

**Minutes of the Meeting of the Gas and Electricity Markets Authority**  
**Thursday, 19 February 2009 at 8.15 am**  
**9 Millbank, London SW1P 3GE**

**Introductory remarks by the Chairman**

1. There were no apologies for absence or declared conflicts of interest in respect of any agenda item. The Chairman noted that Dr Simon Cran-McGreehin, one of Ofgem's graduate trainees, would be joining the meeting for some agenda items, as an observer. The Chairman reminded Members about the need to complete FRS8 forms for the Annual Resource Accounts.

**Minutes of the Authority Meeting held on 15 January 2009**

2. The minutes were approved.

**Reports from the Chief Executive and Managing Directors**

3. Introducing his report, the Chief Executive concentrated on the following main issues:
  - the current view of the impact of the credit crisis on the energy sector, and an analysis of the positions of GB utility companies and European counterparts.
  - reported market and supplier views on some of the problems of attracting further investment in the present capital and debt environment.
  - the possibility of some delays in commissioning of investment in gas storage and certain wind arrays.
  - Ofgem's plans for continuing to monitor the situation closely through new projects, the tracking of individual companies' performance and plans, and through meetings.
  - linked to this, the forthcoming network financial distress arrangements "War Game" exercise to test the adequacy of Ofgem's responses on which a report would come to the Authority.
  - the plans to consult further on aspects of the Probe in preparation for the special session of the Authority on 5 March.
  - a forward view of the main challenges ahead for Ofgem, and their priorities, and the results of recent discussions with Ministers and senior officials.
4. On Corporate Affairs, the Authority was briefed on the latest issues on the industry codes governance review, and some of the messages emerging to date from the consultation processes in train. Key issues were the role of Ofgem in leading and managing code changes in major policy areas; proposals for more industry self governance; and new powers to allow the Authority to set "decision by" dates. A full report on developments would be given to the Authority in April. On fuel poverty, the Authority noted current activities, including a planned review by the Government, continuing Parliamentary interest, forthcoming meetings with Ministers and DECC consultations in progress on the Home Energy Savings Strategy. A further update on fuel poverty issues would be presented in March. The Authority welcomed the moves by the big six suppliers to align their social tariffs with Ofgem's guidance that these should be equivalent to the lowest available from the supplier, in the region, regardless of payment method. The hearing before the CAT on the Authority's CA'98 decision against National Grid in respect of their Metering Service Agreements had concluded. A decision was expected in three to six months time. Finally, it was noted that the Authority was

planning a Powering the Energy Debate seminar on future networks issues for 28 April. The Authority's open meeting would be set for the afternoon of 18<sup>th</sup> June.

5. The Authority noted the key developments on networks matters, including details of the "War Game" exercise to test legal frameworks, Ofgem processes and approaches, and the arrangements for dealing with special administration steps in the event of a network company failure. On the National Grid Gas National Transmission System offtake arrangements, as discussed at the last meeting, a revised modification had been approved. On the issue of Scottish Power's requested re-opening of the DPCR4 price control in respect of their losses incentive scheme, the Authority was informed that an impact assessment would soon be published. NGET's capital expenditure on asset replacement in the first year of the price control had been reviewed with the company. The issue would be considered further by the Authority's Price Control Committee, meeting that day, with recommendations to the full Authority in due course. Finally, annual regulatory reports on transmission and distribution, showing company performance and capex for the last financial year, would soon be published, the Authority noting the main messages emerging in relation to recent price control settlements.
6. On markets, the Authority was given a presentation on gas market developments which examined gas supply and demand over the winter to date. This concluded that the market had responded as would be expected, despite the severe challenges resulting from the cold weather and the Russia-Ukraine dispute. On electricity, GB generation availability appeared broadly comfortable relative to likely demand for the remainder of the Winter. Oil prices had been steady over the last months, although spot gas prices remained sensitive to both the weather and perceived supply risks. With supply risks greater in the rest of Europe, French and German electricity prices at wholesale levels were expected to rise above those for the UK across the forward curve.
7. At retail level, four companies - Centrica, SSE, E.On and EDF - had announced price cuts for gas and electricity supply to residential customers. These reductions were significantly smaller than the increases announced last year. However, based on Ofgem's model, hedged prices were at a much higher level than at this time in 2008; and, in addition there were increasing costs in meeting the requirements of environmental schemes, and in addressing social tariffs and differentials.
8. The Authority was briefed on aspects of the Russia-Ukraine dispute over supplies and pricing, and on progress on smart metering matters. A successful Seminar on LNG had been held on 11 February with strong attendance from interested parties. Finally, the Authority was informed about the major projects ahead for the Markets Division.

