

Minutes of the Meeting of the Gas and Electricity Markets Authority

Thursday, 18 June, 2009 at 8.15 am

Ofgem, 9 Millbank, London SW1P 3GE

Introductory remarks by the Chairman

1. There were no apologies for absence. One Member declared that the organisation with which he was associated, and with a major interest in social and consumer issues, had commented on aspects of Ofgem's proposed way forward on measures in respect of the retail market. There were no other potential conflicts declared in relation to agenda items. The Chairman commented that the Awayday on 17th June had been productive, and had included timely and important presentations on two major topics for the Authority – the future security of energy supply and the RPI-X@20 project – as well as some valuable reflections on a number of governance and performance issues.

Minutes of the Authority Meetings held on 21 May, 2009

2. The minutes of the May Authority meeting were approved.

Reports from the Chief Executive and Managing Directors

3. The Chief Executive briefed the Authority on his discussions with other regulators about their approaches to a range of price control settlement issues including cost of capital and pensions, and on his contacts with energy companies over the current price control review. There had been useful liaison with Consumer Focus in their new role and on their priorities for energy, with a welcome recognition of Ofgem's work on consumer issues - such as the establishment of Consumer First, the consumer panels - and on Board appointments. Ofgem was working closely with DECC on transmission access issues and recent meetings had covered smart meters and steps to deal with the scope for abuse in the wholesale market. Finally, the Chief Executive noted some of the international energy company developments where growing activity was expected on mergers and acquisitions, and in the creation of investment capital.
4. On networks, the Authority was briefed on National Grid's request for three new exit capacity revenue drivers on the National Grid Gas Transmission System. The Authority agreed that the MD Networks, in consultation with the Executive, should be given authority to determine these in line with the principles adopted for TPCR4.
5. On the electricity transmission access review, the Authority noted the current impasse on progress on the "fourth model" modification for transmission access reform, on which a letter had gone to the companies. Reactions remained mixed, some agreeing that the NG model was worth pursuing, but others, in the majority, remaining opposed. In the light of this, and despite Ofgem's best efforts to encourage appropriate and timely measures through the industry codes processes, the Authority agreed that the Chairman should write to the Secretary of State recommending that he use his powers under the Energy Act 2008 to implement new enduring transmission access arrangements.
6. The Authority was briefed on proposals that had been received from NG for short term measures to deal with significant levels of transmission constraints in Scotland. These were being analysed, in consultation with NG, and would be presented to the Board in due course. NGG's plans to use some of the unused gas transmission assets in Scotland for CO₂ transport, as part of HMG's carbon capture and storage (CCS) demonstration projects, were explained, together with

the results of the recent Ofgem consultation. This matter was being pursued with NGG in the light of stakeholders' comments and questions.

7. Finally, the Authority was brought up to date on likely future requests for determinations, now being lodged with Ofgem, in respect of laterals and risers. These were the electrical wiring systems found within communal properties such as flats. Many now needed replacement, the issue being whether they were part of the distribution system, with the treatment of replacement costs under price control revenues; or were the responsibility of the owners of the buildings. The Authority would be advised of the outcomes.
8. On markets issues, the Authority received its regular briefing, noting the continuing rise in oil prices, their impact on gas prices, and the forward price curves for GB, including comparisons with continental Europe. The near doubling of oil prices reflected a number of factors such as the weakening of the US dollar, the speculation on global economic recovery with the prospects for increased demand. Electricity prices were lower than in 2008, as a result of lower fuel costs, improved nuclear power availability and falling demand.
9. The Authority was informed about current gas security of supply matters in both a UK and EU context, recalling that its Project Discovery would be addressing longer term security of supply issues. A report on liquidity in wholesale markets had been published by Ofgem and had been well received. There were some liquidity concerns in the electricity market, due to a number of interrelated causes, and options for tackling the present decline had been set out. The Authority would be briefed further in the Autumn following seminars and events involving industry participants. Finally, the Authority noted the current position on capacity management on the England-France interconnector.
10. On corporate affairs, the Authority was briefed on the timing and aspects of the forthcoming Energy White Paper from DECC, and the supporting policy announcements and further consultations expected to be launched at the time of its publication. Meetings with DECC officials on matters as they concerned Ofgem would continue. An update was provided on current developments on social tariffs following the discussion at the last Authority meeting. The issue of Ofgem's financial penalty powers, and current time limitations, had been raised with DECC and was under review. The results of an audit of suppliers' compliance with complaint standards were soon to be published. The Authority noted the recommendation of the Efra Select Committee that winter fuel payments be made taxable; and the issues arising for regulatory bodies from the Arculus review on better regulation, commissioned by the Conservative Party.

