



Promoting choice and value

for all gas and electricity customers

2013 Great Britain and Northern Ireland National Reports to the European Commission

**National Reports in relation to Directives 2009/72/EC
(Electricity) and 2009/73/EC (Gas)**

Ofgem 2013 National Report to the European Commission

Overview

The Directives on gas and electricity liberalisation stipulate a reporting obligation. To that end, this report covers Ofgem's¹ annual reporting requirements to the European Commission, in accordance with Directives 2009/72/EC (Electricity) and 2009/73/EC (Gas).

Ofgem is the Office of Gas and Electricity Markets. It is governed by the Gas and Electricity Markets Authority (the Authority).² The Northern Ireland report is found in the second section of this UK response.

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

- Developments in the GB energy markets in 2012 and 2013 Quarter I + II
- The regulation and performance of the GB electricity and gas markets along the themes of Network Regulation, Promoting Competition, and Security of Supply
- Our compliance with the Electricity and Gas Directives on consumer protection and dispute settlement

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 since 2007. While the structure of the 2013 report has been updated from previous years, much of the information remains unchanged, although latest data is supplied where relevant. Where background on particular issues is not included, please see the 2012 GB report. It should be noted that some of the information in this report relates to matters which are outside of Ofgem's jurisdiction. Where external sources are used references are provided.

Finally, for further information on Ofgem's activities, please consult our Annual Reports. The 2012-13 Ofgem Annual Report is available at the link below³.

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

² The Authority determines strategy, sets policy priorities and takes decisions on a range of matters, including price controls and enforcement. See the Ofgem website for more information
<http://www.ofgem.gov.uk/About%20us/Pages/AboutUsPage.aspx>

³ http://www.ofgem.gov.uk/About%20us/annlrprt/Documents1/Ofgem%20AR_R%202012_13_final.pdf

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1. Ofgem Foreword

In recent years the energy sector has witnessed fundamental changes. The impact of each change – in policy, in technology, in generation and in demand to mention but a few – has brought continuing challenges for Ofgem in what we do, and how we do it. But one thing has not changed: Ofgem’s principal concern remains to get the best results for, and look after, the interests of consumers, present and future.

Key decisions over the past year reflect this objective. Arguably Ofgem’s main task in 2012-13 was to set the price controls for the transmission companies and the gas distribution companies. The successful development and (unchallenged) application for the coming eight years of the new RIIO (Revenue = Incentives + Innovation + Outputs) framework – which replaced the RPI-X regime – marked the culmination of a reform process started in 2007. RIIO is a price control that is relevant to today’s networks challenges. It will enable us to develop and grow sustainable networks, encourage engineering leadership and innovation, and reward through incentives.

The fully researched retail market review also established a sound basis for the radical simplification of the accumulated complexity of energy tariffs. And our enforcement activities will further ensure that energy companies comply fully with their obligations and, as a result perhaps improve the prospects of greater trust being placed in them from their consumers. We have taken a lead on setting out the risk for consumers in relation to security of supply, helping to inform the UK Government’s Electricity Market Reform package and taking actions within our remit.

We continue to take a leading role in European energy regulation, working with the Agency for the Cooperation of Energy Regulators (ACER) and the Council of European Energy Regulators (CEER) – of which I am respectively Chair of the Board of Regulators and President. Significant progress has been made on the internal market, including development of Framework Guidelines and Network Codes, and on infrastructure development with ACER’s assessment of the first list of projects of common interest. We have been preparing for the practical application of the new European legislation on wholesale market integrity (REMIT) and in June 2013, the UK Government provided Ofgem with enforcement powers in this regard.

As I pass on my role at Ofgem after ten years to a new Chair, I believe that the Authority and staff of Ofgem are strong and competent. I have every confidence, therefore, that I hand over an organisation well equipped to meet the challenges it will face in the future.



Lord Mogg, Chairman

2. Main developments in the gas and electricity markets

2.1 Market Developments

2.1.1 Electricity Markets

Electricity Market Reform (EMR)

In November 2012 the UK's Department for Energy and Climate Change (DECC) introduced the Energy Bill into the House of Commons that will provide the legislative framework for its Electricity Market Reform (EMR) policies. Accompanying the Energy Bill's publication was a series of documents providing more detail on the EMR policies.⁴ The key elements of DECC's proposed reform package include:

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

Ofgem undertook a joint study with DECC to assess the conflicts and synergies of the National Grid as System Operator taking on the role of EMR delivery body. We continue to work closely with DECC on what role Ofgem may play in the implementation and administration of EMR.

Electricity Cash-out Significant Code Review (SCR)

In our February 2010 Project Discovery⁵ consultation we expressed concerns that electricity cash-out prices⁶ may not be correctly signaling the value of flexibility and peaking generation, increasing the risks to future security of supply.

We launched a Significant Code Review (SCR) of the Electricity Balancing Arrangements in August 2012, with the publication of an Initial Consultation Document.⁷ This review will allow us and the industry to consider ways to improve the balancing arrangements and their contribution to delivering an efficient level of security of supply. This review also

⁴<https://www.gov.uk/government/organisations/department-of-energy-climate-change/series/energy-bill>.

⁵ Project Discovery: Options for delivering secure and sustainable supplies. Available here:

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

⁶ When a market participant generates or consumes more or less electricity than they have contracted for, they are exposed to the imbalance price, or 'cash-out' price, for the difference.

⁷ Electricity Balancing Significant Code Review (SCR) – Initial Consultation. Available here:

<http://www.ofgem.gov.uk/Markets/WhIMkts/ComandEff/electricity-balancing-scr/Documents1/Electricity%20Balancing%20SCR%20initial%20consultation.pdf>.

allows us to assess whether changes are needed to make the balancing arrangements robust to changes in the generation mix and to implement the European Electricity Target Model.

Cross-border electricity market developments

The England-France Interconnector (IFA) and BritNed interconnectors are participating in the North West European project to implement a common regional approach to day-ahead market coupling and intraday trading. These are key pilot projects for the implementation of the European target model.

Following the removal of Transmission Network Use of System (TNUoS) charges on cross-border flows in 2011, the Authority took decisions to remove all further potential charges on cross border flows in 2012. On 1 May 2012 the Authority approved a decision to remove charges for GB transmission network losses from cross border flows. On 15 August 2012 the Authority approved a decision to remove Balancing Services Use of System (BSUoS) charges from cross border flows. On 23 January 2013 the Authority approved a decision to remove Residual Cashflow Reallocation Cashflow (RCRC) from cross border flows.

Unbundling

Under the ownership unbundling requirements set out in the Third Package Directives and Regulations and the GB transposing legislation, during 2012, the Authority certified two Transmission System Operators (TSOs) on the basis of a derogation granted under Article 9(9) of the Electricity Regulation, namely Scottish Power Transition Limited (SPTL)⁸ and Scottish Hydro Electric Transmission Limited (SHETL)⁹, and two TSOs as fully ownership unbundled, namely National Grid Electricity Transmission plc (NGET)¹⁰ and National Grid Interconnectors Limited (NGIL)¹¹. To date, the Authority has also certified five Offshore Transmission Owners (OFTOs) and one preferred bidder, as independent.

There were no changes or additions to the population of electricity distribution system operators (DSOs) in Great Britain during 2012. There continue to be fourteen electricity DSOs and six independent (embedded) electricity distribution system operators.

In 2013, the Authority:

- (i) has, pursuant to section 10D(1) of the Electricity Act, made a preliminary decision to certify the electricity interconnector, BritNed Development Limited (BritNed) under the ground in section 10E(7) of the Electricity Act; namely, on the basis of an exemption granted to BritNed in accordance with BritNed's licence and under Article 7 of Regulation (EC) No. 1228/2003. On 20 March 2013, the Authority notified its preliminary decision to the European Commission in accordance with section

⁸ <http://www.ofgem.gov.uk/Europe/Documents1/SHETL%20certification%20decision.pdf>

⁹ <http://www.ofgem.gov.uk/Europe/Documents1/SPTL%20certification%20decision.pdf>

¹⁰ <http://www.ofgem.gov.uk/Europe/Documents1/NGET%20certification%20decision.pdf>

¹¹ <http://www.ofgem.gov.uk/Europe/Documents1/NGIL%20certification%20decision.pdf>

- 10D(4) of the Electricity Act and Article 10(6) of the Electricity Directive. The Authority is awaiting the Commission's opinion on this preliminary decision in accordance with Article 3 of the Electricity Regulation.
- (ii) is processing an application for certification made by Moyle Interconnector Limited (MIL) and received by the Authority on 5 February 2013. This application is made on the ground set out in section 10E(3) of the Electricity Act; namely, that MIL meets the ownership unbundling tests set out in section 10F of the Electricity Act.

2.1.2 Gas Markets

Gas Security of Supply Significant Code Review

In response to Ofgem's Project Discovery¹², DECC's Energy Bill 2010 and the entry into force of the EU Gas Security of Supply Regulation, in January 2011 we launched the Gas Security of Supply Significant Code Review (Gas SCR). In addition, the Energy Act 2011¹³ established powers to allow the Authority to require changes to the Uniform Network Code (UNC) if the Authority considers that such modifications will decrease the likelihood or severity of a gas supply emergency.

The aim of the SCR is to assess whether reforms to the current gas market arrangements are required to improve security of supply; the primary focus being on the gas emergency cash-out arrangements. The cash-out arrangements are designed to target the cost of energy balancing incurred by the system operator to the parties who created those costs (i.e. those parties who do not balance their inputs and outputs within the relevant balancing period). As such, parties who are not in balance incur charges that reflect the costs incurred by the System Operator in addressing the imbalance. These charges are known as cash out prices.

We published a draft policy decision on the SCR in November 2011¹⁴, and a proposed final decision in July 2012¹⁵, which set out our minded-to position to strengthen the incentives on market participants to deliver adequate gas supplies through cash-out reform. These set out our proposals to reform the emergency cash-out arrangements such that the cost of curtailing supplies to firm gas consumers is reflected in the cash-out price, and to ensure that consumers are paid appropriately in the event that their load is reduced as a result of a gas deficit emergency. This is consistent with the principles encapsulated in the European Gas Balancing Network Code.

¹² Project Discovery investigated whether current market arrangements in GB are capable of delivering secure and sustainable energy supplies over the next 10-15 years. It identified a number of concerns with the current gas emergency arrangements. As part of Project Discovery we set out a range of policy options for addressing these issues, some of which will be considered as part of the SCR. Project Discovery publications can be found on the Ofgem website: <http://www.ofgem.gov.uk/Markets/WhIMkts/monitoring-energy-security/Discovery/Pages/ProjectDiscovery.aspx>

¹³ <https://www.gov.uk/government/publications/energy-act-2011>

¹⁴ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=46&refer=Markets/WhIMkts/CompandEff/GasSCR>

¹⁵ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=85&refer=Markets/WhIMkts/CompandEff/GasSCR>

Following stakeholder feedback, we are working to consider developments to our proposals, including the potential to incorporate a mechanism for centrally managed demand-side response which could be incorporated into the emergency cash-out arrangements.

Given that GB will be becoming increasingly dependent on gas imports we have also recommended investigation of the need for, the impacts and effects of, various further measures to enhance gas security of supply. We provided a report to government on gas security of supply, which was published in November 2012¹⁶. Investigation of further measures is being progressed by DECC through a separate process to the Gas SCR.

Cross-border gas market developments

In cooperation with the Northern Irish regulator (UREGNI) and the Republic of Ireland regulator (CER) we have been working throughout 2012 to develop and approve a virtual reverse flow service from Northern Ireland to Great Britain. We published in February 2013 the decision approving the bilateral agreements under the gas interconnector licence between Bord Gais Eireann (BGE) (UK) and Premier Transmission Limited (PTL)¹⁷, the two companies holding an interconnector licence on this route, to allow for a virtual reverse flow service from Northern Ireland to Great Britain.

In addition, we have worked closely with the Belgian regulator (CREG) and the Dutch regulator (ACM, formerly NMa) on issues around cross-border gas flows between Great Britain and the continent. We launched a call for evidence in October 2012 on the use of gas interconnectors and the possible barriers to trade¹⁸. Our initial analysis suggests that gas flows across the two interconnectors, between GB and Belgium (Interconnector UK) and between GB and the Netherlands (Balgzand Bacton Interconnector), could be further optimised and that there are occasions where gas does not flow to the market where price signals highest demand. This can lead to inefficiencies and markets exporting when in fact they should be importing or vice-versa. The public consultation closed in December 2012. We will proceed with a follow up to this joint review in 2013.

Implementation of the first European Union network code for gas

The Third Package has created a new legal framework to promote cross border trade. A number of legally binding network codes designed to promote the creation of liquid markets and the efficient use of interconnectors are being established in an effort to ensure integration between the gas markets of EU Member States.

For Great Britain, the main impact from the network codes will be on the way capacity is allocated, gas is nominated, and tariffs are paid at interconnection points. Along with

¹⁶<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=3&refer=Markets/WhIMkts/monitoring-energy-security/gas-security-of-supply-report>

¹⁷ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=166&refer=Europe> & <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=167&refer=Europe>

¹⁸ http://www.ofgem.gov.uk/Europe/Documents1/120928_Interconnector_Open%20Letter%20Final.pdf

neighbouring NRAs we are considering how these future network codes can be implemented.

We published an open letter in March 2013 outlining the next steps for the implementation of the first of these network codes, the Congestion Management Procedures (CMP) Guidelines¹⁹; which is annexed to the Gas Regulation and which must be implemented by Member States by 1 October 2013²⁰. Ofgem, as the national regulatory authority for GB, has the obligation under Article 24 of the Gas Regulation to ensure compliance of gas undertakings with the network code. Meanwhile, the UK Department of Energy and Climate Change (DECC) is responsible for implementation. In the open letter, we set out our views on the minimum steps we expect relevant parties to take in order to comply with the CMP Guidelines. We are working closely with all relevant interconnectors and neighbouring regulators to introduce the appropriate measures of the CMP Guidelines by 1 October 2013.

Unbundling

Under the ownership unbundling requirements set out in the Third Package Directives and Regulations and the GB transposing legislation, during 2012, the Authority certified National Grid Gas plc (NGG)²¹ as fully ownership unbundled.

In 2013, the Authority:

- (i) made on 24 April, and on 8 May the Authority published²², its final certification decision (pursuant to sections 8F of the Gas Act and Article 3(2) of Regulation (EC) No. 715/2009 (“the Gas Regulation”)) in respect of BBL Company VOF. The Authority’s final certification decision for this TSO was to certify BBL as independent on the sixth certification ground set out in section 8G(8) of the Gas Act, subject to conditions relating to the non-exempted portion of its capacity. In accordance with Article 3(2) of the Gas Regulation, the Authority made these final certification decisions having taken utmost account of the Commission’s opinion received by the Authority on 18 March 2013.
- (ii) made on 21 May, and on 22 May the Authority published²³, its final certification decision (pursuant to sections 8F of the Gas Act and Article 3(2) of Regulation (EC) No. 715/2009 (“the Gas Regulation”)) in respect of Interconnector (UK) Limited (IUK). The Authority’s final certification decision for this TSO was to certify IUK as of and from the date of this decision until 11:59pm on 2 March 2015, as independent on the Substantially Similar Ground set out in section 8G(8) of the Gas Act, with certification continuing from 3 March 2015 on the Ownership Unbundling Ground set out in section 8G(3) of the Gas Act subject to conditions relating to the appointment of directors and other senior officers and voting/access to information,

¹⁹<http://www.ofgem.gov.uk/Europe/Documents1/Ofgem%20CMP%20Implementation%20Open%20Letter.pdf>

²⁰ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:231:0016:0020:EN:PDF>

²¹ <http://www.ofgem.gov.uk/Europe/Documents1/NGG%20certification%20decision.pdf>

²² <http://www.ofgem.gov.uk/Europe/Documents1/Certification%20decision%20on%20BBL%20Company%20VOF.pdf>

²³ [http://www.ofgem.gov.uk/Europe/Documents1/Certification%20decision%20on%20Interconnector%20\(UK\)%20Limited%20\(I\(UK\)\).pdf](http://www.ofgem.gov.uk/Europe/Documents1/Certification%20decision%20on%20Interconnector%20(UK)%20Limited%20(I(UK)).pdf)

which are set out in the Schedule of the Authority's final decision and subject to the Authority being satisfied that as at 3 March 2015, the Applicant meets the ownership unbundling requirement set out in section 8H of the Gas Act. In accordance with Article 3(2) of the Gas Regulation, the Authority made these final certification decisions having taken utmost account of the Commission's opinion received by the Authority on 2 April 2013.

- (iii) is processing an application for certification made by Premier Transmission Limited (PTL), a gas interconnector, and received by the Authority on 5 February 2013. This application is made on the ground set out in section 8G (3) of the Gas Act; namely, that PTL meets the ownership unbundling tests set out in section 8H of the Gas Act.
- (iv) is processing an application for certification in respect of the gas interconnector between the Republic of Ireland and GB on the ground set out in section 8G(6) of the Gas Act and Chapter IV of the Gas Directive (independent transmission operator). The Authority has, pursuant to section 8D(4) of the Gas Act, requested further information from the applicant. A draft response has been received and the Authority is awaiting a formal response while liaising with the regulators for the Republic of Ireland and Northern Ireland to assist them in reaching a preliminary certification decision.

There were no changes or additions to the population of gas distribution system operators in Great Britain during 2012. There continue to be eight gas distribution service providers and fourteen independent (embedded) gas distribution system operators.

2.1.3 Retail Markets

Retail Market Review

Ofgem continued its work on the Retail Market Review (RMR)²⁴ throughout 2012 and consulted on our domestic and non-domestic proposals in October 2012 and March 2013. The RMR aims to make the domestic retail energy market simpler, clearer and fairer for consumers. Our proposals include a cap on the number of tariffs each supplier can offer, standardised tariff structures, and rules on discounts and bundled offers.

They also include a suite of information remedies which will help consumers understand their options. These include a price comparison tool, a standardised Tariff Information Label, and standardised Annual Statements. We also propose that suppliers will have to tell consumers how much they could save by switching to their cheaper tariffs. Finally, we propose to introduce binding Standards of Conduct, which will require suppliers to treat their customers fairly. We believe that these measures, if implemented, will increase consumer engagement in the energy market.

The Retail Market Review equally aims to ensure that all business consumers, particularly small businesses, are able to get the best deal from the market and do not have to spend unnecessary time managing their energy accounts. Here, our proposed reforms to the

²⁴ <http://www.ofgem.gov.uk/MARKETS/RETMKTS/RMR/Pages/rmr.aspx>

market include: amending existing rules to bring more businesses under our micro business protections, new rules to make processes clearer and simpler for smaller businesses, new sanctions on energy suppliers who do not deal with smaller business customers fairly. The proposals will also extend existing safeguards so that 160,000 more businesses get clear information on their contracts. Finally, our proposals introduce a requirement to put contract end dates on consumer bills to help address contract rollovers. We are considering a ban of contract rollovers for micro-businesses and will take forward work including an analysis of impacts of this during the course of the year.

We have asked Government for powers under Business Protections from Misleading Marketing Regulations legislation to address mis-selling and poor marketing practices by third party intermediaries (brokers). We currently do not have powers to regulate this market. The relevant Government department (BIS) has agreed we can pursue our case. We received support in response to a consultation we undertook at the beginning of 2013 in advance of putting our detailed case to Government.²⁵

We are also increasing our monitoring of suppliers when switching businesses, and progressing work to help all business customers engage confidently with third party intermediaries.

2.2 Network Developments

RIIO price controls (Revenue = Incentives + Innovation + Outputs)

In December 2012 we published final proposals for the RIIO-T1^{26,27} and RIIO-GD1²⁸ price controls. These determine the outputs, allowed revenues and other elements of the regulatory frameworks for the gas distribution, gas transmission and electricity transmission network companies for an eight-year period from 1 April 2013 to 31 March 2021.

These are the first price controls to implement the new RIIO regulatory framework that was the outcome of our RPI-X@20 project, which concluded in October 2010.²⁹ The RIIO approach builds on the success of the previous RPI-X regime, but meets the investment and innovation challenge by placing much more emphasis on incentives to drive the innovation needed to deliver a sustainable energy network at value for money to existing and future consumers.

²⁵ <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Gaining%20enforcement%20powers%20under%20the%20Business%20Protection%20from%20Misleading%20Marketing%20Regulations%20consultation.pdf>

²⁶ National Grid Electricity Transmission and National Grid Gas Transmission
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=342&refer=Networks/Trans/PriceControls/RIIO-T1/ConRes>

²⁷ SP Transmission and Scottish Hydro Electric Transmission
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=190&refer=Networks/Trans/PriceControls/RIIO-T1/ConRes>

²⁸ Gas distribution network companies
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=438&refer=Networks/GasDistr/RIIO-GD1/ConRes>

²⁹ RIIO: A new way to regulate energy networks:
<http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/Decision%20doc.pdf>

As part of the innovation stimulus package, we run the Network Innovation Competitions (NICs). Through the NICs, we award funding for electricity transmission projects and gas distribution and transmission projects.³⁰ Funding is provided for the innovation projects which help all network operators understand what they need to do to provide environmental benefits and security of supply at value for money as Great Britain (GB) moves to a low carbon economy. RIIO puts sustainability alongside consumers at the heart of what network companies do; it provides a transparent and predictable framework that rewards timely delivery.

As part of the new RIIO price control approach for Transmission System Operators (TSOs) and Distribution Network Operators (DNOs) in GB, we have introduced an 'Annual Iteration Process' for the financial model that calculates base revenues.

This refinement means that price control allowances, performance outturns and incentive adjustments can be applied interactively during the price control period, supporting the more stable planning framework embodied in a longer eight year price control approach.

For electricity transmission we put in place a mechanism to allow Transmission Owners (TOs) to bring forward large investment projects – known as Strategic Wider Works (SWW) – where funding had not been awarded as part of the price control review due to uncertainty over their costs or whether they were needed. The mechanism allows Ofgem to consider the need and funding for these projects during the price control period so that delivery of agreed investments is brought forward in a timely manner.

RIIO-ED1

RIIO-ED1 is the first electricity distribution price control review under the RIIO model, it follows the overall process that was used for RIIO-T1 and RIIO-GD1, making minor adjustments to incorporate lessons learned. The RIIO-ED1 price control will set the outputs that the 14 electricity distribution companies (DNOs) need to deliver for their consumers and the associated revenues they are allowed to collect from 1 April 2015 to 31 March 2023.

The RIIO-ED1 price control will set outputs for safety, reliability, customer satisfaction and stakeholder engagement, with strong incentives for efficient delivery. DNOs will also need to explain how they plan to accommodate uncertain levels of low carbon technologies onto their networks. The RIIO-ED1 package will ensure they do this at an efficient cost, using smart grids tools and techniques whilst providing good service to new and existing customers. DNOs will also be incentivised to manage their carbon footprint and will have to report on how their actions have contributed to broader environmental objectives.

Innovation will play a key part in the DNOs delivering at an efficient cost and dealing with uncertainty. In the current price control, the Distribution Price Control Review 5 (DPCR5)³¹, we established the Low Carbon Network (LCN) Fund. This allows up to £500m

³⁰ <http://www.ofgem.gov.uk/Networks/nic/Pages/nic.aspx>

³¹ More information DPCR 5 can be found on our website:
<http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Pages/DPCR5.aspx>

support to projects sponsored by the DNOs to try out new technology, operating and commercial arrangements. We expect to see the learning from the LCN Fund trials embedded in the DNOs' business plans.

In March 2013, we published our strategy for the key elements of the regulatory framework within which DNOs will need to develop their business plans. DNOs must submit their plans to us by July 2013³². Our scrutiny of these plans will consider whether any are suitable to be 'fast-tracked' and have their price control concluded earlier in the process.

Project TransmiT

In September 2010 we launched Project TransmiT as an independent and open review of electricity transmission charging and associated connection arrangements.³³ The aim of TransmiT is to ensure that we have in place arrangements that facilitate the timely move to a low carbon energy sector whilst continuing to provide safe, secure and high quality network services at value for money to existing and future consumers.

We have the power unilaterally to instigate reviews of industry codes. A review of transmission use of system (TNUoS) charges was launched in July 2011. As part of the review we considered whether a form of socialised charging should be introduced and whether improvements made to existing Investment Cost Related Pricing (ICRP) methodology should be brought forward. We concluded in spring 2012 and issued a direction to National Grid Electricity Transmission Plc (NGET) to raise a modification proposal for industry to consider and develop an improved ICRP charging approach. This industry process is now nearing its conclusion. Once this industry-led process is complete we will then be presented with the industry's proposals and recommendations, which we will decide whether to approve and on which we will consult.

Offshore

2012 has seen further development of GB's offshore transmission regime. In collaboration with the UK Government, we have established a new regulatory regime for offshore transmission networks. The regime ensures that new offshore renewable generation projects are connected to the mainland's electricity grid economically and efficiently.

A key part of the regime is the grant of offshore transmission licences on the basis of a competitive tender process. We are responsible for managing this process.

In the first tender round (Transitional Round 1 'TR1') Preferred Bidders have been appointed for all nine projects, for assets of £1.1 billion in value. The first Offshore Transmission Operator (OFTO) licence was awarded in March 2011 for the Robin Rigg³⁴

³² <http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/riio-ed1/consultations/Documents1/RIIOED1DecOverview.pdf>

³³ <http://www.ofgem.gov.uk/Networks/Trans/PT/Pages/ProjectTransmiT.aspx>

³⁴ <http://epr.ofgem.gov.uk/Pages/EPRInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRFiles%2fTC+Robin+Rigg+OFTO+Limited+-+Offshore+Electricity+Transmission+Licence+as+Issued+02-03-2011.pdf>

project, with the most recent being awarded in September 2012 for the Walney 2 project³⁵. Licences have now been awarded for six out of the nine projects in TR1. The three remaining TR1 projects all have Preferred Bidders who are progressing towards licence grant and asset transfer.

The second round of tenders (Transitional Round 2 'TR2') began in November 2010. Preferred bidders have been appointed for the Lincs and London Array projects whilst qualifying bidders have been invited to tender for the Gwynt-y-Mor project. The tender process for West of Duddon Sands commenced in December 2012. In total, up to £2 billion of offshore transmission links will be tendered in the second transitional tender round which will connect 2.8GW of wind power.

There has also been further development of offshore transmission policy, with the publication of consultations on both the enduring regime and coordinated networks. Both of these policy areas will be progressed in the year ahead.

Incentivising investment in new cross-border interconnection

In March 2013 we consulted on a new regulatory regime for electricity interconnector investment for application to project NEMO, the proposed interconnector between GB and Belgium³⁶. The regime has been developed together with the Belgian regulator Commission de Régulation de l'Electricité et du Gaz (CREG).

We published our preliminary conclusions on the high level principles and design of the regime in December 2011. Based on these principles, together with CREG we have developed a proposed approach for the regime and the methodology for setting the cap and floor on returns for NEMO. In March 2013, we outlined our proposals and sought views on the proposed design and methodology.

Together with CREG, we will consider all consultation responses with the aim of publishing a decision document by the end of 2013. This will outline our final cap and floor regime design and the methodology for setting the cap and floor on returns for the NEMO project.

Integrated Transmission Planning and Regulation (ITPR)

We initiated the Integrated Transmission Planning and Regulation (ITPR) project in March 2012³⁷ and recently published our 'Emerging thinking consultation' (May 2013)³⁸. The ITPR project is reviewing the existing GB electricity transmission arrangements. It is looking at how the system is currently planned and delivered, assessing whether any changes are

³⁵<http://epr.ofgem.gov.uk/Pages/EPRInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRFiles%2fBlue+Transmission+Walney+2+Limited+-+Offshore+Electricity+Transmission+Licence+-+25-09-2012.pdf>

³⁶<http://www.ofgem.gov.uk/Europe/Documents1/Cap%20and%20Floor%20Regime%20for%20Regulated%20Electricity%20Interconnector%20Investment%20%20for%20application%20to%20project%20NEMO.pdf>

³⁷ Project documents can be found on Ofgem's website:
<http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/itpr/Pages/index.aspx>

³⁸http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/itpr/Documents1/ITPR_emerging_thinking_consultation.pdf

appropriate to facilitate a future integrated system. This is in response to the longer term challenges arising from the move to a decarbonised energy system.

Our focus is on whether the separate regimes for onshore and offshore transmission and for interconnection can continue to ensure the efficient, coordinated and economic development of the overall network over the longer term.

2.3 Enforcement and Consumer Protection Developments

2.3.1 Enforcement

REMIT

EU Regulation No 1227/2011 of 25 October 2011 on wholesale energy market integrity and transparency (REMIT) came into force on 28 December 2011. The Regulation introduces, for the first time, a consistent EU-wide framework:

- Defining market abuse, in the form of actual or attempted market manipulation and insider trading, in wholesale energy markets
- Introducing the explicit prohibition of market abuse in wholesale energy markets
- Establishing a new framework for the monitoring of wholesale energy markets to detect and deter market abuse
- Providing for the enforcement of the prohibitions and the sanctioning of breaches of market abuse rules at national level

As an EU Regulation, the provisions of REMIT are directly applicable in Great Britain. Nevertheless, there are certain steps that are necessary to complete its implementation.

Article 13 of REMIT requires Member States to ensure their National Regulatory Authority (NRA) has the necessary investigatory and enforcement powers in place to fulfil their functions under REMIT. The UK Government has now granted these powers to Ofgem. They took effect from the 29 June 2013. Ofgem plans to consult formally on our REMIT penalty policy and enforcement procedures until 29 August 2013.

In addition, Ofgem, in conjunction with the Agency for the Cooperation of Energy Regulators (ACER) and other NRAs, has continued to consider issues relating to the application of REMIT in practice. These areas include – but are not limited to – the registration of market participants and transparency around inside information. We published an Open Letter³⁹ covering these specific issues in March 2013. This letter highlighted some of the obligations in REMIT and sought input from interested parties on the topics to inform our considerations.

³⁹ <http://www.ofgem.gov.uk/Markets/WhlMkts/remit/Documents1/Ofgem%20-%20REMIT%20Open%20Letter%20-%20Final%20published.pdf>

Investigations

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

The investigation into EDF Energy was closed in May 2012. We continued to progress our investigations into RWE npower, Scottish Power, SSE and E.ON during 2012.

In April 2013 we gave a notice of our intention to impose a financial penalty of £10.5 million on SSE Energy Supply Ltd and Southern Electric Gas Ltd (“SSE”) for alleged non-compliance with its obligations under conditions 23 and 25 of the Standard Conditions of the supply licences⁴⁰. This follows an investigation into SSE’s compliance with its licence conditions in relation to the marketing of gas and electricity to domestic customers. A notice confirming the decision to impose a penalty of £10.5m on SSE was issued in May 2013.

For a complete list and details of our investigations in 2012 please see sections 3.1.5 and 4.1.5 of this report.

2.3.2 Consumer Protection

Protecting domestic customers

Collective Switching

Collective switching is a new development in the UK market which has the potential to empower consumers to group together to negotiate better deals for their energy use, and has potential to be an innovative and effective channel to engage vulnerable and disengaged consumers.

The UK saw the first collective switch in May 2012, where 280,000 consumers registered with the “Big Switch” organised by Which? (a consumer champion organisation) and 38 Degrees (one of the UK’s biggest campaigning communities). A number of smaller exercises have followed, and activity is growing in this area and is set to continue to grow rapidly in 2013.

Ofgem has played a key role in the development of collective switching, participating in the Department of Energy and Climate Change collective purchasing working group, contributing to information leaflets DECC published for consumers and organisers of collective purchasing and the Secretary of State’s roundtable discussions. We published an open letter in April 2012 which provided general information to help suppliers and other

⁴⁰<http://www.ofgem.gov.uk/About%20us/enforcement/Investigations/ClosedInvest/Documents1/SSE%20Penalty%20notice.pdf>

parties wishing to participate in collective purchasing and switching schemes understand aspects of the legal framework which licensed suppliers are required to operate within.⁴¹

Complaints transparency

It is important that consumers have access to meaningful information about suppliers' performance. The complaints data currently published does not provide a full picture of suppliers' complaints or contextual information which demonstrates how well they are performing and the measures they are taking to improve. Making more information available about performance will help incentivise suppliers to improve and could potentially help consumers make choices using the different levels of service.

Therefore, we have been working with the six largest suppliers and Energy UK (the trade association for the energy industry) since last summer to persuade them to become more transparent about, and take greater responsibility for, their complaints performance. We were encouraged by suppliers' generally positive response. The main six suppliers agreed to publish substantially improved complaints data on a quarterly basis, starting from 31 January 2013 (October-December 2012 data). Some suppliers started to publish better complaints data in advance of this date.

To aid transparency we have developed a standard box format that all suppliers use for presenting information:

- total complaints open and closed, and by 100,000 customers
- percentage closed at day +1
- percentage closed at 8 weeks

Allowing suppliers to express complaints made per 100,000 customers alongside total complaints numbers provides an opportunity for suppliers to contextualise the data, and to do so further by adding narrative to explain what may be driving their complaints and what they are doing to improve matters.

⁴¹<http://www.ofgem.gov.uk/Markets/RetMkts/Compet/Documents1/collective%20switching%20open%20letter.pdf>

3. The electricity market

3.1 Network regulation

The National Electricity Transmission System (NETS) is used to transfer bulk electricity at high voltage from generating power stations to substations near demand. The NETS comprises both onshore and offshore transmission networks. In order to participate in the transmission of electricity for the purpose of enabling a supply to be given, a transmission licence needs to be granted by Ofgem.

Transmission assets are owned and maintained by regional monopoly Transmission Owners (TOs)⁴² and Offshore Transmission Owners (OFTO). The NETS is operated by National Grid Electricity Transmission plc (NGET) which is the sole System Operator (SO). The SO has responsibility for making sure that electricity supply and demand stay in balance and the system remains within safe technical and operating limits.

Electricity distribution networks carry electricity from the transmission system, and some generators that are connected to the distribution networks, to industrial, commercial and domestic users. Domestic and most commercial consumers buy their electricity from suppliers who pay the Distribution Network Operators for transporting their customers' electricity along their networks. Suppliers pass on these costs to consumers. Distribution costs account for about 16% and transmission costs for about 4% of the average electricity bill⁴³.

In order to participate in the distribution of electricity for the purpose of enabling a supply to be given, a Distribution Licence needs to be granted by Ofgem. There are currently fourteen electricity distribution operators (DSOs) each responsible for a distribution services area in Great Britain, these are owned by six different groups. There are also six independent network operators who own and run smaller networks embedded in the DNO networks⁴⁴.

⁴² Three onshore TOs: National Grid Electricity Plc (NGET) who own the transmission system in England and Wales; SP Transmission Limited (SPTL) who own the transmission system in southern Scotland and Scottish Hydro Electric Transmission Limited (SHETL) which owns the transmission system in northern Scotland

⁴³ The average bill is based on average annual consumption figures of 3 300 kWh for electricity, averaged across all big suppliers and across GB.

⁴⁴ The relatively small independent DSOs do not have area-specific obligations and provide both embedded distribution networks and site specific infrastructure, such as gas pipelines serving power stations.

3.1.1 Unbundling

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

On 10 November 2011, the Electricity and Gas (Internal Markets) Regulations 2011 (the GB Regulations) came into force. The GB Regulations implement the Third Package into GB domestic legislation, including the ownership unbundling requirements set out in the Third Package Directives and Regulations in respect of Transmission System Operators (TSOs) and the unbundling requirements in respect of Distribution System Operators (DSOs). The GB Regulations have amended the Electricity Act 1989 (Electricity Act) to include the requirement for the holders of electricity interconnector and electricity transmission licences to be certified as independent pursuant to one of the grounds for certification set out in the Electricity Act.

The GB Regulations have designated the Authority as the National Regulatory Authority (NRA) for GB and have given it the responsibility for administering the certification process in GB. The Authority is also required to notify the European Commission upon receipt of an application for certification where the applicant is from a third country or is controlled by a person from a third country.

Transmission System Operators (TSOs)

On 19 June 2012, the Authority made, and on 20 June 2012 the Authority published, its final certification decisions (pursuant to sections 10D(6)-(8) of the Electricity Act and Article 3(2) of Regulation (EC) No. 174/2009 (the Electricity Regulation) in respect of Scottish Power Transmission Limited (SPTL) and Scottish Hydro Electric Transmission Limited (SHETL)^{45,46}. The Authority's final certification decisions for these two TSOs were to grant a derogation pursuant to Article 9(9) of Directive 2009/72/EC (the "Electricity Directive") and to certify SPTL and SHETL on this ground under section 10G(4) of the Electricity Act, because on 3 September 2009, SPTL and SHETL belonged (and continue to belong) to a vertically integrated undertaking and there are arrangements in place which guarantee more effective independence of SPTL and SHETL than the provisions of Chapter IV on Independent Transmission Owners. In accordance with Articles 3(2) and 3(6) of the Electricity Regulation, the Authority made the final certification decisions for SPTL and SHETL in compliance with the Commission's opinion dated 14 May 2012.

On 19 June 2012, the Authority made, and on 20 June 2012 the Authority published, its final certification decisions (pursuant to sections 10D(6)-(8) of the Electricity Act and Article 3(2) of the Electricity Regulation in respect of National Grid Electricity Transmission plc (NGET) and National Grid Interconnector Limited (NGIL)^{47,48}. The Authority's final certification decisions for these two TSOs were to certify NGET and NGIL on the ground in

⁴⁵ <http://www.ofgem.gov.uk/Europe/Documents1/SHETL%20certification%20decision.pdf>

⁴⁶ <http://www.ofgem.gov.uk/Europe/Documents1/SPTL%20certification%20decision.pdf>

⁴⁷ <http://www.ofgem.gov.uk/Europe/Documents1/NGET%20certification%20decision.pdf>

⁴⁸ <http://www.ofgem.gov.uk/Europe/Documents1/NGIL%20certification%20decision.pdf>

section 10E(3) of the Electricity Act, namely that NGET and NGIL met each of the ownership unbundling tests set out in section 10F of the Electricity Act implementing Article 9 of the Electricity Directive. In accordance with Article 3(2) of the Electricity Regulation, the Authority made these final certification decisions having taken utmost account of the Commission's opinion received by the Authority on 19 April 2012.

In July 2012, the Authority reviewed the annual declaration submitted on behalf of NGET and NGIL and remained satisfied that the ground for NGET and NGIL's certifications remained valid.

Distribution System Operators (DSOs)

There were no changes or additions to the population of electricity distribution system operators (DSOs) in Great Britain during 2012⁴⁹. There continue to be fourteen electricity distribution services providers (DSPs); Northern Powergrid (Northeast) Limited, Northern Powergrid (Yorkshire) plc, London Power Networks plc, South Eastern Power Networks plc, Eastern Power Networks plc, Electricity North West Ltd, Scottish Hydro Electric Power Distribution plc, Southern Electric Power Distribution plc, SP Distribution Ltd, SP Manweb plc, Western Power Distribution (East Midlands) plc, Western Power Distribution (West Midlands) plc, Western Power Distribution (South West) plc and Western Power Distribution (South Wales) plc.

There also continues to be six independent (embedded) electricity distribution system operators: Independent Power Networks Ltd, Energetics Electricity Ltd, The Electricity Network Company Ltd, ESP Electricity Ltd, UK Power Networks (IDNO) Ltd and Utility Assets Ltd. Each independent DSO owns and operates a number of relatively small networks at various geographical locations. There was some consolidation of ownership in the independent sector but this has not given rise to any competition concerns.

During the year we have reviewed the returns submitted by DSOs relating to business independence, financial reporting and output performance. In that context we are satisfied that Directive requirements relating to unbundling are being properly observed.

We have also reviewed a number of charging methodologies for licence-exempt private networks in relation to third party access requirements.

Offshore Transmission Owners (OFTOs)

In 2012 the Authority certified the following OFTOs as independent⁵⁰: TC Robin Rigg OFTO Limited, TC Gunfleet Sands OFTO Limited, TC Barrow OFTO Limited and TC Ormonde OFTO Limited. Our decision on the aforementioned OFTOs was published on 26 June 2012⁵¹. In 2013 the Authority certified Blue Transmission Walney 1 Limited as the preferred bidder

⁴⁹ In relation to Article 26 of Directive 2009/72/EC

⁵⁰ In relation to Article 10 and 11 of Directive 2009/72/EC and following procedures in Article 3 Regulation (EC) 714/2009

⁵¹ <http://www.ofgem.gov.uk/Networks/offtrans/rott/Documents1/TCP%20final%20decisions%20120627.pdf>

for TC Lincs OFTO Limited. Our decision on the aforementioned OFTOs was published on 1 March 2013⁵².

In accordance with section 10I of the Electricity Act 1989, the Authority will monitor whether the basis upon which it decided to certify the aforementioned OFTOs continues to apply following the Authority's final decision and if appropriate, will review its certification decision.

3.1.2 Technical functioning

- Article 37(6)(b), Article 37(8), Article 37(1)(h), Article 37(1)(m), Article 37(1)(t), and Article 11 Regulation (EC) 713/2009

Balancing services

National Grid Electricity Transmission (NGET) is the System Operator (SO) for the high voltage electricity transmission system in GB, with responsibility for making sure that electricity supply and demand stay in balance and the system remains within safe technical and operating limits. NGET's licence contains conditions⁵³ regarding the Balancing and Settlement Code (BSC) – the document which defines the rules and governance for the balancing mechanism and imbalance settlement – and regarding the procurement and use of balancing services. The BSC objectives are set out in NGET's licence and include the efficient, economic operation of the transmission system and compliance with European Commission decisions.

The current electricity balancing arrangements are designed to provide commercial incentives for generators to physically match the amount they notify⁵⁴ to that which they deliver to the system and for suppliers to physically match the amount they notify they will offtake to that they offtake from the system. Generators' imbalance relates to the difference between the amount they physically deliver and supplier's imbalance related to the difference between that notified and that offtaken. They impose cash-out charges for these imbalances and Ofgem is continuing to consider improvements to these arrangements as part of its electricity balancing significant code review.

NGET recovers the costs of balancing the System through Balancing Services Use of System (BSUoS) charges, derived from the BSUoS charging methodology which is set out in the Connection and Use of System Code (CUSC) and approved by Ofgem. Ofgem places financial and reputational incentives on the SO to ensure that it is incentivised to keep the costs of operating the system as low as possible for system users within the safety and security bounds which are set out under the codes and licences. In addition, Ofgem is

⁵² <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=47&refer=Networks/offtrans/rttt>
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=21&refer=Networks/offtrans/rott/w1>

⁵³ All licence conditions are enforceable by the Authority. We can make orders to ensure compliance and can impose a financial penalty of up to 10% of the licensee's turnover for failure to comply with a licence condition.

