

Minutes of the Meeting of the Gas and Electricity Markets Authority
Thursday, 19th March 2009 at 8.15 am
Ofgem, 9 Millbank, London SW1 3GE

Introductory remarks by the Chairman

1. There were apologies for absence from Judith Hanratty and George Yarrow, and from John Wybrev - whose written comments on a number of agenda items were referred to during the meeting. The interest of a non-Executive Member in a company mentioned in one paper, which was delivering aspects of the Government's programme to tackle fuel poverty, was noted. The Chairman said that Michal Lurka, one of Ofgem's graduate trainees, would be joining the meeting for some agenda items, as an observer. Lord Turner (Chair of the Climate Change Committee and of the FSA) would be meeting the Authority over lunch and would be accompanied by David Kennedy (Chief Executive: Climate Change Committee).

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2. The minutes were approved.

Reports from the Chief Executive and Managing Directors

3. Introducing his report, the Chief Executive drew attention to the following main issues and developments:
 - On finances, Ofgem was expected to hit its target budget for 2008/09.
 - Ofgem was on track to meet its targets for all the main deliverables on its operational programmes.
 - Staff turnover was now very small; and the graduate entry scheme was very heavily oversubscribed. As might be expected, a tough pay round was in prospect.
 - An overview of the key pressure points ahead where Ofgem's activities and performance would again be closely examined, together with the related communications implications.
 - The forward-looking (and linked) projects now under way, designed to meet consumers' needs, including RPI@20, the remedies emerging from the retail price probe, the industry codes governance Review access to networks, offshore wind and the LENS project on long term electricity network scenarios.
 - An analysis of the continuing impact of the shortage of credit on energy company activities and future investment.
 - The need to anticipate, monitor and respond to forthcoming issues such as Winter 09/10, wholesale/retail price linkages and international security of supply matters.
4. The briefing for the Authority on corporate affairs noted that Nick Durlacher would be standing down as Chair of Elexon and the BSC panel; and set out plans for the appointment of a new Chair which the Authority approved. On consumer issues, the Authority was informed about some concerns which had been raised by Consumer Focus about meter tampering or interference and associated re-connection charges and liability for them. The Authority noted ongoing interest in a decision to close a case against npower for failure to notify changed tariffs together with a commitment from the company to provide compensation to those customers affected. Finally, the Authority was briefed on the results emerging

from the Ofgem Consumer First panel which had recently considered the consumer viewpoint on future energy markets, based on the scenarios built by the LENS studies. Notable points emerging were the conclusions on the need for gradual greening of energy generation and supply; concerns over the high associated costs of doing so in the current economic climate; and the importance of a Government lead on these issues.

5. On networks issues, the Authority was briefed on the network of last resort studies and "War Game" undertaken in the previous week which had been designed to practise and test incident response rates and roles, communications, decision-taking and coordination with stakeholders in the event of a collapse, under financial stress, of a network operator. A full account of the exercise and its implications for the process manual would be brought back to the Authority at a future meeting. The Authority noted the history and latest developments on the modification for a new offtake regime at the National Grid Gas NTS Moffat interconnector with Ireland; and the need to reach an early decision - on which further advice from Counsel would be sought. On the review of NGG NTS capacity buy-back incentives, the Authority was briefed on the latest proposals, put to consultation, to reduce the target level of costs from £21m to £13m. It was agreed that the MD networks be given delegated authority to negotiate the terms of a final scheme with NGG, clearing the results as necessary through the Senior Management Team. Finally, on gas network extensions, the Authority noted that schemes were now in place, following incentives in the last gas distribution price control, to connect off-grid gas customers and so help to alleviate fuel poverty. Companies were now being asked by Ofgem about their gas delivery plans over the price control period.
6. On markets, the Authority was provided with detailed analyses of the key market developments. The "Big 6" companies had all announced retail energy price decreases, mainly for electricity, and from late March, and there was evidence that concerns from the Probe were being addressed. Data were presented on price spreads by tariff type for the companies. At the wholesale level, oil prices had been steady; spot gas prices had halved in a month as winter risks had receded; spreads in electricity prices remained modest; and demand for both electricity and gas had reflected recessionary factors. Storage and gas supply build-up appeared comfortable. Ofgem was working closely with DECC and NG in reviewing the prospects for Winter 09/10. The Authority was briefed on the current position on the roll out of smart meters. Progress to date on the major Markets Directorate projects was outlined.