DPCR5

11. The Authority considered a paper and presentation seeking approval for the approaches suggested for incentivising desired behaviour from the DNOs and the mechanisms that might be used to do this as part of the Initial Proposals. The paper also reviewed progress to date on DPCR5, including on cost assessment and on financial issues. The Authority was briefed on the plan to publish Initial Proposals on 3 August, and the proposed steps in the lead up to this; on the results of recent meetings with the DNOs; on the work of the Authority's DPCR5 Committee; and on contacts with the Consumer Challenge Group. A "road map" for the timing of decisions on each of the main DPCR5 elements was presented. The possible need for additional discussions by the Authority, after its July meeting but before Initial Proposals were published, was noted.
12. The Authority reaffirmed its approach to DPCR5 which was to protect the interests of customers, and to ensure that an efficient DNO would be able to finance its business. The Authority had also agreed, in this review, covering the period 2010-2015, to take an holistic approach, using a measure of return on regulatory

equity (RORE). Initial consultations had established three themes for action: environment, customers and networks. These objectives, it was suggested, could be translated into a range of policy incentives and licence requirements. If approved in principle, each incentive mechanism would require further work to establish the incentives' strengths and the number of basis points in RORE which could be earned and/or lost under the mechanism. Analysis would be presented for decision as Initial Proposals in July.

13. The proposed incentives and obligations would be as follows:
- Environment: here, the objective was to incentivise DNOs to facilitate distributed generation, demand side management and other initiatives related to creating a low carbon economy and to encourage them to manage their own carbon footprint. The Authority considered a range of new mechanisms including a low carbon innovation fund, an amended network losses scheme, and obligations for DNOs to improve information available to distributed generators.
 - Customers: the aim was to encourage DNOs to consider customer satisfaction across their entire range of services, including matters such as complaint handling and DNO stakeholder engagement. The Authority considered a range of new mechanisms including an incentive structured around a broad measure of customer satisfaction to replace the current telephony scheme and an allowance to assist worst-served customers.
 - Networks: the aim was to encourage DNOs to invest efficiently for their own business needs but also to consider how customer needs and networks might evolve for the future. New measures proposed included equalisation of incentives across capex and opex, to remove the current distortion to business decisions; and the continuation of the Innovation Funding Initiative from DPCR4. It was proposed that DNOs should commit to a series of network output measures and be accountable for achieving these, linking investment to the overall health and utilisation of networks.

The Authority was provided with the detailed underpinning of these proposed new arrangements, each of which were addressed in presentations which dealt with their rationale and mechanisms, and their likely reception by DNOs and other stakeholders.

14. In discussion, the Authority noted that the range of measures suggested, with some new approaches, were worthwhile and forward-looking changes to explore further and introduce for the price control settlements of the 14 DNOs, albeit at the cost of adding some complexity in DPCR5 and for its future monitoring. The resource implications for Ofgem in monitoring and securing deliver of these elements of the package would need to be considered. The Authority would also wish to consider, in due course, the overall balance and interplay between these incentives and other elements of the package – notably the proposed WACC and capex settlements – in reaching a final view; and the impact of pass-through to customers.
15. The results of working level meetings with the DNOs to discuss their business plans were explained, each having been invited to submit evidence where the Ofgem team had identified significant issues. Finally, the Authority had a first exchange on the factors which would influence the setting of the cost of capital, and was briefed on DNOs' suggestions to date. The impacts of the present credit crisis, the relative volatility of some of the key indicators and certain liquidity concerns were recognised. Further advice would be coming forward first to the Authority's DPCR5 Committee and then to the Authority meeting in July.

