

Minutes of a Meeting of the Gas and Electricity Markets Authority

Thursday 24th November 2011 at 8.15 am

Cardiff

Introductory remarks by the Chairman

1. There was an apology for absence from David Fisk who was abroad on business. The Chairman noted the interest of a Member who was providing help to a company advising on complaint handling: should their future work involve the energy sector, the Member would not take part. Bob Hull had been appointed to join the Audit and Risk Committee of UKTI and had registered this interest.
2. It was agreed that the previous evening's Dinner with the First Minister and a number of senior energy contacts had gone well, and that the Authority should consider a further visit and meeting in Wales for November 2012. The Authority expressed its grateful thanks to Charles Gallacher and his team for the arrangements and their continuing and productive work in Wales on Ofgem's behalf.
3. The Chairman and the Legal Adviser explained that, following a number of small changes needed to the membership provisions for the Enforcement Committee, there were equivalent modifications required in respect of the membership of the Settlement Committee, again after recent personnel moves, new titles and promotions. These were explained to and agreed by the Authority.
4. The Chairman noted that NEDs' views on the current working of remote access IT systems were being reviewed by the Secretary. The emerging view was that substantial investment in new systems was unlikely to be warranted. The Secretariat would liaise with IT colleagues.
5. On appointments, it was understood that Ministers at DECC were being consulted on both re-appointments and new appointments of Non-Executive Directors to the Authority, and their terms, and processes planned for taking forward a recruitment exercise in 2012.
6. The Chairman noted that he was signifying his approval for delegated authority to agree new regulations in respect of the DECC Renewable Heat Incentive scheme.

Minutes of the Authority Meeting held on 13th October 2011

7. The minutes of the previous meeting were approved. A few, minor drafting changes proposed would be taken forward before the minutes were published.

Reports from the Chief Executive, Senior Partners and MD/E-Serve

8. In his report, the Chief Executive presented a view on the development of and the actions taken under the Retail Market Review, including the history of the main measures taken since 2008 to protect the interests of energy consumers, and the energy companies' responses. This noted the next steps on the RMR with the launch of detailed proposals to enhance consumer choice and reduce tariff complexity for domestic customers, and the measures announced to help non-domestic consumers. The liquidity proposals, designed to promote competition and new supplier entry, would be considered further at the present meeting and again in December. The report covered the content of the series of Quarterly Reviews (QRs) requested by Ministers, their findings, and reactions to the analyses presented. Another QR report was due for consideration and publication in December. The Authority would be presented with the results of forensic accountants' examination of companies' accounts, looking at improved transparency, early in 2012. Finally, the Chief Executive set out the main policy strands which might feed into the development of the next Corporate Plan and Strategy.
9. The Authority welcomed this analysis, and its overall perspective, and noted the importance of communicating effectively the steps which were being taken under Ofgem's leadership in championing the interests of consumers, present and future. Rising prices, and the reasons for these, remained a major concern, as did tariff complexity and billing. In debate, it was acknowledged that the industry had taken some steps to deal with the underlying concerns of consumers. But there was still a significant way to go in addressing these worries comprehensively, as well as gaps in delivery when suppliers' intentions and achievement were compared. The Authority was clear that this argued for continuing the pursuit of appropriate, well researched and balanced sets of remedies, aimed at protecting consumers and restoring their confidence in the retail market and its workings.
10. On the QR, the Authority concluded that there would be benefit in preparing and publishing more frequent analyses and trends in factors such as margins. The Executive would review and report further. As regards the elements of the next strategy, wider developments such as the Government's plans for electricity market reform and their delivery, in particular, plus EU developments and other interdependencies relating to Ofgem's work, argued for careful review and debate early in the New Year as some of these key determinants began to clarify.