⁵⁴ In order to balance the network, NGET relies on generators to provide accurate Final Physical Notifications (FPNs) of how much energy they expect to produce in the next half hour.

required to approve any change to the charging methodology. How BSUoS charges are levied is discussed in more detail in section 3.1.3 of this report.

Security and reliability standards, quality of service and supply

Transmission

The National Electricity Transmission System Security and Quality of Supply Standard (NETS SQSS) contains coordinated criteria and methodologies that Transmission Owners (TOs) and the System Operator (SO) are required by their respective licences to use when planning and operating transmission systems. We must approve any change to the NETS SQSS.

National Grid Electricity Transmission (NGET), in its role as the SO, produces an annual report on the overall performance of the transmission system. This report includes information on system availability, security and quality of service.⁵⁵

System Reliability

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

Offshore Transmission Owners (OFTOs) are allocated an incentive target, contained in the Licensee's offshore transmission licence and enforceable by us. The mechanism incentivises the OFTO to maintain availability, reliability and to minimise loss of supply events. Special condition E12-J4 requires OFTOs to report, on a quarterly basis, offshore transmission system performance and whether that performance has fallen below the monthly incentive target set out in licences. Reductions in system availability below the agreed target have an impact on the OFTO's revenue. There are exclusions provided for in the licence to protect the OFTO's availability target, when outages are as a result of actions of another network user or because of circumstances beyond the OFTO's reasonable control.

The RIIO price control model includes, among other outputs, a reliability output which from April 2013 until April 2021, will be based on performance of Energy Not Supplied (ENS). There is a target, an incentive rate based on an estimate of average value of lost load to reward/penalise deviations from this target, and there is a collar on liabilities from the incentive of 3% of allowed annual revenues. There are exemptions (e.g. for severe weather) but many of these are more limited in scope than the previous arrangements and

⁵⁵ The latest version of the report covers the period to 31 March 2012 and is available on National Grid's website. <http://www.nationalgrid.com/NR/rdonlyres/FB8E72DA-6286-4C0F-AB53-9EB9DD80594C/56380/NationalElectricityTransmissionSystemPerformanceReport20112012.pdf>

involve a case by case assessment. There are also a suite of network output measures that inform the safety and reliability of a TO's network and will directly affect the funding at the start of next price control, RIIO-T2, in 2021.

Distribution

In GB, licensed electricity Distribution Network Operators (DNOs) are required by their licence to design their networks to meet the requirements of Engineering Recommendation P2/6. This specifies the maximum supply interruption times for specified contingencies. In the event that a Licensee cannot comply with this licence condition it is able to apply to us for a derogation.

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

In April 2010, the current electricity distribution price control took effect and as part of this we chose to continue operating the 'Interruptions Incentive Scheme' (IIS). This scheme was introduced a number of years ago, to incentivise the 14 incumbent electricity DNOs in GB, to deliver a good level of performance in respect of customer interruptions, and customer minutes lost. It encourages DNOs to invest in and operate their networks to manage and reduce both the frequency and duration of power cuts experienced by their customers.

We set the targets and incentive rates for customer interruptions and customer minutes lost for each DNO as part of the price control process. The incentive rates for the current price control for each DNO are based on our research into customers' 'willingness to pay'. The major changes between the previous price control and the current one are that DSOs now face asymmetric annual rewards and penalties depending on each DSO's performance against its targets. For the 2011-12 regulatory year, DNOs were rewarded £109 million in total due to their performance.

As part of the Distribution Price Control Review 5 (DPCR5) price review, we also updated the "Electricity (Standards of Performance) Regulations 2010" (SI 2010/698). The purpose of these standards is to provide signals to DNOs to meet certain expected levels of service and to provide payments to end customers in the event of individual standards not being met. The major changes in this area have been in adjusting the payment levels to account for inflation, and the introduction of new standards.⁵⁶

We have published annual reports on DNO IIS performance since 2001-02. Recently this report⁵⁷ has moved beyond focussing exclusively on interruptions performance and looks at a wide range of DNO activities, which include: Reliability and Availability; Network Investment; Customer Satisfaction; Connections; Social Responsibility; and Environment.

⁵⁶ The new standards are: a '5,000 customer standard' (payments are due to customers if 5,000 customers are interrupted as part of a single electricity incident on a DSO's network and they have not been restored to supply after 18 hours); and 'Supply restoration: rota disconnection' (this standard applies where a rota disconnection policy is employed to share out available load, where some customers are off for 24 hours or longer, in aggregate, across an entire event).

⁵⁷ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=702&refer=Networks/ElecDist/PriceCtrls/DPCR5>

This report is intended to be as useful as possible to customers, and is structured in a format similar to our new RIIO price control format.

We have recently published our strategy decision regarding the next price control, RIIO-ED1⁵⁸. These include tighter targets for DNOs under the IIS, tightening the normal weather Guaranteed Standard from 18 down to 12 hours, and up rating the payment levels accounting for inflation to the mid-point of the price control. In addition, a penalty rate of 20 per cent will be applied to unpaid compensation beyond the mechanism to recover unclaimed payments from DNOs in the form of a negative revenue adjustment.

Monitoring time taken to connect and repair

Transmission

Since 2011, under the Connect and Manage regime, generators have been able to connect to the system in GB ahead of wider system reinforcements, as soon as any identified “enabling works” (local transmission works required to connect) are complete. It is the responsibility of the System Operator to ensure that the power flows across major system boundaries are within the capabilities of the system. The additional cost of these actions and the resulting ‘Constrained Dispatch’ of generation (constraint costs) are socialised, i.e. spread across all generation and demand (levied 50:50) in GB and are recovered through Balancing Services Use of System (BSUoS) charges.

We publish regular annual reports⁵⁹ to the Secretary of State monitoring the impacts of the ‘Connect and Manage’ regime. These reports include analysis of the following–

- impact on connections by generation type and region
- developers’ confidence in the new arrangements
- costs and benefits to consumers of the new arrangements
- progress and costs of delivering the necessary wider grid investments

The most recent report (November 2012)⁶⁰ noted that under the ‘Connect and Manage’ regime, the time taken to connect was, on average, six years less than under the previous ‘Invest and Connect’ approach.

Offshore Transmission Owners (OFTOs) are allocated an incentive target, which is set out in the Licensee’s offshore transmission licence and which we can enforce. The mechanism incentivises the OFTO to maintain availability, reliability and to minimise loss of supply events. Special condition E12-J4 obliges each OFTO to report its offshore transmission system performance and whether that performance has fallen below the monthly incentive target set out in its licence, on a quarterly basis. Reductions in system availability below the agreed target have an impact on the OFTO’s revenue. There are exclusions provided for in the licence to protect the OFTO’s availability target when outages are as a result of actions of another network user or because of circumstances beyond the OFTO’s reasonable control. In terms of reporting, each transmission Licensee is required to report

⁵⁸ <http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/Decision%20doc.pdf>

⁵⁹ <http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Pages/Traccrw.aspx>

⁶⁰ http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Documents1/110930_CM_report_to_SoS.pdf

on the security and quality of service of the NETS⁶¹ under standard licence condition C17 (Transmission system security, standard and quality of service).

Distribution

Following the Third Package, we now monitor the time taken to make connections and repairs. In addition, Distribution Network Operators (DNOs) have to provide information that it considers necessary to enable us to perform our functions under the Electricity Directive as well as domestic legislation.

Historically, we have monitored the maximum, minimum and average time taken by DNOs to provide connection offers⁶². Since October 2010, we have monitored the time taken by DNOs to provide connections. We have also established guaranteed standards for connections that provide compensation payments to customers where the DNO fails to deliver specified connection services within minimum timescales. These standards cover the provision of quotations, scheduling agreed dates for works with customers and completing works on the dates agreed with customers. Failure to meet these standards on 90 per cent of occasions in each quarter constitutes a breach of licence.

We also monitor the time taken to repair faults through the Interruptions Incentive Scheme (IIS). The time taken to repair has been incentivised as part of the customer minutes lost element of the IIS - this is dealt with more fully in the previous section on "Security and reliability standards, quality of service and supply".

Monitoring safeguard measures

Under the provisions set out in domestic legislation, during a fuel crisis the UK government has the power to direct the behaviour of the operators of certain power stations and transmission Licensees to ensure industry obligations are fulfilled. The details of these arrangements are set out in the Fuel Security Code (standard licence condition B11)⁶³. Transmission Licensees have licence requirements to comply with the code. Under the Fuel Security Code, in an emergency the Energy Emergencies Executive ('E3') Committee⁶⁴ will establish the Joint Response Team to liaise between industry and government and to develop the mechanism by which the practical management of an emergency can be achieved.

The principal objective of this Fuel Security Code is to provide an administrative structure during a fuel crisis enabling appropriate measures be taken by the government with the minimum of interference with normal market arrangements.

⁶¹ The national electricity transmission system includes both onshore and offshore transmission systems.

⁶² <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=702&refer=Networks/ElecDist/PriceCtrls/DPCR5> and <http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/TAR/Pages/Traccrw.aspx>

⁶³ <http://epr.ofgem.gov.uk/EPRFiles/Electricity%20transmission%20full%20set%20of%20consolidated%20standards%20licence%20conditions%20-%20Current%20Version.pdf>, see page 87

⁶⁴ E3 includes representation from DECC, Ofgem and National Grid. Ofgem's role is to provide information and guidance on the operation of the gas and/or electricity markets during an emergency.

RES regulatory framework

For connections, we regulate where necessary and seek to encourage competition where possible in an effort to protect the customer's interests. Through the following two reports: Electricity Distribution Annual Report (EDAR)⁶⁵ and the Connections Industry Review (CIR)⁶⁶, we publish information on the areas where competition is growing, where competitors appear to be engaging well in the market and where there may still be room for improvement. These reports also outline the performance of DNOs in line with specific licence requirements associated with the provision of connections services where DNOs must provide connections to all parties who request them, within specific delivery timescales, i.e. access and dispatch.

Through our current (2010-2015) DPCR5 price control⁶⁷ we have also sought to assist the development of competition. This has involved requiring DNOs to charge a regulated margin of four per cent on contestable connection activities in certain segments of the market. DNOs are also required to bring forth an application to pass a Legal Requirements and Competition Test for these market segments before 31 December 2013. Those that are able to demonstrate effective competition is present will be allowed to charge an unregulated margin on contestable connection works. We will review any segments of the market that do not pass the Competition Test and may refer these to the Competition Commission. Progress on this process will be reported in more detail in forthcoming editions of the EDAR (as the CIR is now being incorporated into the EDAR to avoid duplication)

Through our new RIIO price control⁶⁸ we are building on these incentives and these will be reported on in greater detail as the price control process progresses throughout 2013.

3.1.3 Network tariffs for connection and access

- Article 37(1)(a), Article 37(6)(a), Article 37(8), Article 37(10), Article 37(12) , Article 37(3)(c) and (d), Article 37(1)(f)

Transmission

Users of the electricity transmission system are subject to three types of transmission charges: connection charges, Transmission Network Use of System (TNUoS) charges and Balancing Services Use of System (BSUoS) charges. The price control process is designed to ensure that these charges allow network owners to be remunerated for the efficient cost of network assets whilst protecting consumers.

⁶⁵<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=702&refer=Networks/ElecDist/PriceCtrls/DPCR5>

⁶⁶ <http://www.ofgem.gov.uk/Networks/Connectns/ConnIndRev/Pages/ConnIndRev.aspx>

⁶⁷ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=348&refer=Networks/ElecDist/PriceCtrls/DPCR5>

⁶⁸ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=120&refer=Networks/ElecDist/PriceCtrls/riio-ed1/consultations>

In terms of charging, the primary requirement of the transmission licence is that the various charging mechanisms should achieve the 'relevant objectives' of facilitating competition; reflecting costs incurred; and taking account of developments in the transmission businesses. While the form of the methodologies must be approved by us, we do not set or approve the level of individual charges.

Transmission charging methodologies form part of the Connection and Use of System Code (CUSC) and are subject to open governance arrangements. This means the wider industry, including generators and suppliers, can raise proposals to modify the charging methodologies. The CUSC governance arrangements ensure that proposals are subject to thorough review and consultation, with the final decision of whether to approve change resting with us.⁶⁹ There are also legislator arrangements in place to allow parties to appeal changes to the CUSC.

Connection Charges

Connection charges relate to the provision and maintenance of connection assets which are solely required to connect a particular user (for example, a generator) to the main transmission system. The costs are recovered under NGET's connection charging methodology⁷⁰. NGET defines "connection assets" as assets solely required to connect an individual user to the GB transmission system, which are not and would not normally be used by any other connected party. The costs of these assets are recovered directly from the generator via connection charges.

Transmission Network Use of System Charges

The TNUoS charging methodology⁷¹ is applied by NGET in its role as SO. TNUoS charges recover the cost of the provision and maintenance of shared electricity transmission assets, or in other words, assets that cannot be solely attributed to a single user. TNUoS charges are recovered from all users of the GB electricity transmission system (excluding interconnectors). These charges vary by location, reflecting the costs that users impose on the transmission network to source (demand) or send (generators) their electricity.⁷² There are 27 charging zones for generation and 14 for demand. For 2012/13 the demand charge varies between £10.74/kW and £31.17/kW whereas the "wider" locational generation charge varies between £-13.35/kW and £22.05/kW.

⁶⁹ If a proposal meets the self governance criteria, it may proceed without Authority approval, and the CUSC Modifications Panel may consult on and determine itself whether to implement the CUSC Modification Proposal.

⁷⁰ <http://www.nationalgrid.com/uk/Electricity/Charges/chargingstatementsapproval/index.htm>

⁷¹ <http://www.nationalgrid.com/uk/Electricity/Charges/chargingstatementsapproval/index.htm>

⁷² See 2010 National Report for a more detailed description of the components of the TNUoS charge:

http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/NATIONAL_REPORTS/National%20Reporting%202010/NR_En/E10_NR_UK-EN.pdf

Balancing Services Use of System (BSUoS) Charges

BSUoS charges relate to the costs of the day-to-day operation of the transmission system and include charges for the recovery of constraint costs.

Key to the calculation of BSUoS charges for each settlement day is the ability of NGET to access up to date volume information and appropriate balancing cost information. While some balancing service costs can be identified on a half hourly basis, some will be incurred over longer timescales and there is no simple method for NGET to allocate these costs to individual (half hourly) settlement periods.

To address this issue, BSUoS charges are calculated, billed and reconciled at scheduled intervals for each settlement day. The process seeks to utilise the best estimate of costs and to refine the daily charge calculation over time through the use of reconciliations based on updated volume and cost information at each incremental settlement stage.

Section 14 of the CUSC⁷³ includes a detailed methodology for the calculation of daily BSUoS charges, some worked examples, and information on timing of BSUoS charges and financial settlement.

In December 2011, NGET raised modification proposal CMP202 to remove BSUoS charges from interconnector Balancing Mechanism (BM) Units and Trading Units associated with interconnectors, including those associated with the Interconnector Error Administrator (IEA). We approved this modification in August 2012.⁷⁴

Project TransmiT

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

In May 2012 we directed NGET (as System Operator) to raise an amendment proposal through the industry process to ensure that the TNUoS methodology:

- Better reflects the costs imposed by different types of generators (in particular renewable generators) on the electricity transmission network.
- Appropriately takes into account the potential Scottish island links that are currently being considered.
- Takes account of the development of HVDC links that will run parallel to the onshore network.

Once this industry process is complete we will then consider the industry amendment proposals and decide whether to approve it for implementation.

⁷³ http://www.nationalgrid.com/NR/rdonlyres/8FFA9408-9DC7-44C2-AF68-93E684A176D8/59890/CUSC_Section_14_v15combined_CMP203_1April2013.pdf

⁷⁴ <http://www.ofgem.gov.uk/Licensing/ElecCodes/CUSC/Amend/Documents1/CMP202%20Decision%20Letter.pdf>

Offshore

Offshore Transmission Owners (OFTOs) are required to submit their charging statements for our approval under their licence. These statements set out the basis upon which charges will be made. This submission and approval of the charging methodology is required before a licence is granted. The Licensee must periodically revise the statements and shall, at least once in every year make any necessary revisions to that statement. Each revision requires our approval before it can come into effect.

Distribution

The electricity distribution licence requires DNOs to have in force at all times a Use of System Charging Methodology and a Connection Charging Methodology (collectively known as the Charging Methodologies) that have been approved by us on the basis that they achieve the relevant objectives.

The relevant objectives are -

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

The licence also requires DNOs to prepare, and make available in a form approved by us, a Use of System Charging Statement and a Connection Charging Statement (collectively known as the Charging Statements). The DNOs' Charging Statements must be prepared in accordance with their approved Charging Methodologies.

The licence requires DNOs to comply with their Charging Methodologies and to charge in line with their Charging Statements. The licence gives us powers to determine in cases in which customers do not consider that a DNO's charges reflect those set out in their Charging Methodology. Under domestic legislation, we have additional powers to determine disputes, and powers to enforce DNOs' compliance with the licence.

The Codes relevant to Electricity contain provisions for affected stakeholders to provide inputs to proposed changes to the methodologies or tariffs. This is done either through participation in various industry working groups, or through the more formalised public consultation processes. We consider any inputs received in reaching a decision on methodologies or tariffs. While we have the power to make a decision on proposed changes to the methodologies, we do not have the power to review these decisions.

Stakeholders have the right to request a judicial review of any such decision. We are not aware of any such request for judicial review on any decision regarding the methodologies or tariffs during 2012.

Prevention of cross-subsidies

In GB, licensed electricity distribution, gas distribution and transmission network operators (including offshore Licensee) are subject to licence conditions prohibiting regulated businesses from giving cross-subsidies to, or receiving cross-subsidies from, related undertakings. The regular information submissions that Licensees are required to make, principally those relating to their price control arrangements, allow us to assess whether any risk or incidence of cross-subsidisation has arisen.⁷⁵

Electricity and gas transmission and distribution licences include a requirement for independent auditors to carry out a range of procedures, agreed with the Authority, to provide assurance that obligations to avoid discrimination and cross-subsidy are being respected. We review the auditors' reports and raise supplementary questions as appropriate.

The unbundling requirements as described in section 3.1.1 also provide for greater structural separation of transmission interests from generation, production and supply interests in order to prevent cross-subsidisation.

We are satisfied that there were no material cross subsidy issues during 2012. However, in audit response letters that we have recently sent out to licensees, we have provided additional guidance on future reporting which, in respect of various individual licensees, addresses requirements to:

- note when longstanding service relationships with affiliates are re-benchmarked;
- provide copies of supporting documentation referred to in reports;
- clearly set out the bases for allocating corporate service and insurance recharges affecting licensees;
- explain any risk included in intra -group loan facilities affecting licensees; and
- state any interest rates applied to bank balances which are 'swept' within the group and treated as loan balances.

The points in the list above were either resolved through supplementary questions in 2012 or will be required for future reporting. We have only referred to one outstanding query in a response letter, which relates to a negative margin, shown as having been charged to a licensee by a related contracting company; we expect to resolve this through correspondence.

⁷⁵ The prohibition on cross subsidies is prescribed by: Internal Markets Electricity Directive (IMED) 2009/72/EC at Article 31(3); the Internal Markets in Natural Gas Directive 2009/73/EC at Article 31(3); Standard Licence Condition 4 of the Electricity Distribution Licence; Standard Special Condition A35 of the Gas Transporter Licence (Standard Condition 41 for independent gas transporters); and Standard Condition B5 of the Electricity Transmission Licence (Standard Condition E6 for offshore transmission network operators).

3.1.4 Cross-border issues

- Article 37(6)(c), Article 37(8), Article 37(9), use of revenues for interconnectors (Article 37(3)(f)), Article 37(1)(g), and Article 37(1)(c)

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

Existing interconnection

The completion of the 500MW EirGrid East-West Interconnector (EWIC) in 2012 increased interconnection between GB and neighbouring countries from 3.5GW to 4GW. Existing interconnection includes the 1000MW BritNed interconnector with the Netherlands (BritNed), the 2000MW IFA interconnector with France (IFA), and the 500MW Moyle interconnector with Northern Ireland. Total interconnection capacity has increased by 1.5 GW since 2011 and could potentially reach 8GW by 2020.

Access rules on interconnection

The Third Package introduced new responsibilities for NRAs regarding the rules for granting access to cross-border electricity infrastructures. Amendments have been made to the standard licence conditions of the electricity interconnector licence in GB to take account of these new responsibilities.⁷⁶

Licensees are required to submit to Ofgem any new or amended access rules (including capacity allocation and congestion management). The interconnector licence also gives us the power to request licensees to review and amend these access rules.

The GB interconnector standard licence conditions place a responsibility on both Ofgem and the interconnector operator to ensure that tariff methodologies and access rules, and any modifications to these, comply with certain objectives. The objectives are objectivity, transparency, non-discrimination and compliance with the Electricity Regulation or any decision of the European Commission and ACER.

Interconnector operators are required to review their access rules at least once a year, or at our request, and to provide us with a report. This report should highlight what amendments, if any, will be made to better facilitate the objectives outlined above. The review must take into account any suggestions we might have in relation to better achieving the objectives.

In addition to the formal review process, we have also continued to informally monitor congestion management on our interconnectors.

⁷⁶ See standard conditions 10, 11 and 11A of the Electricity Interconnectors Licence: http://epr.ofgem.gov.uk/EPRFiles/Electricity_Interconnector_Standard%20Licence%20Conditions%20Consolidated%20-%20Current%20Version.pdf

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

IFA

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

Capacity is allocated explicitly in long-term, day-ahead and intraday closed auctions, using a single coordinated capacity platform and harmonised capacity products. Netting⁷⁷ and Use-it-or-sell-it (UIOSI) are applied to ensure that the maximum possible capacity is made available to market participants in all timeframes.

NGIC and RTE are participating in the North West Europe (NWE) project to implement market coupling. NWE market coupling was expected to go-live on IFA at the end of 2012. However implementation has been delayed until November 2013. As part of this process NGIC will consult with stakeholders on the necessary amendments to the IFA access rules.

BritNed

The 1000MW BritNed HVDC cable between GB and The Netherlands commenced operation in April 2011. BritNed allocates capacity on its cable through a blend of implicit and explicit auctions. It holds medium term (monthly and annual) and intra-day explicit auctions and day-ahead implicit auctions. The implicit auction day-ahead system is also used to implement Use-it-or-lose-it (UIOLI).

BritNed has a 25-year exemption from rules around the use of interconnector revenues and charging methodologies.⁷⁸ However, it must still comply with the interconnector licence condition around access rules, introduced as a result of the Third Package.⁷⁹ Following stakeholder consultation, BritNed introduced explicit intraday auctions in May 2012. BritNed are participating in the NWE project to implement market coupling.

Moyle

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

⁷⁷Netting is the superposition of hourly nominations in two opposite directions, in order to release some capacity in the more congested direction for the next allocation step

⁷⁸ Standard conditions 9 and 10 of the Electricity Interconnector Licence

⁷⁹ Standard condition 11A of the Electricity Interconnector Licence

Similarly to BritNed, Moyle has an exemption from regulations around charging methodologies, but not from access rules. On 4 September 2012, Ofgem approved amended access rules for Moyle to facilitate the introduction of implicit intraday trading⁸⁰. In approving the access rules we requested Moyle to undertake a further consultation on precisely how capacity is curtailed in the event of an outage, as this was one of the key concerns raised by stakeholders in the access rules approval process.

EirGrid East-West Interconnector

The EirGrid East-West Interconnector (EWIC) became operational in November 2012. It has a technical capacity of 500MW between Wales and Ireland and uses the same capacity allocation platform as Moyle. It offers capacity through explicit long-term (monthly and annual), daily and implicit intraday auctions and applies UIOSI to long-term capacity.

The EirGrid EWIC is not exempt from any regulations around access rules and charging methodologies. On 4 September 2012, Ofgem approved the access rules⁸¹ and charging methodology⁸² for EirGrid EWIC. In approving the access rules we requested EirGrid EWIC to undertake a further consultation on precisely how capacity is curtailed in the event of an outage, as this was one of the key concerns raised by stakeholders in the access rules approval process.

Monitor TSO investment plans in view of TYNDP

We set price controls for the electricity transmission system operator. As part of this process we review the companies' investment plans. We explicitly require these plans to consider the interaction with wider European developments as part of the context of the plan. We also require the company to consider the various uncertainties across the period for which the control is set (and across a longer period). Under the price control we require the transmission companies to report on their performance against these plans on a regular basis.

The Electricity Ten Year Statement (ETYS) was first published in November 2012 to combine the former National Grid electricity publications, the Seven Year Statement (SYS) and the Offshore Development Information Statement (ODIS). This includes assumptions on the capacity of interconnectors with the rest of Europe. We are in the process of establishing a monitoring approach to ensure consistency with the community wide network development plan.

Cooperation

Article 37(1) (c) imposes new duties on us to consult and cooperate with ACER and the NRAs of other member states, on cross-border issues. Changes have been made to the

⁸⁰ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=117&refer=Europe>

⁸¹ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=119&refer=Europe>

⁸² <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=121&refer=Europe>

Electricity Act to reflect this.⁸³ This includes the requirement to provide ACER and other NRAs with the information they may need to carry out their responsibilities under the Third Package.

The changes to the Electricity Act also place a responsibility on us to cooperate with the NRAs of other member states to promote certain objectives. These include enabling an adequate level of interconnector capacity and supporting jointly managed cross-border trade in electricity and the allocation of cross-border capacity.

Examples of cooperation

We have been cooperating with the NRAs of adjacent member states over a number of issues around interconnectors. For example, we have worked closely with the Irish and Northern Irish regulators to develop and approve common trading arrangements for the Moyle and Eirgrid EWIC and on the SEM European market integration project⁸⁴.

In addition, we have been cooperating closely with the Belgian regulator, CREG, over project NEMO, the proposed interconnector between GB and Belgium. In December 2011, Ofgem and CREG published our preliminary conclusions on the high level principles and design of a new regulatory regime for electricity interconnector investment.⁸⁵ Based on these principles, Ofgem and CREG developed a proposed approach on the regime and the methodology for setting the cap and floor on returns for NEMO. In the March 2013 consultation we outlined our proposals and sought views on the proposed design and methodology.

Under the Third Package, NRAs are required to certify TSOs, including interconnector operators, as compliant with the ownership unbundling requirements. This has required cooperation between us and the Irish, French and Dutch NRAs.

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

In addition to this, we have been consulting with many other NRAs through our role as the lead regulator for the North West Europe (NWE) intraday project. The NWE projects were established by 13 TSOs, covering nine countries, with the objective of developing a common approach to cross-border capacity allocation and implementing a common day-ahead market coupling solution and intraday solution across the NWE countries.

We have also contributed to ACER's work in the development of Framework Guidelines and

⁸³ See Regulation 35 of the Electricity and Gas (Internal Market) Regulations 2011, which inserts section 3F into the Electricity Act 1989: <http://www.legislation.gov.uk/uksi/2011/2704/regulation/35/made>

⁸⁴ http://www.allislandproject.org/en/TS_Current_Consultations.aspx?article=5dc5e905-db0a-4cde-b3bb-5cf9b1873559&mode=author

⁸⁵ <http://www.ofgem.gov.uk/Europe/Documents1/Cap%20and%20floor%20regime%20for%20regulation%20of%20new%20subsea%20interconnector%20investment5.pdf>

Network Codes for the European electricity market. We are chairing the Electricity Working Group and we are leading the project team on the grid connection codes. We are also actively involved at CEER, holding the chair position of the Electricity Working Group and co-chair of the Sustainable Development Task Force and actively contributing to the work on smart grids.

3.1.5 Compliance

- Article 37(1) (d), Article 39, Article 37(1)(b), Article 37(1)(q), Article 37(3)(a),(b),(e) and Article 37(5) all but (a) and (c) + imposing penalties Article 37(4)(d)

Ensuring compliance with binding decisions of the Agency and the Commission, and with the Guidelines⁸⁶

Under the Third Package NRAs are required to ensure compliance with and implement binding decisions of ACER and of the European Commission. In order to enable Ofgem to do this, the Electricity Act has been amended so as to provide the Authority with the necessary powers to carry out its functions in the manner that it considers is best calculated to implement or ensure compliance with any binding decision of ACER or of the European Commission.

Compliance of transmission and distribution companies, system owners and electricity undertakings with relevant Community legislation, including cross-border issues

We have powers to investigate compliance of transmission and distribution, electricity undertakings with relevant Community legislation. If a breach is found, we have powers to impose penalties.

As a condition of certification, TSOs are obliged to notify the Authority if they know (or reasonably should know) of an event or circumstances which has occurred, or is likely to occur, that may affect their eligibility for certification and must provide an annual declaration (approved by a resolution of the TSO's board of directors) in this regard. The Authority also has powers to require information to be provided by the TSO for the purpose of monitoring the TSO's certification.

Once the European network codes are finalised, we will have an obligation to ensure these are fully implemented in GB. Ofgem, in close cooperation other relevant NRAs, will ensure

⁸⁶ The Guidelines being those Guidelines referred to in the Gas and Electricity Directives and Regulations under the Third Package.

TSOs are compliant with network codes through our access rules approval process (as required by UK TSO licences) and by monitoring TSO business rules, standard transportation agreements and any and all other relevant operational rules and agreements. Ofgem will require TSOs to notify the Authority if they know (or reasonably should know) of an event or circumstances which has occurred, or is likely to occur, that may affect their compliance with the Ofgem approved network code compliance regime. The Authority also has powers to require information to be provided by the TSO for the purpose of monitoring the TSO's Network Code compliance.

Update on Ofgem's enforcement investigations

We have set out below some of the key enforcement investigations and actions we undertook in 2012 against both electricity and cross-cutting undertakings.

Investigations concluded

Mis-selling

Cross-cutting (electricity & gas)

In May 2012 we made the decision to impose a financial penalty following an investigation into compliance by EDF Energy plc with the obligations under conditions 23, 25 and 27 of the Standard Conditions of the Electricity and Gas Supply Licences. This followed an investigation into EDF Energy's compliance with its licence conditions in relation to the marketing of gas and electricity to domestic customers.

The Authority decided it was appropriate to impose a penalty on EDF Energy for these contraventions. However, EDF Energy has agreed to make payments amounting to £4.5 million which benefit consumers. The Authority decided that the payments offered by EDF Energy will benefit electricity and gas consumers more than would be the case if a significant penalty were to be imposed, so it decided to impose a reduced penalty of £1. In addition, from an early stage of the investigation, EDF Energy took proactive steps to put corrective measures in place.

Complaints handling standards investigations

Cross cutting (electricity & gas)

In January 2012 we made the decisions to impose a financial penalty of £2.5 million on British Gas Trading Limited and £2 million on RWE Npower plc following investigations into compliance with the Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008. These Regulations set the standard for the way energy companies handle customer complaints.

Competition Law

Electricity

In May 2012 we issued a Decision to accept binding commitments from Electricity North West Limited (ENW) over connection charges. The case concerns a complaint made by Independent Power Networks Limited about aspects of the charges levied on it by ENW for connection into its distribution service area.

Following consideration of the allegation, Ofgem launched a formal investigation into allegations of abuse of a dominant position by ENW, under section 18 of the Competition Act 1998 (the Chapter II prohibition). Electricity North West Limited offered Ofgem binding commitments in order to address competition. Ofgem considered that the commitments offered by ENW fully addressed competition concerns. Formal acceptance of the commitments by Ofgem resulted in the termination of the investigation without the need for any decision on whether or not competition law had been infringed.

Price apportionment

Cross-cutting (electricity & gas)

In August 2012 an open letter was sent to Energy UK to consider if suppliers are acting in accordance with the "Code of Practice for Accurate Bills" which requires that suppliers, which are party to it, use all available information to produce accurate, clear and timely bills.

We found no evidence of systematic errors in the approach taken by suppliers to allocate charges nor, in the cases reviewed, any deliberate attempts by suppliers to overcharge. However our observation from the information presented to us is that there are cases where customers seeking advice from suppliers remained unsure how consumption was apportioned when there was a price change within the billing period (and therefore how the corresponding charges were calculated). We therefore asked Energy UK, as the owner of the code, to consider, in the first instance, whether suppliers were acting in compliance with the code and take an appropriate action in necessary. Ofgem may nonetheless decide to take action in the future if deemed appropriate.

Misreporting

Electricity

In October 2012 we made the decision to impose a financial penalty of £125,000, following an investigation into compliance by Opus Energy Limited with reporting requirements under the Renewables Obligation.

By 1 July each year, electricity suppliers are required to inform the Authority of the amount of electricity supplied to customers in England & Wales and Scotland during the previous obligation period (from 1 April to 31 March). Ofgem's investigation concerned Opus's procedures for the reporting of electricity supply data under the Renewables Obligation and information misreported for the obligation period 2009-10.

Ongoing investigations

Cross-cutting (electricity & gas)

Our investigations into the below matters are ongoing and further information can be found on our website⁸⁷.

Consumer Protection from Unfair Trading Regulations 2008

Ofgem commenced an investigation in June 2011 into Scottish Power's compliance with the Consumer Protection from Unfair Trading Regulations 2008. Ofgem is investigating whether Scottish Power is complying with the requirements of the Consumer Protection from Unfair Trading Regulations 2008 (CPRs) in relation to its online tariff, Scottish Power Direct – October 2012 Offer. In particular, Ofgem is investigating whether aspects of the marketing and promotion of that tariff and/or its terms and conditions (Ts&Cs) are prohibited under the CPRs because they amount to misleading action under Regulation 5(1) of the CPRs and/or a misleading omission under Regulation 6(1) of the CPRs.

The CPRs prohibit traders in all sectors from engaging in, amongst other things, unfair commercial practices which mislead consumers and set out rules that determine when such commercial practices are unfair and misleading.

Customer transfer blocking

In January 2012 Ofgem launched an investigation into whether British Gas Business are complying with the requirements of condition 14 of their gas and electricity supply licence (SLC14).

Condition 14 sets out the provisions around non-domestic customer transfer blocking. The only permissible reasons for objecting to a request to transfer a non-domestic supply (SLC14.2) are relevant contractual agreement or transfers initiated in error. Electricity suppliers are allowed an additional reason for system reasons, namely if the new supplier has not applied for all relevant meter points on the same working day.

Misreporting

In March 2011 we launched an investigation into misreporting of the distribution of compact fluorescent lamps (CFLs) (Article 16(1)(a) of the Electricity and Gas (Carbon Emissions Reduction) Order 2008). Ofgem is investigating the accuracy of information provided by E.ON regarding the way in which it has met obligations on limiting carbon emissions by distributing free light bulbs. Article 16(1)(a) requires that an energy supplier must provide to the Gas and Electricity Markets Authority information relating to:

⁸⁷ <http://www.ofgem.gov.uk/About%20us/enforcement/Investigations/Pages/Invstigtions.aspx>

- (i) its proposals for complying with any aspect of the carbon emissions reduction obligation; and
- (ii) whether the supplier has complied with those obligations.

Mis-selling

In September 2010, we launched investigations into four of the “Big 6” suppliers (RWE npower, Scottish Power, SSE and EDF Energy) to determine whether they were complying with obligations under standard licence condition 25 of both the gas and electricity supply licences relating to the marketing of gas and electricity to domestic customers. In April 2012, we launched a ‘mis-selling’ investigation into E.ON.

The investigation into EDF Energy was closed in May 2012. We continued to progress our investigations into RWE npower, Scottish Power, SSE and E.ON during 2012. The investigation into SSE was concluded in May 2013.

Tariffs

In March 2011 we launched an investigation into Scottish Power’s compliance with obligations under the gas and electricity supply licences (Standard Licence Condition 27.2A). Condition 27.2A requires that any difference in the terms and conditions between different payment methods must be reflective of the costs to the supplier of those different methods. The investigation has been launched in relation to the significant difference between Scottish Power’s standard and direct debit tariffs.

3.2 Promoting Competition

3.2.1 Wholesale markets

The electricity wholesale market in Great Britain has been open to competition since 1990, with the creation of the Electricity Pool. This allowed electricity to be traded in bulk through a centrally managed trading system. In 2001, the Pool was replaced with the New Electricity Trading Arrangements (NETA) in England and Wales. The British Electricity Trading Transmission Arrangements (BETTA) replaced NETA in 2005, extending the previous arrangements to Scotland. This created the current single wholesale electricity trading market in Great Britain which is mostly based on bilateral trading between generators, suppliers, traders and customers across a series of markets.

Policy developments in several areas of GB’s wholesale electricity market have continued throughout 2012. Some notable policy areas include:

- Electricity Market Reform (EMR)
- Electricity Cash-out Significant Code Review (SCR)

- Future Trading Arrangements design
- Cross-border electricity market developments
- Wholesale Liquidity developments
- Transmission Constraint Licence Condition (TCLC) implementation

The legislative framework for the EMR policies was provided in November 2012 by the Department of Energy and Climate Change (DECC) through the introduction of the Energy Bill into the House of Commons. This followed pre-legislative scrutiny in June 2012. Accompanying the Energy Bill's publication was a series of documents providing more detail on the EMR policies.

On cross-border market developments in 2012, the Authority approved the decision to remove two separate charges⁸⁸ relating to cross-border electricity flows. The TCLC also came into force in October 2012. The TCLC prohibits generators from obtaining an excessive benefit for electricity generation in relation to periods of transmission constraints.

Total over the counter (OTC) trading (excluding exchange based trading) in 2011/12 (Aug 11 to Jul 12) was around 9% higher than total OTC traded volume the previous year. For exchanges, the APX Power UK Exchange saw a decrease in total volumes traded in 2012 from 2011, whereas there was an increase in total volumes traded on the N2EX exchange for the same period. GB annual churn decreased in 2012.

The total installed capacity on the GB system at the end of 2012 was 84.9 GW⁸⁹, an increase from 83.5 GW in 2011. However, de-rated margins have fallen in 2012 compared to 2011. Based on metered volume data, EDF again contributed the largest proportion of power generation in GB. Centrica, Drax, E.ON, RWE, Scottish Power and SSE all produced more than 5 per cent of total GB generation. Actual peak electricity demand⁹⁰ rose in 2012 by 5.0%. GB's physical integration with other markets was extended further in 2012 with the completion of the East-West interconnector between GB and Ireland. It has a capacity of 500 MW and is expected to start full commercial operation in 2013.

Monthly averaged OTC Day-Ahead baseload and peakload electricity prices displayed seasonal variability throughout 2012. Prices were higher in winter as weather-driven demand was higher, and fell during the summer as demand fell. They reached their highest levels of 2012 during the winter of 2012/13.

⁸⁸ These were charges for GB transmission network losses from cross border flows and Balancing Services Use of System (BSUoS) charges from cross border flows.

⁸⁹ This is based on transmission connected generation in the Gone Green scenario of National Grid's 2012 UK Future Energy Scenarios. Available here:

<http://www.nationalgrid.com/uk/Gas/OperationalInfo/TBE/Future+Energy+Scenarios/>.

⁹⁰ Total Gross System Demand. This is includes station load, pump storage pumping and interconnector exports. Data available from National Grid: <http://www.nationalgrid.com/uk/Electricity/Data/Demand+Data/>.

3.2.1.1 Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition

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

Price Monitoring

Under Article 37(1)(i) we have an obligation to monitor the level of transparency of wholesale prices. In GB wholesale prices are compiled and made available to market participants by a number of independent pricing agencies, energy market brokers and via exchanges. Argus Media, ICIS Heren and Platts provide pricing based on reported over the counter (OTC) trades, and made available to the market via subscription services. Data providers produce pricing data for a wide variety of peak and baseload contracts up to three years ahead of delivery. Financial data providers (such as Bloomberg PROFESSIONAL service) also provide close to real time energy broker pricing based on OTC trades.

In addition to a wide range of OTC pricing data, the three exchange providers in the GB electricity market⁹¹ all provide pricing data to the market. Please see below for a description of GB wholesale power exchanges.

Description of the wholesale market

The GB wholesale market is mostly based on bilateral trading between generators, suppliers, traders and customers across a series of markets. The wholesale market can mainly be divided into bilateral over the counter (OTC) trading and power exchange trading, followed by Balancing Mechanism (BM) activity and imbalance settlement⁹².

Over the counter (OTC) trading⁹³

On the basis of analysis undertaken by the Financial Services Authority (FSA), total OTC trading (excluding exchange based trading) in 2011/12 (Aug 11 to Jul 12) was around 998 TWh.⁹⁴ This is around 9% higher than total OTC traded volume the previous year.

⁹¹ The APX Group, N2EX (a Nord pool Spot and Nasdaq OMX commodities joint venture) and the Intercontinental Exchange (ICE)

⁹² Further detail on the structure of the wholesale electricity market was provided in our 2008 National Report and has broadly remained unchanged. See National Report here: http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/NATIONAL_REPORTS/National%20reporting%202008/NR_En/OfgemNationalReport2008%20-%20FINAL%20V2.pdf

⁹³ Bilateral trading between two market participants or where an intermediary (the broker) brings together a buyer and seller

⁹⁴ Data available from: <http://www.fsa.gov.uk/static/pubs/other/energy-2012.pdf>

Power exchanges

Total traded volume on the APX Power UK Exchange in 2012 was around 18.4 TWh, a decrease of around 21% (5.0 TWh) on the calendar year for 2011.⁹⁵

N2EX, which started to operate in the GB wholesale market in January 2010, saw trading of around 94.6 TWh for its day-ahead auction in 2012, up from 18.8 TWh in 2011. N2EX also operates a near-term continuous market. 38.1 TWh was traded on this market in the course of 2012, up from 26.9 TWh in 2011.⁹⁶ However, the continuous volumes do not originate on the platform – they are OTC trades which have been given up for clearing on the N2EX exchange. UK power futures exchange traded contracts are also available on the Intercontinental Exchange (ICE).

For 2012 as a whole, around 85 percent of all power traded in GB was OTC traded and around 15 percent was exchange traded. In 2011, these figures were around 95 per cent and 5 per cent for OTC and exchanges, respectively.

Liquidity

We have been concerned for some time that poor liquidity in the wholesale electricity market may be a barrier to competition in both generation and supply. By limiting the ability of firms to enter and grow, this may be imposing costs on consumers. Our concerns are particularly in relation to poor liquidity in longer-dated products.