### **Energy Supply Probe**

9. The Authority studied papers and was given a series of presentations on a number of aspects following up the Energy Supply Probe, these focussing on the package of measures to reform aspects of the retail market proposed in this investigation and on which Authority reactions were sought prior to further debate at the March meeting. It was agreed at the outset that responses to the concerns arising on wholesale issues would be taken forward on a separate timetable; and that the matter of price discrimination would be the main focus of the Special Session of the Authority called for 5 March. The planned timetables and processes for these workstreams were explained to and agreed by the Authority.

10. Many of the suggested remedies for the retail markets responded to issues with broadly similar themes such as information quality, making it easier for consumers to engage in competitive processes and their fair treatment. The Authority recognised that there was choice to be made between adopting a more prescriptive rule-based approach and the relative flexibility of approaches relying on guidelines or principles or standards. The Authority agreed that the policy team should develop a suitable set of guiding standards of conduct for consultation.
11. The Authority reviewed a considerable quantity of analysis on the individual elements of a potential package of retail measures in response to these concerns, and reflecting these overarching standards, including new steps on billing information, switching advice, common metrics for price and energy consumption information, quotations, and price comparison information. An equivalent set of proposals, dealing with the particular concerns of small business consumers, was presented and discussed. Finally, the Authority considered a range of options for improved financial reporting to Ofgem by supply companies and how this information might be handled. The detail and rationale for measures to address all these issues was developed and explained alongside analyses of the results so far from the consultation exercise.
12. The Authority welcomed this initial presentation on options for progress and suggested further work in preparation for discussions at its March meeting. A number of presentational and timing issues were noted, also for future consideration.

### **Direct Debits**

13. The Authority considered a paper and presentation setting out Ofgem's analyses hitherto of the issues relating to direct debit payment arrangements. These had been raised with Ofgem as a result of concerns expressed by the BERR Select Committee which had handed over a substantial dossier of complaints; further information had been forwarded by a national newspaper, pursuant to a campaign; and complaints had also come directly to Ofgem. Ofgem had assessed some 1000 complaints; had gathered information from and had questioned suppliers about their DD practices; and had held meetings with the Energy Retail Association, industry representatives, and with Consumer Focus.
14. It was agreed that a further update together with recommendations for a way forward should be discussed at the Authority meeting scheduled for 5 March.

### **RPI-X@20**

15. The Authority received a presentation the RPI-X@20 project. This was reviewing current arrangements for regulating energy networks and examining the need for change, and on which final recommendations would be made in Summer 2010. The Authority also considered a draft of a first consultation paper for issue in February. The Authority noted that, at this stage, Ofgem were canvassing views at a broad and "visionary" level. Towards the end of 2009, work would focus on potential changes to the present approach embodied in RPI-X.
16. The Authority agreed that, nearly 20 years on, it was an appropriate time to review RPI-X which had served customers' needs well, encouraging investment whilst delivering lower prices and better services though increasingly at the cost of considerable complexity. However, there was a particular need for regulation to respond to and facilitate the move to a low carbon economy with a range of

future and (as yet undeveloped) policies to address this; to deal with technological development and the important role of incentives for innovation; to maintain security of supply; and for regulatory policy to align with the evolving European energy policy agenda. Some of the uncertainties on future network development had already been illustrated in the LENS studies. The overlay of current financial and recessionary factors and their implications for networks added to these concerns and the task of devising new methodologies for determining the revenue streams required by energy networks to deliver efficient services to current and future customers, and in the light of environmental policy development.

17. The Authority recognised that this challenging, overarching project would require extensive engagement with industry customer groups, financial markets and Government. In terms of guiding principles, the Authority agreed that thorough and pro-active consultation was important, with high transparency and close attention to Better Regulation tenets. On substance, the Authority concluded that consultation – and the questions raised – should focus on consumer needs, efficiency and value for money; must facilitate the delivery of ambitious targets for carbon reduction; should respond to the renewables agenda and related demand management issues; and should play a role in delivering social objectives. At this stage, consultation should consciously embrace a wide range of ideas for future network regulation, from adaptation of the existing regimes to fundamental overhaul. The Authority considered aspects of the communications strategy for this project, its links to other major projects addressing future regulatory policy, and looked forward to discussions planned at future meetings.