11. The report from Markets Division began with an update on energy market developments. There had been a modest drop in wholesale energy prices in the UK due to mild weather conditions and weaker economic forecasts. Gas demand was down some 13%, year on year, and had been lower for every month in 2011 thus far than in 2010.
12. Despite concerns over the global economy, and the prospect of fully resumed Libyan production, oil prices remained high. International LNG prices were significantly higher, notably in Japan, and were now at higher levels than European oil-indexed contract rates. The NBP spot rate for gas and the forward curve had fallen recently, with Winter 2011/12 prices below 70p/therm, perhaps due to weak fundamentals rather than other factors. However, Winter 2012/13 prices remained high reflecting a substantial risk premium. Gas storage was at about 99% of capacity, higher than in any of the past six years at this point.
13. The UK forward power curve had fallen compared to the previous month with UK prices remaining cheaper than for mainland Europe at the prompt end of the curve. This was not the pattern seen for Q1 to Q3 2012, some considering that this may be due to the evolution of French nuclear prices and the solar generation envisaged in Germany at that time. UK power demand had been lower in almost every week in 2011 compared to 2010. Spark/dark spreads confirmed the pre-eminence of coal, across the forward curve, despite some softening of gas prices. Finally, data were presented on the current position on remaining running hours for LCPD opted-out GB power stations, and projected closure dates.
14. The headlines on the proposed action on the Retail Market Review had been published on October 14th, and a series of steps for the non-domestic sector had issued on 21 November. The details of the domestic sector proposals would be published during the week commencing 28 November, including information on Ofgem's commissioned consumer research and Impact Assessments. The Authority noted that some companies were now announcing their own proposals for simplifying energy tariffs, and some other moves, to try to rebuild relationships with their customers.
15. Proposals for a scoping consultation on electricity cash-out reform had been published on 1 November, this being a key Project Discovery commitment which had significant links both to the Government's plans for electricity market reform and steps to improve liquidity in the market. On gas security of supply, proposals for the related Significant Code Review had issued on 8 November. Work with DECC had led to agreement on an Ofgem study on residual gas security of supply risks, with advice sought in late Spring 2012.
16. The Authority was briefed on progress on National Grid's work to revise the metering service agreement contracts which had been the subject of a successful case, under the Competition Act 1998, brought by Ofgem. British

Gas' proposed derogation from the requirement for two-yearly inspections of meters has been approved by HSE and Ofgem would now consider the consumer impacts. On other metering aspects, the Authority noted a brief report about the DECC programme to introduce smart meters, and the key steps taken, and now planned, for the roll-out.

17. A briefing was provided on the new EU regulations ("REMIT") which addressed market abuse – such as insider dealing and market abuse – in physical wholesale gas and electricity markets. Ofgem would implement these in the UK; ACER would be advising on the detail; and Member States would be granted an 18 month lead-in time for establishing powers for monitoring, data collection and enforcement measures. The Authority noted some of the resource and legal implications for Ofgem. Consultations by DECC and Ofgem were soon to be launched on new licence conditions, pursuant to the Energy Act 2011, dealing with enforcement action to tackle market abuse in relation to transmission constraints.
18. The Transmission Division report focussed first on the initial results of Project TransmiT where initial modelling conclusions were now being received. This linked to an information paper explaining that three broad charging options were being explored whose broad initial impacts were explained and noted. A paper was planned for the December Authority meeting, refining these models and their impacts, with a view to the publication of a consultation document on the proposals.
19. In the matter of the claim by National Grid in the Courts to recover damages in the light of the EU Commission's ruling on the activities of an insulated switchgear cartel, the Authority was asked for, and agreed to give, delegated authority to the Executive, in conjunction with the Legal Adviser, to determine an appropriate way forward in the light of the progress in the case.
20. The Authority noted the current position on the proposed reinforcement of the network around Sloy to increase transmission capacity in Western Scotland under the TIRG mechanism, the delays in commissioning, and the proposed Ofgem treatment of the remuneration of agreed efficient expenditure. In respect of carbon capture and storage, the Government had announced that it had been unable to reach a conclusion on a commercial scale demonstration project at Longannet power station; and that the earmarked funding would be used for other projects. It was understood that other CCS options/sites were being considered by industry groups. The Authority would be kept informed, given the need to consider the potential use of part(s) of the gas transmission system for CO₂ transmission.
21. The report from Sustainable Development Division recalled the progress being made in dealing with a substantial workload of enforcement cases. This dealt also with compliance activity, and letters issued to companies on needed action, and the possibility that enforcement activity would follow. The

Authority welcomed the progress being made, recognised both the challenge and complexity of the work, and acknowledged the efforts of the team as well as the major input of NEDs as members of the enforcement committees.