Scottish Power DNOs: allowed loss percentages

16. The Authority considered a paper, and supporting background analyses, including the impact assessment and consultation document and responses to it, updating the position on the representations for higher annual loss percentages by Scottish Power for its two DNOs, SP Distribution Ltd and SP Manweb plc. The Authority recalled its “minded to” decision to reject this effective re-opening of the DPCR4 settlement on the main ALP issue. The Authority considered written legal advice on the issues arising, should the Authority decide to reject the application for revised ALPs, and the company then seek judicial review in a Scottish Court. The Authority agreed to maintain its current stance on the SP request, and expected to make a final decision at its July meeting, in the light of further advice from Scottish Counsel.

Addressing undue discrimination

17. The Authority had taken a “minded to” decision at its March 2009 meeting to introduce two new licence conditions designed to address unjustified price differentials following its Market Probe investigation. There had been consultation on a final set of proposals in April including, proposed draft guidelines, and an update for the Authority at its May meeting, including a report on the views expressed by interested parties. The present paper and presentation now sought final decisions from the Authority on whether to proceed to statutory consultation on the proposed (or modified) licence conditions and associated guidelines in the light of comments arising from the consultation and the impact assessment. Licence Condition A would deal with the cost-reflectivity of payment methods and would clarify EU Directive requirements; Licence Condition B would create a prohibition against undue discrimination.
18. The Authority first reviewed the consultation responses: several of the “Big Six” companies commented in relation to the impact of competition and enforcement processes, and the need seen for explicit guidelines and a sunset clause for these new licences. Small suppliers generally supported the measures. Consumer groups did so too - but in some cases were urging tougher action -while academic respondents opposed the new licences due to perceived risks to competition and, potentially, in turn, to consumers.
19. The Authority debated a number of modifications to the licence conditions and guidance in the light of the consultation exercise, including removing the reference to compensation in the enforcement processes, and the suggestion that there should be references to the guidelines in the licence conditions. These were agreed as acceptable, as was a proposal to apply a 50,000 customer threshold test to Licence Condition B. It was agreed that the measures should be consulted upon. The Authority would be kept informed of the results of the next consultative steps; and agreed that the decision on whether to make the modifications, if there was not a blocking objection, should be delegated to the MD Markets in consultation with Executive colleagues.

Retail market remedies

20. Under this item, the Authority discussed a paper and presentation on the development of a package of remedies to improve the functioning of the retail energy supply market, following the recent close of a consultation exercise launched in April. The key objectives were to improve the quality and accessibility of information available to customers to inform their decisions on supply; to empower more customers to engage effectively in the market; and to secure greater transparency on the activities of major supply and generation businesses, thus promoting confidence that markets were fair and competitive.

21. Some 42 responses had been received and analysis, still under way, showed that there had been broad support for both the objectives and the proposals, many seen as helpful and pro-competitive. There had been concerns over the risks and unintended consequences not least to customers from the suggested ban on automatic contract roll-over and on the particular proposals put forward to address debt-blocking in cases of adverse contractual change, though these had gained some support of consumer groups. Aspects of the proposals for new systems of financial reporting by the "Big Six" companies – showing profits, underlying costs and revenues separately for gas and electricity consumers, and domestic and non-domestic consumers – had raised company doubts as to the value of all of the data requested, and the compliance costs. Other aspects of the retail package remedies appeared to be relatively uncontroversial and included new debt thresholds for PPM switches, simplified presentation of tariffs, switching guarantees, accreditation of non-domestic switching sites and market monitoring, though aspects of detail would need to be addressed.
22. The Authority was invited to agree the way forward involving further discussions with interested parties - some of whom had themselves suggested revisions to the remedies – with the aim of bringing a revised package to the July meeting of the Authority for finalisation ahead of statutory consultation, with a view to certain provisions coming into effect in Autumn 2009. In debate, the Authority agreed that alternative versions of the important measure to prevent debt-blocking in instances of adverse unilateral contract variations (such as price increases) should be pursued with suppliers and consumer bodies. On the rollover of small business contracts, the Authority agreed that a variant should be pursued to address the concerns identified, which fell short of an outright ban. These proposals would provide greater transparency and minimum contractual standards and offer a proportionate response to the problems identified. On new financial reporting requirements, the Authority agreed that the best balance between benefits and costs could be achieved by requiring companies to publish separate financial information on their gas supply, electricity supply and electricity generation businesses.
23. The Authority looked forward to the results of further work and discussions with stakeholders, with revised proposals on the lines agreed, and updates on the remainder of the package of measures, for presentation at its July meeting.