### **Electricity Distribution: structure of charges**

18. A paper was presented dealing with the difficult past history and proposed next steps in delivering this project, designed to secure robust, cost-reflective charging structures for networks. The Authority recalled the proposals in October 2008 requiring DNOs to implement a common methodology with open governance arrangements which had been generally welcomed in terms of efficiency and transparency and accountability. The proposed Long Run Incremental Cost (LRIC) formula for the EHV level had however been objected to by two companies, SSE and SP, and had therefore fallen. Consultations had taken place in December on ways forward including the possibility of referring matters to the Competition Commission for a ruling – on which there were divided views among DNOs and suppliers and concerns that this would slow needed progress. The Authority welcomed however the emerging support for a common methodology at high voltage/low voltage (HV/LV) level for introduction in April 2010. In terms of customer numbers, some 90% were connected at HV/LV level. There was consensus across the industry that commonality of cost-reflective charging on HV/LV would deliver network benefits and efficiencies for suppliers and that improved and more open governance arrangements were appropriate.
19. The Authority agreed to seek licence modifications to deliver new governance and common charging at the HV/LV level. As for EHV, the Authority took the view that progress might best be made by requiring DNOs to implement either a LRIC or modified Forward Cost pricing (FCP) methodology, but, given the Authority's concern about whether the FCP model was sufficiently cost reflective, companies opting for this approach should face an *ex post* review of the efficiency of their capital expenditure at the end of the next price control review process. This would disallow capital expenditure if there was clear evidence that the charges were leading to inefficient capital expenditure because they were not sufficiently cost reflective.

## **DPCR4 – ESQCR and TMA reopeners**

20. The Authority considered a paper which noted that the introduction of the Electricity Safety, Quality and Continuity regulations and other changes such as the impact of the Traffic Management Act would place additional costs on DNOs in respect of overhead line building clearances and tree cutting for network resilience. The Authority had earlier decided to give delegated Authority to the MD Networks to decide necessary revenue adjustments for the first round of DPCR4 re-openers following applications from ENW, CE and WPD. Applications had now been received from SSE, SOP and CN, and a further from CE. The Authority approved a recommendation granting delegated authority to the MD Networks in respect of new reopener applications, in line with the assessment methodology approved by the Authority in July 2008.

## **Gas and electricity transmission: system operator external incentive schemes**

21. The Authority considered a paper setting out Ofgem's proposals for National Grid's external gas and electricity system operator incentive schemes from April 2009, following a trailer paper reviewed at its last meeting. The proposals had been developed in discussion with NG, with an assessment of NG's scheme options and forecast costs, and through consideration of respondents' views on NG's initial proposals. The main proposed changes to the current incentive scheme covered the shrinkage scheme covering energy used to transport gas around the system; the residual balancing scheme to minimise the impact of NGG on markets when purchasing or selling gas for balancing purposes; improved demand forecasting accuracy; targets to reduce the venting of methane; and operating margins.
22. The Authority noted that, in very recent meetings, NG had further lowered their forecasts of costs. The approach set out in the paper was agreed, as a set of proposed statutory licence conditions. The MD Markets was granted delegated authority to agree with NG changes to the proposals - within the parameters set out in the paper - and prior to their publication; and authority also to approve the licence conditions needed to give effect to these revisions, subject to the views of respondents.

## **Offshore electricity transmission: policy proposals**

23. The Authority received and discussed a paper providing an update on the development of the offshore electricity transmission regime, seeking approval of proposals for policy, prior to publication of two consultation documents:
  - a joint Ofgem/DECC document setting out the final Government decisions for the offshore transmission regime and the related Ofgem proposals for the regulatory framework.
  - a final Ofgem consultation document setting out updated proposals for tender processes and the underpinning regulations (secondary legislation).

The regulatory design proposed would be carried forward in part through the standard framework documents, as conditions set by the Secretary of State under the Energy Act 2004, as well as conditions set by the Authority under its powers. The tender regulations would be subject to approval by the Secretary of State. The paper also explained current Ofgem thinking on implementation, including the approach to establishing regulatory asset values for those projects qualifying for the first transitional tender round. The paper noted cost allocation measures.

24. The Authority recalled that it had agreed the key policy proposals in April 2008 and welcomed the extensive consultation on them since that date leading to more detailed recommendations on the regulatory regime notably in respect of the regulation of roles of offshore transmission owners (OFTOs). These included measures to deal with the end of the revenue stream period and licence revocation after 20 years. Measures had also been elaborated to set out positions on several predefined adjustment mechanisms to help provide certainty for investors entering the tender process including the treatment of inflation risks through indexation; the clawback of refinancing gains; allowances for incremental capacity investments; decommissioning costs; costs arising from code changes; and the treatment of leasing, licence fee and Ofgem tender costs. An operational performance incentive for OFTOs was proposed with flexibility to adjust around a default target on a case by case basis. Proposals had also been elaborated to deal with future requirements of the regime, including the Crown Estate's Round 3 process and the EU's Third Package in respect of unbundling where generators were participating in offshore transmission; and proposals were presented for the detailed design of the competitive process and its various stages.
25. The Authority thanked its Offshore Transmission Committee which had reviewed these proposals carefully and had endorsed them, and welcomed also the attention given to them by the Audit Committee from the viewpoints of cost recovery and risk. The Authority accordingly approved the revised proposals for consultation.

