

Minutes of the Meeting of the Gas and Electricity Markets Authority

Thursday, 15 January, 2009 at 8.15 am

9 Millbank, London SW1P 3GE

Introductory remarks by the Chairman

1. There were no apologies for absence. The Chairman welcomed to their first meeting two new Non-Executives, Jim Keohane and David Harker, who had recently been appointed to the Authority by the Secretary of State. Each gave an outline of their backgrounds and interests in energy matters. The Chairman noted also that Prof David Fisk and John Howard had also been appointed and would be joining the Authority in July. The Chairman and the Authority congratulated the Chief Executive on his recent award of the CBE in Her Majesty's New Year Honours list; and on the appointment, as a Non-Executive, of Jayne Scott as a Member of the Council for Healthcare Regulatory Excellence. Tim Bailey, one of Ofgem's graduate entrants, would be attending the meeting as an observer for part of the session.
2. The Chairman confirmed that the Authority would need to set up a new Enforcement Committee to consider issues arising on a potential licence breach on which NED participation would need to be settled in due course. The new arrangements for NED remunerations were now in place, including those for Non-Executives who chaired Committees of the Authority. Finally, the Chairman confirmed that there had been no declared conflicts of interest in respect of any items on the agenda.

Minutes of the Authority Meeting held on 11 December, 2008

3. The minutes were approved subject to a minor drafting correction.

Reports from the Chief Executive and Managing Directors

4. The Chief Executive introduced his report, drawing out the main issues as follows:
 - on security of supply, recent concerns about the prospects of there being an "energy gap" from 2015/6.
 - the current Russia-Ukraine gas supply dispute and its knock-on effects for continental Europe.
 - reported developments in the EU ETS and the impact on the functioning of markets.
 - the plans for Ofgem's examination of wholesale markets and their functioning on which there would be reports to the Authority in April and June.
 - the response of some companies, banks and ratings agencies to the current credit crisis and Ofgem's continuing tracking of financial impacts on the energy sector.
 - the evolution of energy prices at retail level in Continental markets and factors underlying these changes.
 - plans for early meetings with Ministers and senior officials, and with Consumer Focus, and the key issues to be covered.
 - the financial performance of Ofgem which was on course for a balanced budget for 2008/9, had achieved its full staff complement, but where significant pressures were expected for 2009/10, especially on new business functions.
5. On market issues, the Authority was briefed on the latest position on the Russia-Ukraine gas dispute and its ramifications for supplies to continental Europe, and initiatives to resolve matters. To date, there had been only a modest price response in the UK reflecting the diversity of supply options and the operation of

markets. A prolonged period of very cold weather and continued substantial IUK exports could require demand side responses. The position in several other EU countries was of concern, some having triggered formal states of supply emergency. Electricity margins in GB appeared comfortable with the UK now at a discount to continental Europe and power flowing in both directions across the interconnector with France. The Authority was given a presentation on the supply/demand position on gas over the current winter period which had seen high residential heating demand during the cold weather to date, some reduced I&C demand given the recession, and IUK exports. Gas flows had been healthy to date though long and medium term storage levels had fallen. Data were presented on forecast demand and supply, with spot process for gas showing some easing from the initial response to a tight demand/supply position. Fuel spreads were examined with the prices of gas, coal and carbon emissions (at 14 euros/tonne) continuing to drive power spreads lower. The forward power curve suggested that GB electricity prices would remain moderate compared to some key continental prices, notably in France and Germany.

6. The Authority was informed about the latest steps on the Probe into retail pricing. A consultation document regarding possible measures to address undue price discrimination had just been published, together with a draft impact assessment, and responses were requested by 20 February. It was agreed that a special session of the Authority should be held in early March to consider the outcome of this consultation and the way forward. The Authority also welcomed a new project planned to re-examine issues on security of supply in the medium term, concentrating on the delivery by energy markets of the needed investments and the risks, both internal and external. There would be an interim report at the April Authority meeting. Finally, the Authority noted that there was likely to be a further delay in the announcement of the key decisions on smart meters as new Ministers considered this and related policies.
7. On networks matters, the Authority was consulted on an aspect of the 2007 price control limiting the prices which National Grid Gas' LNG could charge system operators for the use of LNG for operating margins until competitive margins had been established (or until 2012, whichever was the soonest). NGG had requested that the Authority remove these price control restrictions if their tender processes were delivering effective competition, this requiring a licence modification, should the Authority approve. The Authority agreed in principle, and delegated to the MD Networks the analysis of the details and results of the proposed tender mechanism; and, if judged satisfactory, the modalities for the lifting of the current price control restrictions. The Authority noted the present position on a request by Scottish Power for the re-opening of their electricity distribution losses incentive under the present price control: the Authority had decided that it was minded to reject this application and that an impact assessment should be published. The issue would return to the Authority for decision in March or April.
8. The Authority recalled that two companies, SP and SSE, had blocked the adoption of a proposed collective licence modification to implement new and more cost-reflective distribution charges. A consultation document had made clear that the Authority was minded to refer the matter to the Competition Commission but would seek further views from interested parties. The Authority agreed that the issue should be examined again at its February meeting. The Authority noted some of the key responses to date to the December consultation document setting out the Authority's approach to DPCR5 where there had been strong support to date for the proposals on innovation and output-based measures. There had been a successful seminar on the RPI-X@20 project with a second advisory group planned for February. The draft of a first consultation document would be offered to the Authority in February. Finally, the Authority was briefed on the "War Game" exercise to be run soon, and reported to the Authority, to test aspects of the Ofgem systems and processes for dealing with the consequences of

the collapse of a major network company through financial distress or special administration.