Corporate Strategy and Plan

7. The Authority considered a further draft of the Corporate Strategy and Plan 2009-2014 and the responses to the consultation on the January draft which had been taken into account in the preparation of the latest text. A revised version of the Foreword was also considered. The Authority agreed the text of the document, confirming its main themes and their continuing relevance, offering some further detailed points of drafting. It was agreed that, subject to these further suggestions, the Strategy and Plan should be published in late March.

Fuel Poverty

8. Under this item, the Authority considered a paper providing an update on current developments on the Government's fuel poverty strategy, social tariffs, and on Ofgem's role and work in this area under its Social Action Strategy. The paper also sought approval for further work in this area. The matter was of concern for many households, given current high energy prices and current economic

conditions, and was continuing to attract high media and political interest. The number of fuel poor households was rising, having fallen in the eight years to 2004, and there were now calculated to be some 5 million households in fuel poverty. DECC were currently reviewing fuel poverty policies and activities; and action had been taken by the Scottish Executive following their own review in 2008 with the introduction of a new Energy Assistance Package. A Private Member's Bill, for debate later in the month, was advocating mandated social tariffs.

9. In debate, the Authority noted that fuel poverty was part of a wider problem of household poverty including the impacts of fuel prices, low incomes and the poor condition of housing stock in terms of energy efficiency. The Authority recalled that it had opposed the idea of introducing mandated social tariffs. This was an element of social policy which should properly be addressed through the tax and benefits system. However, the Authority had much welcomed the voluntary initiatives on tariff measures brought forward by the energy supply companies. This was an area of policy where competition was seen as important to promote innovation and help, with the challenging task of identifying and targeting those most in need of help. Ofgem's work following the Fuel Poverty Summit it had hosted in 2008, its contacts with companies and with consumer interests, and the continuing work of the Social Action Strategy Review Group, had lead to valuable and innovative steps by suppliers.
10. The Authority reviewed an analysis of, and debated the issues raised by the existing voluntary arrangements and those presented under mandated approaches. It agreed the need for further work to develop the analysis for presentation and discussion by the Authority at its meeting in May.

Audit Committee

11. The Authority received a briefing from the Chair of the Audit Committee on the Committee's current activities which included:
 - Risk management in the Markets Directorate including the international dimension and security of supply.
 - An audit of Ofgem's IT security, including the management of the risk of fraud.
 - The current financial position of Ofgem at year-end which would be reflected in the Resource Accounts, soon to be published, a document which had also been reviewed and approved in draft by the Committee.
 - Internal audits of four workstreams - Office Services, renewables and CHP IT systems, Project Management and action on infringements - all of which had gained substantial assurance ratings.
 - An examination of cost recovery processes for the Offshore Tender regime where systems were judged robust.
 - A review of the terms of reference of the Audit Committee where some minor changes had been proposed to reflect current best practice; and the suggestion that a report from the Committee should be presented annually to the Authority.
12. The Authority thanked the Audit Committee for its work, approved the revised terms of reference, and the plans for an annual report.