We have regularly assessed liquidity against a number of quantitative and qualitative indicators. These show that our liquidity objectives for the wholesale market remain unmet. For example, churn continued to fall in 2012. However, we have noted some early signs of progress in the access to wholesale products for independent suppliers.

In order to improve liquidity, we have considered a number of intervention options. In December 2012⁹⁷ we published a consultation on a "Secure and Promote" licence condition. This would aim to secure some positive industry-led initiatives, and potentially promote progress along the curve. This could include a market-making obligation, which would oblige firms to post prices at which they would be prepared to buy and sell electricity.

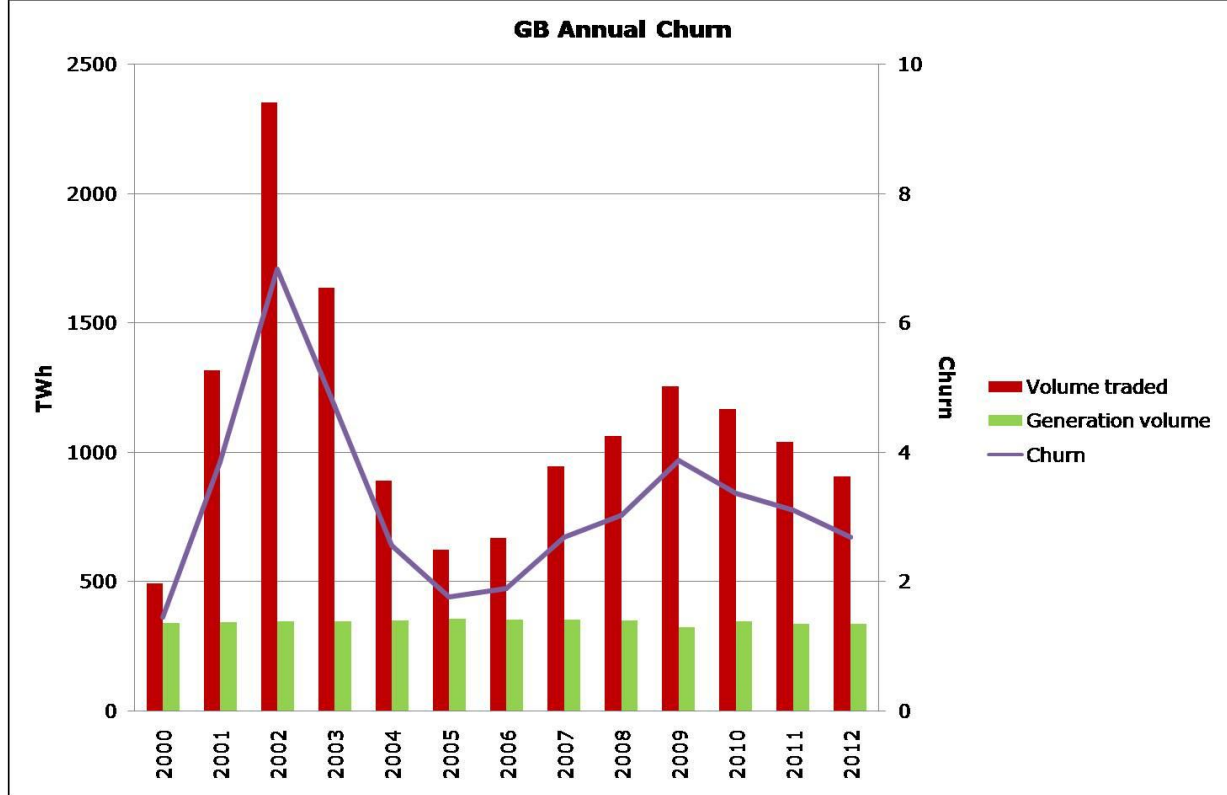
The consultation closed in February 2013. We are now considering responses to the consultation and progressing our policy development. In the event of a decision to intervene, we would aim to modify licence conditions by the end of 2013.

⁹⁵ Includes both APX Continuous and Day Ahead auctions Data available from: <http://www.apxgroup.com/>

⁹⁶ Includes Prompt and Day Ahead auctions. Data available from: <https://www.n2ex.com/>

⁹⁷ Wholesale power market liquidity: consultation on a 'Secure and Promote' licence condition. Available here: <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Secure%20and%20Promote%20Consultation.pdf>.

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



Source: APX, DUKES, ICE, N2EX.

Balancing mechanism (BM)

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

Around 7.7 TWh of offers and 8.6 TWh of bids were accepted in 2012 – this compares to 6.7 TWh of offers and 8.4 TWh of bids in 2011.

In our February 2010 Project Discovery⁹⁸ consultation we expressed concerns that electricity cash-out prices may not be correctly signalling the value of flexibility and peaking generation, increasing the risks to future security of supply.

We launched a Significant Code Review (SCR) of the Electricity Balancing Arrangements in August 2012, with the publication of an Initial Consultation Document.⁹⁹ This review will allow us and the industry to consider ways to improve the balancing arrangements and their contribution to delivering an efficient level of security of supply. This review also allows us to assess whether changes are needed to make the balancing arrangements robust to changes in the generation mix and to implement the European Electricity Target Model.

Given the challenges identified in our 2010 Project Discovery, and subsequent market and policy developments, it is important that the electricity trading arrangements remain fit for purpose and if necessary adapt to the changes triggered by Government policy, EU reforms and market trends.

In February 2013 we published a letter¹⁰⁰ seeking Stakeholder's views on whether to launch a project to assess whether the GB electricity market arrangements are adequate for delivering secure and sustainable supplies.

Generation capacity

The total installed capacity on the GB system at the end of 2012 was 84.9 GW.¹⁰¹ This represents an increase from 83.5 GW reported a year ago. This increase in capacity is mainly due to new gas-fired and renewable (predominantly wind) generation beginning operation in 2012. However, the total increase has been curbed by a reduction in coal generation of almost the same magnitude. Further, we anticipate that further coal and oil capacity will close in 2013 due to European environmental legislation.

The increase in installed generation capacity in 2012 has not increased de-rated capacity margins in the market, however, as these have fallen relative to 2011. Our 2012 Capacity Assessment¹⁰² forecast the de-rated capacity margin in 2012/2013 to be relatively high by

⁹⁸ Project Discovery: Options for delivering secure and sustainable supplies. Available here:

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

⁹⁹ Electricity Balancing Significant Code Review (SCR) – Initial Consultation. Available here:

<http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/electricity-balancing-scr/Documents1/Electricity%20Balancing%20SCR%20initial%20consultation.pdf>.

¹⁰⁰ Update on the Electricity Balancing Significant Code Review (EBSCR) and request for comments on proposed new process to review future trading arrangements. Available here:

<http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/electricity-balancing-scr/Documents1/Update%20on%20EBSCR%20and%20new%20process%20to%20review%20Future%20Trading%20Arrangements.pdf>.

¹⁰¹ This is based on transmission connected generation in the Gone Green scenario of National Grid's 2012 UK Future Energy Scenarios. Available here:

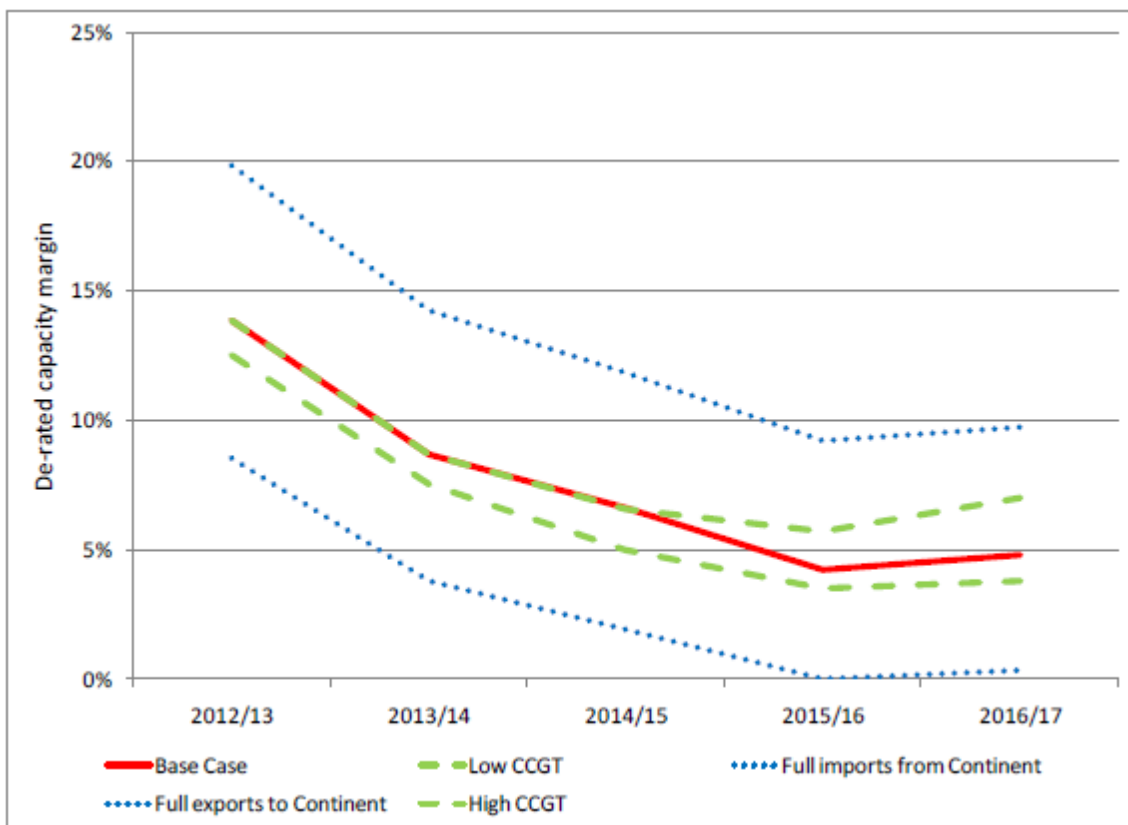
<http://www.nationalgrid.com/uk/Gas/OperationalInfo/TBE/Future+Energy+Scenarios/>.

¹⁰² Please see the Electricity Capacity Assessment 2012 for more details. Available here:

<http://www.ofgem.gov.uk/Markets/WhIMkts/monitoring-energy-security/elec-capacity->

historical standards (around 14%). These then fall over the next few years to a low of 4.2% in 2015/2016 in the Base Case (see Figure 2). There is a slight uplift in 2016/2017 reflecting renewable build at the end of the period.¹⁰³ Demand is expected to remain broadly flat. However, there will be a significant reduction in electricity supplies from coal and oil plants over the period, primarily driven by closures required by European environmental legislation. Figure 2 shows de-rated capacity margins for the Base Case and for sensitivities on interconnectors and CCGT mothballing and new build assumptions.

Figure 2: De-rated capacity margins for the Base Case and for sensitivities on interconnectors and CCGT mothballing and new build assumptions (Capacity Assessment).



Source: Electricity Capacity Assessment 2012, Ofgem

[assessment/Documents1/Electricity%20Capacity%20Assessment%202012.pdf](#).

¹⁰³ Relatively modest demand increases driven by economic growth offset by improvements in energy efficiency and the availability of demand side response measures.

Market integration

For background information on GB interconnection, interconnection policy and market coupling please refer to the 3.1.4 *Cross Border issues* section of this report.

In broad terms, the GB market is integrated with neighbouring markets to the extent that market parties are able to trade between them, with prices for such trade established using market based methods. Physical integration was extended further in 2012 with the completion of the East-West interconnector between GB and Ireland. It has a capacity of 500 MW and is expected to start full commercial operation in 2013.

GB typically imports from France, through the IFA interconnector, and exports to Northern Ireland via the Moyle interconnector. In winter, when there are high demands in France, GB often exports to France through the IFA. In February 2012, GB exports to France were particularly strong, totalling almost 0.5 TWh¹⁰⁴ over the month, as France experienced below seasonal normal temperatures. Prices for access to interconnectors reflect market dynamics, with non-discriminatory auctions regularly held for daily, weekend, monthly, quarterly, seasonally and annual capacity.

Figure 3 shows flows across the GB-France interconnector for the whole of 2012. Both imports from, and exports to France were lower in 2012 compared to the previous year¹⁰⁵, primarily due to ongoing maintenance. Total imports from France for 2012 were down to 3.7 TWh, while total exports to France were 0.5 TWh.¹⁰⁶ This represents absolute import and export flows¹⁰⁷ of 87 per cent and 13 per cent, respectively, across the interconnector over 2012.

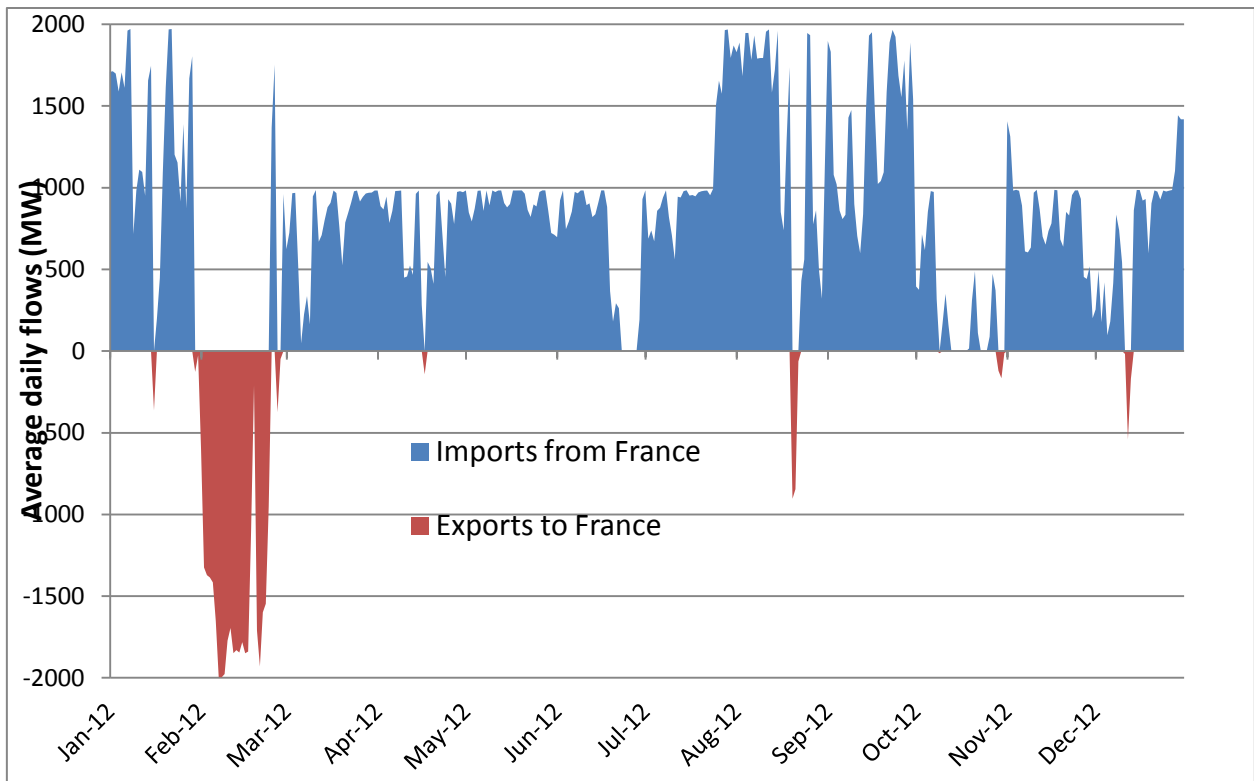
¹⁰⁴ Data available from NETA Reports: <http://www.netareports.com/index.jsp>

¹⁰⁵ Please, note the figures for this year cover the complete calendar year for 2012. Whereas the figures for last year are valid for April 2011 to March 2012.

¹⁰⁶ Data available from NETA Reports: <http://www.netareports.com/index.jsp>.

¹⁰⁷ Imports are from France, exports are to France.

Figure 3: Average net system transfers for IFA, 2012



Source: National Grid¹⁰⁸

The IFA and BritNed interconnectors are participating in the North West European project to implement a common regional approach to day-ahead market coupling and intraday trading. These are key pilot projects for the implementation of the European target model.

Following the removal of TNUoS charges on cross-border flows in 2011, the Authority took decisions to remove all further potential charges on cross border flows in 2012. On 1st May 2012 the Authority approved a decision to remove charges for GB transmission network losses from cross border flows. On 15th August 2012 the Authority approved a decision to remove Balancing Services Use of System (BSUoS) charges from cross border flows. On 23 January 2013 the Authority approved a decision to remove Residual Cashflow Reallocation Cashflow (RCRC) from cross border flows.

Price Monitoring: Market opening and competition

As noted above, the bulk of contract trading in the GB wholesale market is bilateral between generators, suppliers, traders and customers across a series of markets. The

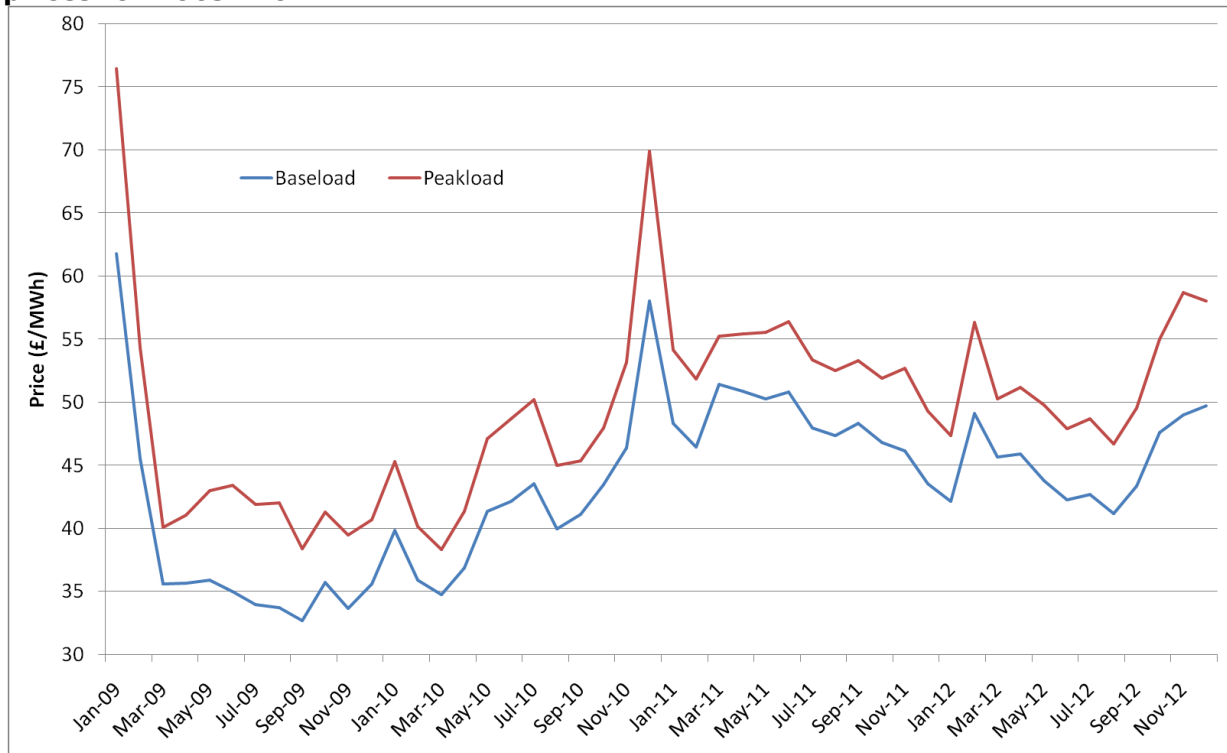
¹⁰⁸ Data available from National Grid: <http://www.nationalgrid.com/uk/Electricity/Data/Demand+Data/>

majority of wholesale market trading is divided into over the counter (OTC) trading and power exchange trading. Balancing Mechanism (BM) activity and imbalance settlement also takes place.

Monitoring prices

Figure 4 below shows how monthly averaged OTC Day-Ahead baseload and peakload electricity prices in GB have changed since the beginning of 2009. During 2012, both baseload and peakload prices displayed seasonal variability. Prices were higher in winter as weather-driven demand was higher, and fell during the summer as demand fell. They reached their highest levels of 2012 during the winter of 2012/13.

Figure 4: GB monthly averaged Day-Ahead baseload and peakload electricity prices for 2009 -2012



Source: Heren

Monitoring competition

We actively monitor competition in the market for wholesale electricity. Competition indicators such as market concentration levels are assessed across different areas of the market.

For electricity generation, seven companies had market shares exceeding five per cent which is the same as 2011. Metered volumes in 2012 indicate that EDF again contributed

the largest proportion of power generation in GB. The total HHI for electricity generation increased from 1259 in 2011, to 1483 in 2012. Please see the *market concentration* section of this chapter for further information.

We have concurrent powers, together with the Office of Fair Trading (OFT), to enforce Chapter I of the Competition Act 1998 (CA98) / Article 101 Treaty on the Functioning of the European Union (TFEU) and Chapter II / Article 102 TFEU in the energy sector.¹⁰⁹ We may undertake an investigation where we have reasonable grounds to suspect a breach of these provisions.

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

Market concentration

As illustrated in Figure 5 below, seven companies had market shares exceeding five per cent and, of these, the largest three companies generated nearly half of electricity consumed in GB in 2012.¹¹⁰

Metered volumes in 2012 indicate that EDF again contributed the largest proportion of power generation in GB. Based on this data, EDF now has a market share of 25%, up by 3 percentage points from 2011. This is on the back of record nuclear generation output in 2012. Centrica, Drax, E.ON, RWE, Scottish Power and SSE all produced more than 5 per cent of total GB generation.

¹⁰⁹ In so far as agreements or conduct relate to commercial activities connected with the generation, transmission or supply of electricity or licensable activities or other activities (such as off-shore activity) which are ancillary to those subject to licences for transportation, shipping or supply of gas. (See section 36A of the Gas Act and section 43 of the Electricity Act).

¹¹⁰ Produced from proprietary data.

Figure 5: 2012 electricity market share in GB based on metered volume¹¹¹

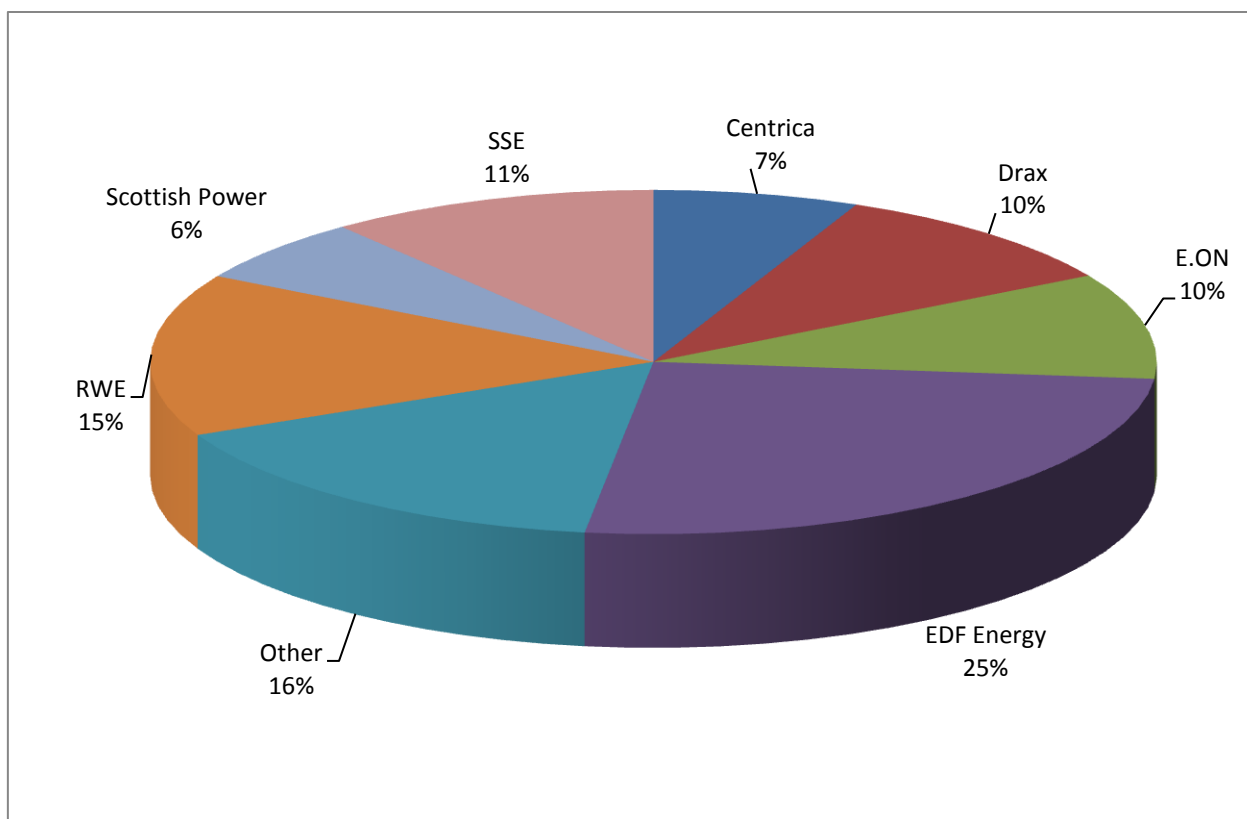


Table 1 provides Herfindahl-Hirschman Index (HHI) analysis based on metered volume by different companies in GB in 2012. The largest individual HHI by capacity is EDF (HHI of 634) which owns and operates a number of nuclear plants in GB.

Table 1: Herfindahl-Hirschman Index (HHI) based upon 2012 metered volume¹¹²

| Company | Capacity (HHI) |
|----------------|----------------|
| Centrica | 42 |
| Drax | 97 |
| E.ON | 96 |
| EDF | 634 |
| Other | 243 |
| RWE | 226 |
| Scottish Power | 36 |
| SSE | 110 |
| Total | 1483 |

¹¹² Produced from proprietary data

Measures to avoid abuses of dominance

Information provision is a key component of the effective and efficient operation of the GB electricity markets. Information relating to the operation of the electricity BM is provided through the Balancing Mechanism Reporting Service (BMRS) website by the Balancing Mechanism Reporting Agent (BMRA)¹¹³.

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

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

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

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

Following this consultation, the TCLC came into force on 29th October 2012. We published guidance on our intended approach to the interpretation and enforcement of the TCLC on the same date.

The TCLC prohibits generators from obtaining an excessive benefit for electricity generation in relation to periods of transmission constraints. This may occur either where the generator artificially creates or exacerbates a transmission constraint, or where the generator obtains an excessive financial benefit for the System Operator in return for reducing their generation.

The TCLC will cease to have effect 5 years after Section 18 of the Energy Act 2010 came into force on 16 July 2012. There is the possibility of a 2 year extension by the Secretary of State.

Market surveillance

Our market surveillance team monitors the gas and electricity markets, including the wholesale electricity market and the Balancing Mechanism. They routinely assess whether

¹¹³ Further information relating to the operation of the BMRS and the information available on this website can be found in our 2008 National Report and at the following link: www.elexon.co.uk

there is any evidence of anti-competitive behaviour or breaches of statutory provisions or licence conditions which may be investigated by us. On the basis of active surveillance and monitoring of the markets, we can investigate the behaviour of market participants if anti-competitive conduct is suspected and, where necessary, enforce domestic and European competition law.

Additionally, the Financial Conduct Authority (FCA)¹¹⁴ has responsibilities for the operation of financial markets in the UK. The FCA works to prevent abuse or distortion of financial markets. The FCA 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

There were no virtual power plant auctions or other capacity release measures in 2012. We are currently consulting stakeholders on measures to increase market liquidity in our liquidity proposals (please see previous *Liquidity* section).

3.2.2 Retail market

The electricity supply market in Great Britain has been open to competition since the late 1990s. Initially this applied to large industrial consumers and then was rolled out across all consumers, including at the household (domestic) level. Although regulations exist to protect consumers and to facilitate competition, price controls on domestic retail energy prices were removed by April 2002. Since that time retail prices have been set by energy suppliers based on their costs and other factors related to their business and market forces. As later sections will show, retail electricity prices for electricity consumers rose by 5 per cent in 2012.

The majority of the domestic electricity supply market is accounted for by 6 large vertically integrated suppliers (integrated generation and supply businesses), which evolved from the 15 former incumbent electricity and gas suppliers between 1998 and 2003.¹¹⁵ There are also 12 small domestic electricity suppliers. We have seen growth in small supplier numbers during 2012, with 3 entering the market. Within the non-domestic market, there were 24 active suppliers at the end of 2012. This is an increase on the 20 that were active in 2011.

¹¹⁴ <http://www.fca.org.uk/>

¹¹⁵ These companies are (i) Centrica plc: Centrica plc owns British Gas Trading, which operates three retail brands: British Gas (in England), Nwy Prydain (in Wales) and Scottish Gas (in Scotland). (ii) E.ON UK: A wholly-owned subsidiary of the German energy group, which operates under the E.on brand. (iii) EDF Energy: A wholly-owned subsidiary of the French energy group. It operates under the EDF Energy brand. (iv) RWE npower: Part of the German energy group, RWE Group. The supply business operates under the npower brand. (v) Scottish and Southern Energy (SSE): It maintains and promotes separate and distinct energy retail brands in England, Scotland and Wales. (vi) Scottish Power: A wholly-owned subsidiary of the Spanish energy group, Iberdrola.

3.2.2.1 Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition

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

Price Monitoring: Transparency

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

Financial transparency

Ofgem requires suppliers to adhere to strict standards of financial reporting, enforced through the Licence Conditions we set. For example, since 2009 we have required large, vertically-integrated suppliers to publish annual Consolidated Segmental Statements (the Statements) on their websites. These Statements provide a breakdown of suppliers' revenues and operating costs and are reconcilable to audited accounts. The information is required for five business segments: electricity generation and four supply segments (domestic and non-domestic, electricity and gas). The Statements set a level of transparency that allows us to assess where revenues are being generated and costs incurred and to compare this across suppliers.

Ofgem produces an annual summary of the Statements, the archive of which can be found on our Retail Market Review (RMR) webpage¹¹⁶. We published a summary of the 2010 and 2010/11 Statements in January 2012.¹¹⁷

To help identify areas where suppliers could improve the quality of information they provide to us, in 2011 we commissioned an independent accountancy firm (BDO) to review suppliers' energy accounts. Following the review, we published consultations in January 2012¹¹⁸ and May 2012¹¹⁹ setting out our proposed way forward. We considered that the proposals strike the right balance between increasing transparency and allowing companies to determine how best to run their businesses. In October 2012, the Authority published its final decision¹²⁰ to change the Financial Information Reporting licence condition. The licence condition details the way large energy suppliers must prepare the financial information in their Statements and on their websites.

¹¹⁶Publication of 2011 CSS <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Pages/rmr.aspx>

¹¹⁷ Ofgem (Jan 2012), "[Financial Information Reporting: 2010 Results](#)"

¹¹⁸ Ofgem (Jan 2012), "[Improving Reporting Transparency](#)"

¹¹⁹ Ofgem (May 2012), "[Improving the Reporting Transparency of Large Energy Suppliers](#)"

¹²⁰ Please see here:

<http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Improving%20Reporting%20Transparency%20-%20Final%20Decision%20Document.pdf>

Transparency for domestic consumers

Our research has repeatedly shown that consumers often do not have key information needed to make informed decisions about their energy supplier. As part of our RMR, in October 2012¹²¹ we consulted on changes to bills, annual statements and price increase notifications to (i) ensure consumers have access to key information that enables them to understand their tariff and be able to compare tariffs within the market; and (ii) help domestic consumers better understand the information suppliers provide to them and how they can use it to help them.¹²²

Our proposals included:

- Using standardised language and terminology to describe key concepts across these communications – this will ensure a consistent approach across industry and enhance consumer familiarity with key terms and the material provided;
- Introducing standard formatting on a specific section of bills giving details that will help consumers compare tariffs, and introducing standard formatting for the majority of the annual statement; and
- Personalising information on price change notifications, explaining clearly what a change would mean for each customer’s energy charges.

At the end of 2012 a stakeholder group on Consumer Bills and Communications¹²³ started discussing a list of terms for sector-wide standardisation. Greater consistency of terms like tariff names (e.g. evergreen contracts, fixed term contracts) will simplify decision-making for consumers and improve transparency.

To further increase the transparency of electricity prices and to help consumers understand the components of their electricity bill, we produce a ‘Household Energy Bills Explained’ factsheet. This is designed to clearly and simply show the relationship between energy bills, wholesale energy costs, and other costs such as those associated with transmission and distribution. We updated the factsheet in May 2012.¹²⁴

Consumers can access information on supplier prices by contacting Consumer Focus (a consumer advocacy body). Consumer Focus publishes price comparison tables for each GB supply region. These show what consumers would pay for a given level of energy consumption, payment type, and tariff. It also hosts on its website an interactive search

¹²¹ This has built on several years of research and policy development, beginning with the Energy Supply Probe in 2008 and including the Retail Market Review (RMR) begun in March 2010. We intend to publish our final statutory RMR consultation in May 2013.

¹²² Ofgem (Oct 2012), “[The Retail Market Review: Domestic Proposals](#)”

¹²³ Please find more information on the composition and purpose of the group here:

<http://www.ofgem.gov.uk/Markets/RetMkts/consumer-bills-and-comms-round-table/Pages/index.aspx>.

¹²⁴ We do not archive these factsheets on our website and so the May 2012 update is not publicly available. For an overview of its content, interested parties should access our latest update produced in January 2013 available at <http://www.ofgem.gov.uk/Media/FactSheets/Documents1/household-bills.pdf>

tool, which allowed consumers to see the cheapest deal available by inputting their post code, energy consumption level and preferred energy and tariff types. In 2012 it maintained a list of over 10 accredited online energy switching sites, each of which enables consumers to compare a wide range of suppliers' tariff prices and service offerings and determine which offer best suits their needs.¹²⁵ It should be noted that since 1 April 2013 Consumer Focus has been replaced by the Citizens Advice Service and Regulated Industries Unit.¹²⁶

Consumers can have confidence in the accuracy of these accredited switching sites because of the 'Confidence Code', which until 27 March 2013 was administered by Consumer Focus. It is a code of practice that sets out the minimum requirements that a provider of an online domestic gas Price Comparison Service (Service Provider) must meet in order to be, and remain, accredited to this voluntary scheme. Ofgem assumed responsibility for administering the Code from 27 March 2013.

Transparency for non-domestic consumers

Ofgem is also working to increase transparency for consumers in the non-domestic market. Our research has shown that some businesses experienced a lack of transparency and clarity in the information provided on bills by their supplier.¹²⁷ As part of our non-domestic RMR proposals published in October 2012, we consulted on expanding the protections that currently apply to micro business customers, to more business customers. We also set out best practice and requirements for the information customers must receive when there is an objection to their supply transfer.¹²⁸

We also consulted on how best to increase the transparency of non-domestic Third Party Intermediaries' (TPIs) activities.¹²⁹ TPIs act as brokers between non-domestic customers and suppliers, assisting customers in finding the most appropriate energy deal for their needs. However, our research from the 2008 Energy Supply Probe and RMR found evidence that TPIs are not always delivering the best outcomes for consumers.

Therefore we consider there is a need for further intervention around TPIs. In October 2012 we proposed to take the lead in developing options for a single Code of Practice (CoP) for TPIs. We also asked stakeholders to contact us if they wanted to be part of a TPI working group that would inform our proposals for the CoP. We received overwhelming interest in the TPI working group and respondents to the October consultation unanimously supported a single CoP for TPIs. In our view, the CoP will help to provide

¹²⁵ Ofgem has taken responsibility for administering the Code from March 2013. These comparison websites can be found at <http://www.ofgem.gov.uk/domestic-consumers/compare-with-confidence/Pages/index.aspx>

¹²⁶ More information on the transition can be found here: <http://www.consumerfocus.org.uk/about-us>

¹²⁷ Research Findings on the Experiences of Non-domestic Customers, Opinion Leader, December 2012, Pages 6-11

http://www.ofgem.gov.uk/MARKETS/RETMKTS/RMR/Documents1/Ofgem_Non%20Doms%20Research.pdf

¹²⁸ We will publish in March 2013 final proposals on the rules around the information that needs to be given to customers before and during their contract.

¹²⁹ Ofgem (Oct 2012), "[The Retail Market Review: Updated proposals for businesses](#)"

increased transparency and clarity for customers and give them confidence when making the decision to switch supplier.

To further increase transparency, we propose to introduce a new obligation on electricity (and gas) suppliers. This will require them to meet prescribed Standards of Conduct (SOCs) in their dealings with small business consumers. The obligation will apply when suppliers are engaging in the relevant activities of billing, contracting, and transferring customers. This definition of small business consumers will match that contained in our standard licence condition 7A proposals.

The SOC will oblige suppliers to treat their customers fairly and require them to take small business consumer needs into account when billing, contracting and transferring customers. We believe this will help to reduce the problems currently faced by small business consumers and improve the effectiveness of their engagement.

In 2012, we took further steps to gain power under the Business Protection from Misleading Marketing Regulations 2008 (BPMRs).¹³⁰

Price Monitoring: Market opening and competition

As noted in section 3.2.2, the GB electricity supply market has been open to competition since 2002.

Since market opening, rules and regulations have been removed and introduced, where appropriate, to facilitate competition and protect consumers. Ofgem has a central role in protecting the interests of consumers, present and future. As part of our role we further refined our RMR in 2012.¹³¹ The RMR looked at both electricity and gas, and examined the effectiveness of competition in the domestic and non-domestic retail markets.^{132,133} It assessed the extent to which the retail market was acting in the interests of consumers.

The RMR found that more could be done to facilitate consumer engagement in the retail energy market. The evidence suggested that consumers found the retail market to be complex and challenging to navigate effectively. The RMR also found that a large proportion of consumers had disengaged from the energy market completely, potentially weakening competitive pressure on suppliers.

¹³⁰ This will allow us to take action against entities that market energy contracts and services to businesses in a misleading manner. Ofgem is seeking information gathering powers and the ability to apply to the Court for an injunction to secure compliance with the BPMRs. We published a consultation (see our website) detailing the powers we are calling for and asking for any further evidence to inform an Impact Assessment. Following this we will provide details to BIS to inform the case for the changes to be made to the relevant legislation.

¹³¹ This built on findings from the Energy Supply Probe in 2008 and the Retail Market Review that began in 2010.

¹³² Ofgem (Oct 2012), "[The Retail Market Review: Updated domestic proposals](#)"

¹³³ Ofgem (Oct 2012), "[The Retail Market Review: Updated proposals for businesses](#)"

Our proposals to address the lack of consumer engagement in the energy market are set out in the section on *Switching rates*. They aim to increase the transparency of the energy market, generating increased consumer engagement, which ultimately should lead to greater competitive pressure between suppliers and more beneficial outcomes for consumers. We consulted on the domestic and non-domestic proposals between October 2012 and December 2012.

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

We have, therefore, set out proposals to address the lack of liquidity and enable new suppliers to better access the wholesale market. Our main proposal is to oblige the main vertically integrated generation and supply companies to sell 25 per cent of their annual energy output through a Mandatory Auction (MA). They would be required to sell specific, key products through the MA in sufficient volume to potentially meet demand and produce robust prices. We completed our initial work programme on this issue in 2011 and consulted in February 2012¹³⁴ and in December 2012.¹³⁵

Overall, we have noted progress in relation to the near-term market and a better chance for independent suppliers to access the products they need in order to hedge. However, if the wholesale market is inhibiting competition and imposing costs on consumers we must address this as soon as possible. We intend to decide whether to proceed with an intervention, and the form of any intervention, before summer 2013.

Monitoring competition

As noted above, we have launched wider reviews of the market where need has arisen, but Ofgem also monitors competition on an on-going basis. For example, we collect data from suppliers and other industry bodies on a monthly basis. We also regularly commission consumer research and have regard to a wide range of data and information from other sources which also serve to inform our view of the market and levels of competition within it.

Another tool we use to monitor competition is the Supply Market Indicators (SMI). The SMI allows us to track changes in domestic electricity bills relative to suppliers' costs, and to estimate indicative net margin on a typical consumer. Since February 2012 we have published the SMI on a weekly basis. We periodically review the SMI and update our assumptions as they change, including for example, our assumptions on environmental

¹³⁴ Ofgem Feb 2012, ["Retail Market Review: Intervention to Enhance Liquidity in the GB Power Market"](#)

¹³⁵ Ofgem Dec 2012, ["Wholesale power market liquidity: consultation on a 'Secure and Promote' licence condition"](#)

programme costs. Where we update our data, we keep a log of when a change takes effect and a short description.¹³⁶

We also use the Statements to monitor competition. They allow us to assess the extent to which the vertically integrated suppliers are making profits on supply and generation, and where they are incurring costs. As the Statements are published annually, we can monitor these indicators over time. As mentioned previously, Ofgem publishes a review of the Statements.¹³⁷

Monitoring competition – domestic market share

We regularly analyse suppliers' monthly domestic customer numbers using two sources of information. Firstly, customer numbers data that the former incumbent energy suppliers provide to us every month on a voluntary basis. Secondly, Meter Point Administration Number (MPAN) data we receive from Distribution Network Operators. This MPAN data is broken down by fuel type, payment method and supplier region. By analysing the data at this granular level, we can make more nuanced assessments of the domestic electricity supply market and assess, for example, the extent to which non-incumbent suppliers are penetrating former incumbent supplier regions, and the extent to which the proportion of customers on different payment methods is changing.

The MPAN data is also useful at an aggregate level to determine each supplier's total market share. In December 2012 there were 27.7m domestic electricity consumers in GB. As Figure 6 shows that the 'Big 6' suppliers accounted for 98 per cent of electricity supply to these customers.