9. As regards corporate affairs matters, Ofgem had now reviewed some 900 complaints on direct debit issues forwarded by the BERR Select Committee and a national newspaper. Suppliers' communications appeared to be poor and further information from them was being sought. A report would be prepared for the Authority, with options for action. On enforcement cases, the Authority was briefed on the commitments secured from a company to compensate certain customers as a result of failure to notify customers of changes to tariff structures. The Authority was updated on OFT's decision to close a case on administrative priority grounds about which there had been some discussions on concurrency. The CAT hearing, likely to last two weeks, was due to start imminently on the Authority's CA'98 decision against National Grid in respect of their Metering Service Agreements. On the Freedom of Information Act, new guidance for public bodies had been produced by and discussed with the Office of the Information Commissioner, alongside other regulatory bodies. On legal risks, the Authority received its regular report. Finally, the Authority was briefed on forthcoming stakeholder events and evidence-giving sessions.

Proposed Corporate Strategy and Plan 2009-2014

10. The Authority reviewed the latest text of the draft Corporate Plan, revised in the light of discussion at its last meeting, and which took account of recent developments on the Probe, in Europe, on sustainable development and the new duties and powers of the Authority under the Energy Act 2008. The text was approved for consultation subject to some further changes to the Foreword.

Energy Act 2008: Ofgem's duties

11. A paper summarised, for information, the changes to Ofgem's duties, in particular the elevation of the duty on sustainable development, and likely timing on Commencement. The note also described the current position on revised social and environmental guidance under the Gas Act 1986 and the Electricity Act 1989 which, when issued, would replace the 2004 guidance. The note analysed the main impacts and implications of these changes, explaining current consideration of how these might be taken forward across Ofgem and especially in the work of the Sustainable Development Committee, and reported on, in due course. The Authority welcomed this briefing, adding its congratulations to the Corporate Affairs teams for its work with the Department and Parliamentarians on these changes.

Consumer issues: update

12. This paper provided a comprehensive update on the main consumer issues last reviewed by the Authority at its July 2008 meeting, concentrating on the new consumer representation arrangements which came into force in October 2008, the success of the transition to Consumer Direct and Consumer Focus and progress on the audit of suppliers' compliance with the new complaints standards. In addition, the Authority was updated on Ofgem's Consumer First initiative in particular the successful formation of the Consumer Challenge Group and Consumer First Panel. Actions following from the April 2008 Fuel poverty Summit hosted by Ofgem, notably the monitoring of suppliers' spend on social initiatives the positive response to Energy Best Deal run jointly with Citizens Advice and the joint EAGA/suppliers tariff advice trial were explained. Ofgem's involvement with consumer policy development in the European context was also noted. The Authority concluded that it had been a successful year of initiatives on consumer and social issues, which when coupled with the results of the Probe, helped further to demonstrate Ofgem's commitment to protecting the interests of consumers.

European developments

13. The Chairman led a discussion on the main issues emerging from a paper reviewing progress on EU energy regulation policy, concentrating on the Third Package to liberalise further European energy markets, one of three goals including security of supply and sustainable development; and how Ofgem's own strategies should continue to develop accordingly. The Third Package proposals were expected to be adopted under the Czech Republic's Presidency in the first half of 2009, the Council and the Parliament having completed their first readings, and with EP elections timed for June 2009. The Chairman provided a personal perspective on the key underlying political factors influencing the adoption of these measures based on his work at ERGEG/CEER and in his many contacts with EU Governments, the Commission and the EP.
14. The Authority agreed that these proposals would offer opportunities for further liberalising of EU energy markets, coupled with significant changes to the institutional and legal frameworks, notably the establishment of a new Agency for cooperation of national regulators (ACER); the empowerment of national regulatory authorities (NRAs), now seen as increasingly independent in their operation in enforcing EU measures ; and provisions for regulatory bodies to work with TSOs in drawing up legally binding, cross-border codes to deal with differences in market operations and structures as between Member States. The EP was additionally looking for enhanced consumer protection powers in these arrangements. A significant issue was the extent of separation of network ownership from competitive interests, the so-called unbundling measures.
15. It was agreed that the main objective should be to continue the fullest Ofgem/Authority engagement, at all levels offered, striving for high anticipation and understanding of the developing debate, and the identification of policy and practical solutions for the relationship between emerging EU regulatory models and GB practices. This included working on the EU's developing regional initiatives involving the UK, France and Ireland. There needed to be close involvement with the main working groups considering the detail underpinning the evolving regime and with the work of ACER. It was also important to work with the UK TSOs, given the domestic implications of EU policy. Ofgem would need to resource this effort appropriately, and consider further aspects of the use of technical experts, training and secondments.