### **Charging for Offshore Transmission**

26. The Authority considered a paper providing background on the Use of System Charging Modification Proposal GB ECM-08, submitted by NGET, dealing with charging arrangements associated with offshore transmission networks and decision-making processes. The Authority's Offshore Transmission Committee had been briefed; and, it was noted, while this was not a reserved matter, the issues surrounding the offshore charging proposal, including the legal considerations, were of sufficient importance to warrant Authority attention. It was concluded by Ofgem that offshore generators should pay for the use of offshore and onshore transmission assets through an integrated transmission charging regime to be developed by NGET. This would run on the same broad principles as the current GB TNUoS charging methodology, as now suggested by NGET, following their own extensive consultations. The Authority noted the proposed approach and the handling and timing issues arising.

### **Transmission Access Review**

27. The Authority reviewed an information paper reporting on progress on the TAR and its three workstrands: short-term improvements to the allocation of transmission capacity; developing enduring arrangements for transmission access; and steps to create incentives to encourage anticipatory investment to build infrastructure required for 2020 ahead of full user commitment. On the first, NG had taken steps to identify substantial advances for access of Scottish generation capacity in the GB queue, and work was in hand to identify and manage constraints. On enduring arrangements, industry had completed work on five of the six Connection and Use of System Code modification proposals - with the final one under discussion - and these were being studied by Ofgem. Finally, on incentives, an initial consultation had been completed on enhanced incentives for TOs which would encourage companies to invest rapidly while protecting consumers from the risks of stranded investment. The Authority noted the paper and the reported developments; and welcomed the significant contribution of the

TAR to wider Authority work including innovative regulatory reform and its support for the RPI-X@20 project.

### **Transmission Investment Incentives: update and recommendations on short term measures**

28. A note on this topic, following earlier trailer papers and decision, invited the Authority to note progress and to endorse the analysis and proposed approach for taking forward a series of short term incentive measures to address current issues for known transmission projects, in the light of further contacts with the transmission operators. The Authority noted that the measures were designed to enable TOs to invest ahead of need through the provision for funding for pre-construction costs; and that the choice lay between focussing on costs to be incurred in 2009/10 in relation to specific activities, or in anticipating the total costs of pre-construction plans for relevant projects. The Authority endorsed the recommendations put forward by Ofgem and in particular favoured the approach which would keep open a range of further options for developing the network in the future. The Authority also agreed that further statutory consultation on this approach was needed on changes in licence conditions to give effect to the incentives for 2009/10, and invited Ofgem to proceed accordingly.

### **Quarterly Wholesale/Retail Price Report**

29. The Authority was presented with, and noted, the first report in this series following from its work in the Probe on the relationship between wholesale and retail energy prices; and the request in the Chancellor's pre-Budget Report to provide quarterly reviews as an aid to greater transparency over future price changes and the passing on of future price changes to consumers.

### **Zonal Transmission Losses**

30. A paper under this agenda item, for the Authority's information at this stage, advised that a modification proposal had been raised on the Balancing and Settlement Code to introduce zonal transmission losses. The Authority noted the history of past proposals on zonal transmission losses and looked forward to advice later in the year when further work had been taken forward by the Modification Group established under the BSC Panel, including issues on process and timing.

### **Other business and date of next meeting**

31. The Chairman noted some of the key issues to be addressed at the next Authority meeting which would be held at Ofgem on Thursday, 19 March at 8.15 am. A special session of the Authority, to examine further the follow-up work on the Probe, was confirmed for Thursday, 5 March at 12.30 pm, also at Ofgem.

### **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  
Steve Smith  
Andrew Wright  
John Wybrew  
Prof George Yarrow

**Those attending**

Charles Gallagher	(all items)
David Ashbourne	( " )
Maxine Frerk	(Probe, Direct Debits)
Jude Cummins	(Probe)
Neil Barnes	( " )
Duncan Sinclair	( " )
Andy Burgess	(Direct Debit)
Sean Baker	( " " )
Emma Kelso	( " " )
Hannah Nixon	(RPI-X@20)
Cloda Jenkins	( " )
Rachel Fletcher	(Use of System Charging)
Mark Cox	( " )
Ian Marlee	(System Operator incentives)
Lisa Martin	( " )
Philippa Pickford	( " )
Michael Brocklehurst	(Legal Adviser to the Authority)
Dr Tony Burne	(Secretary to the Authority)