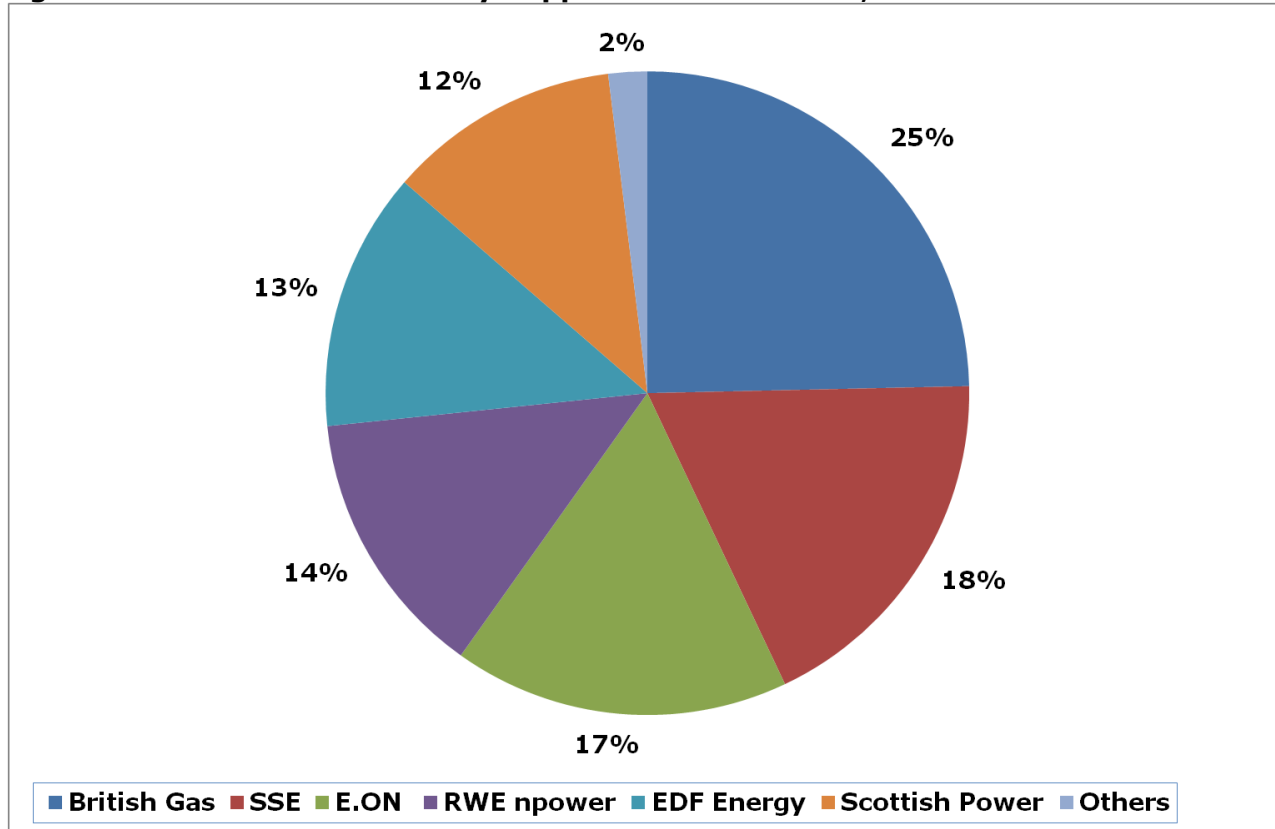
There were 12 small suppliers active in the market in 2012, with a combined market share of two per cent. These are Co-Operative Energy; Economy Energy; Ecotricity; First Utility; Flow Energy; Good Energy; Green Energy; iSupply Energy; LoCo2; OVO Energy; Spark Energy; and Utilita. Although these suppliers account for two per cent of the electricity market, we have seen growth in this area. As a group, their market share increased from one to two per cent, between December 2011 and December 2012.

The figures relating to the national market shares do not reveal regional characteristics of the electricity market, which are a legacy of the regional monopolies that existed in the electricity sector prior to market liberalisation. The former electricity incumbents have a market share of 38 per cent. However, evidence suggests that suppliers are increasingly penetrating each others' markets. Between January and December 2012 the market share of non-incumbents increased by 1 per cent whilst that of incumbents fell by 1 per cent.

¹³⁶ Available on our website at: <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Pages/indicators.aspx>.

¹³⁷ Available on our website at: <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Pages/rmr.aspx>

Figure 6: GB Domestic Electricity Suppliers' Market Share, December 2012



Source: Ofgem

Monitoring competition – non-domestic market share

Ofgem also monitors non-domestic suppliers' market shares. We gather some data directly from suppliers, but also contract with Datamonitor, an independent consultancy, to provide non-domestic customer numbers. Datamonitor collates information based on feedback from industry and other analysis and releases it on a quarterly basis.

The non-domestic market is supplied by the six former incumbent suppliers, a group of independent suppliers and smaller new entrants. The individual segments of the non-domestic market are dominated by the former incumbent suppliers, as shown in Table 2, who each have a market share greater than 5 per cent but together supply between 80 per cent and 93 per cent of the Half Hourly (HH) and non-HH segments respectively.¹³⁸ However, smaller and independent suppliers have begun to penetrate the non-domestic market, and in 2012 supplied 7 per cent of non HH sites and 19 per cent of HH sites.

¹³⁸ HH customers have their electricity meters read every half-hour. HH customers tend to be large organisations that consume a peak load of more than 100kWh at any time during the day. Non HH customers tend to be smaller organisations that do not consume large volumes of electricity and therefore do not need their meters read at short intervals.

Some of these smaller and independent suppliers focus on a specific market niche, such as renewable energy, while others choose to compete more broadly.

The three suppliers with highest market shares in the non HH segment are British Gas, E.ON Energy and EDF Energy, which together have a 61 per cent share of the segment. The HH segment is dominated by RWE npower, EDF Energy and E.ON Energy, which together have a 54 per cent share.

Table 2: Electricity suppliers' non-domestic market share in November 2012

| Electricity supplier | Non Domestic Sites | | |
|----------------------|--------------------|---------------|------------------|
| | Non HH | HH | All Non Domestic |
| British Gas | 24.3% | 6.2% | 23.5% |
| E.ON Energy | 22.1% | 15.0% | 21.8% |
| EDF Energy | 14.8% | 18.2% | 15.0% |
| Gazprom | 0.2% | 1.2% | 0.2% |
| GDF | 0.0% | 3.5% | 0.2% |
| Good Energy | 0.1% | 0.2% | 0.1% |
| Haven Power | 1.6% | 1.7% | 1.6% |
| Opus Energy | 5.1% | 1.2% | 5.0% |
| RWE npower | 8.8% | 20.6% | 9.3% |
| ScottishPower | 7.4% | 5.6% | 7.4% |
| Smartest Energy | 0.0% | 2.3% | 0.1% |
| SSE | 15.2% | 14.4% | 15.2% |
| Total Gas and Power | 0.0% | 1.7% | 0.1% |
| Others | 0.2% | 8.2% | 0.6% |
| Total | 100.0% | 100.0% | 100.0% |

Source: Datamonitor

Monitoring competition – HHIs

Herfindal-Hirschman Indices (HHI)¹³⁹ are often used to gauge market concentration. Though HHI does not provide conclusive evidence on the level of competition, it offers pointers as to whether a market has the potential to deliver competitive outcomes. The relevant HHIs¹⁴⁰ for electricity are:

- domestic (Dec 2012) - 1,720

¹³⁹ HHI is commonly used to assess market concentration, ranging from 10,000 for a monopoly to just above zero for perfect competition. Office of Fair Trading Guidelines categorise a market as 'concentrated' if its HHI exceeds 1,000 and 'highly concentrated' if its HHI exceeds 1,800.

¹⁴⁰ Domestic HHIs have been calculated using suppliers' monthly customer numbers and non-domestic HHIs have been calculated using market shares information provided to us by Datamonitor.

- non-domestic, non-half hourly metered sites (Nov 2012) - 1,695
- non-domestic, half-hourly metered sites (Nov 2012) - 1,351

All three electricity markets are judged to be 'concentrated' according to the threshold HHI levels (1,000) used by the Office of Fair Trading.

Distortion or restriction of competition

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

Investigating anti-competitive activity

As well as undertaking this broad assessment of competition, the Authority has concurrent powers under the Competition Act 1998 to investigate suspected anti-competitive activity in respect of the gas and electricity sectors in Great Britain. It 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 (OFT) in respect of market investigation references to the Competition Commission. There have been no changes to Ofgem's enforcement powers since the 2012 National Report.

We have set out in sections 3.1.5 and 4.1.5 the key enforcement investigations and actions that we undertook in 2012 against both gas and electricity undertakings.

Prices for household consumers including prepayment systems

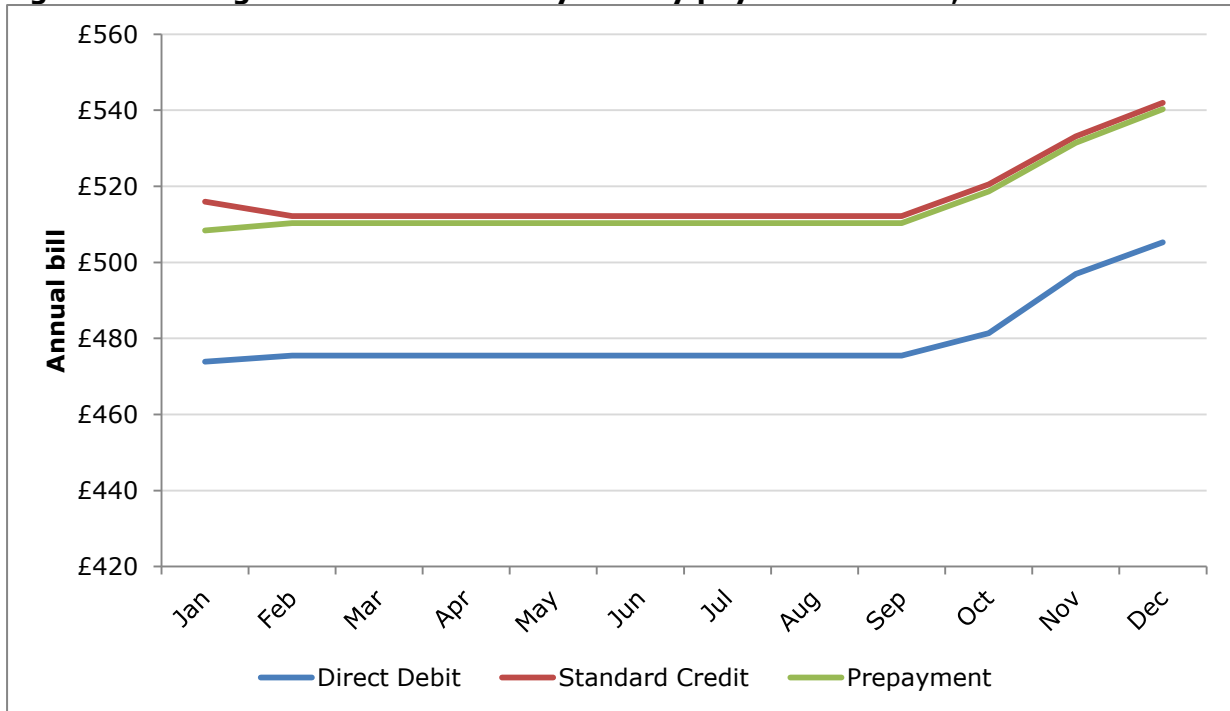
All final consumer prices in the GB retail energy markets are determined by market forces as all price controls on final consumer prices were lifted by April 2002. However, there are elements of the final price which are attributable to the regulated aspects of the market, in particular distribution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

Ofgem actively monitors domestic suppliers' electricity prices across GB. We receive price change notifications from suppliers and use these to calculate the implications for domestic customers' retail bills based on characteristics such as their consumption level, payment type, and region.

Figure 7 shows the change in average domestic electricity bills in GB's electricity market for direct debit, prepayment and standard credit customers between January and

December 2012. Overall, average electricity bills increased by 5.1 per cent (£25) over the year.¹⁴¹ Prices fell slightly for all three payment methods from December to February, and remained at those levels until September. From October onwards, prices for all three payment methods increased at the same pace, reflecting price increases by five of the 'Big 6' suppliers.

Figure 7: Average domestic electricity bills by payment method, Jan – Dec 2012



Source: Ofgem

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

As well as monitoring domestic electricity bill levels, we also assess the extent to which particular costs have an impact on these bills. Suppliers face a range of costs that influence how they set retail electricity prices. These costs can vary within and between years, and include wholesale energy costs, the costs of UK Government environmental and social policies such as the Renewable Obligation and the Warm Home Discount, and transmission and distribution costs. We use our SMI to explore the relationship between retail bills and these costs. Since February 2012 we have published the SMI on a weekly basis.¹⁴²

Figure 8 shows the change in average domestic dual fuel bills in GB's dual fuel market for direct debit, prepayment and standard credit customers between January and December

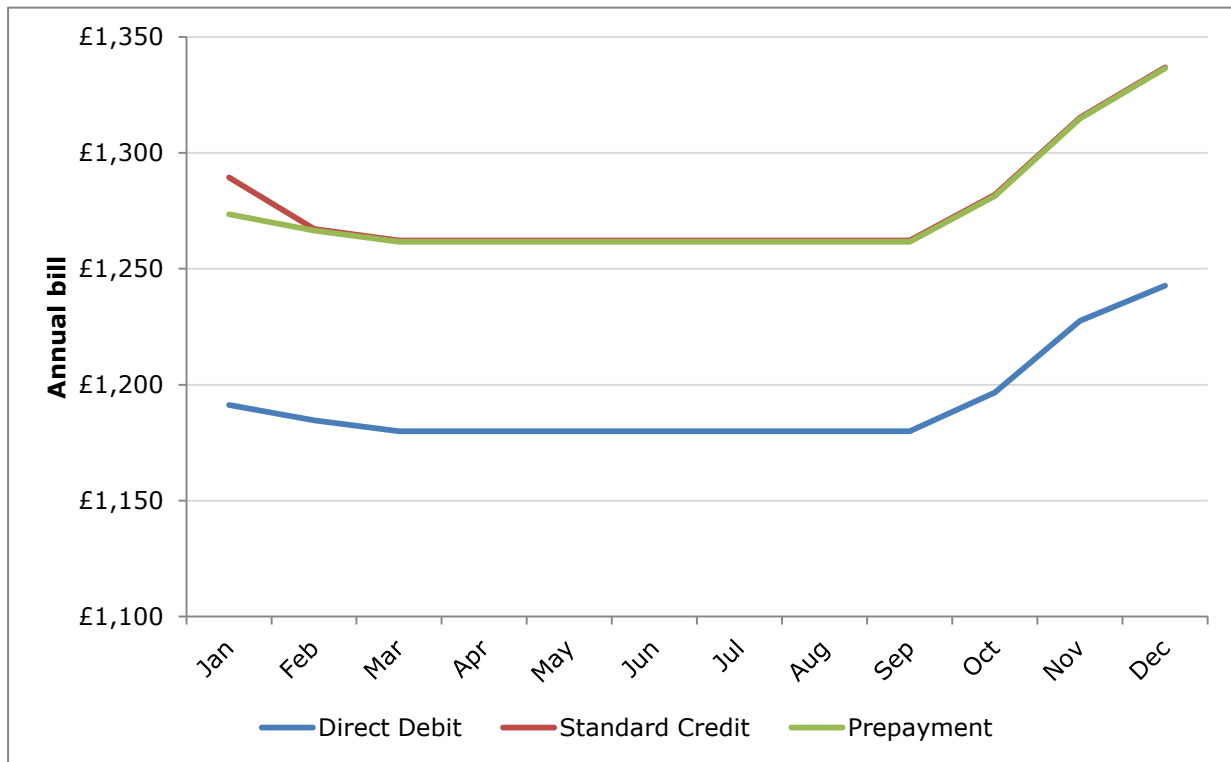
¹⁴¹ Change for the three payment methods was: direct debit, 5.7% (£27); prepayment, 5.4% (£28); standard credit, 4.2% (£22).

¹⁴² Available on the Ofgem website at:

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

2012. Overall, average dual fuel bills increased by 4 per cent (£50) over the year.¹⁴³ Prices fell slightly from December to March, most steeply for standard credit. They then remained static until September. From September onwards, prices for all three payment methods increased at the same pace, reflecting price increases by the former incumbent suppliers.

Figure 8: Average domestic dual fuel bills by payment method, Jan – Dec 2012



Source: Ofgem. Notes: 1) Standard tariffs 2) Medium consumption levels, 3300kwh per year for electricity and 16500 kWh for gas

Switching rates

Domestic

Consumers' ability to switch their energy supplier is important for a well-functioning, competitive energy market. Ofgem monitors switching rates on an ongoing basis. We receive monthly data from electricity suppliers on the number of customers they have lost and gained and use this data to calculate switching rates. In 2012, 3.3m domestic consumers switched their electricity supplier, equivalent to 275,000 per month. This is a switching rate of 12 per cent, 3 per cent lower than in 2011.

¹⁴³ Change for the three payment methods was: direct debit, 3.9% (£47); prepayment, 4.6% (£59); standard credit, 3.3% (£43).

As part of our monitoring of switching rates, we annually commission IPSOS MORI, an independent research company, to explore switching with consumers. We published the latest survey in April 2012. The company conducted a sample of 1,461 interviews with domestic electricity customers and explored whether they had switched in 2011, their reasons for switching (or not), and what would make them more likely to switch. It found that in 2011, 14 per cent of the sample had switched electricity supplier.¹⁴⁴

In 2012 we also published the results of a number of additional pieces of qualitative research on consumer behaviour.^{145,146,147} The evidence base gathered from our consumer research helped to inform our updated RMR domestic proposals in October 2012. We considered that consumer engagement levels in the market were low, and that this was contributing to competition within the retail energy markets not being as strong as it could be. Our proposals included features that aim to make the domestic energy market simpler, improving consumers' ability to identify the best electricity deal and make informed switching decisions. Examples of proposals we consulted on in October 2012 include:

- a requirement that a supplier can only offer four core tariffs per fuel and meter type;
- standardised rules for how discounts and bundled products could be used;
- a requirement to ban expensive tariffs which are no longer available to prospective consumers; and
- a requirement for all tariffs to include key information in a Tariff Information Label with the format mandated by Ofgem.

Non-domestic

Our updated non-domestic RMR proposals, published in October 2012¹⁴⁸, examined issues around non-domestic switching. We found evidence that suppliers were objecting to customer transfers more than we would expect. We have received complaints from, or on behalf of, businesses concerning the difficulty of switching. In particular, data shows that most suppliers object to around a quarter of attempted transfers. We believe this experience could negatively affect non-domestic customers' perceptions of the energy industry and their willingness to engage in switching in the future. We will use our market monitoring powers to improve the data we receive on supplier objections to transfer. We are monitoring this portion of the market closely and will assess the extent to which non-domestic switching improves over time.

¹⁴⁴ Ipsos MORI April 2012, "[Customer Engagement with the Energy Market – Tracking Survey](#)"

¹⁴⁵ Ipsos MORI (January 2012), "[Ofgem Consumer First Panel Year 4, Findings from first workshops](#) (held in October and November 2011)"

¹⁴⁶ Ipsos MORI Aug 2012, "[Consumer engagement with the energy market, information needs and perceptions of Ofgem, Findings from the Ofgem Consumer First Panel Year 4: second workshops \(held in March 2012\)](#)"

¹⁴⁷ Ipsos MORI (Oct 2012), "[Prompting engagement with and retention of written customer communications](#)"

¹⁴⁸ Ofgem (Oct 2012), "[The Retail Market Review: Updated proposals for businesses](#)"

We also found evidence of barriers that deterred or prevented businesses with proportionately low energy costs from actively managing their energy use and their relationship with their supplier.¹⁴⁹ These barriers included unclear information on energy bills and tariffs, and the perceived difficulty of switching.

An analysis of data from electricity distribution companies indicates that the annualised switching rate was 22 per cent between April 2011 and March 2012 in the smaller end (non-HH) of the business sector.¹⁵⁰ Our research evidence highlights that small businesses are less engaged in the market than larger firms and are more likely to have never considered switching. For example, 31 per cent of small and 31 per cent of micro businesses (i.e. those with 1-9 employees) surveyed said they had never considered switching their electricity supplier, compared to 15 per cent of large businesses.¹⁵¹

Disconnection rates

Ofgem requires electricity suppliers to record and report on the number of disconnections of domestic customers. Suppliers are required to submit quarterly and annual returns on disconnections. Ofgem also submitted these returns to Consumer Focus, the consumer advocacy body.¹⁵² The data we receive allows us to monitor disconnection rates between suppliers and the rate of change between quarters and years. It also gives us a basis to engage with suppliers if they have an abnormally high number of disconnections. Our latest quarterly and annual reports on electricity disconnections can be found at our Social Obligations Monitoring webpage.¹⁵³ The page also contains links to consultations that we carry out regarding disconnection and suppliers' other social obligations. Latest available data shows that there were 138 electricity disconnections in Q2 2012. This represents a 63 per cent decrease from the 375 disconnections reported in Q2 2011. It continues the trend from 2011, during which electricity disconnections fell by 54% on 2010 figures.

Charges for and the execution of maintenance services

To assess performance, the electricity distribution networks are required to submit regulatory returns on an annual basis providing relevant cost and volume information to Ofgem. A component of the Distribution Use of System charges that all customers pay as part of their electricity bills are maintenance costs associated with the volume of maintenance work undertaken.

¹⁴⁹ Opinion Leader (Dec 2012), "[Research Findings on the Experiences of Non-Domestic Customers](#)", p8.

¹⁵⁰ Datamonitor estimate the switching rate in 2011 for major energy users (spending more than £50,000 per year on energy) at 24 per cent for electricity. For SMEs (spend <£50,000 per year) the switching rate is estimated at 23 per cent for electricity.

¹⁵¹ Accent, Quantitative Research into Non-domestic Customer Engagement and Experience of the Energy Market, June 2012.

¹⁵² Consumer Focus became the Citizens' Advice Service and Regulated Industries Unit in April 2013. More information on the transition can be found here: <http://www.consumerfocus.org.uk/about-us>

¹⁵³ <http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Pages/SocObMonitor.aspx>

The value in this information to Ofgem is to allow us to monitor the Distribution System Operators' performance over the price control which is funded via the Use of System charges. The company's investment and maintenance choices made today affect both their current and future customers' experience of the networks.

Complaints by household consumers

Ofgem does not directly investigate domestic customer complaints. However, we do set the standards to which suppliers must adhere when dealing with and processing customer complaints.¹⁵⁴ If a consumer wishes to make a complaint about an electricity supplier or network operator, they should contact the relevant company in the first instance. The energy company then has up to eight weeks to resolve the complaint. If a vulnerable consumer requires assistance with their complaint, they can go to the Consumer Focus Extra Help Unit to deal with that complaint on their behalf.

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

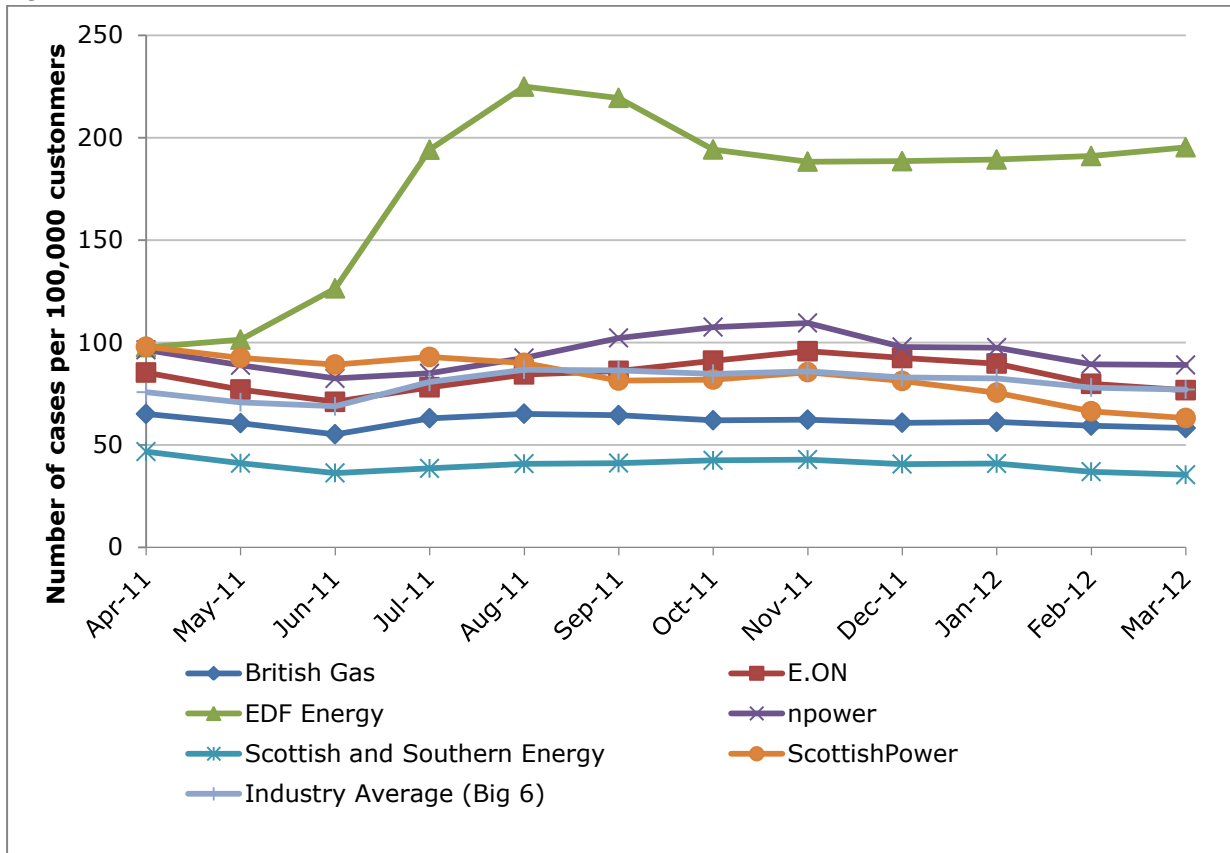
In addition, Ofgem has been working with suppliers in 2012 to arrange that former incumbent suppliers publish their direct complaints data. Suppliers began to publish this data in early 2013.

Figure 9 below shows, for the former incumbent suppliers, the number of cases per 100,000 customers received by Consumer Direct and referred onto the suppliers' dedicated handling teams, Consumer Focus's Extra Help Unit, or the Energy Ombudsman.¹⁵⁵ It is not possible to break down these figures for the electricity market only, therefore, data represents relevant contacts for issues relating to both gas and electricity. The data shows that complaints remained relatively stable in the first three months of 2012, however they were slightly on the rise for EDF Energy.

¹⁵⁴ The complaint standards are prescribed by "The Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008" which came into force on 1 October 2008 and are published at: http://www.opsi.gov.uk/si/si2008/uksi_20081898_en_2#pt2-l1q3

¹⁵⁵ Consumer Focus uses a methodology to weight the seriousness of the complaints. Full details of the methodology can be accessed on the Consumer Focus website at <http://energyapps.consumerfocus.org.uk/performance/methodology>

Figure 9: Domestic suppliers' performance on cases received by Consumer Direct, Consumer Focus Extra Help Unit and the Energy Ombudsman, April 2011-March 2012



Source: Consumer Focus, data extracted by Ofgem

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

Finally, the UK government has now published its decision to streamline the structure of its consumer advice services. One change occurred on 2 April 2012, when the advice and information helpline operated by Consumer Direct was replaced by the Citizens Advice consumer service operated by Citizens Advice. A Regulated Industries Unit has been created which will replace Consumer Focus and will transfer to Citizens Advice in April 2013. The existing Extra Help Unit will continue to assist vulnerable consumers and consumers who have had their supply disconnected or who are at threat of disconnection with their complaint.

Monitoring restrictive contractual practices

Ofgem recognises the importance of monitoring restrictive contractual practices in the electricity market. We have dedicated Retail (responsible for monitoring and policy development relating to domestic and non-domestic markets) and Enforcement teams that engage with a variety of stakeholders and suppliers, ensuring that we are both proactively monitoring the market, and that we are open and receptive to any issues that may be brought to our attention.

Whilst it is challenging to actively monitor all bilateral contractual interactions in the entire domestic and non-domestic electricity markets, we have a range of data and information that we regularly analyse and assess to help us understand trends and identify issues. Further, we may seek additional information where needed and have a legal power to investigate further where we receive information that suggests restrictive practices are occurring. Ofgem is able to compel the provision of information and documents from regulated persons for the purposes of monitoring the matters referred to in Article 37(1)(k).

Respecting contractual freedom

Ofgem issues licences which prescribe the regulatory requirements with which energy suppliers must comply. Suppliers must comply with the conditions of their licences. Where licence conditions are not being complied with, we have the power to investigate and ultimately take action, ranging from fines to revocation of the supplier's licence.

The supply licence contains some conditions relating to supply contracts to help ensure the provision of clear contractual information to household and small business consumers. However, as part of our RMR, we are proposing to put in place stronger rules to ensure the transparency of contractual information, particularly for fixed term contracts, for household customers.

At present, there are no bespoke regulatory rules that seek to regulate the fairness of terms expressly agreed between a supplier and customer. However, household customers are protected by the general national rules which transpose Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. These rules are set out in the Unfair Terms in Consumer Contracts Regulations 1999 and Ofgem is one of the public bodies with enforcement powers. In addition, in respect of special types of contract that are deemed by national law to exist between a supplier and customer, there are bespoke rules in place which protect both household and business customers from unduly onerous terms.

Contributing to the compatibility of data exchange processes

Ofgem is obliged under the Electricity Act 1989 – 3F (2) (f)) to cooperate with ACER and other National Regulatory Authorities (NRAs) to establish coordinated network codes. Ofgem would therefore cooperate if the European Commission decides to launch work to develop additional network codes on Interoperability or Data Exchange Rules.

The previous sections have shown the range of information that Ofgem makes publicly available. In 2012, this included regular updates such as the weekly SMI, which provides analysis of supplier costs and the retail bill for electricity. It also included the quarterly disconnection data. We have published our work to refine and update the Consolidated Segmental Statements, which will make these annual reports more consistent and informative. Finally, it included the RMR, which built on and developed a significant amount of supporting market data and consumer research. The sections have also shown the information that is available from other parties such as Consumer Focus. Market participants are free to access this information if they wish.

3.2.2.2. Recommendations on supply prices, investigations and measures to promote effective competition

- Article 37(1)(o), Article 37(4)(b)

All final consumer prices in the GB retail energy markets are determined by market forces as all price controls on final consumer prices were lifted by April 2002. Prices can be affected by numerous costs, most notably wholesale energy prices, costs associated with environmental and social programmes such as Renewable Obligation Certificates¹⁵⁶ and the Warm Home Discount¹⁵⁷, and transmission and distribution costs.

Therefore prices in the supply market are not within Ofgem's direct control and we do not make annual recommendations on supply prices nor provide these to the competition authorities.

However, Ofgem's primary role is to protect the interests of present and future consumers. By fulfilling this role we aim to ensure the electricity and gas markets deliver the best outcomes for consumers. Through our Licence Conditions, our market monitoring activities and our regular market reviews we aim to ensure supply prices comply with the relevant paragraphs in Article 3 of the Electricity Directive, namely:¹⁵⁸

- **Clearly comparable prices:**

- Consumers can compare suppliers' electricity prices using a wide range of online switching websites. These sites can tailor quotes based on consumers' individual circumstances. In 2012 Consumer Focus, the consumer advocacy organisation, published a list of over 10 accredited switching websites that consumers can access; and
- Our 2012 updated Retail Market Review proposals aim to facilitate consumer engagement and enhance consumers' ability to compare suppliers' tariff terms and prices. For example, we have proposed 'Information Remedies', including a standard Tariff Information Label, to increase the transparency of prices and enable consumers to more easily compare tariffs.

- **Transparent prices:**

- Ofgem regularly publishes a Factsheet that shows consumers the components of their household electricity bill. The Factsheet provides clear information on electricity bills and the charges that comprise them; and

¹⁵⁶ <http://www.ofgem.gov.uk/Sustainability/Environment/RenewablObl/Pages/RenewablObl.aspx>

¹⁵⁷ <http://www.ofgem.gov.uk/Sustainability/Environment/WHDS/Pages/WHDS.aspx>

¹⁵⁸ Our interpretation of Article 3 is that paragraph 3 has the most relevance for supply prices. It states that "Member States shall ensure that all household customers, and, where Member States deem it appropriate, small enterprises...enjoy universal service, that is the right to be supplied with electricity of a specified quality within their territory at reasonable, easily and clearly comparable, non-discriminatory prices."

- Throughout 2012 we published the SMI, which shows the relationship between wholesale costs, other costs, and electricity retail bills.¹⁵⁹

Investigations

We have set out in section 3.1.5 the main investigations that we carried out in 2012. Please refer to this section for further details.

3.3 Security of supply (if and insofar as NRA is competent authority)

The Department of Energy and Climate Change (DECC) is the competent authority in GB for electricity security of supply.

In December 2010 DECC launched the Electricity Market Reform (EMR), which aims to meet the significant long-term challenge of de-carbonisation and to deliver our renewable energy targets, while maintaining secure and affordable electricity supplies.

In July 2011 DECC published 'Planning our electric future: a White Paper for secure, affordable and low-carbon electricity'¹⁶⁰, which was supplemented by a technical update in December 2011. In the technical update DECC specified that the system operator (in GB the role of the system operator is carried out by National Grid), best meets the criteria for delivering the Feed-in-tariffs with Contracts for Difference (FiT CfD) and the capacity mechanism. In 2012, we continued our joint work with DECC on the project to identify the potential conflicts and synergies that may arise from the designation of the System Operator as the EMR delivery body.¹⁶¹

In November 2012 DECC introduced the Energy Bill into the House of Commons that will provide the legislative framework for the EMR policies. This followed pre-legislative scrutiny in June 2012. Accompanying the Energy Bill's publication was a series of documents providing more detail on the EMR policies.¹⁶² The key elements of DECC's proposed reform package include:

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

¹⁵⁹ Ofgem's Electricity and Gas Supply Market Indicators webpage, which has a full archive of the updates, can be found at <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Pages/indicators.aspx>

¹⁶⁰ Planning our electric future: a white paper for secure, affordable and low-carbon energy. Available here: http://www.decc.gov.uk/en/content/cms/legislation/white_papers/emr_wp_2011/emr_wp_2011.aspx.

¹⁶¹ See here for link to consultation and responses on Potential Synergies and Conflicts of Interest: <http://www.ofgem.gov.uk/Markets/WhlMkts/EffSystemOps/Pages/effSystemOps.aspx>.

¹⁶² <https://www.gov.uk/government/organisations/department-of-energy-climate-change/series/energy-bill>.

The Third Package also puts an obligation on NRAs to monitor investment in generation capacities in relation to security of supply. We undertake this duty in a number of ways:

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

Second, our 2010 Project Discovery provided an outlook for de-rated capacity margins up to 2025, and we continue to internally monitor developments in the generation background in GB.

Third, in a joint publication with DECC we publish an annual Statutory Security of Supply Report¹⁶³ which analyses the availability of electricity and gas for meeting the reasonable demands of consumers in Great Britain.

In addition to our Third Package obligations, we produced our first Electricity Capacity Assessment¹⁶⁴ report to the Secretary of State in 2012. It estimated a set of plausible electricity capacity margins that could be delivered by the market over the next four years and the associated risks to security of supply.

We found that the risks to electricity security of supply will increase in the next four years. In particular, de-rated capacity margins are expected to decrease significantly whilst the risk of electricity customer disconnections is expected to increase. It is very difficult to accurately forecast the level of security of supply provided by the market. This is because of future market uncertainties.

The following section provides a brief overview of the peak electricity demand conditions in 2012, a capacity assessment and a summary of the forthcoming generation projects in GB.

Peak electricity demand conditions

NGET annually publishes the UK Energy Future Scenarios¹⁶⁵, which provides a detailed description of the scenarios used in NGET's future analysis, and was published for the second time in September 2012. NGET's Electricity Ten Year Statement¹⁶⁶ (ETYS) was

¹⁶³ For more information see:

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

¹⁶⁴ Electricity Capacity Assessment 2012. Available from: <http://www.ofgem.gov.uk/Markets/WhlMkts/monitoring-energy-security/elec-capacity-assessment/Documents1/Electricity%20Capacity%20Assessment%202012.pdf>

¹⁶⁵ Future Energy Scenarios 2012. Available

from: <http://www.nationalgrid.com/uk/Gas/OperationalInfo/TBE/Future+Energy+Scenarios/>.

¹⁶⁶ Electricity Ten Year Statement. Available from: <http://www.nationalgrid.com/uk/Electricity/ten-year-statement/current-elec-tys/>. The ETYS publication replaced the Seven Year Statement (SYS), and was published for the first time in November 2012. For more information please see:

<http://www.nationalgrid.com/uk/Electricity/ten-year-statement/consultation/>.

published in November 2012 for the first time replacing the Seven Year Statement. As the document focuses on the development of the transmission network, the demand figures provided below are demand as viewed on the transmission system.¹⁶⁷ The two documents therefore contain a range of complementary information. For this reason we present data from both documents. The focus of this section is the period between 2012 and 2020.

Actual peak electricity demand¹⁶⁸ rose in 2012 to 58.9 GW, up by 2.8 GW (5.0%) from 2011, primarily due to the cold temperatures. Based on demand data from ELEXON, which excludes own use demand at power stations and interconnector exports, peak demand in 2012 rose by 0.6 GW (1.1%) to 56.2 GW. Again, this was mainly a result of colder temperatures in the winter.

Looking forward, Table 3 shows National Grid's peak demand forecast from the 2012 ETYS¹⁶⁹ for the Gone Green scenario. Demand is steady out to 2020 as increased demand due to economic growth is offset by energy efficiency measures and increasing embedded generation.

Table 3: GB peak forecast electricity demand (Gone Green scenario)

| | GB electricity demand (GW) | | | | | | | |
|----------------------|----------------------------|------|------|------|------|------|------|------|
| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
| Peak forecast demand | 57.7 | 57.7 | 57.6 | 57.4 | 57.5 | 57.3 | 57.4 | 57.6 |

Source: ETYS 2012, National Grid¹⁷⁰

We have also published scenario analysis as part of our Project Discovery¹⁷¹ in 2010 – this included projections on peak electricity demand assumptions. This scenario analysis considered a similar range of factors to National Grid, such as economic growth and energy efficiency. These Discovery scenarios indicated a range of peak demand from 58GW to 67GW in 2015 and from 57 GW to 70 GW in 2020.

Generation fuel mix

NGET developed three different scenarios for the Future Energy Scenarios publication. In this report we present Gone Green scenario data. Gone Green is considered the baseline

¹⁶⁷ Any increase in embedded generation is therefore recorded as a reduction in transmission system demand.

¹⁶⁸ Total Gross System Demand. This includes station load, pump storage pumping and interconnector exports. Data available from National Grid: <http://www.nationalgrid.com/uk/Electricity/Data/Demand+Data/>.

¹⁶⁹ Demand is defined as transmission peak demand including losses and excluding station demand, exports and pumping demand. Small embedded generation is treated as 'negative demand'.

¹⁷⁰ National Grid's Electricity Ten Year Statement.

¹⁷¹ References to our Project Discovery Energy Market Scenarios Update refer to the version published in 3rd February 2010. Available from: http://www.ofgem.gov.uk/Markets/WhlMkts/monitoring-energy-security/Discovery/Documents1/Project_Discovery_FebConDoc_FINAL.pdf.

scenario, as it meets the Government's environmental targets and it has been widely consulted with the industry.¹⁷²

With regard to electricity generation, the main features of the 'Gone Green'¹⁷³ scenario are as follows: the UK's renewable and emission targets are met in the Gone Green scenario. This is largely achieved by the fast development of wind capacity by 2020, and in particular offshore wind. Nuclear and CCGT capacity increase out until the end of the forecast in 2032. Coal capacity sees a dramatic decrease in capacity by 2032, with the assumption that new thermal capacity after 2025 will be fitted with CCS.¹⁷⁴

A breakdown of installed generation capacity at the end of 2012 is shown in Figure 10. Similar to previous years, the majority of GB capacity (84.9 GW) comes from gas/CHP¹⁷⁵ and coal-fired plants (37 and 29 percent of total generating capacity, respectively).

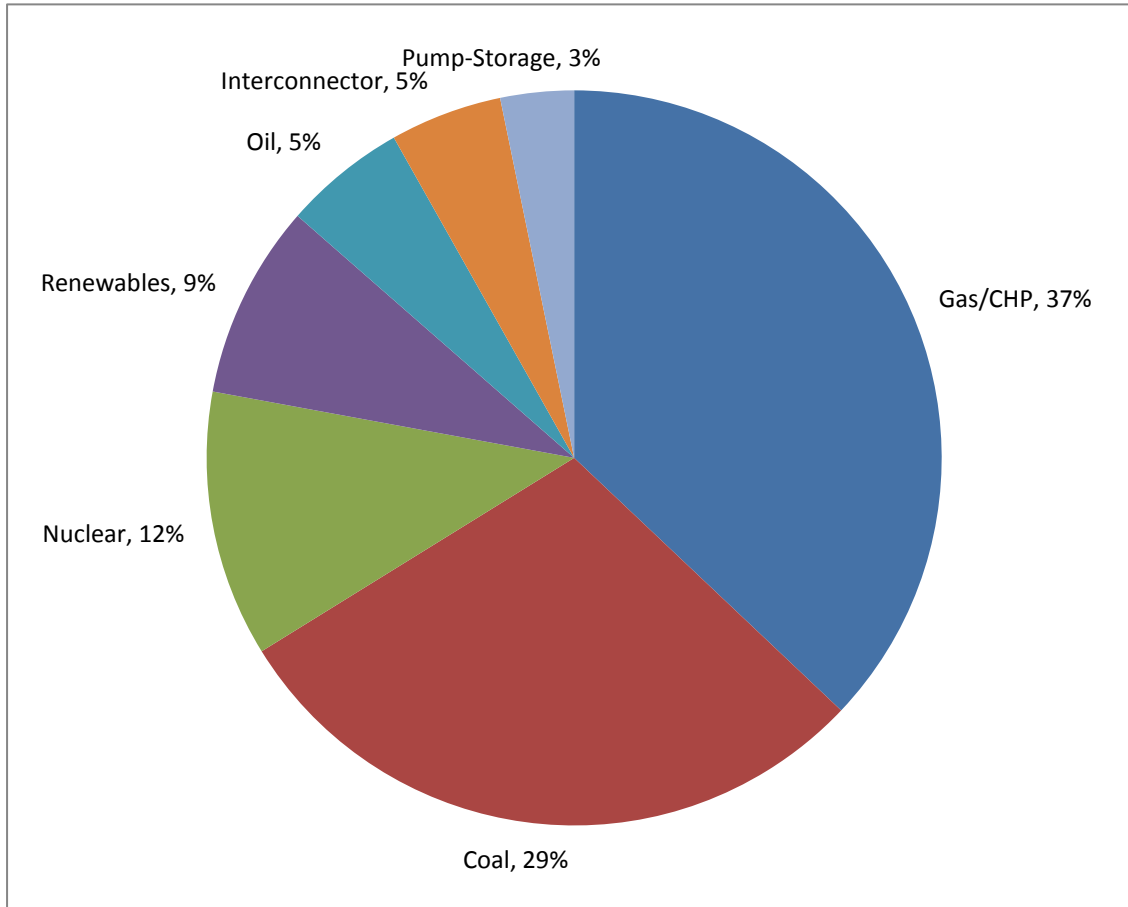
¹⁷² The two other scenarios 'Slow Progression' and 'Accelerated Growth' consider the cases in which either gas-fired generation remains dominant or the case in which wind generation develops faster than expected respectively.