22. On the competition landscape, an announcement on the Government's conclusions was anticipated shortly. An outstanding issue was expected to be on decision-making in competition cases, and hence the role of the CAT, or of competition authorities such as Ofgem. The Authority would be advised in due course on the impacts for Ofgem. The Authority was briefed on the consumer landscape reforms where Ministers were considering options for the delivery of the regulated industries functions.
23. The Authority was informed about the report on supplier obligations for Q2/2011 which covered disconnections of electricity and gas customers; household debt numbers and average debt levels; and repayment rates. There was also a report on supply companies social spend in 2010/2011, including on social and discounted tariff rates and rebates; trust funds; and partnerships on energy efficiency measures. This was welcomed and the Authority noted that, over the three years of the voluntary programme, suppliers' spend in total had exceeded commitments made to Government. An Open Letter was planned on business back-billing welcoming, and noting, industry progress but arguing for shorter periods of retrospective debt claims than under the current self-regulatory approach being developed by representatives of suppliers.
24. Smarter Grids and Governance (Distribution) Division's report noted that one company had submitted its RIIO-GD1 plan ahead of schedule and had embraced the new HSE approach towards iron mains replacement with savings to planned repex. A report commissioned by the Smart Grid Forum, and sponsored by Ofgem had been published. This specified the framework to be used to evaluate the costs and benefits associated with the move to smart grids under a number of scenarios. It would help to underpin policy development in GB, assist DNOs in their business planning, and Ofgem in leading future thinking on smart grid policy in the EU.
25. The Authority was briefed on the first application under DPCR5 to encourage DNOs to facilitate competition in connections, with the prospect of the lifting of price regulation in those market segments with effective competition. Some detailed work was in progress with all DNOs to ensure that steps were being taken to remove barriers, for new entrants.
26. The E-Serve report focussed on a range of key issues. New resources were being devoted to the minimisation of the risk of fraud and in increasing the resilience of IT services in the light of evolving needs. Consultancy advice would be deployed to evaluate any other needed enhancements. The Invitation to Tender for the London Array connection would be issued in late November as a continuation of Tender Round 2a (TR2a). NAO were

continuing their audit of TR1 and their work would be discussed at the Offshore Committee. The volumes of applications for the FIT Scheme continued to run at substantially higher levels than projected. DECC had consulted publicly on lowered tariffs, in late October. It was understood that a number of parties had initiated Judicial Review proceedings to challenge the decision taken.

27. On the RHI, there had been a delay of about a month in the launch of the scheme while possible state aid issues were examined by DECC and others. Ofgem had issued its draft guidance and would be attending some dozen industry events. The Stage 2 systems had been developed but had been delayed by a similar degree. Finally, a revised MoU had been drafted covering Ofgem's work for DECC: comments were awaited from the Department.

Report of the Group Finance Director

28. From his report, the Group Finance Director highlighted the following main issues:

- Spend to date was running some 9% below phased budget and reforecast were suggesting an underspend for year as a whole of which a substantial proportion was related to reductions in funded scheme work
- Vacancies were contributing to a staff underspend, currently of the same order
- Other costs would rise as staff numbers increased and vacancies filled
- The good progress on all major projects. Their current status and issues arising, with the planned dates for Authority updates, were noted.

29. The Authority noted that further work was planned to examine and test further the levels of resilience of Ofgem's IT systems and anti-fraud measures, an issue on which the Audit Committee would be involved.

Liquidity: options

30. At this item, the Authority continued its preparatory consideration of proposals for action to improve liquidity in the electricity market, including an update on proposals for a mandatory auction (MA) model and its key design features on which further work on a range of technical aspects and options had been further considered and developed.
31. The Authority noted that some of the "Big Six" companies had recently taken steps to trade smaller clip sizes for independent suppliers; and that one

company had committed to auction 100% of their power output in the day ahead market.

