 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 are fully implemented. To date a fuel mix calculation has not been carried out in Northern Ireland and the current methodology for Ireland used to calculate the 2007 disclosure figures is no longer applicable with the introduction of the Single Electricity Market (SEM). Therefore new arrangements are required to calculate suppliers' fuel mix disclosure in the SEM. The SEM Committee has issued a decision in March of this year outlining the high level methodology for these 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 2010.

6.2 Vulnerable Customers

Following an extensive consultation process carried out from January to June 2009 the Utility Regulator will be publishing a Social Action Plan as a statement of how we intend to take forward our work in relation to social responsibilities and ensure that we meet our statutory duty to protect customers in the present and in the future. The Social Action Plan has been developed around two main themes: issues of financial vulnerability and issues of equal access to utility services. Planned activities have been categorised under five themes:

- Reducing financial insecurity;
- Equal access to utility services for vulnerable groups;
- Energy and water efficiency;

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- Working with others;
- Monitoring and review of Social Action Plan.