¹⁷³ See National Grid's Electricity Ten Year Statement for more details.

¹⁷⁴ Carbon capture and storage.

¹⁷⁵ Combined heat and power.

Figure 10: Transmission connected generation capacity by plant type at the end of 2012



Source: UK FES 2012, National Grid¹⁷⁶

The installed capacity of power generation has remained approximately constant since last year. Declining coal capacity has been replaced by new gas-fired and renewable generation (most notably wind). However, the figures include coal and oil generation which is due to close in early 2013 due to European environmental legislation. See the end of this chapter for more information.

Table 4 below shows expected changes in installed capacity from 2012 to 2020, based on the Gone Green scenario in the National Grid's UK Future Energy Scenarios. This shows that the GB electricity market is set to become increasingly dependent on gas and renewable capacity.

¹⁷⁶ Available from : <http://www.nationalgrid.com/NR/rdonlyres/812568C0-5D56-488D-8A4E-E7933A07B351/56766/UKFutureEnergyScenarios2012.pdf>

Table 4: Forecast changes in installed generation capacity (GW) by fuel type between 2012 and 2020, Gone Green scenario¹⁷⁷

| Fuel type | Installed Capacities (GW) | |
|---------------------------|---------------------------|--------------|
| | 2012 | 2020 |
| Coal | 24.7 | 17.9 |
| Gas | 31.5 | 34.8 |
| Oil | 4.6 | 0.8 |
| Nuclear | 9.9 | 9.5 |
| Renewables ¹⁷⁸ | 7.3 | 28.9 |
| Pump-Storage | 2.7 | 2.7 |
| Interconnectors | 4.2 | 6.6 |
| Total | 84.9 | 101.1 |

Generation Investment

The Electricity Ten Year Statement provides forecasts of generation projects that are either under construction or have consent approved.¹⁷⁹ In 2012, there was a total of 1.2 GW of generation capacity under construction, with a further 0.4 GW having consent approved. By 2020, National Grid forecast that there will have been a total of 14.8 GW of generation capacity with consent approved. This will be made up of around 9.3 GW of gas and 5.5 GW renewable generation.

Table 5.1: Generation projects under construction

| Fuel type | Generation Capacity - Under Construction (GW) | | | | | | | | |
|----------------|-----------------------------------------------|------------|------------|------------|------------|------------|------------|------------|------------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
| Coal | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Gas | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Oil | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Nuclear | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Renewables | 0.6 | 1.3 | 1.4 | 1.4 | 1.6 | 1.6 | 1.6 | 1.6 | 1.6 |
| Pump-Storage | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Interconnector | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Total | 1.2 | 1.9 | 2.1 | 2.1 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 |

Source: ETYS 2012, National Grid¹⁸⁰

¹⁷⁷ Source: National Grid Future Energy Scenarios.

¹⁷⁸ Renewables includes biomass, hydro, marine and wind energy.

¹⁷⁹ From 1st March 2010, the Planning Inspectorate (PINS) became responsible for processing new planning applications under the Planning Act 2008. Section 36 applications received by DECC before 1 March 2010 will remain with the Department for examination and decision. Please see the following link for a list of major energy infrastructure that the PINS will deal with: <https://www.og.decc.gov.uk/EIP.htm>.

¹⁸⁰ Data from Appendix F3.2 - Generation Data: <http://www.nationalgrid.com/uk/Electricity/ten-year->

Table 5.2: Generation projects with consent approved

| Fuel type | Generation Capacity - Consent Approved (GW) | | | | | | | | |
|----------------|---------------------------------------------|------|------|------|------|------|------|------|------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
| Coal | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Gas | 0.0 | 0.0 | 3.9 | 5.9 | 7.9 | 8.3 | 9.3 | 9.3 | 9.3 |
| Oil | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Nuclear | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Renewables | 0.4 | 1.6 | 2.3 | 4.3 | 5.1 | 5.3 | 5.5 | 5.5 | 5.5 |
| Pump-Storage | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Interconnector | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total | 0.4 | 1.6 | 6.2 | 10.2 | 13.0 | 13.7 | 14.8 | 14.8 | 14.8 |

Source: ETYS 2012, National Grid¹⁸¹

The tables 5.1 and 5.2 above only provide information on projects under construction or that have consent approved. Longer term forecasts are available from a number of sources, including DECC's UK Renewable Energy Roadmap Update 2012.¹⁸² This publication outlines DECC's forecast for installed renewable generation capacity. By 2020, they forecast up to 18 GW of offshore wind¹⁸³, and up to 13 GW of onshore capacity. Further, biomass and solar PV could contribute up to 6 GW and 7 to 20 GW of capacity, respectively.

Generation commissions/retirements

Information on generation projects with consents and which is under construction is provided in the previous section. In terms of plant closures, the Large Combustion Plant Directive (LCPD) opted-out plant comprises of 12 GW of coal and oil capacity. Out of this capacity, 7.4 GW has now closed¹⁸⁴ with all of this plant closing before the end of 2015. However, the operational lives of two nuclear power plants have been extended. The two plants, with a combined capacity of around 1.8 GW, will now operate until at least 2023.¹⁸⁵

[statement/current-elec-tys/](#).

¹⁸¹ Data from Appendix F3.2 - Generation Data: <http://www.nationalgrid.com/uk/Electricity/ten-year-statement/current-elec-tys/>.

¹⁸² Available from: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/80246/11-02-13_UK_Renewable_Energy_Roadmap_Update_FINAL_DRAFT.pdf.

¹⁸³ Assuming costs come down.

¹⁸⁴ Figure correct at the end of Q1 2013.

¹⁸⁵ Hinkley Point B and Hunterston B were previously scheduled to close in 2016.

4. The gas market

4.1 Network regulation

There is one gas transmission network, the National Transmission System (NTS), which is used to move gas at high pressure from coastal terminals, interconnectors and storage sites to power stations, industrial customers and Gas Distribution Networks (GDNs). This is owned and operated by National Grid Gas plc (NGG) under a transmission licence granted by Ofgem. In the text below, NGGT, is used to refer to NGG in its role as licence holder for this system, NGG is both a System Operator (SO) and a Transmission Operator (TO).

There are eight GDNs, each of which covers a separate geographical region of Britain and is granted a licence by Ofgem. Four of these are owned by National Grid Gas plc. In addition there are a number of smaller networks owned and operated by Independent Gas Transporters (IGTs) - most but not all of these networks have been built to serve new housing. Distribution costs account for about 16% and transmission costs for about 2% of the average gas bill¹⁸⁶.

4.1.1 Unbundling

- Articles 10,11, 26 2009/73/EC Article 3 Regulation (EC) 715/2009

On 10 November 2011, the Electricity and Gas (Internal Markets) Regulations 2011 ("the GB Regulations") came into force. The GB Regulations implemented the Third Package into GB domestic legislation, including the ownership unbundling requirements set out in the Third Package Directives and Regulations in respect of Transmission System Operators (TSOs), storage and Liquefied Natural Gas (LNG) system operators, as well as the unbundling requirements for Distribution System Operators (DSOs). The GB Regulations have amended the Gas Act 1986 ("Gas Act") to include the requirement for the holders of gas transporter and gas interconnector licences to be certified as independent pursuant to one of the grounds for certification set out in the Gas Act.

The GB Regulations have designated the Authority as the National Regulatory Authority (NRA) for GB and have given it the responsibility for administering the certification process in GB. The Authority is also required to notify the European Commission upon receipt of an application for certification where the applicant is from a third country or is controlled by a person from a third country.

¹⁸⁶ The average bill is based on average annual consumption figures of 16 500 kWh for gas, averaged across all big suppliers and across GB.

Transmission System Operators (TSOs)

On 19 June 2012, the Authority made, and on 20 June 2012 the Authority published, its final certification decision (pursuant to sections 8F(6)-(8) of the Gas Act and Article 3(2) of Regulation (EC) No. 715/2009 ("the Gas Regulation") in respect of National Grid Gas plc (NGG)¹⁸⁷. The Authority's final certification decision for this TSO was to certify NGG on the ground in section 8G(3) of the Gas Act, namely that NGG met each of the ownership unbundling tests set out in section 8H of the Gas Act implementing Article 9 of Directive 2009/73/EC (the "Gas Directive"). In accordance with Article 3(2) of the Gas Regulation, the Authority made these final certification decisions having taken utmost account of the Commission's opinion received by the Authority on 19 April 2012.

In July 2012, the Authority reviewed the annual declaration submitted on behalf of NGG and remained satisfied that the ground for NGG's certification remained valid.

Distribution System Operators (DSOs)

There were no changes or additions to the number of gas distribution system operators (DSOs) in Great Britain during 2012¹⁸⁸. There continue to be eight gas distribution services providers (DSPs); four network areas for National Grid Gas plc, Northern Gas Networks Ltd, Scotland Gas Networks plc, Southern Gas Networks plc and Wales and West Utilities Ltd; and fourteen independent (embedded) gas distribution system operators; Energetics Gas Ltd, ES Pipelines Ltd, ESP Connections Ltd, ESP Networks Ltd, ESP Pipelines Ltd, Fulcrum Pipelines Ltd, GTC Pipelines Ltd, Independent Pipelines Ltd, Quadrant Pipelines Ltd, SSE Pipelines Ltd, Severn Gas Transportation Ltd, Greenpark Energy Transportation Ltd, SP Gas Transportation Cockenzie Ltd and SP Gas Transportation Hatfield Limited. Each independent DSO owns and operates a number of relatively small networks at various geographical locations. There was some consolidation of ownership in the independent sector but this has not given rise to any competition concerns.

During the year we have reviewed the returns submitted by DSOs relating to business independence, financial reporting and output performance. In that context we are satisfied that Directive requirements relating to unbundling are being properly observed.

Storage and LNG System Operators

The GB Regulations have also introduced in the Gas Act a number of unbundling requirements applicable to storage and LNG system operators.

Specifically, storage facilities which are technically and/or economic necessary and are part of vertically integrated undertakings shall be independent from activities relating to the production and supply of natural gas. These provisions contained in Articles 15-16¹⁸⁹ of the EU Gas Directive, have been transposed in the Gas Act in Section 8 (R).

¹⁸⁷ <http://www.ofgem.gov.uk/Europe/Documents1/NGG%20certification%20decision.pdf>

¹⁸⁸ In relation to Article 26 of Directive 2003/55/EC

¹⁸⁹ A system storage operator shall be independent at least in terms of their legal form, organisation and decision making from other activities not relating to transmission, distribution and storage.

In GB, only two facilities (all the other hold a minor facility exemption) are subject to these provisions: Rough and Hornsea. Rough is owned and operated by Centrica Storage Limited (CSL) while Hornsea by SSE Hornsea Limited (SSEHL). Under these new provisions both facilities are required, amongst other things, to publish an annual report, which states how they comply with these requirements. Ofgem provided guidance on compliance with these new requirements in its nTPA guidance in December 2011¹⁹⁰.

For LNG facilities, the EU Gas Directive (Article 31) and the Gas Act (Section 19E(2)-(4)) only require LNG system operators to keep their (financial) accounts separate from any other business. In GB, all the existing LNG import facilities are owned by separate legal entities and are therefore compliant with these requirements.

4.1.2 Technical functioning

- Article 41(6)(b), Article 41(8), Article 41(1)(h), Article 41(1)(m), (Article 41(1)(n), Article 41(1)(s), Article 41(1)(t)

Balancing services

Under the Third Package, regulators fix or approve the terms and conditions for the provision of balancing services. These balancing services must be performed in the most economic manner and incentivise network users to balance their input and off-takes.

In Great Britain (GB), the primary responsibility for balancing lies with gas shippers. The current gas balancing arrangements are designed to provide shippers with commercial incentives to balance their inputs to and off-takes from the GB high-pressure national gas transmission system (NTS) over the course of each daily balancing period, which corresponds to a gas day. As such, parties who are not in balance incur charges that reflect the costs incurred by the System Operator in addressing the imbalance. These charges are known as cash out prices and they provide the commercial incentives for shippers to balance their positions.

National Grid Gas (NGG), in its role as System Operator for the NTS, has a role as residual balancer and, as such, it can buy and sell gas to correct residual imbalances and thus ensure that the system remains in balance at all times; the primary tool that NGG uses to balance the system is the on-the-day commodity market (OCM). Ofgem has oversight through licensing arrangements over the types of balancing tools that NGG can use and their tendering processes.

In addition, the Third Package requires regulators to ensure that transmission system operators are given appropriate incentives to increase efficiencies, foster market integration and security of supply. Ofgem financially incentivises NGG in its role as a residual balancer. The residual balancing incentive scheme consists of two interacting

¹⁹⁰ Guidance is published on the Ofgem website- see chapter 3:
<http://www.ofgem.gov.uk/Markets/WhIMkts/CompanEff/Documents1/Guidance%20on%20the%20regulatory%20regime%20for%20gas%20storage%20facilities%20in%20GB.pdf>

measures, a price measure and a linepack measure. The price measure incentivises NGG to trade at a price close to the market price, thereby minimising the impact of NGG's balancing actions in the market on a daily basis, whilst the linepack measure incentivises NGG to ensure that the linepack at the end of each gas day is similar to that at the start of the same day, so that the costs of resolving imbalances are accurately targeted on those shippers who caused them.

Security and reliability standards, quality of service and supply

Transmission

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

Distribution

Standard special licence condition D10 of the gas distribution licence sets timescales within which Gas Distribution Network companies (GDN) must provide connections services, attend/respond to gas emergencies and respond to telephone calls to its emergency services and enquiry service obligations telephone line. GDNs must provide services within these timescales at least 90 or 97 per cent of the time (dependent on the obligation) in order to comply with their licence obligations. The guaranteed standards of performance also require GDNs to meet expected levels of service or pay customers compensation if they fail.

We monitor quality of service by:

- requiring GDNs to comply with and monitoring performance against standard special licence condition D10 – quality of service standards of the gas distribution licence
- monitoring GDN performance against guaranteed standards of performance contained in the Gas (Standards of Performance) Regulations 2005 SI No. 1135. Standard special licence condition D10

Monitoring time taken to connect and repair

Transmission

Connections to the National Transmission System (NTS) are governed by the Uniform Network Code (UNC). Connections to the NTS are infrequent and for major pipeline developments can take many years.

In 2012, formal governance of the NTS connection processes was introduced by UNC Modification 0373. This requires NGGT to provide quarterly data on connections agreements. NGGT has published this data for their quarterly reporting periods, with the

reports published in October 2012, January 2013 and April 2013. The data can be found in "Gas Connections Quarterly Reporting".¹⁹¹

Distribution

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

We did not monitor the end to end time taken by GDNs to make connections in 2012-13 but standard licence condition 24.1 of the gas transporter licence has been amended to enable the Authority to perform its functions under the Directive as well as domestic legislation. Also, section 24(1A) Gas Act 1986 has been introduced, requiring the Authority to keep under review the time taken to make connections and repairs.

In 2011, we wrote to all GDNs to notify them that they will be required to report information on the time taken to make connections in the future in order to meet their obligations under *Article 41(1)(m)*. Since then, we have met with GDNs to discuss time to connect reporting and we have notified them that they will be required to report time to connect information going forward.

Monitoring access to storage, linepack and other ancillary services

Regulators are required under the Third Package to monitor and review the access conditions to storage, linepack and other ancillary services. In the GB gas market, the default regime is for all storage facilities to offer negotiated third-party access unless the facility has been granted an exemption. Key requirements for storage facilities are:

- to be legally unbundled from related undertakings if the related undertaking does certain other activities, and
- to offer access to third-parties on non-discriminatory terms.

Once the Third Energy Package legislation entered into force in GB, Ofgem published a guidance document in December 2011 in respect of the new regulatory regime¹⁹². Our approach to monitoring is to pro-actively monitor compliance as well as to receive complaints or hear concerns from market participants.

¹⁹¹ <http://www.nationalgrid.com/uk/Gas/Connections/National+Transmission+System+-+Gas+Connections/>

¹⁹² Guidance on the regulatory regime for gas storage facilities in Great Britain:
<http://www.ofgem.gov.uk/Markets/WhlMkts/CompandEff/Documents1/Guidance%20on%20the%20regulatory%20regime%20for%20gas%20storage%20facilities%20in%20GB.pdf>

Monitoring correct application of criteria that determine model of access to storage

Under the Third Package, regulators must monitor the correct application of the criteria that determine whether a storage facility falls under negotiated or regulated access. As noted above, the GB default regime for all storage facilities is to offer negotiated third-party access unless the facility has been granted an exemption.

Ofgem grants a 'minor facility exemption' where we are satisfied that access to the storage facility by other persons is not technically or economically necessary for the operation of an efficient gas market. The key criteria are the test of technical and economic necessity. The owner of a storage facility may apply to Ofgem for such an exemption, and Ofgem may revoke an exemption if the criteria are no longer met. More details of our approach are set out in an open letter¹⁹³.

Ofgem has not granted any new minor facility exemptions in 2012.

Monitoring safeguard measures

The regulatory authorities are required under the Third Package to monitor the implementation of safeguard measures (Article 41(1) (t)). These safeguard measures will be used in the event of a sudden crisis in the energy market as referred to in Article 46 of the Gas Directive. Article 46 is taken forward by and further specified in Articles 10 (6) and (7) of the EU Gas Security of Supply Regulation (No 994/2010). As such, under Article 10 of the Gas Security of Supply Regulation, the competent authority is required to prepare an Emergency Plan that outlines the action that it intends to take in an emergency. In GB, the competent authority is DECC and in November 2012 it published the National Emergency Plan - Gas (NEP - G)¹⁹⁴ which describes the arrangements established between the gas industry, DECC, and the European Commission for the safe and effective management of gas supply emergencies. Ofgem has provided comments to DECC on the National Emergency Plan throughout the drafting process and as such we are comfortable that the appropriate safeguard measures have been implemented.

¹⁹³ Gas storage third party access (TPA) exemptions – minor facilities:

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

¹⁹⁴ National emergency plan: gas: <https://www.gov.uk/government/publications/national-emergency-plan-gas>

4.1.3 Network and LNG tariffs for connection and access

- Article 41(1)(a), Article 41(6)(a), Article 41(8), Article 41(10), Article 41(12), Article 41(1)(f), and Article 41(1)(s)

Transmission

National Grid Gas Transmission (NGGT) is the owner and operator of the GB gas National Transmission System (NTS). The revenue NGGT can collect from NTS users via network charges is determined by us at the price control review. The current gas and electricity transmission price control, based on the RIIO model, began on 1 April 2013 and will run until 31 March 2021.

Based upon our assessment, we establish cost allowances and performance targets which form the basis of the price control and incentive framework. Included in these arrangements is an incentive which allows NGGT's allowed revenue to increase in response to user signals for new capacity. Together, these elements determine the total amount of revenue (the "allowed revenue") that NGGT may earn in each year, and NGGT is required by the regulatory regime to set charges for use of the network such that it complies with the limits on allowed revenue that have been set. Should more or less than the maximum permitted revenue be earned in any formula year, then a compensating adjustment is made in the following year.

Users of the NTS are subject to three main elements of transmission charges: Transmission Owner (TO) entry and exit charges and System Operator (SO) charges. TO charges are charges for the provision and maintenance of transmission network assets. NGGT aims to recover all of its TO allowed revenue on the basis of TO entry and exit capacity charges, but TO entry and exit commodity charges (charges based on actual gas flows) are levied where NGGT forecasts a shortfall in collected revenue versus target revenue. NGGT collects its SO allowed revenue via SO commodity charges which are levied on the basis of gas flows at entry and exit. System operator charges are costs incurred by the SO in its day to day operation of the NTS. Connection charges are levied on new connections to the NTS and reflect the costs incurred by NGGT in providing any assets required to connect a user to the NTS. These costs are not determined by the price control review.

Under its licence, NGGT is obliged to develop and maintain a methodology which sets out how NTS charges are determined and which complies with certain charging methodology objectives. These objectives are mentioned above: that the methodology results in charges that are reflective of the costs incurred by NGGT in its transportation business; that the methodology facilitates effective competition between gas shippers and between gas suppliers; that the methodology takes account of developments in the gas transportation business; and that the methodology is in compliance with the regulation and legally binding decisions of the European Commission and/or ACER.

We have approved NGGT's charging methodology. However, following its implementation, the charging methodology has been incorporated into the contractual framework between GB gas network users and operators, the UNC. This means that modification proposals to the charging methodology are subject to the governance procedures of the Uniform Network Code (UNC) and that, consequently, such modification proposals can be raised by

any UNC party. Implementation of charging methodology modification proposals are subject to approval by us and our assessment of the extent to which the proposed methodology changes better meet the relevant licence objectives described above. Self governance provisions exist within the UNC governance procedures to allow low impact modifications to be implemented without approval by us. A number of criteria are set out in the licence which a proposal must meet in order to be classified as self governance.

We do not approve the network charges levied, only the charging methodology used to determine them. NGGT is obliged to provide 150 days' indicative notice of proposed changes to the level of charges, and 60 days' final notice of actual changes. Subject to the methodology TO entry and exit capacity charges are levied on all network users, including storage sites, LNG terminals, and beach terminals in a non-discriminatory way. TO and SO commodity charges are not levied on gas storage users as it is not considered cost reflective to do so. NGGT is also required to submit a report each year to us which notes developments in the gas transmission charging methodology in the previous formula year and what further changes may be necessary to improve compliance with the relevant objectives. In 2012, no significant changes were made.

LNG facilities

The three¹⁹⁵ Liquefied Natural Gas (LNG) facilities currently operating in GB have an exemption¹⁹⁶ from third party access and therefore the provisions of Articles 41(10) and 41(6) do not apply to them.

Any exempted LNG facility is required to operate under the terms and conditions of its exemption. Commercial terms and conditions are agreed between the facility operator and its primary capacity holders. However, in the event that there is a need to modify the terms and conditions for LNG operators as we believe they are disproportionate or discriminatory we would take actions under the enforcement provisions contained in the Gas Act - in particular section 28.

We published guidance on regulated third party access to LNG facilities in 2012 but no investment under this route has taken place yet¹⁹⁷.

Distribution

There are eight GB Gas Distribution Networks (GDNs). As with gas transmission, the revenue the GDNs can collect from GDN users via network charges is determined by us at

¹⁹⁵ Isle of Grain, South Hook and Dragon LNG.

¹⁹⁶ Ofgem recently published its final decision to grant an exemption to the Isle of Grain LNG terminal for an expansion ('phase 4') of approximately 8.4 billion cubic meter/year (bcm/y) of capacity, The European Commission is currently reviewing Ofgem's decision according to Article 36 (9) of the EU Gas Directive of 13 July 2009. Ofgem's decision can be found at the following link:

<http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/TPAccess/Documents1/Isle%20of%20Grain%20-phase%204%20final%20views%20document.pdf>

¹⁹⁷ Please follow this link for more information on the regulation of LNG facilities in GB:

<http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/TPAccess/Pages/TPAccess.aspx>

the price control review. The current gas distribution price control RIIO-GD1 began on 1 April 2013 and will run until 31 March 2021.

Based upon our assessment, we establish cost allowances and performance targets which form the basis of the price control and incentive framework. These elements determine the total amount of revenue (the 'allowed revenue') that the GDNs may earn in each year, and the GDNs are required by the regulatory regime to set charges for use of their networks such that they comply with the limits on allowed revenue that have been set. Should more or less than the maximum permitted revenue be earned in any formula year, then a compensating adjustment is made in the following year.

The GDNs recover their allowed revenues via a combination of Local Distribution Zones (LDZ) capacity and commodity charges, and an LDZ customer charge. The GDNs are obliged to provide 150 days' indicative notice of proposed changes to the level of these charges, and 60 days final notice of actual changes.

In common with NGGT, under the licence the GDNs are obliged to develop and maintain a methodology which sets out how LDZ charges are determined and which complies with the same NTS charging methodology objectives. These objectives as mentioned above: that the methodology results in charges that are reflective of the costs incurred by NGGT in its transportation business; that the methodology facilitates effective competition between gas shippers and between gas suppliers; that the methodology takes account of developments in the gas transportation business; and that the methodology is in compliance with the Regulation and legally binding decisions of the European Commission and/or ACER. With the additional inclusion of the objective that the Licensee shall not show any undue preference towards, or undue discrimination against, any person who operates, or proposes to operate, a pipe-line system in relation to the connection of that system to the pipe-line system to which the licence relates, these charging methodology objectives also apply to the GDN's connection charging methodology which the GDNs are also obliged to maintain under licence.

We do not approve the LDZ charges levied, only the charging methodology used to determine them. The GDN charging methodologies have also been incorporated into the contractual framework between GB gas network users and operators, the UNC. This means that modification proposals to the charging methodologies are subject to the governance procedures of the UNC and that, consequently, such modification proposals can be raised by any UNC party. Implementation of charging methodology modification proposals are subject to approval by us and our assessment of the extent to which the proposed methodology changes better meet the relevant licence objectives described above. Self governance provisions exist within the UNC governance procedures to allow low impact modifications to be implemented without our approval.

The Codes relevant to Gas contain provisions for affected stakeholders to provide inputs to proposed changes to the methodologies or tariffs. This is done either through participation in various industry working groups, or through the more formalised public consultation processes. We consider any inputs received in reaching a decision on methodologies or tariffs. While we have the power to make a decision on proposed changes to the methodologies, we do not have the power to review these decisions. Stakeholders have the right to request a judicial review of any such decision. We are not aware of any such request for judicial review on any decision regarding the methodologies or tariffs during the past year.

Prevention of cross-subsidies

In GB, licensed electricity distribution, gas distribution and transmission network operators are subject to licence conditions prohibiting regulated businesses from giving cross-subsidies to, or receiving cross subsidies from, related undertakings. The regular information submissions that Licensees are required to make, principally those relating to their price control arrangements, allow us to assess whether any risk or incidence of cross-subsidisation has arisen¹⁹⁸.

Electricity and gas distribution licences include a requirement for independent auditors to carry out a range of procedures, agreed with us, to provide assurance that obligations to avoid discrimination and cross-subsidy are being respected. We review the auditors' reports and raises supplementary questions as appropriate.

We are satisfied that there were no material cross subsidy issues during 2012.

Regulated and negotiated access to storage

Under the Third Package, regulators must monitor the correct application of the criteria that determine whether a storage facility falls under negotiated or regulated access. In the GB gas market, the default regime is for all storage facilities to offer negotiated third-party access unless the facility has been granted an exemption. Key requirements for storage facilities are:

- to be legally unbundled from related undertakings if the related undertaking does certain other activities, and
- to offer access to third-parties on non-discriminatory terms.

Once the Third Energy Package legislation entered into force in GB, Ofgem published a guidance document in December 2011 in respect of the new regulatory regime¹⁹⁹.

Ofgem grants a 'minor facility exemption' where we are satisfied that access to the storage facility by other persons is not technically or economically necessary for the operation of an efficient gas market. The key criteria are the test of technical and economic necessity. The owner of a storage facility may apply to Ofgem for such an exemption, and Ofgem may revoke an exemption if the criteria are no longer met. More details of our approach are set out in an open letter²⁰⁰. Ofgem has not granted any new minor facility exemptions in 2012.

¹⁹⁸ The prohibition on cross subsidies is prescribed by: Internal Markets Electricity Directive (IMED) 2009/72/EC at Article 31(3); the Internal Markets in Natural Gas Directive 2009/73/EC at Article 31(3); Standard Licence Condition 4 of the Electricity Distribution Licence; Standard Special Condition A35 of the Gas Transporter Licence (Standard Condition 41 for independent gas transporters); and Standard Condition B5 of the Electricity Transmission Licence (Standard Condition E6 for offshore transmission network operators).

¹⁹⁹ Guidance on the regulatory regime for gas storage facilities in Great Britain:

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

²⁰⁰ Gas storage third party access (TPA) exemptions – minor facilities:

<http://www.ofgem.gov.uk/Markets/WhIMkts/CompandEff/TPAccess/Documents1/Storage%20Exemptions%20Ope>

4.1.4 Cross-border issues

- Article 41(6)(c), Article 41(8), Article 41(9), Article 41(10), Article 41(12), Article 41(1)(c), and Article 41(1)(g)

Access to cross-border infrastructure including allocation and congestion management

Access rules on interconnection

The Third Package has introduced new responsibilities for regulatory authorities regarding the rules for granting access to cross-border gas infrastructures.²⁰¹ In Great Britain, changes have been made to the standard conditions of the Gas Interconnectors Licence to take full account of these new responsibilities.²⁰² The requirements of the Third Package were transposed to domestic legislation on 10 November 2011 and are reflected in the Interconnector Licences as follows:

- The interconnector licence has been changed to require licensees to submit to Ofgem any new or amended access rules. The interconnector licence also gives us the power to request licensees to review and amend these access rules.
- The interconnector licence conditions place a responsibility on both us and the interconnector operator to ensure that tariff methodologies, and any modifications to these, comply with certain objectives. These are objectivity, transparency, non-discrimination and compliance with the Regulation or any decision of the Commission and ACER.
- The interconnector licence conditions have also been changed to require interconnector operators to review their access rules at least once a year, or at our request, and to provide us with a report. This report should highlight what amendments, if any, will be made to better facilitate the objectives above. The review must take account of any suggestions we might have in relation to better achieving the objectives.

In August 2012, the European Commission adopted the Congestion Management Procedures (CMP) Guidelines amending the existing Annex to the Gas Regulation (EC) no.

[n%20Letter%2009%20 For%20publication .pdf](#)

²⁰¹ See Articles 41(6)(c), 41(8), 41(9) and 41(10) of the Gas Directive 2009/73/EC

²⁰² See standard conditions 10, 11 and 11A of the Gas Interconnector Licence:

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

715/2009²⁰³. The main requirements of the Guidelines are incentives for TSOs to offer capacity in addition to their technical levels to allow users to surrender their unused capacity for resale. The CMP Guidelines must be implemented by 1 October 2013. We are working closely with all relevant interconnectors and NRAs to introduce the appropriate measures of the CMP Guidelines by this date. We published an open letter in March 2013 setting out our views on the minimum steps we expect relevant parties to take in order to comply with these Guidelines²⁰⁴.

The GB gas system is interconnected with Belgium, the Netherlands, Northern Ireland and the Republic of Ireland. The paragraphs below give an overview of the arrangements on each of our interconnectors.

IUK

The interconnector with Belgium, Interconnector UK (IUK) became operational in 1998. IUK can physically flow gas in both directions and has an import capacity of 25.5bcm/year and an export capacity of 20bcm/year.

To secure financing for the interconnector, original IUK customers agreed to book and pay for primary capacity on a 20 year term. Subsequent capacity expansions have also been funded on the basis of primary capacity charges. Primary capacity gives holders ("IUK Shippers") the right to flow a certain volume of gas in Forward Flow and/or Reverse Flow. Primary Interruptible Capacity is also available to IUK shippers to account for the fact that the physical capacity of IUK may vary depending on operating conditions. Secondary capacity can be made available to non-IUK Shippers through subletting or capacity transfers. IUK has sold all of its capacity in long-term contracts until 2018. However, IUK is due to consult in 2013 on offering oversubscription capacity on a firm basis subject to an auction based buy-back regime. IUK is also consulting on a mechanism for shippers to surrender capacity and put in place long-term Use-it-or-lose-it principle.

BBL

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

The BBL Company offers forward flow capacity, on a first-come first-served basis, to any shipper that signs an agreement to become a BBL Shipper. As not all capacity offered in

²⁰³ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:231:0016:0020:EN:PDF>

²⁰⁴ <http://www.ofgem.gov.uk/Europe/Documents1/Ofgem%20CMP%20Implementation%20Open%20Letter.pdf>

the open season in 2007 has been contracted, a limited amount of firm capacity is available for sale. An unlimited amount of interruptible forward flow capacity is also available. Interruptible reverse flow capacity, from the UK to the Netherlands, is sold through daily, monthly and quarterly auctions at a zero reserve price. Capacity on BBL is subject to the Use-it-or-lose-it (UIOLI) principle to ensure that the maximum possible capacity is available to other capacity holders.

BBL has an exemption from licence requirements around access rules and charging methodologies for some of its forward capacity.²⁰⁵

Moffat

The Moffat interconnector with the Republic of Ireland became operational in 1993. The commercial capacity available to exit the system at Moffat is 433.4 GWh/day. In December 2011, a virtual reverse flow service was introduced. This allows shippers to nominate flows from Ireland to GB on an interruptible basis. The maximum entry capacity at Moffat is 432.7GWh/day.

From 1996 a branch off the Moffat pipeline at Twynholm in Scotland became operational to flow gas from GB to Northern Ireland. This is also known as the Scotland to Northern Ireland Pipeline (SNIP). As of February 2013, a virtual reverse flow service was introduced to nominate flows from Northern Ireland to GB.

Until 30 September 2012 existing exit capacity (including GB exit capacity at Moffat) was released on a first come first served basis. Since October 2012 (the introduction of enduring exit reform) users have been able to purchase long-term exit capacity (from GB to Ireland) at the Moffat interconnection point through applications made during a window each year in July. Short-term exit capacity and interruptible entry capacity (for virtual reverse flow) on the GB side are also available through daily auctions with a zero reserve price. In addition, incremental exit capacity can be allocated if the interconnector capacity is sold out via the long-term booking process. Oversubscription and UIOLI are applied at exit capacity at Moffat to ensure the maximum amount of capacity is available.

Access to LNG Terminals and Storage Facilities

The Third Package gives regulators the power to modify the tariffs or charging methodologies applied by LNG System Operators and Storage System Operators (SSOs), to ensure that they are proportionate and applied in a non-discriminatory manner²⁰⁶.

In Great Britain, we do not have a separate licensing regime for LNG system operators. All LNG system operators currently have an exemption from third party access and therefore Article 41(10) does not apply to them. However, in the event there is a need to change charging methodologies and access rules when we consider that they are disproportionate

²⁰⁵ Standard conditions 10,11 and 11A of the Gas Interconnector Licence

²⁰⁶ See Article 41(10) of the Gas Directive 2009/73/EC

or discriminatory, we would take actions under the enforcement provisions contained in the Gas Act²⁰⁷.

Storage is also a non-licensed activity in GB and is regulated under a negotiated Third Party Access (nTPA) regime. Under the nTPA regime, we do not have the responsibility to approve tariffs or charging methodologies for storage facilities. Instead, it is up to the SSOs to ensure that their tariffs meet the requirements of the Regulation. We have the power to proactively monitor SSOs' compliance with the Regulation and can take enforcement action if we deem that any tariffs or tariff methodologies are disproportionate or are discriminatory²⁰⁸.

The Gas Directive gives the right to any party affected to submit a complaint for review regarding a decision on methodologies taken or concerning the proposed tariffs or methodologies. Changes have been made to the Gas Act to extend the scope of the dispute resolution mechanism in order to cover disputes arising out of complaints to the Authority against owners of gas storage facilities and owners of LNG import or export facilities²⁰⁹. We have not received any complaints in 2012.

Cooperation

The Third Package imposes new duties on Ofgem to consult and cooperate with ACER and the regulatory authorities of other member states over cross-border gas issues (Article 41(1)(c)). Changes have been made to the Gas Act 1986 to reflect this²¹⁰.

The changes to the Gas Act also place a responsibility on us to cooperate with the regulatory authorities of other member states to promote certain objectives. This includes promoting the integration of national gas markets and supporting jointly managed cross-border trade in gas and the allocation of cross-border capacity.

Examples of cooperation

We have been cooperating with the regulators of neighbouring member states over a number of issues around interconnectors. For example, we have worked closely over the last years with the Northern Irish regulator (UREGNI) and the Republic of Ireland regulator (CER) to develop and approve a virtual reverse flow service from Northern Ireland to Great Britain. In February 2013, we published the decision letter approving the bilateral agreements between Bord Gais Eireann (BGE) (UK) and Premier Transmission Limited (PTL) to allow for virtual reverse flow service from Northern Ireland to GB²¹¹.

In addition, we have closely collaborated with our Belgian and Dutch counterparts throughout 2012 on cross-border gas issues. The GB, Belgian and Dutch gas markets are

²⁰⁷ See section 28 of the Gas Act 1986: <http://www.legislation.gov.uk/ukpga/1986/44>

²⁰⁸ See sections 28 and 34 of the Gas Act 1986

²⁰⁹ Regulation 28 amends sections 27B-27D of the Gas Act:
<http://www.legislation.gov.uk/uksi/2011/2704/regulation/28/made>

²¹⁰ See Regulation 34 of the Electricity and Gas (Internal Market) Regulations 2011, which inserts section 4D into the Gas Act 1986: <http://www.legislation.gov.uk/uksi/2011/2704/regulation/34/made>

²¹¹ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=166&refer=Europe> and
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=167&refer=Europe>

interconnected by Interconnector UK (IUK, between GB and Belgium), the Balgzand Bacton Interconnector (BBL, between the Netherlands and GB) and several Interconnection Points (IPs) between Belgium and the Netherlands. These assets play an important role in gas security of supply by allowing for gas to flow to where it is valued most and are a key infrastructure to integrating European gas markets.

In October 2012, we launched together with the Belgian and Dutch regulators a Call for Evidence on the use of gas interconnectors on Great Britain's borders and on possible barriers to trade²¹². Our initial analysis suggests that gas flows across the two interconnectors (IUK and BBL) between GB and Belgium and between GB and the Netherlands could be further optimised and that there are occasions where gas does not flow to the market where price signals highest demand. This leads to inefficiencies and markets exporting when in fact they should be importing or vice-versa. The public consultation closed in December 2012. We are also working closely with the two regulators on the implementation of CMP Guidelines.

We have also contributed to ACER's work to develop Framework Guidelines for the network codes of the European gas market. We led the drafting process, on behalf of ACER, on the gas Balancing Framework Guidelines and on ACER's opinion of the Balancing Network Code and the Capacity Allocation Mechanism Network Code and have been actively involved in the development of the Harmonised Tariff Structures Framework Guidelines.

Ofgem has also been actively involved at CEER. We are co-chairing, alongside two other regulators, CEER's incremental capacity work stream which focuses on developing a market-based approach for cross-border investment. We have continued to contribute to CEER's projects around sharing experiences on regulatory matters, including on storage and LNG issues.

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

We set price controls for the gas transmission system operator. As part of this process we review the company's (National Grid Gas Transmission) business plans. We explicitly require the business plans to consider the interaction with wider European developments as part of the context of the plan. We also require the company to consider the various uncertainties across the period for which the control is set and across a longer period.

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

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

²¹² http://www.ofgem.gov.uk/Europe/Documents1/120928_Interconnector_Open%20Letter%20Final.pdf

We are establishing a monitoring approach to review ongoing performance against the outputs determined in the price control. We are involved in work comparing the domestic investment plans with the EU-wide plan.

4.1.5 Compliance

- Article 41(1)(d), Article 43, (Article 41(1)(b), Article 41(1)(r), Article 41 (3) and Article 41(5), and imposing penalties (Article 41(4)(d)

Compliance of regulatory authorities with binding decisions of the Agency and the Commission and with the Guidelines

Under the Third Package NRAs are required to ensure compliance with and implement binding decisions of ACER and of the European Commission and with the Guidelines. In order to enable Ofgem to do this, the Electricity Act has been amended so as to provide the Authority with the necessary powers to carry out its functions in the manner that it considers is best calculated to implement or ensure compliance with any binding decision of ACER or of the European Commission.

Compliance of transmission and distribution companies, system owners and natural gas undertakings with relevant Community legislation, including cross-border issues

We have powers to investigate compliance of transmission and distribution companies, system owner, and natural gas undertakings with relevant Community legislation. If a breach is found, we have powers to impose penalties.

As a condition of certification, TSOs are obliged to notify the Authority if they know (or reasonably should know) of an event or circumstances which has occurred, or is likely to occur, that may affect their eligibility for certification and must provide an annual declaration (approved by a resolution of the TSO's board of directors) in this regard. The Authority also has powers to require information to be provided by the TSO for the purpose of monitoring the TSO's certification.

IUK and BBL are obliged to give quarterly reports to the Authority on progress in complying with conditions set out in the Authority's final certification decision.

Once the European network codes are finalised, we will have an obligation to ensure these are fully implemented in GB. Ofgem, in close cooperation other relevant NRAs, will ensure TSOs are compliant with network codes through our access rules approval process (as required by UK TSO licences) and by monitoring TSO business rules, standard transportation agreements and any and all other relevant operational rules and agreements. Ofgem will require TSOs to notify the Authority if they know (or reasonably should know) of an event or circumstances which has occurred, or is likely to occur, that

may affect their compliance with the Ofgem approved network code compliance regime. The Authority also has powers to require information to be provided by the TSO for the purpose of monitoring the TSO's Network Code compliance.

Update on Ofgem's enforcement investigations

We have set out below some of the key enforcement investigations and actions we undertook in 2012 against gas undertakings. Please see Section 3.1.5 for an update on Ofgem's cross-cutting enforcement actions for 2012.

Gas Emergency Standards investigations

In February 2012 we made the decisions to impose a financial penalty of £900,000 on Northern Gas Networks Limited and of £4.3 million on National Grid Gas plc following investigations into the failure to comply with standard special condition (SSC) D10 paragraph 2(g) of the gas transporters licence. In accordance with SSC D10 paragraph 2(g), Gas Distribution Network operators are required to attend 97 per cent of uncontrolled gas escapes within one hour and 97 per cent of controlled gas escapes within two hours ("the Gas Emergency Standards").