Electricity Market Reform

32. The Authority noted that DECC was expected to publish its next policy document on the Electricity Market Reform package in December, with proposals on both the preferred capacity mechanism and on delivery institutions. This could raise a number of issues on underlying policy matters, and potentially aspects of Ofgem's regulatory role. The Authority explored in a preliminary way how some of these issues might impact on Ofgem and the means by which these might be reflected in the continuing dialogue with DECC.

Regulating the Gas and Electricity Systems Operators

33. The Authority was briefed on the System Operators project (SO 2013) which aimed to provide a substantial overhaul of the present measures, potentially for the period 2013 to 2021, so as to align these incentives with those to be developed for RIIO-T1. The incentives covered some £1 billion per annum of direct costs to consumers. System operators played a key role in the competitive market, and in delivering reliable and economical system operations, including balancing and constraint management. The Authority noted that three main factors would influence the longer term development of SO incentive policies : the impact of the DECC EMR proposals for SOs' responsibilities; work on the role of SOs in the context of offshore and North Sea planning; and the possibility of changes to policies on security of gas supply.
34. Since some of the current gas SO incentives were due to expire in March 2012, Ofgem had announced a one year roll-over of the measures to the beginning of April 2013. Taking on board consultation responses, Ofgem now proposed to the Authority three changes to the extended proposals. These involved updating of incentives for NG, as system operator, to reduce "shrinkage" costs, covering gas lost in the transmission network, and electricity used to power gas compression; revised targets for NG's gas demand target; and the removal of the incentive to reduce the volume of "unaccounted for gas". The Authority agreed these approaches.

Offshore transmission coordination: update

35. Under this item, the Authority was given an update on the work underway to provide future-proofing of the offshore transmission regime to help ensure that efficient and coordinated networks could be developed. Consultancy advice had been provided on both asset delivery and the commercial, economic and regulatory considerations. An Offshore Transmission Coordination Group had been established to review the issues.

36. The Authority noted this review, and the plans to submit a paper to the December Authority meeting for decision on the substance of a consultation early next year.

TPCR4 adapted roll-over: final proposal

37. The Authority received advice on recommended final proposals for the TPCR4 adapted roll-over for the four gas and electricity transmission operators, applicable for 2012/13. This would continue to use the present approach to price controls involving incentive-based regulation under the RPI-X approach; and the extension would enable the full incorporation of the RIIO recommendations and methodology. Three consultations had taken place in 2011, with Initial Proposals being published in August, setting out allowable revenues and incentives and the required delivery outputs.
38. In the light of the consultations, and subsequent exchanges with TOs, some proposed changes had been developed to cost forecasts and on the approach to “truing up” on the capex incentive. Other elements, it was proposed, would remain in the Final Proposals, as set out in the Initial Proposals. The Authority agreed the recommendations made.

Strategy and Policy Statement

39. The Authority noted that exchanges with DECC had continued on the detailed development of the legal framework for introducing the SPS. The present position on a range of issues was explained, including the handling of any changes to the SPS, and reporting by Ofgem. The Authority noted these developments, and supported the line proposed for addressing the remaining issues.

Implications for Sustainable Development

40. The Authority was informed of Ofgem’s plans to develop a Strategic and Sustainability Assessment (SSA) framework. This would enable long term and often qualitative considerations to be part of Ofgem’s Impact Assessments, and also provide help in informing robust decisions on sustainability. While these considerations were already covered in many of the Ofgem programmes and their outputs, the SSA approach would provide improved coherence, consistency and clarity. Elements would include long horizon discounting and depletion; stress and security tests; diversity considerations; and supply chain development; and aspects of the treatment of policy options.
41. The new framework would be trialled over the coming months with the view to amending and consulting on changes to the Impact Assessment framework in due course. Authority welcomed the proposed approach and

suggested that reports should come forward in due course on the results and success of these new assessment tools.