LENS project

16. The Authority was briefed further on the work carried out by the Long term Electricity Networks Scenarios (LENS) Project and was presented with the key findings of the project published on 7 November. The final report had examined a range of plausible electricity network scenarios for GB for 2050 – five in number - as a basis for discussion with industry participants, Government and other stakeholders. The work highlighted the huge range of plausible scenarios. This differed from those suggesting the need for substantially more transmission and distribution capacity - to meet growing demand from renewables, other large, low carbon generation and electric vehicles and transport load - to those proposing a move to more local generation, with active consumers whose demand responded to prices, this indicating the need for much smaller transmission and distribution systems.
17. The Authority welcomed these studies as a significant and novel contribution to foresight and future planning. The Authority agreed that the findings of the LENS project would provide important input to the RPI-X@20 project and the current distribution price control review. It would also be important to stress test any network regulation arrangements and incentives to see that they were robust to the wide range of possible network scenarios and to ensure that, as far as

possible, they kept options open and were sufficiently flexible to accommodate the different scenarios. The degree of uncertainty suggested that Ofgem's regulatory activities should not set the networks down one path that would preclude other scenarios. The Authority agreed that the profile of this work should be maintained through presentations, briefings and fact-sheets for a range of interested parties.

Case under the Competition Act 1989

18. The Authority was given an oral update on a potential case under the Act, against Scottish Power and Scottish and Southern Energy concerning alleged constraints and abuse of dominance in the market, recalling the Authority's discussion and "minded to" decision at its December meeting. The Authority was also briefed on recent meetings with the complainants. In discussion, the Authority confirmed that the investigation should now be closed on the grounds of administrative priority. The Authority noted, however, that a number of issues had come to light which were of concern. It was agreed that the MD Markets should write accordingly to the two companies concerned; and that Ofgem should also signal that it would publish an initial consultation document with alternatives for addressing potential market abuse matters, it remaining open to Ofgem to re-commence an investigation at a later date. Ofgem would continue to monitor the functioning of the market closely.

Audit Committee Report

19. The Chair of the Audit Committee presented a short report surveying the Committee's recent work and discussions, drawing particular attention to the following items:
 - the risk assessment on transmission issues and the TAR deadline of 2020.
 - the agreed winter supplementary for the current year enabling Ofgem to stay within budget but the tight financial position for 2009/10.
 - the Committee's plan to brief and involve the Authority on the longer term financial and budgetary positions.
 - future plans for examining the risk registers by Ofgem Directorates.

British Energy/EdF merger

20. The Authority was informed about the decision on 22 December 2008 by the European Commission to approve the merger, under Phase I procedures, and the remedies secured as a condition of that approval. The Authority would be briefed on any developments on corporate transactions related to this merger.

Offshore Electricity Transmission

21. The Authority noted a trailer paper which set out the current position on final regulatory proposals, developed with DECC, for a new competitive offshore transmission regime; the emerging policy issues, including the roles of offshore transmission owners; the proposed price control elements; and the associated plans for consultations on Ofgem's tendering processes. The Authority agreed that discussion and final agreement on the proposals should be taken at its February meeting, with a view to the joint publication with DECC, in March, of the decision document which would be subject to a period of statutory consultation.

Development of System Operator incentives

22. A trailer paper provided the Authority with news on the development and current status of Ofgem's proposed System Operator incentives for National Grid, to apply from April 2009, in respect of its costs in maintaining the gas transmission network, and those for the operation and balancing of the GB electricity system.

Discussions with NGG and NGET were outlined, with some further talks scheduled. The Authority noted that preparations were in hand for final decisions at its February meeting.

Other business and date of next meeting

23. The Chairman noted some of the key issues to be addressed at the next meeting of the Authority on 19 February at 8.15 am; and proposed that the special additional meeting to examine aspects of Ofgem's Probe into GB retail energy markets, and future work arising, should be held on Thursday, 5 March starting at 12.30 pm over lunch.

Those present

The Lord Mogg, KCMG	(Chairman)
Alistair Buchanan	(Chief Executive)
Dr Robin Bidwell	
Miriam Greenwood	
Judith Hanratty	
Sarah Harrison	
David Harker	
Jim Keohane	
Jayne Scott	(Chair: Audit Committee)
Steve Smith	
Andrew Wright	
John Wybrew	
Prof George Yarrow	

Those attending

Maxine Frerk	(all items)
Charles Gallacher	(")
David Ashbourne	(")
Andy MacFaul	(Corporate Plan) (Ofgem duties)
Irene Hurrell	(Ofgem duties)
Jude Cummins	(Consumer/social issues)
Martin Crouch	(Europe)
Pamela Taylor	(")
Stuart Cook	(LENS)
Ian Marlee	(CA '98 case)
Duncan Mills	(")
Colleen Hanley	(")
Michael Brocklehurst	(Legal Adviser to the Authority)
Dr Tony Burne	(Secretary to the Authority)