Misreporting

In October 2012 we made the decision to impose a financial penalty of £375,000, following an investigation into the failure by Wales & West Utilities Limited to comply with Standard Special Conditions A40(5), D9(2), D9(5)(c), and Special Conditions E2B(8)(3)(b), E20(3)(a) and (b) and E20(7)(a) of its gas transporter licence.

In accordance with its licence, WWU is required to provide Ofgem for each regulatory year a report of the gas main decommissioning work completed by WWU in that year. The ability of regulators to rely on accurate information from regulated companies is a fundamental part of the regulatory regime. The Authority therefore regards any contraventions of the obligations on accurate reporting of regulatory information as serious.

4.2 Promoting Competition

4.2.1 Wholesale markets

The privatisation of the GB gas market as a whole began with the Gas Act 1986. The GB wholesale market today is based mostly on trading between gas producers, shippers, suppliers, traders and customers across a series of markets. Trade on the wholesale market consists of over the counter (OTC) trading (through brokers and off-market) and exchange trading.

In July 2012²¹³, we proposed our final policy decision on the Gas SCR (significant code review). This set out our minded-to position to strengthen the incentives on market participants to deliver adequate gas supplies through cash-out reform. This is through proposals to reform the emergency cash-out arrangements such that the cost of curtailing supplies to firm gas consumers is reflected in the cash-out price. We also propose to ensure that consumers are paid appropriately in the event that their load is reduced as a result of a gas deficit emergency. We are working to consider developments to our proposals following stakeholder feedback.

The total volume and estimated market value of OTC trades in the UK gas market fell in 2011/2012 compared to 2010/2011.²¹⁴ There was a year-on-year (2011 to 2012) increase in the combined traded volumes on the APX Gas UK (OCM) and APX Gas UK (NBP²¹⁵)²¹⁶, as well as on the IntercontinentalExchange (ICE) UK Gas Futures exchanges. In September 2012, the ICE agreed to buy a majority share of APX-Endex's (APX) derivatives and spot natural gas business. Gasunie, the Dutch gas grid operator, is to hold the remaining share of the business.²¹⁷

There are three price reporting agencies (PRAs) which provide prices based on reported over-the-counter (OTC) trades, as well as two exchanges which offer pricing information to the market. In addition to these, in early 2013, three of the large brokerages which facilitate the OTC market have joined together to launch a new pricing index called Tankard based on trades that they broker.²¹⁸

There have been no major changes to shippers and owners at GB's major LNG import terminals. There remain six shippers who import gas through the Isle of Grain. The South Hook Terminal is owned by a UK joint venture of Qatar Petroleum (QP), ExxonMobil and Total. Dragon LNG is equally owned by two shareholders, BG Group and Petronas.

There are a total of 222 holders of Shipper Licences in GB.²¹⁹ Based on latest data, four shippers had a market share over 5 per cent, with the largest market share recorded under 8 per cent. On the interconnectors, there are currently 12 Shippers which hold primary capacity rights on IUK.²²⁰ For BBL, there are currently 14 shippers, 3 of which have primary capacity rights.²²¹

²¹³ Gas Security of Supply Significant Code Review - Proposed Final Decision. Available from: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=85&refer=Markets/WhlMkts/ComandEff/GasSCR>.

²¹⁴ Source: FSA. The data covers the period August to July and excludes exchange trading. Available from: <http://www.fsa.gov.uk/static/pubs/other/energy-2012.pdf>.

²¹⁵ NBP – National Balancing point.

²¹⁶ These figures include the OCM, NBP and storage markets.

²¹⁷ It has been reported that ICE and Gasunie will have shares of 79.12% and 20.88%, respectively. Source: <http://www.platts.com/RSSFeedDetailedNews/RSSFeed/ElectricPower/6632541>.

²¹⁸ Please see the Tankard website for further information. Available from: <http://www.tankardindex.com/>.

²¹⁹ Correct as of Q1 2013. A full list of licence holders is available from: http://www.ofgem.gov.uk/Licensing/Work/Documents1/external_gas_list.pdf.

²²⁰ Information correct as of Q1 2013. Shippers are listed on BBL's website: <http://www.interconnector.com/Commercial/shippers.htm>.

²²¹ Shippers are listed on BBL's website: <http://www.bblcompany.com/commerce/shippers-list>. 11 of the shippers hold capacity rights for virtual reverse flow. Information correct as 23/04/2013.

Forecasts by GB's TSO for UKCS (UK continental shelf)²²² supplies increased for the first time since 2002 for 2012/13. In 2012 the number of offshore drilling licence applications reached the highest level since the scheme began in 1964.²²³ The forecast GB gas import requirement has fallen in line with this. In 2012, LNG represented 17 per cent of total gas supplies in GB, down from 30 per cent in 2011²²⁴, with imports in 2012 falling by around 45 per cent on 2011. Total gas storage capacity increased in 2012 with the completion of Aldbrough I and the opening of Holford facility.²²⁵ GB gas demand for 2012 was around 5.4 per cent lower than the previous year.²²⁶ Gas in GB, the US and Japan has continued to be priced at significantly different levels.

4.2.1.1 Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition

- Article 41(1)(i) , (j), (k) (l) (u) and Article 44(3)

Wholesale price transparency

Wholesale gas prices in GB are compiled and made available to market participants by a number of independent pricing agencies, energy market brokers and via exchanges. Argus Media, ICIS Heren and Platts provide pricing based on reported over-the-counter (OTC) trades, made available to the market via a subscription service. In addition, financial data providers (such as Bloomberg PROFESSIONAL service) provide close to real time energy broker pricing based on OTC trades.

In addition to a wide range of OTC pricing data, in 2012 there were two exchange providers in the GB gas market both providing pricing data to the market. Please see below for a description of GB wholesale gas exchanges.

In 2012, three of the large brokerages which facilitate the OTC market have joined together to launch a new pricing index called Tankard based on trades that they broker.²²⁷

Description of the wholesale market

In brief, the GB wholesale market is based mostly on trading between gas producers, shippers, suppliers, traders and customers across a series of markets. Trade on the

²²² UK indigenous gas production.

²²³ DECC press release: <https://www.gov.uk/government/news/record-breaking-north-sea-licensing-round>.

²²⁴ Source: DECC Energy Trends – Gas. Available from: <https://www.gov.uk/government/publications/gas-section-4-energy-trends>.

²²⁵ Holford started operating at the end of 2011. See E.ON press release: <http://pressreleases.eon-uk.com/blogs/eonukpressreleases/archive/2011/12/19/1768.aspx>.

²²⁶ Source: DECC Energy Trends – Gas. Available from: <https://www.gov.uk/government/publications/gas-section-4-energy-trends>.

²²⁷ Please see the Tankard website for further information. Available from: <http://www.tankardindex.com/>.

wholesale market consists of OTC trading (through brokers and off-market) and exchange trading.

Over the counter trading (OTC)

OTC trading (i.e. bilateral deals between two market participants, including via an intermediary [the broker] brings together a buyer and seller) typically operates from a year or more ahead of real time up until 24 hours ahead of real-time.²²⁸

The Financial Services Authority (FSA) conducts an annual survey to determine the total volume of OTC trades, as outlined below in Table 6.

Table 6: Estimated value of UK gas market

| | Volume traded (bcm) | Est. value of market (£ billion) |
|---------|---------------------|----------------------------------|
| 2011/12 | 1443.2 | 276 |
| 2010/11 | 1557.3 | 299 |
| 2009/10 | 1211.5 | 146 |
| 2008/09 | 910.0 | 157 |
| 2007/08 | 934.9 | 176 |

Source: Analysis of activity in the energy markets 2012, FSA²²⁹

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

Although trading on exchanges can extend out as far as the contract OTC 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.

Total traded volume on the APX Gas UK (OCM) and APX Gas UK (NBP²³⁰)²³¹ exchanges in calendar year 2012 was 138.3 TWh (~13.1 bcm), slightly higher than 2011's figure of 138.0 TWh (~13.0 bcm).²³² Traded volume on the Intercontinental Exchange (ICE) UK Gas Futures exchange totalled 595 bcm in 2012, up by around 17 per cent from 508 bcm in 2011.²³³ In September 2012, the Intercontinental Exchange (ICE) agreed to buy a

²²⁸ Examples of typical contracts include annual contracts (contracts for the delivery of a given volume of gas at a specified price throughout a year), seasonal contracts (summer/winter), quarterly contracts and monthly contracts. However, this market is also used for non-standard contracts designed to match a consumer's anticipated demand profile.

²²⁹ Source: FSA. The data covers the period August to July and excludes exchange trading. Available from: <http://www.fsa.gov.uk/static/pubs/other/energy-2012.pdf>.

²³⁰ NBP – National Balancing point.

²³¹ These figures include the OCM, NBP and storage markets.

²³² Source: APX.

²³³ Source: ICE. Represents total volumes traded in monthly, seasonal and quarterly products from 1st Jan 2012 to 31st Dec 2012. Available from: www.theice.com.

majority share of APX-Endex's (APX) derivatives and spot natural gas business. Gasunie, the Dutch gas grid operator, is to hold the remaining share of the business.²³⁴

Figures from DECC show that GB gas demand for the year 2012 was 78.3 bcm, around 5.4 per cent (4.5 bcm) lower than the previous year.²³⁵ This is mainly due to warmer weather, and the substitution of gas-fired generation by coal as dark/spark spreads favoured coal.

Balancing

We launched the Gas Security of Supply Significant Code Review (Gas SCR) in January 2011. The objective of the Gas SCR is to evaluate whether reforms to the current gas market arrangements are required to enhance security of supply; the primary focus being on the gas emergency cash-out arrangements.

We published a draft policy decision on the Gas SCR in November 2011²³⁶, and a proposed final decision in July 2012²³⁷, which set out our minded-to position to strengthen the incentives on market participants to deliver adequate gas supplies through cash-out reform. These set out our proposals to reform the emergency cash-out arrangements such that the cost of curtailing supplies to firm gas consumers is reflected in the cash-out price, and to ensure that consumers are paid appropriately in the event that their load is reduced as a result of a gas deficit emergency. This is consistent with the principles encapsulated in the European Gas Balancing Network Code.

Following stakeholder feedback, we are working to consider developments to our proposals, including the potential to incorporate a mechanism for centrally managed demand-side response which could be incorporated into the emergency cash-out arrangements.

Given that GB will be becoming increasingly dependent on gas imports we have also recommend an investigation of the need for, the impacts and effects of, various further measures to enhance gas security of supply. We provided a report to government on gas security of supply, which was published in November 2012.²³⁸ Investigation of further measures is being progressed by DECC through a separate process to the Gas SCR.

²³⁴ It has been reported that ICE and Gasunie will have shares of 79.12% and 20.88%, respectively. Source: <http://www.platts.com/RSSFeedDetailedNews/RSSFeed/ElectricPower/6632541>.

²³⁵ Source: DECC Energy Trends – Gas. Available from: <https://www.gov.uk/government/publications/gas-section-4-energy-trends>.

²³⁶ Draft Policy Decision - Gas Security of Supply Significant Code Review. Available from: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=46&refer=Markets/WhIMkts/CompanEff/GasSCR>.

²³⁷ Gas Security of Supply Significant Code Review - Proposed Final Decision. Available from: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=85&refer=Markets/WhIMkts/CompanEff/GasSCR>.

²³⁸ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=3&refer=Markets/WhIMkts/monitoring-energy-security/gas-security-of-supply-report>.

Market integration

Table 7 – GB forecasts for demand, UKCS production and import requirements (Gone Green Scenario)

| | 11/12 | 12/13 | 13/14 | 14/15 | 15/16 | 16/17 | 17/18 | 18/19 | 19/20 |
|-----------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Demand (inc. exports) (bcm) | 84.1 | 84.0 | 84.9 | 83.3 | 81.1 | 78.9 | 77.5 | 75.1 | 73.8 |
| UKCS production (bcm) | 35.9 | 38.5 | 39.4 | 40.4 | 39.5 | 34.9 | 31.4 | 28.9 | 26.1 |
| Import Requirement | 57% | 54% | 51% | 51% | 55% | 58% | 60% | 63% | 62% |

Source: Gas Ten Year Statement 2012, National Grid²³⁹

Table 7 shows the long-term decline in production from the UK Continental Shelf (UKCS) and the associated increase in import requirements for the years ahead. However, it also shows a forecast increase in UKCS supplies for the first time since 2002 for 2012/13. In 2012 the number of offshore drilling license applications reached the highest level since the scheme began in 1964.²⁴⁰ This is related to a combination of government financial incentives and an increase in gas prices. The resulting increase in production at current sites and the opening of some new fields has increased the forecast out to 2014/15. The forecast for import requirements over this period has decreased as a result.

In terms of IUK (the gas interconnector between GB and Belgium), each shipper has a share of the Forward Flow and Reverse Flow Standard Capacity. Originally, nine Shippers acquired Capacity Rights in IUK for a period of 20 years from 1 October 1998 through to 30th September 2018. Currently 12 Shippers hold primary capacity rights.²⁴¹

Since the installation of a fourth compressor at BBL, in April 2011, no further forward flow interconnector capacity expansion has occurred, and some long-term firm forward flow capacity remains unsold on the interconnector. Interruptible virtual reverse flows have been in use on BBL since the beginning of 2011. 13 shippers subscribed in the first year of its operation (Oct 2010-Sep 2011). There are currently 14 shippers on BBL, 3 of which have primary capacity rights.²⁴² Experience so far shows that interruptible virtual reverse flows do not always reflect price signals, e.g. they are utilised even when NBP prices are higher than TTF²⁴³ prices while during other times they are underutilised despite TTF prices exceeding NBP prices. The recent price trend is NBP prices exceeding those of TTF, and there has been no utilisation of Virtual Reverse Flow since early October 2012.

²³⁹ Source: Gas Ten Year Statement 2012. Available from:

<http://www.nationalgrid.com/uk/Gas/TYS/current/GTYS2012.htm>.

²⁴⁰ DECC press release: <https://www.gov.uk/government/news/record-breaking-north-sea-licensing-round>.

²⁴¹ Information correct as of Q1 2013. Shippers are listed on IUK's website:

<http://www.interconnector.com/Commercial/shippers.htm>.

²⁴² Shippers are listed on BBL's website: <http://www.bblcompany.com/commerce/shippers-list>. 11 of the shippers hold capacity rights for virtual reverse flow. Information correct as 23/04/2013.

²⁴³ TTF - Title Transfer Facility

Interruptible virtual reverse flows are also now introduced on the all the Irish interconnectors. So far, they have been utilised on very few occasions.

Interactions with Global LNG markets

2010 saw the completion of two new LNG importation terminals in GB (Isle of Grain Phase 3 and South Hook Phase 2), taking the country's total LNG importation capacity to 49.0 bcm/year²⁴⁴ (or 53.1 bcm/year including the Teeside GasPort facility; the facility lacks any storing capability).

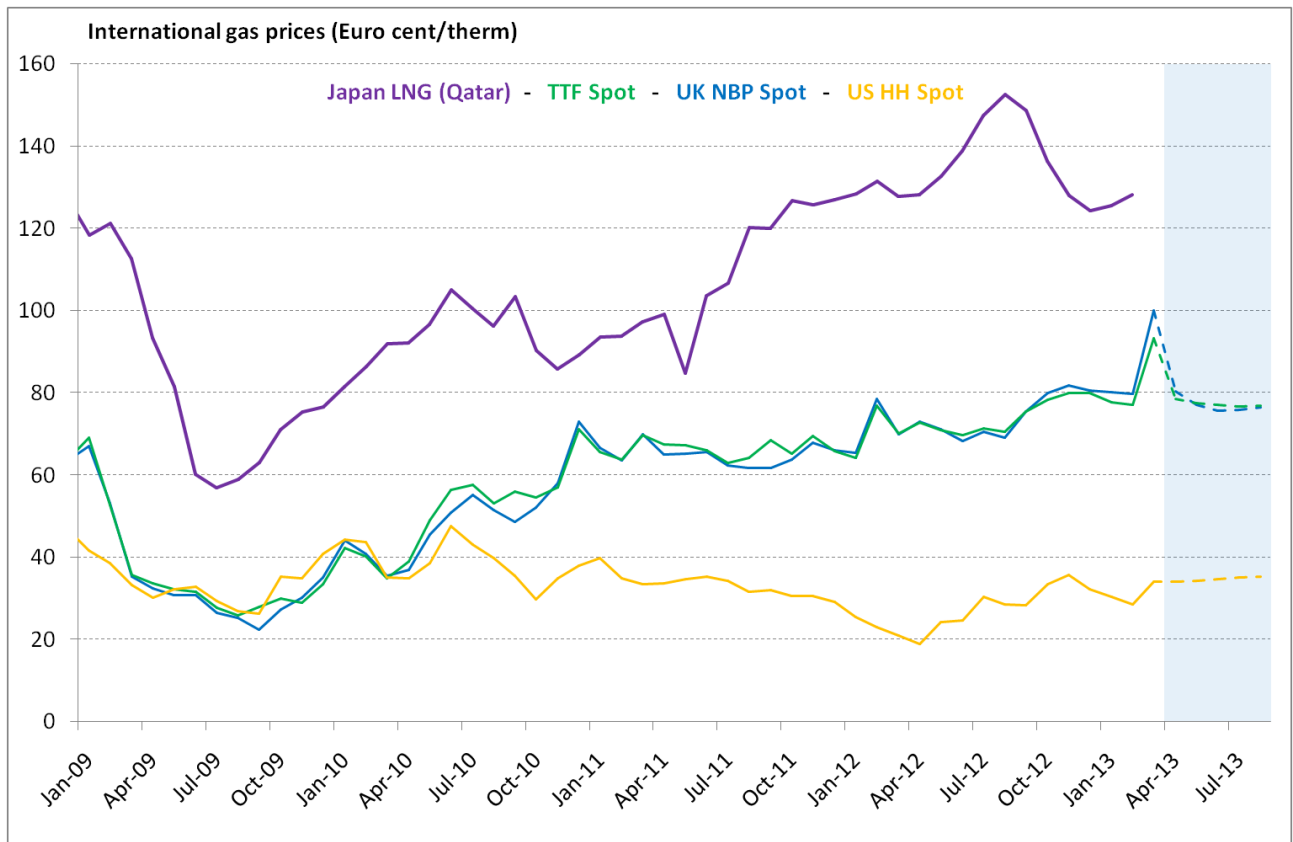
In 2012, LNG represented 17 per cent of total gas supplies in GB, down from 30 per cent in 2011.²⁴⁵ The market for LNG is increasingly a global one, with supply and demand conditions in regions such as Asia impacting upon the volume of LNG deliveries available to GB. This has been demonstrated over the past few years. For example, deliveries in 2009 and 2010 were high as economic conditions suppressed LNG demand in competing markets, GB had increased import facilities, and US domestic production was boosted by high volumes of unconventional gas. More recently, there is evidence that global LNG prices have been driven by high gas demand in Japan. Following the Fukushima Daiichi nuclear accident, the country shut down much of its nuclear power plant fleet, and supply has mainly shifted to gas- and oil-fired generation. In part reflecting this, LNG imports in 2012 fell by around 45 per cent (or 11.7 bcm) on 2011.

Figure 11 below shows that UK NBP and US gas prices have diverged significantly, in part due to the global dynamics mentioned above.

²⁴⁴ Source: National Grid Gas Ten Year Statement. Available from: <http://www.nationalgrid.com/uk/Gas/TYS/current/GTYS2012.htm>.

²⁴⁵ Source: DECC Energy Trends – Gas. Available from: <https://www.gov.uk/government/publications/gas-section-4-energy-trends>.

Figure 11: Monthly averaged GB, Dutch, US and Japanese gas prices from 2009 (forward prices are shown in the dotted lines and shaded area)



Source: Bloomberg/Ofgem

Market opening and competition

As noted above, the bulk of contract trading in the GB wholesale market is bilateral between gas producers, shippers, suppliers, traders and customers across a series of markets. The majority of wholesale market trading is divided into over the counter (OTC) trading and power exchange trading. The market underwent the first stages of privatisation in the late 1980s, and is now open to competition.

The rules and regulations that were put in place, following market opening, have been removed and replaced with legislation aimed at facilitating competition and protecting consumers. We are bound by our statutory duties to protect the interests of consumers, both existing and future. Wherever appropriate, we perform our functions in a manner which we considers would further this principal objective by promoting effective competition. However, before exercising our functions in this manner, we must consider whether the interests of consumers would be better protected by exercising our functions in other ways.

Monitoring competition

We actively monitor competition in the market for wholesale gas. Competition indicators such as market concentration levels are assessed across different areas of the market.

In terms of UKCS gas production, there are six companies with a market share greater than five per cent, up by two from 2011. The three largest companies have a combined market share of 41.6% (CR3). There are a total of 222 holders of Shipper Licences in GB, down from 292 in 2011. Four shippers had a market share over 5 per cent, with the largest market share recorded at under 8 per cent. Please see the *market concentration* section of this chapter for further information.

We have concurrent powers, together with the Office of Fair Trading (OFT), to enforce Chapter I of the Competition Act 1998 (CA98) / Article 101 Treaty on the Functioning of the European Union (TFEU) and Chapter II / Article 102 TFEU in the energy sector. We may undertake an investigation where we have reasonable grounds to suspect a breach of these provisions.

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

Market Concentration

The GB market receives its gas supplies from a variety of different sources encompassing indigenous supplies from the UKCS, imports from Norway (via the Vesterled, Langeled and Tampen Link pipelines), imports from Continental Europe (via the Interconnector UK and BBL pipelines) and from the LNG market through the Isle of Grain, South Hook and Dragon LNG terminals and the Teeside GasPort facility for energy bridge regasification vessels (EBRV).

Based on the latest data that we have access to, there are five companies whose market share of production exceeds five per cent for UKCS. 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.

There are six shippers (BP, Centrica, GDF Suez, E.ON, Iberdrola and Sonatrach) who import gas through the Isle of Grain. The South Hook Terminal is owned by a UK joint venture of Qatar Petroleum (QP) (67.5%), ExxonMobil (24.15%) and Total (8.35%). Dragon LNG is equally owned by two shareholders, BG Group and Petronas.

It is difficult to make precise quantitative evaluations in terms of market shares in the overall GB wholesale gas market. However, in terms of market share for gas storage, over

50 per cent of capacity in Rough, the largest gas storage facility in GB, was held by three parties when last full.²⁴⁶ Market share figures are liable to change as capacity can be traded on the secondary market.

In addition, it is also possible to assess the market share of gas shippers²⁴⁷ in the GB gas market. There are a total of 222 holders of Shipper Licences in GB.²⁴⁸ Market concentration is also low. Based on the latest data we have access to, four shippers had a market share over 5 per cent, with the largest market share recorded at under 8 per cent. The data underlying these estimates are market sensitive and therefore confidential.

Storage services

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.

The Rough and Hornsea storage facilities are required to offer Third Party Access (TPA), whilst the other facilities are exempt from this requirement. Table 3 below provides details of the technical characteristics and the TPA status of existing UK storage facilities.

Table 8: Existing UK storage and TPA status

| Facility | Space (bcm) | Deliverability (mcm/d) | Owner | TPA Status |
|-----------------------|-------------|------------------------|--------------------|---------------------------------------------------------|
| Rough | 3.3 | 41 | Centrica Storage | Operated under nTPA + (varied) Rough Undertakings |
| Hornsea | 0.3 | 18 | SSE | Operated under nTPA |
| Avonmouth LNG Storage | 0.08 | 13 | National Grid LNGS | TPA offered under section Z of the Uniform Network Code |
| Aldbrough I | 0.3 | 40 | SSE/Statoil | Exempt |
| Hatfield Moor | 0.1 | 2 | Scottish Power | Exempt |
| Holehouse Farm | 0.05 | 11 | EDF Trading | Exempt |
| Humbly Grove | 0.3 | 7 | Star Energy | Exempt |
| Holford | 0.2 | 22 | E.ON | Exempt |
| Total | 4.6 | 154 | | |

²⁴⁶ Data corresponds to September 2012, when Rough was 97.4% full.

²⁴⁷ A Shipper Licence allows the licensee to arrange with a GT for gas to be introduced into, conveyed through, or taken out of a pipeline system operated by that GT. In all instances, the purpose of the gas movement should be general or for purposes connected with the supply of gas to premises. It cannot be held in conjunction with a Gas Transporter Licence or a Gas Interconnector Licence.

<http://www.ofgem.gov.uk/Licensing/Work/LicensAct/Pages/LicensAct.aspx>.

²⁴⁸ Correct as of Q1 2013. A full list of licence holders is available from: http://www.ofgem.gov.uk/Licensing/Work/Documents1/external_gas_list.pdf.

Source: Tables 2.3E – Gas Ten Year Statement 2012, National Grid²⁴⁹

Total gas storage capacity increased in 2012 with the completion of Aldbrough I and the opening of Holford facility.²⁵⁰ This will increase further by the end of 2013 with the opening and commercial operation of Hill Top Farm and Stublach.²⁵¹

The Rough and Aldbrough I facilities account for around 80 per cent of total storage space and 50 per cent of total daily deliverability. Rough has a standard working gas capacity of about 3.3 bcm although depending on the injection profile over the course of the year it can store large quantities – with the record to date, reached in October 2011, being 3.7 bcm.²⁵² The only LNG storage facility (Avonmouth) accounts for 1.7 per cent of space and approximately 10 percent of total daily deliverability.²⁵³

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.

Undertakings at the Rough storage facility were provided by Centrica PLC to the Secretary of State in 2003 following the referral to the Competition Commission (CC) of its purchase of Dyengy. In April 2010, Centrica PLC and Centrica Storage Limited (CSL) wrote to the Office of Fair Trading (OFT) and the CC to request a review of the undertakings. In January 2011, the CC provisionally decided that the Undertakings should stay in place. In April 2011, the CC confirmed its provisional decision and therefore the undertakings have been retained, albeit some variations which took effect in March 2012.²⁵⁴

National Grid LNG Storage holds annual auctions for the sale of storage capacity on a pay-as-bid basis and publishes the weighted average price paid to the wider market. Scottish and Southern Energy auctions annual capacity at Hornsea ahead of each storage year. Annual average prices are published on its website. We have no information on rejected applications for storage capacity. Furthermore, we have not received complaints regarding the allocation mechanism, and currently all capacity has been sold.

The Transmission System Operator (TSO) tenders for its Operating Margins gas requirements. Gas storage, LNG importation with storage are some of the sources that can

²⁴⁹ Space is working gas capacity and deliverability is withdrawal capacity.

²⁵⁰ Holford started operating at the end of 2011. See E.ON press release: <http://pressreleases.eon-uk.com/blogs/eonukpressreleases/archive/2011/12/19/1768.aspx>.

²⁵¹ National Grid Gas Ten Year Statement has planned start up dates of 2012/13 and 2013/14 for Hill Top Farm and Stublach, respectively.

²⁵² Source: National Grid. Available from: <http://marketinformation.natgrid.co.uk/gas/DataItemExplorer.aspx>.

²⁵³ The LNG storage facilities are required to offer TPA under sections Z of the Uniform Network Code.

²⁵⁴ The varied undertakings, as well as detailed information on the review process, are available at: <http://www.competition-commission.org.uk/our-work/reviews-of-orders-and-undertakings/completed-reviews/review-of-centrica-undertakings>.

provide this service. It is up to the operators to decide whether to participate in the tender. In 2011-12 the TSO requirements for operating margins are around 103 mcm.²⁵⁵

Measures to avoid abuses of dominance

Transparency

Transparency is a key component in the effective and efficient operation of the GB gas market. National Grid have an obligation to ensure information required by Article 18 and the revised Chapter 3 Annex to Gas Regulation (EC) No 715/2009 is available on its website.²⁵⁶

Market surveillance

Our market surveillance team monitors the gas and electricity markets, including the wholesale gas market and the Balancing Mechanism. They routinely assess whether there is any evidence of anti-competitive behaviour or breaches of statutory provisions or licence conditions which may be investigated by us.

Additionally, the Financial Conduct Authority (FCA)²⁵⁷ has responsibilities for the operation of financial markets in the UK. The FCA works to prevent abuse or distortion of financial markets. The FCA has the power to fine persons who have abused the market, where "market abuse" is defined under the Financial Services Market Act 2000.

4.2.2 Retail market

The gas supply market in Great Britain has been open to competition since the late 1990s. Initially this applied to large industrial consumers and then was rolled out across all consumers, including at the household (domestic) level. Although regulations exist to protect consumers and to facilitate competition, price controls on domestic retail energy prices were removed by April 2002. Since that time retail prices have been set by energy suppliers based on their costs and other factors related to their business and market forces. As later sections will show, retail gas prices for domestic consumers rose by 3.5 per cent during 2012.

The majority of the domestic gas supply market is accounted for by 6 large vertically integrated suppliers (integrated generation and supply businesses), which evolved from

²⁵⁵ 2012 Operating Margins Tender Information Report. Available from: http://www.nationalgrid.com/NR/rdonlyres/7BB8FF7D-B398-4A3A-AF9D-1B5A502E1668/54123/Tender_Outcome_2012.pdf.

²⁵⁶ For more information, see: <http://www.nationalgrid.com/uk/Gas/Data/>.

²⁵⁷ <http://www.fca.org.uk/>.

the 15 former incumbent electricity and gas suppliers between 1998 and 2003.²⁵⁸ There are also 10 small domestic gas suppliers. We have seen growth in small supplier numbers during 2012, with 3 entering the market. Within the non-domestic market, there were 30 active suppliers at the end of 2012. This is an increase on the 20 that were active in 2011.

4.2.2.1 Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition

- Article 41(1)(i),(j) (k), (l) (u) and Article 44 (3)

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

Financial transparency

Ofgem requires suppliers to adhere to strict standards of financial reporting, enforced through the Licence Conditions we set. For example, since 2009 we have required large, vertically-integrated suppliers to publish annual Consolidated Segmental Statements (the Statements) on their websites. These Statements provide a breakdown of suppliers' revenues and operating costs and are reconcilable to audited accounts. The information is required for five business segments: electricity generation and four supply segments (domestic, non-domestic, electricity and gas). The Statements set a level of transparency that allows us to assess where revenues are being generated and costs incurred and to compare this across suppliers.

Ofgem produces an annual summary of the Statements, the archive of which can be found on our Retail Market Review (RMR) webpage.²⁵⁹ We published a summary of the 2010 and 2010/11 Statements in January 2012.²⁶⁰

To help identify areas where suppliers could improve the quality of information they provide to us, in 2011 we commissioned an independent accountancy firm (BDO) to review suppliers' energy accounts. Following the review, we published consultations in January 2012²⁶¹ and May 2012²⁶² setting out our proposed way forward. We considered that the proposals strike the right balance between increasing transparency and allowing

²⁵⁸ These companies are (i) Centrica plc: Centrica plc owns British Gas Trading, which operates three retail brands: British Gas (in England), Nwy Prydain (in Wales) and Scottish Gas (in Scotland). (ii) E.ON UK: A wholly-owned subsidiary of the German energy group, which operates under the E.on brand. (iii) EDF Energy: A wholly-owned subsidiary of the French energy group. It operates under the EDF Energy brand. (iv) RWE npower: Part of the German energy group, RWE Group. The supply business operates under the npower brand. (v) Scottish and Southern Energy (SSE): It maintains and promotes separate and distinct energy retail brands in England, Scotland and Wales. (vi) Scottish Power: A wholly-owned subsidiary of the Spanish energy group, Iberdrola.

²⁵⁹ Publication of 2011 CSS <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Pages/rmr.aspx>

²⁶⁰ Ofgem (Jan 2012), "[Financial Information Reporting: 2010 Results](#)"

²⁶¹ Ofgem (Jan 2012), "[Improving Reporting Transparency](#)"

²⁶² Ofgem (May 2012), "[Improving the Reporting Transparency of Large Energy Suppliers](#)"

companies to determine how best to run their businesses. In October 2012, the Authority published its final decision²⁶³ to change the Financial Information Reporting licence condition. The licence condition details the way large energy suppliers must prepare the financial information in their Statements and on their websites.

Transparency for domestic consumers

Our research has repeatedly shown that consumers often do not have key information needed to make informed decisions about their energy supplier. As part of our RMR, in October 2012²⁶⁴ we consulted on changes to bills, annual statements and price increase notifications to (i) ensure consumers have access to key information that enables them to understand their tariff and be able to compare tariffs within the market; and (ii) help domestic consumers better understand the information suppliers provide to them and how they can use it to help them.²⁶⁵

Our proposals included:

- using standardised language and terminology to describe key concepts across these communications – this will ensure a consistent approach across industry and enhance consumer familiarity with key terms and the material provided;
- introducing standard formatting on a specific section of bills giving details that will help consumers compare tariffs, and introducing standard formatting for the majority of the annual statement; and
- personalising information on price change notifications, explaining clearly what a change would mean for each customer's energy charges.

At the end of 2012 a stakeholder group on Consumer Bills and Communications²⁶⁶ started discussing a list of terms for sector-wide standardisation. Greater consistency of terms like tariff names (e.g. evergreen contracts, fixed term contracts) will simplify decision-making for consumers and improve transparency.

To further increase the transparency of gas prices and to help consumers understand the components of their gas bill, we produce a 'Household Energy Bills Explained' factsheet. This is designed to clearly and simply show the relationship between energy bills, wholesale energy costs, and other costs such as those associated with transmission and distribution. We updated the factsheet in May 2012.²⁶⁷

²⁶³ Please see here:

<http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Improving%20Reporting%20Transparency%20-%20Final%20Decision%20Document.pdf>

²⁶⁴ This has built on several years of research and policy development, beginning with the Energy Supply Probe in 2008 and including the Retail Market Review begun in March 2010. We intend to publish our final statutory consultation in May 2013.

²⁶⁵ Ofgem (Oct 2012), "[The Retail Market Review: Domestic Proposals](#)"

²⁶⁶ Please find more information on the composition and purpose of the group here:

<http://www.ofgem.gov.uk/Markets/RetMkts/consumer-bills-and-comms-round-table/Pages/index.aspx>.

²⁶⁷ We do not archive these factsheets on our website and so the May 2012 update is not publicly available.

Consumers can access information on supplier prices by contacting Consumer Focus (a consumer advocacy body). Consumer Focus publishes price comparison tables for each GB supply region. These show what consumers would pay for a given level of energy consumption, payment type, and tariff. It also hosts on its website an interactive search tool, which allowed consumers to see the cheapest deal available by inputting their post code, energy consumption level and preferred energy and tariff types. In 2012 it maintained a list of over 10 accredited online energy switching sites, each of which enables consumers to compare a wide range of suppliers' tariff prices and service offerings and determine which offer best suits their needs.²⁶⁸ It should be noted that since 1 April 2013 Consumer Focus has been replaced by the Citizens Advice Service and Regulated Industries Unit.²⁶⁹

Consumers can have confidence in the accuracy of these accredited switching sites because of the 'Confidence Code', which until 27th March 2013 was administered by Consumer Focus. It is a code of practice that sets out the minimum requirements that a provider of an online domestic gas Price Comparison Service (Service Provider) must meet in order to be, and remain, accredited to this voluntary scheme. Ofgem assumed responsibility for administering the Code from 27 March 2013.

Transparency for non-domestic consumers

Ofgem is also working to increase the transparency for consumers in the non-domestic market. Our research has shown that some businesses experienced a lack of transparency and clarity in the information provided on bills by their supplier.²⁷⁰ As part of our non-domestic RMR proposals published in October 2012, we consulted on expanding the protections that currently apply to micro business customers, to more business customers. We also set out best practice and requirements for the information customers must receive when there is an objection to their supply transfer.²⁷¹

We also consulted on how best to increase the transparency of non-domestic Third Party Intermediaries' (TPIs) activities.²⁷² TPIs act as brokers between non-domestic customers and suppliers, assisting customers in finding the most appropriate energy deal for their needs. However, our research from the 2008 Energy Supply Probe and RMR found evidence that TPIs are not always delivering the best outcomes for consumers.

Interested parties should access our latest update produced in January 2013 for an overview of its content, available at <http://www.ofgem.gov.uk/Media/FactSheets/Documents1/household-bills.pdf>

²⁶⁸ Ofgem has taken responsibility for administering the Code from March 2013. These comparison websites can be found at <http://www.ofgem.gov.uk/domestic-consumers/compare-with-confidence/Pages/index.aspx>

²⁶⁹ More information on the transition can be found here: <http://www.consumerfocus.org.uk/about-us>

²⁷⁰ Research Findings on the Experiences of Non-domestic Customers, Opinion Leader, December 2012, Pages 6-11.

²⁷¹ We will publish in March 2013 final proposals on the rules around the information that needs to be given to customers before and during their contract.

²⁷² Ofgem (Oct 2012), "[The Retail Market Review: Updated proposals for businesses](#)"

Therefore we consider there is a need for further intervention around TPIs. In October 2012 we proposed to take the lead in developing options for a single Code of Practice (CoP) for TPIs. We also asked stakeholders to contact us if they wanted to be part of a TPI working group that would inform our proposals for the CoP. We received overwhelming interest in the TPI working group and respondents to the October consultation unanimously supported a single CoP for TPIs. In our view, the CoP will help to provide increased transparency and clarity for customers and give them confidence when making the decision to switch supplier.

To further increase transparency, we propose to introduce a new obligation on gas (and electricity) suppliers. This will require them to meet prescribed Standards of Conduct (SOCs) in their dealings with small business consumers. The obligation will apply when suppliers are engaging in the relevant activities of billing, contracting, and transferring customers. This definition of small business consumers will match that contained in our standard licence condition 7A proposals.

The SOC will oblige suppliers to treat their customers fairly and require them to take small business consumer needs into account when billing, contracting and transferring customers. We believe this will help to reduce the problems currently faced by small business consumers and improve the effectiveness of their engagement.

In 2012, we took further steps to gain power under the Business Protection from Misleading Marketing Regulations 2008 (BPMRs).²⁷³

Price Monitoring: Market opening and competition

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

Since market opening, rules and regulations have been removed and introduced, where appropriate, to facilitate competition and protect consumers. Ofgem has a central role in protecting the interests of consumers, present and future. As part of our role we further refined our RMR in 2012.²⁷⁴ The RMR looked at both electricity and gas, and examined the

²⁷³ This will allow us to take action against entities that market energy contracts and services to businesses in a misleading manner. Ofgem is seeking information gathering powers and the ability to apply to the Court for an injunction to secure compliance with the BPMRs. We published a consultation (see our website) detailing the powers we are calling for and asking for any further evidence to inform an Impact Assessment. Following this we will provide details to BIS to inform the case for the changes to be made to the relevant legislation.

²⁷⁴ This built on findings from the Energy Supply Probe in 2008 and the Retail Market Review that began in 2010.

effectiveness of competition in the domestic and non-domestic retail markets.^{275,276} It assessed the extent to which the retail market was acting in the interests of consumers.

The RMR found that more could be done to facilitate consumer engagement in the retail energy market. The evidence suggested that consumers found the retail market to be complex and challenging to navigate effectively. The RMR also found that a large proportion of consumers had disengaged from the energy market completely, potentially weakening competitive pressure on suppliers.

Our proposals to address the lack of consumer engagement in the energy market are set out in the section on *Switching rates*. They aim to increase the transparency of the energy market, generating increased consumer engagement, which ultimately should lead to greater competitive pressure between suppliers and more beneficial outcomes for consumers. We consulted on the domestic and non-domestic proposals between October 2012 and December 2012.

Monitoring competition

As noted above, we have launched wider reviews of the market where needs have arisen, but Ofgem also monitors competition on an on-going basis. For example, we collect data from suppliers and other industry bodies on a monthly basis. We also regularly commission consumer research and have regard to a wide range of data and information from other sources which also serve to inform our view of the market and levels of competition within it.

Another tool we use to monitor competition is the Supply Market Indicator (SMI). The SMI allows us to track changes in domestic gas bills relative to suppliers' costs, and to estimate indicative net margin on a typical consumer. Since February 2012 we have published the SMI on a weekly basis. We periodically review the SMI and update our assumptions as they change, including for example, our assumptions on environmental programme costs. Where we update our data, we keep a log of when a change takes effect and a short description.²⁷⁷

We also use the Statements to monitor competition. They allow us to assess the extent to which the vertically integrated suppliers are making profits on supply and generation, and where they are incurring costs. As the Statements are published annually, we can monitor these indicators over time. As mentioned previously, Ofgem publishes a review of the Statements.²⁷⁸

²⁷⁵ Ofgem (Oct 2012), "[The Retail Market Review: Updated domestic proposals](#)"

²⁷⁶ Ofgem (Oct 2012), "[The Retail Market Review: Updated proposals for businesses](#)"

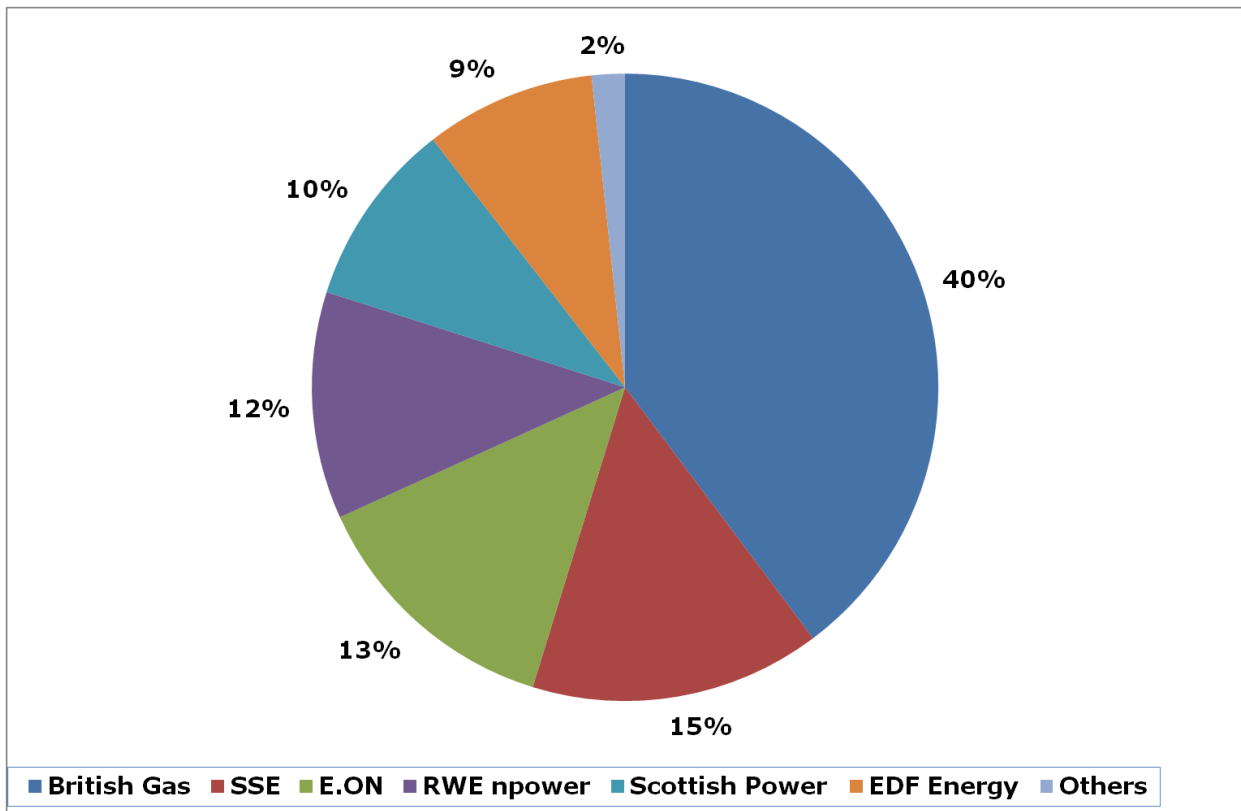
²⁷⁷ Available on our website at: <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Pages/indicators.aspx>.