Probe

13. On this item, the Authority considered a paper and presentation, further to its review of and guidance on the package of possible retail measures which might be taken forward, based on the remedies identified and proposed in the Probe report into retail prices of gas and electricity. A draft paper, reflecting work in progress on these reforms was presented and described. The aim would be to publish this in April to seek stakeholder views with a target of Summer 2009 for agreement on reforms such that these could be in place for Winter 2009. Should there be no agreement on the reform package, the option remained of referrals to the Competition Commission (CC) on individual licence conditions; or the reference of the market, as a whole, to the CC for investigation. There were two other main Probe elements: one on price discrimination, where the Authority had decided that it was minded to propose licence conditions to require cost reflectivity in suppliers' tariffs; and another on wholesale market issues, where the aim was to reduce barriers to entry and competition. Both were being taken forward separately.
14. The first element on the package of proposed retail measures concerned a series of overarching standards of conduct for suppliers in the retail market, forming a preamble to the relevant licence conditions which would underpin them. These would address the sales of products or services which should be fully understood by customers and be appropriate to their needs; the need to create effective communications, with explanations, about changes to customers' products or services; measures which would ensure that the switching of products or suppliers was not impeded; and steps which would require suppliers to act promptly and courteously to put matters right should they get them wrong. To facilitate customer engagement with competitive markets, a second set of proposals could require improved information on customer bills, annual consumption statements and suitable price metrics, information on switching supplier, and advice to those who were "debt-blocked" and thus unable to switch. In the interests of helping consumers to make well-informed choices, and to prevent misleading sales or marketing activity, suppliers could be further required to provide consumers with quotations or comparisons with customers' current deals, where comparative claims were made, and to establish the basis of customers' agreement after a sale.
15. In terms of improving the functioning of the market to assist small business consumers, the proposals envisaged informational remedies, action to prevent the automatic rolling on of contracts when existing ones expired, and new steps on the accreditation of switching sites designed to cater for SME needs. A further set of proposed measures were aimed at providing greater transparency on certain aspects of the market, giving consumers and firms greater confidence that markets were competitive and fair, and so enable Ofgem to monitor the effectiveness of the Probe's suggested remedies. Under this, and to assist transparency, action might be taken to collect suitable cost and revenue data from the major suppliers, from supply and generation businesses, and from consumers, with appropriate publication of information.
16. After discussion of the various elements, and with suggestions for some revisions and development of the themes, the Authority gave its approval to the broad thrust of the package of planned reforms presented, concluding that these should help promote competition in the interests of consumers, present and future. On timing, it was agreed that the measures should be published in April with the aim of reaching agreement on the package over the Summer period. Finally, the Authority noted the communications plans associated with these proposed new measures.

Transmission Access Review

17. A paper on this topic provided a further update to the Authority on progress on the reforms to the arrangements for access to the high voltage electricity network. The TAR reforms involved three strands of reform covering short term improvements to the allocation of existing electricity transmission; the development of new, enduring commercial arrangements for transmission access; and the creation of incentives to encourage anticipatory investment by the transmission companies, for example, to secure the infrastructure needed for 2020.
18. The paper and presentation noted significant progress on all three elements including action by NG to identify scope to advance some 450 MW of Scottish renewable generation. The paper also noted the steps being taken by National Grid in relation to the management of constraint costs.
19. On enduring arrangements, six CUSC modification proposals had been submitted to Ofgem. Future debate was likely to focus on the choice between models for transmission access, including: evolutionary change with no change to existing transmission access rights; auctions of rights; "connect and manage"; or variants based on applications for volume and duration with subsequent bids for transmission access against NG forecasts of costs and prices.
20. Final proposals had been published on short term transmission investment incentives with a notification of the necessary changes to the licences to the three transmission companies. The Authority noted that longer term issues would be taken forward later in the year with initial and statutory licence consultations planned in Summer and Winter 2009, respectively.
21. The Authority welcomed the progress to date and also noted the potential risks, including the possibility of legal challenge. The Authority agreed that the Secretary of State be advised that the industry processes should continue at this time but that progress should be kept under close review, with a further update for Ministers before the end of June.