Smarter energy markets

42. Under this agenda item, the Authority was briefed on the proposal to consult on the potential scope of a strategy for shaping smarter market development, based on the platform of the mandatory, DECC-led roll-out of smart meters to all GB domestic and smaller non-domestic customers. This was part of the delivery of aims in the current Corporate Plan. It was considered that, while smart metering would help to drive significant cost savings through greater energy efficiency, market developments may in addition unlock and catalyse significant customer value. These could include improving industry efficiency and incentives, promoting competition, and the stimulation of innovation, all to the benefit of consumers. The initiative would require reform of a number of existing regulatory approaches which were outside the scope of the DECC programme.
43. Close engagement with stakeholders in recent months had led to two broad suggestions for consideration in this project. The first would involve examining the potential for supply chain innovation – such as new products and services, for example time-of-use tariffs. The second element might examine improvements to industry processes which supported the operation of the market – for example making changes of supplier faster and more reliable. The project would seek to identify benefits and associated potential customer risks.
44. The Authority noted and welcomed the plans outlined and looked forward to reports from the planned consultation on the scope of the study, in due course.

LCNF

45. The Authority was provided with an update on progress of the Low Carbon Networks Fund (LCNF) following the completion of the second annual competition. The standard of submissions had improved and it was proposed that all six projects submitted for the 2011 tranche be approved for funding, three as proposed; and three with some additional conditions. An announcement was planned for the end of November.
46. The four projects selected for funding in 2010 were broadly on track to deliver their planned outcomes, and trials on the learning outcomes and their uptake were already in progress. It was proposed that a review of the LCNF scheme would begin after two years' experience such that lessons in running the Fund could be incorporated for future years' activity.

Smart Meters: Installation Code of Practice

47. The Authority was briefed on DECC progress and the key issues emerging on the drafting of licence conditions underpinning the smart meters installation code of practice, as well as the drafting of the code itself. DECC had tasked suppliers with developing the Code and its objective was to provide advice and guidance to direct suppliers - and installers working on their behalves - when installing smart meters and in-home displays.
48. The contents of the Code, and Ofgem's role in its approval and modification, and in respect of supplier compliance, were noted, alongside Ofgem's response to DECC's consultation and plans for implementation.

Enforcement Strategy

49. At this item, the Authority was informed about proposals to consult on Ofgem's revised Enforcement Guidelines on Complaints and Investigations, and the plan to call for evidence to feed into a wider review of Ofgem's approach to enforcement. Updating of the 2007 Guidelines was desirable to reflect evolving practice and new areas of work, and experienced gained, as proposed in the Corporate Strategy and Plan 2011/2016. Consultations were planned for December.

Enforcement cases

50. The Authority considered and noted its monthly schedule of enforcement cases and the progress of each case under review. The Chairman recalled the substantial progress being made, and the complexity of the present cases and their demands, adding his congratulations to the Ofgem teams involved and offering once more his thanks to those NEDs participating in this important work.

Other business and date of next meeting

51. There was no other business. The next Authority meeting would be held on **Thursday 15th December at Ofgem at 8.15 am.**

Those present

The Lord Mogg	(Chairman)
Alistair Buchanan	(Chief Executive)
Stuart Cook	
David Harker	
Sarah Harrison	
John Howard	

Jim Keohane

Jayne Scott

Andrew Wright

John Wybrew

Those attending

David Pimm (all items)

Rachel Fetcher (")

Hannah Nixon (")

Ian Marlee (")

Charles Gallacher (")

Michael Brocklehurst (Legal Adviser to the Authority)

Dr Tony Burne (Secretary to the Authority)

Those attending by phone link

Giles Stevens (Liquidity) (EMR)

Camilla Eggington (")

Phil Slarks (")

Tim Collins (")

Sarah Cardell (") (EMR)

Graham Knowles (EMR)

Tom Harper (")

Peter Hicks (")

Sukinder Lalli (")

Anna Saksonov (")

Giuseppina Squicciarini (SOs)

Jane Corera (")

Bob Hull	(Offshore Transmission)
Mark Cox	(" ")
Jon Parker	(" ")
Natasha Ranatunga	(TPCR4)
Gareth Walsh	(TPCR4)
Peter Trafford	(")
Chris Watts	(")
Adam Cooper	(")
Joanna Whittington	(SPS)
Andy McFaul	(")
Megan Forbes	(") (Sustainable Development)
Sarah Samuels	(Sustainable Development)
Michael Grubb	(" ")
Neil Barnes	(Smarter Markets)
Colin Sausman	(" ")