²⁷⁸ Available on our website at: <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Pages/rmr.aspx>

Monitoring competition – domestic market share

Ofgem also monitors competition on an on-going basis. For example, we regularly analyse suppliers' monthly domestic customer numbers, from which we calculate each supplier's market share. In December 2012 there were 22.4m domestic gas consumers in GB. As Figure 12 shows, the former incumbent suppliers accounted for 98 per cent of gas supply to these customers.

Figure 12: GB Domestic Gas Suppliers' Market Share, December 2012



Source: Ofgem

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

There were 10 small suppliers active in the market in 2012, with a combined market share of two per cent. These are Co-Operative Energy; Dali Gas; Economy Energy; Ecotricity; First Utility; Flow Energy; Good Energy; OVO Energy; Spark Energy; and Utilita. Although these suppliers account for 2 per cent of the gas market, we have seen growth in this area. As a group, their market share increased from one or two per cent between December 2011 and December 2012.

Monitoring competition – non-domestic market share

Ofgem also monitors non-domestic suppliers' market shares. We gather some data from suppliers but also contract with Datamonitor, an independent consultancy, to provide non-

domestic customer numbers. Datamonitor collects the information from suppliers and releases it on a quarterly basis.

The non-domestic gas market is characterised by a larger number of independent suppliers compared to the domestic gas market. In addition to the former incumbent suppliers, there are 24 independent suppliers, with varying focus and market share across the non-Daily Metered sites (Non-DM) and Daily Metered sites (DM) sectors.²⁷⁹

The DM segment is by far the most fragmented, with the top three suppliers holding 47 per cent of the market share. It is also the segment that suppliers other than the former incumbents have penetrated the most. The most significant of these suppliers are Dong Energy Sales and GDF Suez. The three suppliers with the highest market shares in the Non-DM segment are British Gas, E.ON Energy and Corona Energy, which together capture 73 per cent of this segment.

Table 9: Gas suppliers' non-domestic market share November 2012

| Gas supplier | Non Domestic Sites | | |
|---------------------|--------------------|---------------|------------------|
| | nDM | DM | All Non Domestic |
| British Gas | 35.5% | 3.4% | 35.4% |
| Corona Energy | 11.9% | 9.0% | 11.9% |
| EDF Energy | 0.3% | 0.0% | 0.3% |
| E.ON Energy | 25.6% | 9.0% | 25.5% |
| ENI | 0.1% | 8.3% | 0.1% |
| Gazprom | 6.5% | 11.0% | 6.5% |
| GDF Suez | 1.4% | 17.2% | 1.5% |
| Opus Energy | 2.4% | 0.0% | 2.4% |
| RWE npower | 0.8% | 4.1% | 0.8% |
| ScottishPower | 1.0% | 0.0% | 1.0% |
| Dong Energy Sales | 2.0% | 18.6% | 2.0% |
| SSE | 5.7% | 0.0% | 5.7% |
| Total Gas and Power | 6.6% | 8.3% | 6.6% |
| Wingas | 0.0% | 5.5% | 0.0% |
| Statoil UK | 0.0% | 5.5% | 0.0% |
| Others | 0.1% | 0.0% | 0.1% |
| Total | 100.0% | 100.0% | 100.0% |

Source: Datamonitor

²⁷⁹ Daily Metered sites are fitted with a meter that records gas consumption on a daily basis, allowing high-usage consumers to better track their gas consumption. Non-Daily Metered sites do not have this type of meter and usage is recorded on a monthly or quarterly basis.

Monitoring competition - HHIs

Herfindal-Hirschman Indices (HHI)²⁸⁰ indicators are often used to gauge market concentration. Though HHI does not provide conclusive evidence on the level of competition, it offers pointers as to whether a market has the potential to deliver competitive outcomes. The relevant HHIs²⁸¹ for gas are:

- domestic (Dec 2012) – 2,373
- non-domestic, non-daily metered sites (Nov 2012) - 2,189
- non-domestic, daily metered sites (Nov 2012) - 1,153

Both domestic and non-domestic, non-DM gas supply markets are 'highly concentrated' according to the threshold HHI levels (1,800) used by the Office of Fair Trading. The non-domestic, DM gas supply market is judged to be 'concentrated'.

Distortion or restriction of competition

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

Investigating anti-competitive activity

As well as undertaking this broad assessment of competition, the Authority has concurrent powers under the Competition Act 1998 to investigate suspected anti-competitive activity in respect of the gas and electricity sectors in Great Britain. It 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 OFT in respect of market investigation references to the Competition Commission. There have been no changes to Ofgem's enforcement powers since the 2012 National Report.

We have set out in sections 3.1.5 and 4.1.5 the key enforcement investigations and actions that we undertook in 2012 against both gas and electricity undertakings.

²⁸⁰ HHI is commonly used to assess market concentration, ranging from 10,000 for a monopoly to just above zero for perfect competition. Office of Fair Trading Guidelines categorise a market as 'concentrated' if its HHI exceeds 1,000 and 'highly concentrated' if its HHI exceeds 1,800.

²⁸¹ Domestic HHIs have been calculated using suppliers' monthly customer numbers and non-domestic HHIs have been calculated using market shares information provided to us by Datamonitor.

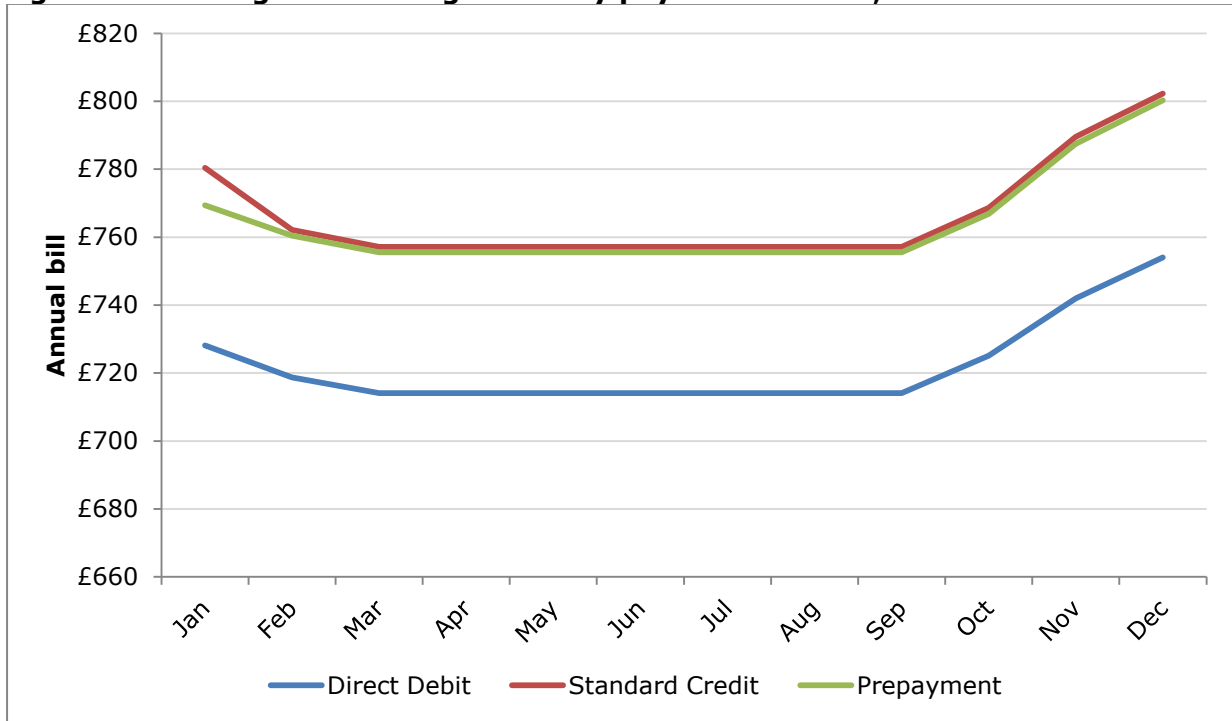
Prices for household consumers including prepayment systems

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

Ofgem actively monitors domestic suppliers’ gas prices across GB. We receive price change notifications from suppliers and use these to calculate the implications for domestic customers’ retail bills based on characteristics such as their consumption level, payment type, and region.

Figure 13 shows the change in average domestic gas bills in GB’s gas market between January and December 2012. Overall, average gas bills increased by 3.5 per cent (£26) over the year.²⁸² The first quarter of the year was characterised by falling bills for all three payment methods. Between August and September, prices remained stable. As the five of the ‘Big 6’ suppliers increased prices in the last quarter, prices for all payment methods rose.

Figure 13: Average domestic gas bills by payment method, Jan– Dec 2012



Source: Ofgem

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

²⁸² Change for the three payment methods was: direct debit, 3.6% (£26); prepayment, 4% (£31); standard credit, 2.8% (£22).

As well as monitoring domestic gas bill levels, we also assess the extent to which particular costs have an impact on these bills. Suppliers face a range of costs that influence how they set retail gas prices. These costs can vary within and between years, and include wholesale energy costs, the costs of UK Government environmental and social policies such as the Renewable Obligation and the Warm Home Discount, and transmission and distribution costs. We use our SMI to explore the relationship between retail bills and these costs. Since February 2012 we have published the SMI on a weekly basis.²⁸³

Switching rates

Domestic

Consumers' ability to switch their energy supplier is important to a well-functioning, competitive energy market. Ofgem monitors switching rates on an ongoing basis. We receive monthly data from gas suppliers on the number of customers they have lost and gained and use this data to calculate switching rates. In 2012, 2.3m domestic consumers switched their gas supplier, equivalent to 194,000 per month. This is a switching rate of 11 per cent, 4 per cent lower than in 2011.

As part of our monitoring of switching rates, we annually commission IPSOS MORI, an independent research company, to explore switching with consumers. We published the latest survey in April 2012. The company conducted a sample of 1,232 interviews with domestic gas customers and explored whether they had switched in 2011, their reasons for switching (or not), and what would make them more likely to switch. It found that in 2011, 13 per cent of the sample had switched gas supplier.²⁸⁴

In 2012 we also published the results of a number of additional pieces of qualitative research on consumer behaviour.^{285,286,287} The evidence base gathered from our consumer research helped to inform our updated RMR domestic proposals in October 2012. We considered that consumer engagement levels in the market were low, and that this was contributing to competition within the retail energy markets not being as strong as it could be. Our proposals included features that aim to make the domestic energy market simpler, improving consumers' ability to identify the best gas deal and make informed switching decisions. Examples of proposals we consulted on in October 2012 include:

- a requirement that a supplier can only offer four core tariffs per fuel and meter type;
- standardised rules for how discounts and bundled products could be used;

²⁸³ Available on the Ofgem website at:

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

²⁸⁴ Ipsos MORI April 2012, "[Customer Engagement with the Energy Market – Tracking Survey](#)"

²⁸⁵ Ipsos MORI (January 2012), "[Ofgem Consumer First Panel Year 4](#), Findings from first workshops (held in October and November 2011)"

²⁸⁶ Ipsos MORI Aug 2012, "[Consumer engagement with the energy market, information needs and perceptions of Ofgem, Findings from the Ofgem Consumer First Panel Year 4: second workshops \(held in March 2012\)](#)"

²⁸⁷ Ipsos MORI (Oct 2012), "[Prompting engagement with and retention of written customer communications](#)"

- a requirement to ban expensive tariffs which are no longer available to prospective consumers; and
- a requirement for all tariffs to include key information in a Tariff Information Label with the format mandated by Ofgem.

Non-Domestic

Our updated non-domestic RMR proposals, published in October 2012²⁸⁸, examined issues around non-domestic switching. For example, we found evidence that suppliers were objecting to customer transfers more than we would expect. We have received complaints from, or on behalf of, businesses concerning the difficulty of switching. In particular, data shows that most suppliers object to around a quarter of attempted transfers. We believe this experience could negatively affect non-domestic customers' perceptions of the energy industry and their willingness to engage in switching in the future. We will use our market monitoring powers to improve the data we receive on supplier objections to transfer. We are monitoring this portion of the market closely and will assess the extent to which non-domestic switching improves over time.

We also found evidence of barriers that deterred or prevented businesses with proportionately low energy costs from actively managing their energy use and their relationship with their supplier.²⁸⁹ These barriers included unclear information on energy bills and tariffs, and the perceived difficulty of switching.

Datamonitor estimate the switching rate for major energy users (spend >£50,000 per year) at 24 per cent for gas in 2011. For SMEs (spend <£50,000 per year) the switching rate is estimated at 21.5 per cent for gas. Though as Table 9 above has shown, there are many more non-domestic suppliers than domestic and the market is considerably more fragmented than the domestic market.

Disconnection rates

Ofgem requires gas suppliers to record and report on the number of disconnections of domestic customers. Suppliers are required to submit quarterly and annual returns on disconnections. Ofgem also submitted these returns to Consumer Focus, the consumer advocacy body.²⁹⁰ The data we receive allows us to monitor disconnection rates between suppliers and the rate of change between quarters and years. It also gives us a basis to engage with suppliers if they have an abnormally high number of disconnections. Our latest quarterly and annual reports on gas disconnections can be found at our Social Obligations Monitoring webpage²⁹¹. The page also contains links to consultations that we

²⁸⁸ Ofgem (October 2012), "[The Retail Market Review: updated proposals for businesses](#)"

²⁸⁹ Opinion Leader (Dec 2012), "[Research Findings on the Experiences of Non-Domestic Customers](#)", p8.

²⁹⁰ Consumer Focus became the Citizens' Advice Service and Regulated Industries Unit in April 2013. More information on the transition can be found here: <http://www.consumerfocus.org.uk/about-us>

²⁹¹ <http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Pages/SocObMonitor.aspx>

carry out regarding disconnection and suppliers' other social obligations. Latest available data shows that there were 33 gas disconnections in Q2 2012. This represents a 77 per cent decrease from the 146 disconnections reported in Q2 2011. It continues the trend from 2011, during which gas disconnections fell by 59% on 2010 figures.

Charges for and the execution of maintenance services

To assess performance, the gas distribution networks are required to submit regulatory returns on an annual basis providing relevant cost and volume information to Ofgem. A component of the Distribution Use of System charges that all customers pay as part of their gas bills are maintenance costs associated with the volume of maintenance work undertaken.

The value of this information to Ofgem is to allow us to monitor the Distribution System Operators' performance over the price control which is funded via the Use of System charges. The company's investment and maintenance choices made today affect both their current and future customers' experience of the networks.

Complaints by household consumers

Ofgem does not directly monitor domestic customer complaints. However, we do set the standards to which suppliers must adhere when dealing with and processing customer complaints.²⁹² If a consumer wishes to make a complaint about a gas supplier, they should contact the relevant company in the first instance. The energy company then has up to eight weeks to resolve the complaint.

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

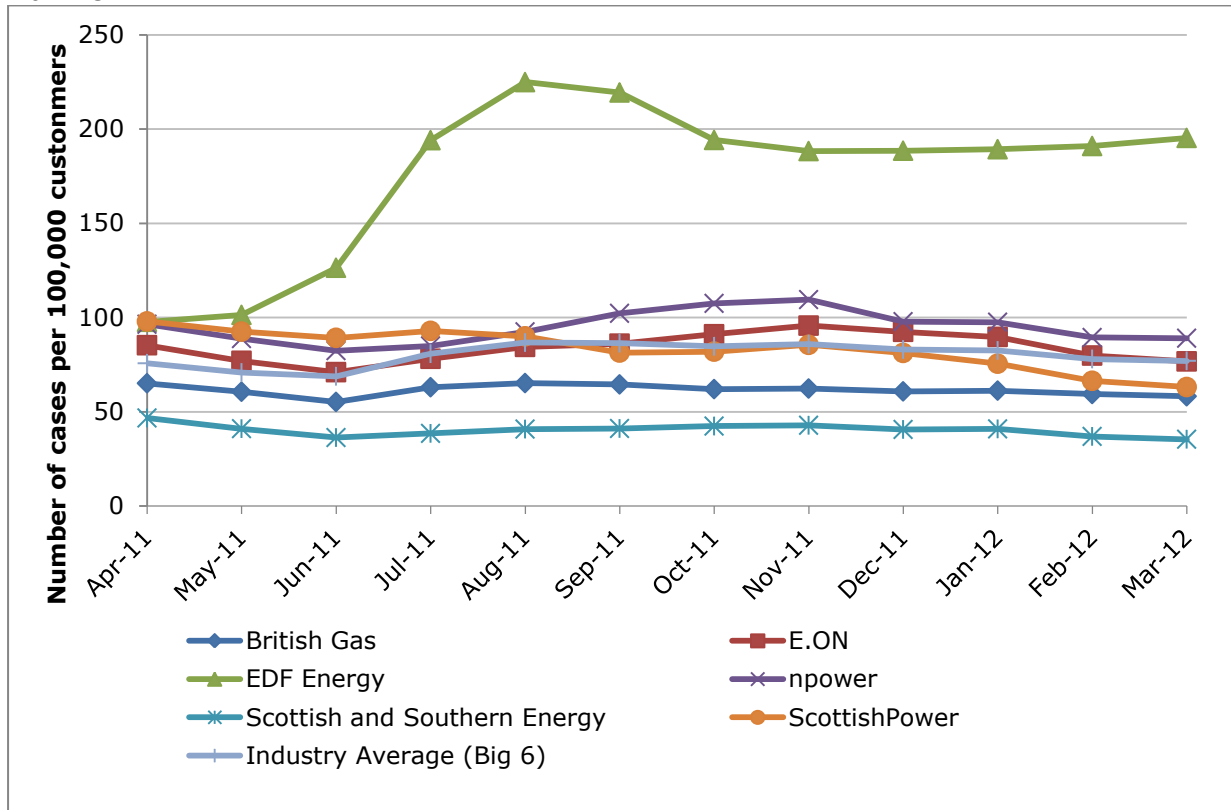
In addition, Ofgem has been working with suppliers in 2012 to arrange that suppliers publish their direct complaints data. Suppliers began to publish this data in early 2013.

The figure below shows, for the former incumbent suppliers, the number of cases per 100,000 customers received by Consumer Direct and referred onto the suppliers' dedicated handling teams, Consumer Focus's Extra Help Unit, or the Energy

²⁹² The complaint standards are prescribed by "The Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008" which come into force on 1 October 2008 and are published at: http://www.opsi.gov.uk/si/si2008/uksi_20081898_en_2#pt2-l1q3

Ombudsman.²⁹³ It is not possible to break down these figures for the gas market only. Therefore data represents relevant contacts for issues relating to both gas and electricity. The data shows that complaints remained relatively stable in the first three months of 2012, however they were slightly on the rise for EDF Energy.

Figure 4.3: Domestic suppliers' performance on cases received by Consumer Direct, Consumer Focus Extra Help Unit and the Energy Ombudsman, April 2011-Mar 2012



Source: Consumer Focus, data extracted by Ofgem

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

Finally, the UK government has now published its decision to streamline the structure of its consumer advice services. One change occurred on 2 April 2012, when the advice and information helpline operated by Consumer Direct was replaced by the Citizens Advice consumer service operated by Citizens Advice. A Regulated Industries Unit has been created which will replace Consumer Focus and will transfer to Citizens Advice in April 2013. The existing Extra Help Unit will continue to assist vulnerable consumers and consumers who have had their supply disconnected or who are at threat of disconnection with their complaint.

²⁹³ Consumer Focus uses a methodology to weight the seriousness of the complaints. Full details of the methodology can be accessed on the Consumer Focus website at <http://energyapps.consumerfocus.org.uk/performance/methodology>

Monitoring restrictive contractual practices

Ofgem recognises the importance of monitoring restrictive contractual practices in the gas market. We have dedicated Retail (responsible for monitoring and policy development relating to domestic and non-domestic markets) and Enforcement teams that engage with a variety of stakeholders and suppliers, ensuring that we are open and receptive to any issues that may be highlighted.

Whilst it is challenging to actively monitor the entire domestic and non-domestic gas markets, we have a range of data and information that we regularly analyse and assess. Further, we may seek additional information where needed and have a legal power to investigate further where we receive information that suggests restrictive practices are occurring. Ofgem is able to compel the provision of information and documents from regulated persons for the purposes of monitoring the matters referred to in Article 37(1)(k).

Respecting contractual freedom

Ofgem issues licences which prescribe the regulatory requirements with which energy suppliers must comply. Suppliers must comply with the conditions of their licences. Where licence conditions are not being complied with, we have the power to investigate and ultimately take action, ranging from fines to revocation of the supplier's licence.

The supply licence contains some conditions relating to supply contracts to help ensure the provision of clear contractual information to household and small business consumers. However, as part of our RMR, we are proposing to put in place stronger rules to ensure the transparency of contractual information, particularly for fixed term contracts, for household customers.

At present, there are no bespoke regulatory rules that seek to regulate the fairness of terms expressly agreed between a supplier and customer. However, household customers are protected by the general national rules which transpose Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. These rules are set out in the Unfair Terms in Consumer Contracts Regulations 1999 and Ofgem is one of the public bodies with enforcement powers. In addition, in respect of special types of contract that are deemed by national law to exist between a supplier and customer, there are bespoke rules in place which protect both household and business customers from unduly onerous terms.

Contributing to the compatibility of data exchange processes

Ofgem is obliged under the Gas Act 1986 – 4D (2) (f)) to cooperate with ACER and other National Regulatory Authorities (NRAs) to establish coordinated network codes. Along with other European NRAs, we are participating in the development of the Interoperability and Data Exchange Network Code.

The previous sections have shown the range of information that Ofgem makes publicly available. In 2012, this included regular updates such as the weekly SMI, which provides analysis of supplier costs and the retail bill for gas. It also included the quarterly disconnection data. We have published our work to refine and update the Consolidated Segmental Statements, which will make these annual reports more consistent and informative. Finally, it included the RMR, which built on and developed a significant amount of supporting market data and consumer research. The sections have also shown the information that is available from other parties such as Consumer Focus. Market participants are free to access this information if they wish.

4.2.2.2 Recommendations on supply prices, investigations and measures to promote effective competition

- Article 41(1)(p), Article 41(4)(b)

All final consumer prices in the GB retail energy markets are determined by market forces as all price controls on final consumer prices were lifted by April 2002. Prices can be affected by numerous costs, these include wholesale energy prices, costs associated with social programmes such as the Warm Home Discount, and transmission and distribution costs.

Therefore prices in the supply market are not within Ofgem's direct control and we do not make annual recommendations on supply prices nor provide these to the competition authorities.

However, Ofgem's primary role is to protect the interests of present and future consumers. By fulfilling this role we aim to ensure the electricity and gas markets deliver the best outcomes for consumers. Through our Licence Conditions, our market monitoring activities and our regular market reviews we aim to ensure supply prices comply with the relevant paragraphs in Article 3, namely²⁹⁴:

Clearly comparable prices

- Consumers can compare suppliers' gas prices using a wide range of online switching websites. These sites can tailor quotes based on consumers' individual circumstances. In 2012 Consumer Focus, the consumer advocacy organisation, published a list of over 10 accredited switching websites that consumers can access; and
- Our 2012 updated RMR proposals aim to facilitate consumer engagement and enhance consumers' ability to compare suppliers' tariff terms and prices. For example, we have proposed 'Information Remedies', including a standard Tariff Information Label, to increase the transparency of prices and enable consumers to more easily compare tariffs.

²⁹⁴ Our interpretation of Article 3 is that paragraphs 2 and 3 are of most relevance to supply prices – these Articles are concerned largely with consumer protection in general and vulnerable consumer protection in particular.

Transparent prices

- Ofgem regularly publishes a Factsheet that shows consumers the components of their household gas bill. The Factsheet provides clear information on gas bills and the charges that comprise them; and
- Throughout 2012 we published the SMI, which shows the relationship between wholesale costs, other costs, and gas retail bills.²⁹⁵

Investigations

We have set out in sections 3.1.5 and 4.1.5 the main investigations that we carried out in 2012. Please refer to this section for further details.

4.3 Security of supply

The Department for Energy and Climate Change (DECC) is the competent authority for gas Security of Supply in the UK.

In November 2011, we were asked by the Security of State for Energy and Climate Change to look into whether further action is needed to ensure that medium to long-term gas supplies for consumers remain secure.

In November 2012 we published our report, which showed that whilst the GB gas market is working well in delivering security of supply for consumers and that disruption to gas supplies for consumers is highly unlikely, a number of risks remained. These included increasing dependency on international gas markets at a time of growing global demand and possible tightening of future Liquefied Natural Gas (LNG) supplies which could have consequences for security of supply and energy prices. Also with gas in electricity generation potentially increasing from around 40 per cent today to over 60 per cent by 2020, this impacts on gas and electricity security of supply.

Given these risks we have recommended investigation of the need for, impacts and effects of, various further measures to enhance gas security of supply. Investigation of further measures is being progressed by DECC through a separate process to the Gas Significant Code Review.

²⁹⁵ Ofgem's Electricity and Gas Supply Market Indicators webpage, which has a full archive of the updates, can be found at <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/smr/Pages/indicators.aspx>

5. Consumer protection and dispute settlement in electricity and gas

5.1 Consumer protection

- Article 37(1)(n), (Article 41(1)(o), Article 37(1)(p) and (Article 41(1)(q)

Compliance with Annex 1

Ofgem complies with the provisions of Annex 1 of the Electricity and Gas Directives. The relevant provisions were either already reflected in relevant licences or in domestic legislation or they were incorporated into the relevant licences or into domestic legislation through amendments made by the Electricity and Gas (Internal Markets) Regulations 2011. The majority of the requirements of Annex 1 of the Electricity Directive are either “relevant conditions” or “relevant requirements” for the purposes of the Electricity Act 1989 and the Gas Act 1986, which Ofgem can enforce.

Smart metering

The government’s most recent Impact Assessment²⁹⁶ concluded there would be a positive economic benefit from introducing Smart Metering in Great Britain with an estimated net benefit of £6.7bn. The government has decided to implement the smart meter rollout through regulation and the rollout will be led by energy suppliers. Licence conditions require suppliers to take “all reasonable steps” to ensure that smart metering systems which comply with the Smart Meter Technical Specification (SMETS) are installed in their domestic and smaller non-domestic premises by the end of 2019 and to roll out advanced gas and electricity meters to their larger non-domestic consumers before 6 April 2014.

Ofgem’s role has been to provide independent advice and expertise to the government’s Smart Meter Implementation Programme. We play a key role in monitoring and, where appropriate, enforcing compliance with any new regulatory obligations relating to smart meters to ensure that the interests of consumers remain protected, both during the transition to smart metering and in the enduring framework.

Ofgem has also advised the government during its procurement of the Data Communications Company (the DCC). The DCC will have an important role in providing secure communications between energy suppliers, network operators and authorised third parties on the one hand, and compliant smart metering equipment in domestic and certain non-domestic premises on the other. The DCC will be governed by its licence which will set out its core obligations, restrictions and entitlements. It will also be bound by the Smart

²⁹⁶ Smart meter roll-out for the domestic and small and medium non-domestic sectors (GB), DECC, January 2013: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/78666/IA-Feb.pdf

Energy Code (SEC), which will constitute the DCC's contractual relationship with its users and will enable them to gain access to DCC services. We will monitor the DCC to ensure it abides by its licence conditions and approve any changes to the SEC. We are also responsible for overseeing changes to the regulatory framework to facilitate the DCC's evolving role.

Considerable effort has gone into ensuring the interoperability of meters, both in the meter design and the use of meters by suppliers when a consumer changes supplier. The DCC will centrally manage communication to and from domestic smart meters and will play an important role in ensuring interoperability. We are also supporting the government's development of a technical specification (the Smart Metering Technical Specification, or SMETS) that is intended to ensure that smart metering equipment fitted in the consumer premises is fully interoperable.

In 2012, Ofgem put in place new licence obligations for gas and electricity suppliers designed to support effective switching for customers during the early, voluntary deployment of domestic meters with smart capability. The licence obligations aim to help domestic customers understand if the advanced meter services they are receiving will be maintained when they switch supplier and therefore to facilitate the switching process for customers with these meters.

We provided input to the Smart Metering Installation Code of Practice Interim Steering Group (SISG) throughout 2012. The code developed will deliver consumer protection and engagement measures for consumers having a smart metering system installed for the first time.²⁹⁷

In July 2012, we published a decision document on our Smarter Markets Programme²⁹⁸. This programme aims to proactively identify, and see implemented, market changes – made possible by smart meters – to enable the development of smarter markets, that are more efficient, dynamic and competitive, delivering better outcomes for consumers.

The Smarter Markets Programme also includes a project on consumer empowerment and protection – the 'Consumer Empowerment and Protection' workstream. This workstream is designed to implement regulatory arrangements that protect and empower consumers so that they can participate effectively in smarter retail energy markets, recognising the opportunities and risks involved.

²⁹⁷ The Authority approved the Smart Metering Installation Code of Practice in April 2013.

²⁹⁸ Promoting smarter energy markets: a work programme – <http://www.ofgem.gov.uk/Markets/sm/strategy/Documents1/Promoting%20smarter%20energy%20markets%20-%20a%20work%20programme.pdf>

Ensuring access to consumption data

Ofgem is committed to ensuring consumers have access to consumption data in the gas and electricity markets. We expect suppliers to adhere to guidance on providing this information to their customers, which is enforced through the Licence Conditions.

In 2010-11, we conducted a review of the retail energy market, which looked at both electricity and gas, and examined the effectiveness of competition in the domestic and non-domestic retail markets. We published our revised proposals in October 2012.^{299,300} Our proposals to improve consumer engagement in the domestic retail market included improving bills, annual statements, contract renewal statements and price increase notifications. This improved information will help consumers to easily understand their consumption data and provide prompt access to such data. Following responses to our October 2012 proposals, we issued our final proposals in March 2013. We will be reviewing final consultation responses and developing the next stage of the Retail Market Review process, including implementation, during 2013.

Ofgem has provided regulatory expertise and advice to the UK government's development of the data access and privacy framework. The aim is to provide a clear framework for who can access consumers' consumption data and at what level of granularity. The government is introducing data access and privacy licence conditions, which will come into force in June 2013, into the supply and network company licences. Ofgem will monitor and, where appropriate, enforce these licence conditions.

The Information Commissioner's Office (ICO) has responsibility for promoting data privacy for individuals and taking appropriate action when the law is broken. Ofgem and the ICO are discussing how best to work together to ensure consumers' interests remain protected.

Ofgem has also provided regulatory expertise and advice to the UK government's implementation of the Energy Efficiency Directive (EED). The EED includes provisions which relate to the roll-out of smart meters in Member States and domestic consumers' rights to having easy access to certain consumption data.

The government is currently considering how best to implement the data access elements of the EED requirements. They consulted on a number of options in December 2012, their preferred options being some form of licence obligation on suppliers. Ofgem will monitor and, where appropriate, enforce any licence obligations on suppliers.

Some other major developments in consumer protection in 2012 are outlined below:

²⁹⁹ The Retail Market Review - Updated domestic proposals
<http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Updated%20domestic%20proposals.pdf>

³⁰⁰ The Retail Market Review - Updated proposals for businesses
<http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Updated%20proposals%20for%20businesses.pdf>

Protecting domestic customers

Consumer Vulnerability Strategy

In carrying out our duties we recognise that some consumers need specific consideration because they have particular needs or may be in situations that make them vulnerable. Our statutory duties require us to have regard to those who are either disabled or chronically sick, are of pensionable age, have low incomes, reside in rural areas. However, we are also able to take into account the specific needs of other groups of consumers.

In 2012, we developed proposals for a new Consumer Vulnerability Strategy which aimed to advance our work by recognising the potentially dynamic and multi-dimensional nature of vulnerability.³⁰¹ We proposed that this more sophisticated understanding of the nature of vulnerability would be reflected in our expectations of suppliers and distributors as a matter of best practice.

Monitoring suppliers' social obligations

In 2012, we concluded a review of the social obligations data we collect from domestic suppliers.³⁰² From July 2012, we increased the data we collect on debt and disconnection and started to collect data related to the use of smart meters. This data will help us:

- identify areas for future policy work
- monitor supplier performance and determine if suppliers are complying with their licence conditions (relating to customers who have a disability, a chronic sickness, are of pensionable age, or are on low incomes.)
- identify and assess particular issues of concern with supplier performance.
- encourage best practice through the publication of data

Our latest quarterly and annual reports can be found at our Social Obligations Monitoring webpage.³⁰³

Debt Assignment Protocol Review: the process for prepayment meter customers switching with a debt

The Debt Assignment Protocol is a process by which prepayment customers can switch gas and/or electricity supplier if they are in debt. The process is designed to assist customers with a debt to participate in the competitive market and switch to the cheapest prepayment deal for them.

³⁰¹<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=73&refer=SUSTAINABILITY/SOCACTION>

³⁰²<http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Pages/SocObMonitor.aspx>

³⁰³<http://www.ofgem.gov.uk/Sustainability/SocAction/Monitoring/SoObMonitor/Pages/SocObMonitor.aspx>

In 2012 we reviewed the Debt Assignment Protocol as few customers were using it. Our review showed that there was no single solution to increase the number of Prepayment customers in debt switching supplier. However, suppliers in the Debt Assignment Protocol responded positively to the challenge of getting more Prepayment customers in debt to switch and they agreed to a number of measures to increase awareness and improve the process.

Following our review they also agreed to voluntarily increase the monetary threshold for prepayment customers switching with a debt. They raised it from £200 to £500 to reflect changes to average fuel debt levels since the Debt Assignment Protocol was introduced and to provide some headroom for any future increase in average debt.³⁰⁴

Energy Best Deal

2012 was the fifth year of a very successful partnership with Citizens Advice (a registered charity that provides free and independent advice to consumers) delivering the Energy Best Deal consumer advice campaign, with funding support from energy suppliers. The campaign provides Citizens Advice advisers and other front line advice workers with the right training they need to deliver a package of face-to-face advice to lower income households on their energy rights and how to get the best from their energy deal.

8,473 consumers and 6,105 frontline workers attended Energy Best Deal sessions in 2011-12. An independent evaluation of Energy Best Deal in this period found that:

- Consumers found the session useful and that 36% (of 153 consumers interviewed) had taken action to get a better deal on their energy bills since the session

Frontline workers felt better informed following the session (on average, three months following the session, frontline workers had passed on information from the session to a median of eight clients)

Protecting non-domestic customers

Debt and disconnection

We expect suppliers to treat fairly non-domestic customers who are in payment difficulties and face disconnection. In 2012, we published an open letter setting out suppliers' approaches and our good practice expectations in relation to debt and disconnection.³⁰⁵ We will monitor the number of customers they are disconnecting through regular information from suppliers. If we see evidence that suppliers are not acting in accordance with our expectations we may consider the case for further intervention.

³⁰⁴ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=252&refer=Sustainability/SocAction/Publication>

³⁰⁵ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=6&refer=Sustainability/Cp/Ewbc>

Back-billing

In April 2012, suppliers introduced voluntary standards limiting the time period for which micro business customers can be back-billed to three years in electricity and 4-5 years in gas (where the customer has taken all reasonable steps to avoid receiving a back-bill).

We consider suppliers should move to a time limit of one year, where there is supplier fault and a number of suppliers have committed to do this. We have publicly named those suppliers who have made this commitment and expect to publish further information on the approaches suppliers are taking to back-billing where it serves the interests of consumers.

Protecting domestic and non-domestic customers

Consumer Insight and engagement

In 2012, we commissioned and published a wide range of research and insight to inform our key policy decisions, this put consumer perspectives at the heart of our regulatory processes. In conducting our research we considered the needs of vulnerable groups by recruiting a range of different consumers or commissioning specific pieces of research focussed on vulnerable groups.

We listen to consumers through regular surveys and workshops, and through innovative approaches such as video research and behavioural trials. For example:

- To inform our Retail Market Review we commissioned bespoke qualitative and quantitative research on tariff options, a tracker survey on engagement with the market and an engagement process that brought together both suppliers and consumers to shape the Standards on Conduct
- To inform our work on better communications we commissioned research and worked with a specialist design agency to design, test and develop clearer bills and annual statements
- Our Consumer First Panel consists of 100 everyday domestic customers recruited from six locations across Great Britain (the Panel meets through regular workshops to discuss key issues impacting on their participation in the energy market, as well as other topics related to energy).
- We have set up a Consumer Challenge Group to make sure that the consumer view is being taken into account in network price controls (the Group comprises a small number of consumer experts who act as Ofgem's 'critical friend' and brings additional expertise that we could not address through market research alone)

To incentivise network companies to engage with their stakeholders, as part of the RIIO approach, we have set up an independent panel to judge the quality of network companies' stakeholder engagement. The Panel comprises senior stakeholder experts from other industries and backgrounds. The process includes an initial sift by Ofgem then an assessment by the expert Panel, against agreed criteria. The Panel gives a score out of 10, which then translates into financial reward which can be worth up to several million

pounds. We undertook a dry run of this process (without monetary incentive) for electricity distribution companies in 2012, and will be running it for real in 2013 together with a dry run for gas & transmission networks.

5.2 Dispute settlement

- Article 37(11), 37(5)(c), Article 37(4)(e), Article 41(11) and Article 41(4)(e)

Sections 44B-D of the Electricity Act set out dispute resolution functions under the Electricity Directive. They were amended by the Electricity and Gas (Internal Markets) Regulations 2011. The amended provisions largely mirror the Article 23(5) provisions from the Second Internal Markets Directive (Directives 2003/54/EC) which was implemented by the Gas and Electricity (Dispute Resolution) Regulations 2009. Sections 44B-D of the Electricity Act now reflect the wider range of disputes under Article 37 of the Electricity Directive which can be referred to us.

Any Article 37 dispute that is referred to us for determination is determined by us or, if we think fit, by an arbitrator appointed by us. The determination's decision is binding on the parties to the dispute. However any party can seek a judicial review of our decision.

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

No Article 37 disputes were raised in 2012.

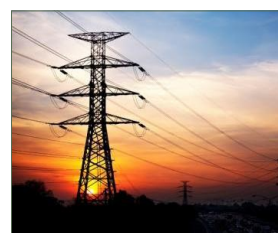
Sections 27B-D of the Gas Act 1986 set out our dispute resolution functions under Article 41(11) and Article 41(4)(e). They were amended by the Electricity and Gas (Internal Markets) Regulations 2011. The amended provisions largely mirror the Article 25 (5) provisions from the Second Internal Markets Directive (Directives 2003/55/EC) which was implemented by the Gas and Electricity (Dispute Resolution) Regulations 2009. Sections 27B-D now reflect the wider range of disputes under Article 41 which can be referred to us.

Any Article 37 dispute that is referred to us for determination is determined by us or, if we think fit, by an arbitrator appointed by us. The determination's decision is binding on the parties to the dispute. However any party can seek a judicial review of our decision.

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

No Article 41 disputes were raised in 2012.

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Foreword

It has been an eventful year for the Utility Regulator as is set out in this report. Our role is always something of a balancing act with the challenge of addressing both short-term and longer term issues. We must strike a balance which both protects today's consumers as well as supporting efficient and necessary investment by the regulated enterprises, that is in the interests of future generations of consumers.

We are all aware that the economic downturn has continued throughout the year. Energy bills are significant for many consumers. Our scrutiny of the regulated enterprises is vital to ensure they continue to deliver essential services but also do so economically and efficiently.

Of course protection of consumers is not just about costs and prices. We have also been in the vanguard of initiatives to promote better quality of services, and where possible, informed and easy choices of energy supplier for consumers.

Benchmarking utilities against their peers both within the UK and Europe provides both us and the utilities with information to test their effectiveness and efficiency.

Network utilities require a high level of skills in asset management to ensure their networks are operated and maintained economically and efficiently for both current and future generations. My experience has convinced me that excellence in asset management is the essential enabler for long-term success in a network utility. As with their peers in the UK there is considerable scope for improvements in this area in the enterprises that we regulate.

We are working with Department of Enterprise, Trade and Investment (DETI) on the potential electricity security of supply issues we all might face in a few years time if the issues cannot be addressed in the interim. We are clear that it is important for consumers that the work on the North-South interconnector is progressed urgently.

Network utilities need to be able to finance their businesses on good terms. We have engaged constructively with the financial community to both improve their understanding of our market and understand their views on investing in our utilities. We are convinced that there is a positive investment climate for supporting the development of utility infrastructure in Northern Ireland. We will continue to play our part by supporting well-evidenced, prudent investment by the

utilities that adds value to the infrastructure in Northern Ireland. Since 2006 we have facilitated over £5 billion of investment in utility infrastructure and will continue to do so (a recent example is our approval of significant investment in the electricity grid to facilitate renewable generation).

Finally, during the last year we said goodbye to four board members who all completed their second term of appointment – my predecessor, Peter Matthews, Clive Elphick, Philip Johnson and Jim Oatridge. I would like to thank them for their considerable contribution to the development of Utility Regulator since the organisation came into being in 2007.