Distribution Price Control

22. The Authority had before it a paper reviewing progress on the electricity distribution price control review (DPCR5). This provided an analysis of the responses to the policy paper of December 2008, an update on the treatment of pension costs, and information on the business plan figures submitted to date by the distribution companies. Overall, DNOs were forecasting an increase in network investment of over 60% and a projected increase in network operating costs and indirect costs of about 13% over the period which would need careful probing. The Authority recognised that securing agreement on final proposals for resetting the revenue allowances for the fourteen electricity distribution networks for 2010 to 2015 would present challenges in the context of the present economic climate and its uncertainties. It would involve, *inter alia*, the resolution of a series of complex issues including the scope for tackling climate change and managing DNOs' carbon footprints, competition in connections, distribution losses and their treatment, pensions, and the approach advocated by the Authority for new measures to assess return on regulatory equity.
23. The Authority was briefed on consultation responses on a number of issues, including setting the cost of capital, rewards for investment in low loss equipment or schemes, transmission exit charges, and the potential role of DNOs in distributed generation and demand side management as contributions to a low

carbon agenda. The Authority noted that there was substantial, emerging support from consultations to date for many aspects of the proposals. This included the role of outputs in the final regulatory settlement, calibration of the overall settlement, the need for innovation incentives, appropriate tools to manage uncertainty, measures to improve customer service, cost bench-marking, the equalisation of opex and capex incentives, and the retention of the information quality incentive measures. The Authority acknowledged further work was necessary on other aspects such as the new innovation incentive.

24. While the Authority was not asked to reach decisions at this stage on any of the elements of the review, it agreed the proposed processes and timetable for 2009, including the planned delivery of a Methodology and Initial Results document in May 2009. The Authority noted also that updated forecasts for 2010-2015 were due from the DNOs in late June. Unless there were major changes to these, there would be no updated proposals required in September. The Authority thanked the Ofgem team and DPCR5 Committee of the Authority for its work, and looked forward to further presentations at its next meeting. It concluded that further work on the Methodology and Initial Results document should be referred to the DPCR5 Committee for consideration and that policy items which were reserve matters should be remitted to the Authority. The value of offering Centrica the chance to meet the Committee was agreed since they had put a high degree of thought into a range of price control matters. The Authority would consider requests for meetings from other stakeholders with a similar degree of engagement. The Chairman noted that non-Executive Members of the Authority who were not Members of the DPCR5 Committee were welcome to take part in the work of this Committee – and indeed other Committees - as they wished.

Gas Distribution Price Control – interruption re-opener

25. The Authority was briefed on a request for a capex re-opener in the current Gas Distribution Price Control period (2008-2013), as submitted by one of the GDN companies in order to pay for necessary network reinforcement construction projects following interruption reform. The request followed the first year of interruption auctions which had taken place in 2008. The Authority agreed the recommendation that the MD Networks should be given delegated authority to negotiate and resolve the final value of a revised capex re-opener allowance, following public consultation on the proposals.

Sustainable Development Committee – revised terms of reference

26. Following recent changes to Ofgem’s duties in respect of sustainable development, and the wider aspects of the growing work of the Committee in recent months, new terms of reference for the SD Committee were now indicated. A draft had been discussed within the Committee, and also with the Chairman and Legal Adviser. The new ToRs were approved by the Authority.

Other business and date of next meeting

27. The Chairman noted some of the key issues to be addressed at the next Authority meeting which would be held at Ofgem on 23 April at 8.15 am. There were no other items of business.

Those present

The Lord Mogg, KCMG	(Chairman)
Alistair Buchanan	(Chief Executive)
Dr Robin Bidwell	
Miriam Greenwood	
Sarah Harrison	
David Harker	
Jim Keohane	
Jayne Scott	
Steve Smith	
Andrew Wright	

Those attending

Charles Gallagher	(all items)
David Ashbourne	(")
Roy Field	(Corporate strategy) (Audit Committee report)
Maxine Frerk	(" ") (Fuel poverty) (Probe)
Andy MacFaul	(" ")
Jude Cummins	(Fuel poverty) (Probe)
Emma Kelso	(") (Probe)
Kersti Berge	(Probe)
Neil Barnes	(")
Colleen Hanley	(")
Stuart Cook	(TAR)
Min Zhu	(")
Rachel Fletcher	(DPCR5)
Kieran Donoghue	(")
Mark Cox	(")
Chris Watts	(")
Michael Brocklehurst	(Legal Adviser to the Authority)
Dr Tony Burne	(Secretary to the Authority)