Bill Emery
Chairman

2 Main developments in the gas and electricity markets³⁰⁶

Main conclusions of the report and a general evaluation of market development and regulation.

2.1 Electricity

We published our price control determination for the period 1 January 2013 - 30 September 2017 (called RP5) on 23 October 2012. Our determination followed a public consultation on our proposals, which were published in April 2012. A separate public consultation was also conducted on an element of the final price control, relating to NIE Transmission and Distribution (NIE T&D) capitalisation practice. The final determination included a decision on the NIE T&D capitalisation practice. NIE T&D rejected our determination in November 2012 and preparations were being advanced for a reference to the Competition Commission in 2013.

The Single Electricity Market (SEM) continues to deliver benefits to consumers. The SEM ensures that the price of electricity charged to consumers is reflective of the costs incurred by the generators to actually produce the electricity. Further development of new generation on the island of Ireland has increased investment and competition in the wholesale market.

The Market Monitoring Unit (MMU), which is based at our offices, has continued to monitor the SEM over the past year. The MMU engaged with generators and operators to monitor compliance with the market rules.

The Third Internal Energy Market Package (IME3) has continued to promote the liberalisation of the energy market across the European Union (EU). IME3 requires the separation of the transmission network from generation and supply (this is called unbundling). IME3 specifies several unbundling options to ensure

³⁰⁶ This report covers developments during the period from January 2012 to December 2012. Where data for the is provided 2012 is the appropriate reference year.

separation of the transmission network from generation and supply.

We are required to certify transmission system operators as being in compliance with the full ownership unbundling requirements or one of the alternative unbundling models set out in IME3.

During the past year, applications for certification have been received from NIE T&D and ESB (on behalf of Eirgrid). The regulatory authorities (the Commission for Energy Regulation – CER and us) evaluated these applications and issued a preliminary decision to the European Commission (EC) in February 2013. The preliminary decision recommended qualified approval for the current Transmission System Operator (TSO) arrangements on the island of Ireland. The EC has two months to consider its decision on the applications. We are also considering an application for certification from Moyle Interconnectors Limited.

Further progress has been made to ensure that our electricity market is compatible with the European Target Model. The SEM will require significant modifications to implement the Target Model. The magnitude of change required for the SEM to achieve this is considerably greater than most other markets in Europe. This is due to its centralised, gross mandatory pool design which differs in a number of key respects from the prevailing market design in most other European Member States.

The first key deliverable is the implementation of cross border electricity trading in all European electricity markets by 2014. For the island of Ireland this will be 2016 (given the greater changes required to the market). This will be a legal requirement on Member States.

The next stage in the project is a consultation and subsequent decision on the proposed High Level Design which will be progressed throughout 2013-14.

A medium term review of the Capacity Payment Mechanism (CPM) was completed in March 2012. The review was aimed at incentivising the availability of both existing generation and new investment in capacity when it is required. The decision for the capacity value for 2013 was published in August 2012. Further to this, the SEM Committee has indicated that no major changes to the CPM are proposed in the medium term in light of the regional integration project.

Work has commenced on setting the CPM for 2014.

2.2 Gas

In 2012 the rollout of the gas distribution network in NI continued across both distribution areas with 154,000 now connected in the Greater Belfast distribution area and 17,000 now connected in the ten towns distribution area. The sale of PSL(Phoenix Supply Ltd) to AGS (Airtricity Gas Supply) in June 2012 resulted in unbundling of the gas supply company from the gas distribution company (Phoenix Natural Gas Ltd) in the Greater Belfast distribution area.

New regulations put in place in NI in order to implement the IME3 Directive will improve consumer protection for gas consumers. The regulations allowed licence conditions to be made which requires Codes of practice to be developed by both the supply and distribution companies.

The gas market in the ten towns distribution area opened to competition in October 2012 for customers with a usage of > 25,000 therms per annum. This required the development of a distribution network code and a Supplier Meter Point agreement to facilitate customer switching. One supplier entered the market to compete with the incumbent. Gas supply licences in NI were amended to facilitate supply in both distribution areas.

A referral was made to the Competition Commission by Phoenix Natural Gas Ltd (PNGL) on their distribution price control. The Competition Commission's Inquiry ended on the 30 November 2012, and the decision was published on the 19 December 2012.

Natural gas is not available in much of the west of Northern Ireland but the Department of Enterprise, Trade and Investment in NI recently consulted on the possibility of extending the network. As a consequence work is ongoing to consider a number of issues related to extending the natural gas network to the west of Northern Ireland.

We are continuing to progress arrangements for harmonising gas transmission



2013 Great Britain and Northern Ireland National Reports to the European Commission

systems across the island of Ireland, we work closely with Commission for Energy Regulation (Ireland) on the project.

3 The electricity market

3.1 Network regulation

3.1.1 Unbundling

Report on TSO certification, DSO provisions regarding branding and resources and new developments regarding certification revisions

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

NIE (the transmission owner) applied for certification under Directive 2009/72/EC on 30 January 2012 on the grounds of Article 9(9) of the Directive being at the date of the test, 3 September 2009, a company within a vertically integrated undertaking as part of the Viridian Group with power procurement and supply interests in Northern Ireland and generation interests in the Republic of Ireland. By the date of application NIE ownership had been acquired by ESB which had extensive generation and supply interests in the SEM. The SEM Committee (SEMC), which had determined that TSO certification was a SEM matter, issued its preliminary decision to the EC on 12 February 2012 recommending certification subject to certain qualification measures including transfer of the transmission planning function from NIE to System Operator Northern Ireland (SONI). The EC made a decision to approve the certification of SONI subject to the qualification measures in the SEM Committee preliminary decision and to some additional measures.

Moyle Interconnector Limited, which owns the electricity interconnector between Northern Ireland and Scotland, applied for certification on the grounds of ownership unbundling on 25 January 2013. The SEM Committee issued a preliminary decision to the EC on 7 May 2013 recommending certification subject to certain qualification measures. The EC has two months to make a final decision on the application which may be extended should it seek advice from ACER.

3.1.2 Technical functioning

- Balancing services (Article 37(6)(b), Article 37(8))
- Security and reliability standards, quality of service and supply (Article 37(1)(h),)

Report relevant security and reliability regulation and data

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

Clarify here at least if there is in your country a definition for “time to connect” for consumers and for producers

- Monitoring safeguard measures (Article 37(1)(t))
- RES regulatory framework: Report on connection, access and dispatching regimes for RES-E, in particular on priority issues. Report also on the balancing responsibility for RES-E. (Article 11 Regulation (EC) 713/2009)

The wholesale electricity market in Ireland (SEM) is a gross mandatory pool, with energy prices set Ex-Post. Balancing services are paid for through imperfections charges, constraint payments and make whole payments. These are pass-through costs; generators recover their short-run marginal costs. SONI is obliged under its licence to take into account the quantity, nature and cost when purchasing System Support Services.

Monitoring of security and reliability standards, time taken to connect and repair and safeguard measures are currently conducted through licence compliance. Transmission licences are held by NIE, Moyle and SONI.

The loss of load expectations statistic is used by SONI as a security standard, which is concerned with the likely number of hours of shortage in a year. The security standard for NI is 4.9 hours per annum and if this standard is exceeded it indicates a higher than acceptable level of risk.

The System Operator, SONI, annually publishes the Generation Adequacy

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

3.1.3 Network tariffs for connection and access

- Article 37(1)(a), Article 37(6)(a), Article 37(8), Article 37(10), Article 37(12) , art 37(3)(c) and (d)

Report on relevant new tariff regulation provisions

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

Specify the methodology used in tariff regulation (i.e. cost plus vs incentive regulation), the method of checking undertaking's cost data, methodology for allocation of costs to grid users and if benchmarking is used please describe methodology used by NRA

Electricity Suppliers in Northern Ireland pay a number of regulated charges which they in turn must pass on to their customers. Regulated charges for the use of the electricity distribution network in Northern Ireland and a levy known as the Public Service Obligation (PSO) are set by NIE and SONI, and the maximum amount recoverable is approved by the Utility Regulator. The "Regulated Tariffs Values" for the tariff year beginning October 2012 was published by the Utility Regulator on 23 Aug 2012, detailing the use of system tariffs for that year.

The transmission network owner in NI is NIE plc. NIE is also the distribution system owner and operator. It has a 5 year price control running from 2007 to 2012. NIE is allowed revenue and therefore annual Distribution Use of System tariffs (DUoS) are determined by the terms of this price control. It also receives a Use of System allowance (UoS) from the TSO. The allowed Capital Expenditure (CAPEX) is limited (mainly statutory maintenance etc.) with exceptional items

individually approved by the regulator. During 2009 work began on RP5, the fifth price control for NIE plc, to run from 2012. This will be the most challenging price control yet as it is set in the context of large planned expansions to the transmission and distribution system to facilitate renewable generation. NIE did not accept the Utility Regulators Final Determination for RP5 or the associated licence modifications. Following the statutory process for situations like this, we have referred the price control to the Competition Commission. The Competition Commission is due to publish its draft determination in September 2013.

Under NIE T&D's licence obligations it is required to ensure that no Separate Business gives any cross-subsidy to, or receives any cross-subsidy from, any other business of the Licensee or of an affiliate or related undertaking of the Licensee (whether or not a Separate Business).

3.1.4 Cross-border issues

- Access to cross-border infrastructure, including the procedures for the allocation of capacity and congestion management (Article 37(6)(c), Article 37(8), Article 37(9), use of revenues for interconnectors (article 37(3)(f))

Report in particular on cases where specific cross-border cooperation between NRAs happened besides the general activity of the NRA in the frame of ACER/FG

- Monitoring technical co-operation between Community and third-country TSOs (Article 37(1)(s))
- Monitor TSO investment plans in view of TYNDP art 37(1)(g)
- Cooperation (Article 37(1)(c))

Other relevant cooperation agreements/activities of the NRA besides the RI

The Moyle Interconnector between Scotland and Northern Ireland lies within a Member State and has not previously been regarded as an interconnector for the purposes of the Electricity Directive. Nonetheless, Moyle has aimed to comply

with the requirements of the directive regarding congestion management.

During 2011 an electronic Auction Management Platform (AMP) was developed which will support weekly, daily or even shorter auctions. This was delivered in October 2011 and scheduled to coincide with the entry of a second interconnector between Ireland and GB (known as the East – West Interconnector) developed by Eirgrid, the TSO for Ireland. Products traded on the AMP include: Daily, Monthly, Annual, Seasonal and 2-3 year products.

The Interconnector Owners are required to prepare relevant access arrangements in respect of the Interconnector. The purpose of these rules is to set out the auction mechanism including how Participants can make an offer to acquire capacity units, together with the requirements on the Interconnector owner in terms of accepting an offer for capacity units from a participant. The access rules also address other areas including the curtailment approach should capacity become unavailable due to an outage.

Moyle Interconnector access rules are approved annually by both Utility Regulator and Ofgem with input from the Regulator in Ireland regarding the East West Interconnector.

The export and import capacity of Moyle has been limited due to a number of technical faults. A fault on one line of Moyle occurred between 24 August 2011 and 19 February 2012 this fault had reduced export and import capacity to 250MW, a second fault has since occurred on the second line beginning on 23 June 2012, this fault has not been resolved, resulting in a reduced export and import capacity of 250MW.

The SEM is a day ahead gross mandatory pool previously no trading could occur after 10.00hrs on the day before actual trading day (D-1). Intra-day trading was implemented in the SEM on 21 July 2012. This allows generators to submit amended bids

3.1.5 Compliance

- Compliance of regulatory authorities with binding decisions of the Agency and the Commission (Article 37(1)(d)) and with the

Guidelines (Article 39))

Which decisions/actions have been taken following binding decisions of the Agency or the Commission.

- Compliance of transmission and distribution companies, system owners and electricity undertakings with relevant Community legislation, including cross-border issues (Article 37(1)(b), Article 37(1)(q), Article 37(3)(a),(b),(e) and Article 37(5) all but (a) and (c) + imposing penalties (Article 37(4)(d))

Report in particular on monitoring systems for TSO certification compliance and in the next future NC compliance. Report on other compliance cases and existing active monitoring methods

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

3.2 Promoting Competition

3.2.1 Wholesale markets

Please provide a brief illustration of the state of competition of wholesale market and the main changes in the recent year

The all-island Single Electricity Market is the combination of two separate jurisdictional electricity markets in Ireland and Northern Ireland and is governed by the SEMC. The SEMC consists of the Commission for Energy Regulation in Ireland, the Utility Regulator in Northern Ireland and an independent member. A SEM Annual report is published every year highlighting the developments in various work streams. The report can be found on <http://www.allislandproject.org>

2012 was the fifth full year of operation of the Single Electricity Market (SEM) – it commenced operation on 1 November 2007. The SEM is a gross mandatory pool with gate closure at 10.00 hrs day ahead. The ex post market schedule sets the half hourly system marginal price and allocates infra marginal rent to those included in the schedule. Capacity payments are made to all available generators based on an annually calculated capacity pot. Regulated directed contracts and

also non directed contracts provide hedging for market participants. The market is operated by SEMO – the Single Electricity Market Operator which is a joint venture between the system operators in NI and Ireland.

Further interconnection between Ireland and GB is planned however the very different market arrangements currently limit the extent of trading between BETTA and the SEM. 2012 also saw the introduction of intra-day trading, and the East-West Interconnector between Ireland and GB (500MW DC interconnector).

3.2.1.1 Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition

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

Report separately the three issues: prices, transparency and effectiveness of competition. In particular regarding prices report on fundamentals, price developments and liquidity. Regarding transparency report on the access to prices and on how robust prices are and if at national level transparency obligations regarding pricing exist.

Price

The Market Monitoring Unit (MMU) forms part of a Market Power Mitigation strategy developed by the RAs during 2006. The MMU reviews the behaviour in the market on an ex-post basis. This includes investigating the exercise of market power and monitoring the compliance of market participants with their licence obligations in relation to participation in the market.

The MMU continuously reviews generator participants' behaviour in the market, including investigations into the exercise of market power, and monitoring the compliance of market participants with the bidding code of practice and other market rules. The MMU is also the point of contact for participants who wish to register complaints relating to market behaviour.

Transparency

The Market Operator for the SEM (SEMO) publishes all commercial and technical

data relating to bids for any trading day.³⁰⁷ This information is published 4 days after the trading day, and also includes all relevant price information for each half hour period.

Effectiveness of competition

The SEM Committee publishes an annual report providing an overview of the market structure and developments in the market over the previous year. The report for 2012 is due for publication in August 2013.

On 2 May 2012, the Regulatory Authorities (RAs) published a decision paper on the collection and publication of information regarding generators' financial performance. The paper sets out the financial reporting template to be completed by generation companies with a combined capacity greater than or equal to 25 MW. It also commits the RAs to publishing an annual report on generation financial performance in SEM, aggregated to preserve commercially sensitive information.

The first report on financial performance was published on 23 May 2013, the Regulatory Authorities (RAs) publish a report on the financial performance of generation companies operating the SEM, with a view to improving transparency. This covers the financial year from April 2011 to March 2012³⁰⁸.

3.2.2 Retail market

Please provide a brief illustration of the state of competition of retail market and the main changes in the recent year

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

³⁰⁷ <http://www.sem-o.com>

³⁰⁸ Report on Generator Financial Performance in the SEM - <http://www.allislandproject.org/GetAttachment.aspx?id=4182743c-f87f-4b26-a80f-b07a3706143a>

market in 2007.

Domestic competition effectively started in June 2010 in the electricity market. Since then, more suppliers have been attracted to the Northern Ireland market. By December 2012, there were 8 active suppliers in the electricity sector, 5 of them operating in both, domestic and industrial sectors.

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

The Utility Regulator's annual *Energy Retail Report*³⁰⁹ provides relevant information relating to the state of evolution of the retail market in Northern Ireland, along with background information. Section two of the report relates specifically to the retail market.

The *Quarterly Transparency Reports*³¹⁰ provide quarterly information on a specific set of data for the energy sectors.

Over 2012 the market share of the incumbent supplier in the domestic sector has continued to decrease (from 87% customer numbers in the domestic credit sector and 94% of prepayment in Dec 2011, to 80% and 76% respectively in Dec 2012).

Competition is more mature in the non-domestic market. By the end of 2012, the share of the non-incumbent suppliers in the non-domestic sector was around 84% of the volume supplied to this sector.

Also, the level of switching activity has increased significantly after the implementation of the switching enduring solution. This project allowed unlimited switching from May 2012, so the number of domestic switches in the domestic

309

http://www.uregni.gov.uk/publications/view/utility_regulators_annual_energy_retail_report_s/

310

http://www.uregni.gov.uk/publications/view/utility_regulator_publishes_retail_energy_market_monitoring_report/

sector along 2012 was 103,177, compared to 62,007 domestic switches in 2011.

3.2.2.1 Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition

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

Report separately the three issues: prices, transparency and effectiveness of competition. In particular regarding prices report on fundamentals, price developments and liquidity. Regarding transparency report on the access to prices and on how robust prices are and if at national level transparency obligations regarding pricing exist. Please report here separately dual fuel prices

In the monitoring of the energy retail market, the indicators we are quarterly informing about are: market shares, active suppliers in each market segment, market activity per market segment, rates of switching, domestic prices in Northern Ireland and a price comparison with other EU countries. Future work in terms of collecting and assessing further retail information will be included into this series of reports.

Northern Ireland electricity domestic price for medium customers – using the tariff applying from October 2012 for an average customer consuming 3,300 kWh per annum – is close to the median of the EU countries in the band of 2,500-4,999 kWh.

The customer complaints procedure in Northern Ireland is detailed on our website: http://www.uregni.gov.uk/customer_information. In the first instance customers are asked to resolve any difficulty with their supplier. All domestic suppliers are required by licence to have a Code of Practice on complaint handling detailing a transparent, simple and inexpensive procedure to facilitate the fair and prompt settlement of complaints and disputes as well as a system for reimbursing or compensating complainants. They are also required under the licence to inform customers of the role and contact details of the Consumer Council Northern

Ireland (CCNI)³¹¹ both in contracts and on bills.

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

The Utility Regulator deals directly with complaints and disputes, with regard to the transmission and distribution operator. Details of our process are given on our website

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

With regard to complaints, IME3 has been implemented and all suppliers are fully compliant with the Code of Practice on Complaints Handling. The Utility Regulator continues to work with suppliers on their Codes of Practice to ensure provision of an accessible, equitable and transparent, simple and inexpensive complaints procedure.

- Article 37(1)(k)

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

- Article 37(1)(l)

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

³¹¹ Consumer Council for Northern Ireland <http://www.consumercouncil.org.uk/>

3.2.2.2 Recommendations on supply prices, investigations and measures to promote effective competition

- Article 37(1)(o)

Report on recommendations at national level on supply prices and competition

Describe system of regulated prices (if they exist)

- Article 37(4)(b)

Report on investigations carried out, main results and possible measures adopted

Report on tariff deficit if it exists

Electricity supply licensees require transparency of customers' terms and conditions, including price. These conditions apply to all licensees and are legally binding. Electricity customers are guaranteed the right to be supplied under fair and transparent terms. They cannot be discriminated in terms of price and the regulatory framework includes legally binding supplier of last resort provisions.

The Utility Regulator has the powers necessary to investigate and enforce effective competition and the functioning of the retail market. We regularly request information to the network and supply companies, and monitor the received data.

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

The new system called the Enduring Solution (ES) went live on 21 May 2012, after a successful three year project. Following this, in September of 2012 we saw the creation of a harmonised market schema for both Northern Ireland and the Republic of Ireland. The all island schema was developed by industry after

direction from the Utility Regulator and the Commission for Energy Regulation (CER). The schema will remove the need for suppliers operating in both jurisdictions to have separate systems and processes and will reduce costs.

3.3 Security of supply (if and insofar as NRA is competent authority)

Implementation of safeguard measures Art. 42

The Fuel Security Code is designed as a Northern Ireland response to a Fuel Security Event. The Fuel Security Code currently in force in Northern Ireland under the Electricity (Northern Ireland) Order 1992 as amended (the 1992 Order) was drafted in 1992 (the 1992 Code) by the then Department of Economic Development, now Department of Enterprise, Trade & Investment (the Department) following the privatisation of Northern Ireland Electricity.

The objectives of the Fuel Security Code are to assist with the effective management of an event where primary fuel supplies for electricity generation are disrupted: a Fuel Security Event.

The Code enables Government to direct the electricity industry to provide information on power supplies and to take specific action to manage such disruption in a way to ensure as far as is reasonably practical.

3.3.1 Monitoring balance of supply and demand

- Article 4

SONI prepare an annual Generation Capacity Statement which covers both demand predictions and the generation margins. The latest statement published in December 2012 shows:

- Current level of electricity peak demand is 1843 MW³¹². This has been

³¹² Observed generation, excludes house load.

forecasted to reach 2043 MW³¹³ by 2021. This forecasted peak is a decrease on previous estimates³¹⁴;

- The large reduction in demand forecasts in NI and Ireland has led to a significant increase in generation adequacy, although a number of conventional plant are due to be decommissioned by 2016 due to environmental constraints (loss of 510MW of capacity);
- During the period 2013 to 2022 there is sufficient generation capacity to achieve compliance with the generation security standard. The report sets out that 2019 is likely to be the year Northern Ireland has the least surplus generation (circa 178MW) mainly due to reasons set out above. This is based on the assumption that forecasts of demand, generation capacity and availability are achieved. It also relies on imports from GB and a reliance on generation in RoI. There remains however a risk of operational scenarios that could result in load shedding due to a generation capacity shortfall as generators unit sizes are large and there is a dependency on imports;
- The current available total fossil fuel net generating capacity is 2321 MW. This figure excludes available capacity via imports on interconnector and tie lines. There is also 429 MW of Partially dispatchable or non dispatchable generation capacity (including 405MW of Wind) installed on the NI system;
- Imports of 250 MW from GB and 100 MW from Ireland are expected to be available to support security of supply.

The most significant transmission project in NI is the second North-South interconnector. Preparatory work is ongoing for this; however the project is encountering significant opposition from residents along the route. Some delays are now expected due to other planning issues that have arisen in the Republic of

³¹³ Total Energy Requirement

³¹⁴ Further information available at:

http://www.soni.ltd.uk/media/documents/Operations/CapacityStatements/All-Island_Generator_Capacity_Statement_2013-2022.pdf

Ireland. Another project is the East – West Interconnector, a 500 MW capacity transmission line linking Britain’s power system to Ireland’s electricity grid, began testing in October 2012. To view SONI’s most recent Generation Adequacy Report (2012) see: <http://www.soni.ltd.uk/upload/All-Island%20GCS%202012-2021.pdf>

3.3.2 Monitoring investment in generation capacities in relation to SoS

- Article 37(1)(r)

Operational network security

- Article 7 2005/89/EC

Investment in interconnection capacity for the next 5 yrs or more

- Article 7 2005/89/EC

Expected future demand and envisaged capacity for the next 5 years and 5-15 years

Article 7 2005/89/EC

In addition to the Generation Capacity Statement SONI are required by licence to publish an annual “Transmission System Capacity Statement” this details the statutory operational requirements, the existing network, its configuration and its planned development over the seven year period to 2018³¹⁵.

3.3.3 Measures to cover peak demand or shortfalls of suppliers

- Article 4

The Transmission System Capacity Statement analyses the potential for the system to meet peak demand.

³¹⁵ <http://www.eirgrid.com/aboutus/publications/transmissionforecaststatement2012-2018/>

4 The gas market

4.1 Network regulation

4.1.1 Unbundling

- Articles 10,11 2009/73/EC Article 3 Regulation (EC) 715/2009
- Article 26

Report on TSO certification, DSO provisions regarding branding and resources and new developments regarding certification revisions. Report also on storage and LNG

NI has two DSOs. At the start of 2012 both of these DSOs had supply businesses. Phoenix Supply Ltd. – the supply business of the DSO for the Greater Belfast area - was purchased by Airtricity Energy Supply (Northern Ireland) Limited and from 22 June 2012. PSL has been renamed Airtricity Gas Supply (Northern Ireland) Limited (**Airtricity**). As before the other DSO does not have, and does not expect to ever have, more than 100,000 customers. It remains an integrated D&S business.

The arrangements for unbundling at the transmission level are being examined as necessary as part of the certification process required under the third energy package.

The Utility Regulator received an application from BGE(UK) to be certified as an Independent Transmission Operator (ITO) on 4th July 2012 under article 10 of Directive 2009/73/EC. The Utility Regulator is considering the application in conjunction with Ofgem and the CER who received similar applications in respect of BGE(UK) and BGE.

The Utility Regulator received applications from PTL and BGTL on 27th November 2012 for certification as fully ownership unbundled (FOU) entities under article 10 of Directive 2009/73/EC. The certification process for PTL and BGTL will be completed in 2013 within the timescales allowed by the Gas Directive.

4.1.2 Technical functioning

- Balancing services (Article 41(6)(b), Article 41(8))
- Security and reliability standards, quality of service and supply (Article 41(1)(h))

Report relevant security and reliability regulation and data

- Monitoring time taken to connect and repair (Article 41(1)(m))

Clarify here at least if there is in your country a definition for “time to connect” for consumers and for producers

- Monitoring access to storage, linepack and other ancillary services (Article 41(1)(n))
- Monitoring correct application of criteria that determine model of access to storage (Article 41(1)(s))
- Monitoring safeguard measures (Article 41(1)(t))

NI currently has no gas storage facilities. However there is significant interest from a development consortium in constructing a salt cavity gas storage facility in the Larne Lough area of Northern Ireland. The developer was granted a gas storage licence by the Utility Regulator in October 2012. The licence contains the 3rd party access regime for the proposed facility which is in line with European requirements.

4.1.3 Network and LNG tariffs for connection and access

- Article 41(1)(a), Article 41(6)(a), Article 41(8), Article 41(10) and Article 41(12)

Report on relevant new tariff regulation provisions

- Prevention of cross-subsidies (Article 41(1)(f))

Specify the methodology used in tariff regulation (i.e. cost plus vs incentive regulation), the method of checking undertaking's cost data and if benchmarking is used please describe methodology used by NRA

- Regulated and negotiated access to storage 41(1)(s)

Report on the decisions adopted by MS

Distribution

In NI for gas distribution the entry exit tariff model is applied. Information is collected in relation to volumes, revenues and costs, split across relevant customer categories, which are then used to calculate appropriate tariffs. A combination of incentive-based regulation, along with performance based outputs is implemented for distribution companies. The standard RPI-X price control is applied, alongside a performance based system, which is retrospectively adjusted based on actual performance, with incentives included to encourage efficiency and network growth. The standard duration of revenue or price caps is usually 5 years. A co-ordinated period is being established for the two distribution companies operating in Northern Ireland (Phoenix Natural Gas Ltd and Firmus Ltd), to provide a more transparent benchmarking process.

The distribution system operator proposes the tariff structure; the Regulator reviews and approves the structure, and then monitors execution. In terms of the regulatory period the distribution system operators have licences extending 30 to 40 years. In terms of investment incentives, a higher RoR for the DSO is fixed until 2016 to encourage investment. Distribution system operators provide information on tariffs, connection charges, to market participants etc. and this information is available on the website of the individual distribution system operators.

Regulations for guaranteed standards of service measures which have to be

upheld by the distribution licence holders have been drafted and consulted on. The Department of Enterprise Trade and Investment (DETI) are reviewing the draft regulations prior to implementation.

In terms of access to the grid in Northern Ireland there have been no cases of refusal of access to the grid, for instance because of insufficient capacity.

Transmission

At the transmission level, tariff methodology is set by the regulator and tariff setting is overseen on an annual basis. The transmission tariffs are calculated by collecting forecast volumes, capacity bookings and revenue requirements from the power and distribution sectors at the beginning of the gas year. The individual submissions are then totalled and capacity and commodity tariffs are calculated for all sectors. A reconciliation process is applied at the end of the year when actual volumes, capacity and revenues are known.

The TSOs are also price controlled in Northern Ireland. The regulatory approach to the price control depends upon the financing model under which the TSO operates.

To improve the rate at which certain pipelines are financed, the Northern Ireland Authority for Utility Regulation has employed a model where the normal regulatory control over any allowed operational expenditure accrued by the TSO has been removed. The resulting transfer of risk onto consumers, through potential inefficient operating costs, can be limited through corporate governance licence conditions contained within the conveyance licence held by the TSO. One of which is a condition that, in the form of a shadow price control, allows the Utility Regulator to review the level of operating expenditure forecast to be incurred by the TSO.

Where a more standard regulatory model is used, a 'pain-gain' mechanism is applied at the transmission level where TSOs can share in any capex efficiencies gained.

On 29 June 2012 the Utility Regulator published its decision in relation to the tariff arrangements for short term daily and Virtual Reverse Flow (VRF) products in NI

which sets out the short term capacity multipliers and the annual charge per exit point registration and/or per each extension of an existing exit point registration for VRF.

LNG

We have no LNG in NI.

4.1.4 Cross-border issues

- Access to cross-border infrastructure including allocation and congestion management (Article 41(6)(c), Article 41(8), Article 41(9), Article 41(10) and Article 41(12))

Report in particular on cases where specific cross-border cooperation between NRAs happened besides the general activity of the NRA in the frame of ACER/FG. Provide case study/data on standard contracts t.b.d by ACER (i.e. average cost/conditions of importing/exporting 1 MW). Only provide text explanations in the National Report as data are included in the data base.

- Cooperation (Article 41(1)(c))

Other relevant cooperation agreements/activities of the NRA besides the RI

- Monitoring investment plans and assessment of consistency with Community-wide network development plan Article 41(1)(g)

The Utility Regulator and Commission for Energy Regulation (CER) have been involved in joint regulatory work in the context of EU network codes, Capacity Allocation Mechanism (CAM), tariffs, and balancing in compliance with Gas Regulation (EC) No 715/2009.

4.1.5 Compliance

- Compliance of regulatory authorities with binding decisions of the Agency and the Commission (Article 41(1)(d)) and with the Guidelines (Article 43)

Which decisions/actions have been taken following binding decisions of the Agency or the Commission

- Compliance of transmission and distribution companies, system owners and natural gas undertakings with relevant Community legislation, including cross-border issues (Article 41(1)(b), Article 41(1)(r), Article 41 (3) and Article 41(5)) + imposing penalties (Article 41(4)(d))

Report in particular on monitoring systems for TSO certification compliance and in the next future NC compliance. Report on other compliance cases and existing active monitoring methods

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

4.2 Promoting Competition

4.2.1 Wholesale markets

Please provide a brief illustration of the state of competition of wholesale market and the main changes in the recent year

All gas for NI is purchased at the UK NBP.

4.2.2.1 Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition

- Article 41(1)(i) , (j), (k) (l) (u) and Article 44(3)

Report separately the three issues: prices, transparency and effectiveness of competition. In particular regarding prices report on fundamentals, price developments and liquidity. Regarding transparency report on the access to prices and on how robust

prices are and if at national level transparency obligations regarding pricing exist.

As above all gas for NI is purchased at the UK NBP.

4.2.2 Retail market

Please provide a brief illustration of the state of competition of retail market and the main changes in the recent year

1. The gas market in the Greater Belfast area has been open to competition to domestic customers since 2007. However, there were no competing suppliers in the domestic market until 2010. In this distribution licensed area there are currently four active gas suppliers in the non-domestic sector: Airtricity Gas Supply (AGS, previously Phoenix Supply Limited, PSL until mid 2012, when it was purchased by AGS), firmus energy, Energia and VAYU. AGS is subject to a price control over the domestic sector and small I&C (industrial and commercial) customers who consume less than 25,000 therms per annum. A maximum average tariff is employed in this sector for customers of AGS. Other suppliers are free to compete against this maximum average tariff.

2. The ten towns gas area opened to competition for large I&C (industrial and commercial) customers in October 2012. AGS have entered this market to compete against the incumbent firmus energy. The domestic and small I&C segments < 25,000 therms per annum still remains supplied exclusively by one incumbent company (firmus energy), and is due to open to competition in April 2015. There is an incentive in the distribution price control on firmus energy to price competitively to acquire customers in the < 25,000 therms per annum sector (ie small I&C and domestic customers).

4.2.2.1 Monitoring the level of prices, the level of transparency, the level and effectiveness of market opening and competition

- Article 41(1)(i),(j) (k), (l) (u) and Article 44 (3)

Report separately the three issues: prices, transparency and effectiveness of competition. In particular regarding prices report on fundamentals, price developments and liquidity. Regarding

transparency report on the access to prices and on how robust prices are and if at national level transparency obligations regarding pricing exist. Make reference to dual fuel if necessary.

Airtricity Gas Supply (Northern Ireland) Limited (previously Phoenix Supply Ltd) have a regulated tariff for domestic and industrial and commercial customers using less than 25,000 therms per annum. The Utility Regulator enters into a formal tariff review process with Airtricity twice per year with a view to tariff changes being effective from 1st April and 1st October each year. The Utility Regulator also monitors gas prices on an ongoing basis and an ad-hoc tariff reviews for Airtricity may be initiated at any stage if the Utility Regulator considers that gas prices have increased or decreased enough to warrant a tariff review.

The Utility Regulator monitors the Airtricity regulated tariff against the tariffs of other supply companies in NI, the UK and ROI. The Utility Regulator published transparency reports every quarter which provides comparisons of the gas tariffs in NI, UK and ROI:

http://www.uregni.gov.uk/uploads/publications/ERR_2012.pdf

The Utility Regulator also reviews the Airtricity gas purchasing strategy each year and also receives monthly gas purchasing reports from Airtricity showing the volumes and cost of gas purchased each month for the short and long term future.

Supply companies have a licence obligation to inform customers in advance of any increase in the tariff.

4.2.3 Recommendations on supply prices, investigations and measures to promote effective competition

- Article 41(1)(p)

Report on recommendations at national level on supply prices and competition

- Article 41(4)(b)

Report on main investigations, results and possible measures adopted

Report on tariff deficit if it exists

In the Greater Belfast gas market Airtricity Energy Supply (Northern Ireland) Limited (previously Phoenix Supply Ltd) is price regulated for customers using less than 25,000 therms per annum. A price control is determined and published for Airtricity which sets out a procedure which Airtricity must comply with in setting tariffs. The price control also sets out a level of operating expenditure for the company for each year of the control.

4.3 Security of supply (Article 5) (if and insofar as NRA is competent authority)

The Department of Energy and Climate Change (DECC) is the designated Competent Authority with respect to the security of supply for the UK Member State (as notified to the Commission under Regulation 994). As such a number of the requirements of Article 5 of Directive 2009/73/EC are carried out by DECC. However the Utility Regulator does contribute to some of the elements identified below.

4.3.1 Monitoring balance of supply and demand

100% of Northern Ireland gas supplies are currently provided from Great Britain via the National Transmission System Exit Point at Moffat. As such the wider monitoring of UK demand and supply is largely carried out by DECC and National Grid. However the Transmission System Operators in Northern Ireland and the Republic of Ireland regularly engage with National Grid on demand and supply issues downstream of Moffat.

There are also a number of government and TSO groups that have been established between the UK and Ireland to facilitate communication on emergencies and security of supply.

4.3.2 Expected future demand and available supplies as well as envisaged additional capacity

| Forecast Total Volumes (bcm) | | | | | | | | | |
|------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| 2012/2013 | 2013/2014 | 2014/2015 | 2015/2016 | 2016/2017 | 2017/2018 | 2018/2019 | 2019/2020 | 2020/2021 | 2021/2022 |
| 1.469 | 1.488 | 1.503 | 1.517 | 1.529 | 1.541 | 1.553 | 1.565 | 1.582 | 1.582 |

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

The Utility Regulator and the Commission for Energy Regulation annually produce a Joint Gas Capacity Statement (JGCS) which examines the capacity of the existing gas network to meet future supply and demand scenarios over a ten year period. This approach ensures that any areas requiring investment are identified and addressed so that future demands on the system can be met. The 2012 JGCS is published on the Utility Regulator website:

http://www.uregni.gov.uk/publications/joint_gas_capacity_statement_2012

4.3.3 Measures to cover peak demand or shortfalls of suppliers

- Art 41(1)(t): implementation of safeguard measures

The transmission companies in Northern Ireland have emergency arrangements in place to deal with either a physical disruption to the network or a restriction in

gas supplies. The arrangements are a legal requirement and are contained within each TSO's Safety Case. The safety case outlines the emergency stages and the actions that are to be undertaken at each stage.

Additionally power stations are required to hold reserves of alternative fuels to enable fuel switching in the event of a restriction to gas supplies. The emergency measures are tested annually alongside the Republic of Ireland and Great Britain exercises.

Supply licenses in NI also require that suppliers have access to gas supplies to meet peak demand during severe winter conditions.

5 Consumer protection and dispute settlement in electricity and gas

5.1 Consumer protection

- Compliance with Annex 1 (Article 37(1)(n)) and (Article 41(1)(o))
- Ensuring access to consumption data (Article 37(1)(p)) and (Article 41(1)(q))

Article 11A of the Electricity Order³¹⁶ provides the Authority with powers to impose conditions on licensees to give effect to this obligation. Part VI of the Energy Order³¹⁷ provides the Authority with such enforcement powers as are necessary to compel compliance. The conditions which ensure that these consumer protection measures are adhered to are in part II of the electricity supply licence, Customer Related Conditions. The implementation of the third package has seen these conditions further enhanced.

The Utility Regulator ensures customer access to consumption data via conditions in the supply licences. Licence Condition 38³¹⁸ ensures that customers are informed of their consumption and that information is provided in such detail and format approved by the Utility Regulator and the consumer representative body. On implementation of the third package, the updated licence conditions will ensure that consumers will be entitled to further detailed information on their electricity consumption. As part of the Utility Regulator's work programme for 2012/2013 guidance on billing format for suppliers will be developed.

The Utility Regulator has consulted on and implemented licence modifications under the EU Third Internal Energy Package. The licence modifications have

³¹⁶ <http://www.legislation.gov.uk/nisi/1992/231/article/11A>

³¹⁷ <http://www.legislation.gov.uk/nisi/2003/419/part/VI/made>

³¹⁸ http://testsite.niaur.gov.uk/uploads/publications/NIE_Energy_Ltd_-_22_March_2012_Supply_Licence_-_Consolidated_Working_Copy_2.pdf

required Codes of Practice to be implemented that will enhance the consumer protection measures. This will provide customers with access to their consumption data, to provide customers with transparent information in relation to tariffs and terms and conditions, to offer customers a range of payment methods, to provide transparent complaints handling procedures, to facilitate supplier transfers within 15 working days, and to provide a code of practice on provision of services for vulnerable customers.

5.2 Dispute settlement

- Article 37(11), 37(5)(c), Article 37(4)(e)
- Article 41(11) and Article 41(4)(e)

Report on cases, in particular on major issues concerning network users (access tariffs, connection disputes/refusals...), including producers and consumers

As a direct result of Directive 2009/72/EC the Utility Regulator was given the legal authority to act as a dispute resolution authority for certain matters in relation to electricity.

Prior to the implementation of the Directive into national law, the Utility Regulator had been, as it still is, able to determine certain complaints or disputes, such as disputes arising between an electricity distributor and any person requiring a connection to that distributor's distribution system.

On the implementation of the Directives, the Utility Regulator's dispute resolution remit was extended further, as now individuals and companies are able to refer certain disputes or complaints regarding the transmission and distribution of electricity in Northern Ireland to the Utility Regulator for resolution.

In June 2011 the Utility Regulator published its "Policy on the Resolution of Complaints, Disputes and Appeals". This sets out procedures which the Utility Regulator will generally follow when dealing with a complaint or dispute which it has been requested to determine. No amendments have been made during 2012

Under the Gas (NI) Order 1996 billing disputes must in the first instance be referred to the Consumer Council for Northern Ireland. The Consumer Council has 3 months in which to resolve the matter to the customers' satisfaction or the matter is referred to the Utility Regulator. We have had no referrals during this period.

The Gas Market Opening Group (GMOG) was established by the Northern Ireland Authority for Utility Regulation (NIAUR) to address any operational barriers to entry into the Greater Belfast gas market. The group has now been extended to cover the Greater Belfast gas market and the Ten Towns gas market. The group includes active representation from supply and distribution licence holders, the Department of Enterprise, Trade and Investment in NI, the Consumer Council in NI and NIAUR. The GMOG identifies barriers to entry into the gas market in NI; these issues are then discussed with the group with a view to making a decision on the best way to address each issue.

The Northern Ireland Authority for Utility Regulation also initiated the set-up of a Gas Supplier Forum group. This group identifies any requirements for supplier to supplier agreements in relation to customer switching and overcoming supplier barriers to competition. Agreements are then drawn up to be included in the Supply Meter Point Agreement. This group includes active representation from gas supply licence holders, the Consumer Council NI and NIAUR; however the Distribution licence holders also attend to ensure all decisions made for supplier agreements will work in accordance with the distribution market rules.

Phoenix Natural Gas Ltd (PNGL), who owns and operates the Gas Distribution Network, for the greater Belfast Area, had during the year a Price Control, referred to as PNGL12. The Price Control, was set for a 2 year duration (For the period 2012 -2013), which was to align with the other Gas Distribution Network operator, outside Greater Belfast area, called Firmus Energy Ltd. Utility Regulator presented its final Determination to PNGL12 in January 2012 for consideration by PNGL. This was rejected and the matter was referred to the Competition Commission (CC) in March 2012. The Commission was requested to investigate and report on the price control primarily because PNGL has declined to consent to the decision in respect of one specific input into the price control calculation – the Total Regulatory Value, or TRV. Utility Regulator framed the determination within the context of the price control as an overall package, on the basis that it should

be fair and balanced, and consistent with our statutory duties.

The main area of disagreement was the removal of Unspent allowances, which can be broken down into two elements:

- unspent capex relating to large capital works that the company has since postponed or decided not to undertake (deferred capex);
- once deferred capex has been removed, the remainder of unspent allowances (outperformance).

The Commission agreed with the proposed revisions made by Utility Regulator in the PNGL12 determination, in terms of current Opex and Capex. When considering the Public Interest Test, its determination, was to remove just under 20% of the value in relation to the TRV adjustment, from the original proposal of Utility Regulator in PNGL12, on the components mentioned above.

The Competition Commission's Inquiry ended on the 30 November 2012, and the decision was published on the 19 December 2012.