Smart meters

24. The Authority discussed a note on the possibility of a role for Ofgem in the preparatory work for the proposed programme for introduction of smart meters, and on which there had been further discussion with DECC. It had been suggested by DECC that Ofgem should collaborate on the first phase of the preparation programme to Spring 2010 on the aims and objectives of the programme, including matters of scope. The second phase, running for some 18 months, would deal with the implementation of the necessary framework in preparation for the deployment of smart meters. The Authority was also presented with an initial, high-level view of the risks seen for the main elements of the planned work.
25. The Authority agreed that, since the issues to be addressed in the preparatory phase would have fundamental implications for a wide range of Ofgem's responsibilities, teams should work closely with DECC, offering to take a lead role for the first phase of the work, subject to the important proviso of there being sufficient management and financial resources. On Phase 2, there were a number of project models for the respective roles of Ofgem and DECC, with differing responsibilities for leading and ownership. The Authority noted the key choices and comparisons, and looked forward to further guidance in the light of continuing discussions.

Direct Debits

26. The Authority's views were sought on the next steps on a range of direct debit issues, last considered at its March meeting, and on which consultations had now closed. An analysis of the results was presented. The consumer concerns over the winter which had prompted Ofgem's investigation had been that some consumers' direct debit payments had increased beyond related movements in energy prices, even for those in credit. Ofgem investigations had produced no evidence of deliberate attempts by suppliers to set unjustified prices to assist their cash flows. Volatility in prices had not helped matters. But poor transparency and communication by suppliers were major issues. The call for proposals at voluntary level, through an ERA code, had led to disappointing responses. Action through a licence condition to address the concerns had been proposed in consultation.
27. The Authority considered the responses, including further action from suppliers and views of consumer groups, and concluded that introducing a high-level outcome-focused licence condition, together with clarificatory changes to the marketing licence condition proposals being progressed in the retail probe, would be an appropriate and proportionate response to the problems identified. This would signal the importance of improved customer service, as well as contribute to the development of competition. Ofgem was asked to proceed accordingly.

Offshore electricity transmission

28. The Authority discussed a paper seeking conclusions on the proposed detailed governance framework – including proposed delegation of authority - to be used for taking decisions during the tender process for the selection of Offshore Transmission Owners (OFTOs). The paper also provided an update on current issues in the development of the offshore regime with respect to the qualification of projects for the first round of tenders, on cost assessment and on tender cost recovery matters. The Authority thanked the members of the Offshore Transmission Team, and the Authority Offshore Transmission Committee, for their considerable work on the detail of this novel and challenging project. It noted that the Tender Regulations had entered into force, and that the "Go-Active" date was 24 June, with tenders expected to commence from late July. A significant number of informal bidder registrations had been lodged and more were expected.
29. The Authority agreed that, for its effective operation, the tender exercise would need key decisions to be taken, on a day-to-day basis, in a robust and timely manner, and on a wide range of issues. These included matters on timing, developer qualification, tender documentation, selection criteria, bidder selection, the granting of licences and their modification as necessary, cancellation procedures and the consideration of representations. There was also the need to determine *ex ante* estimates of the transfer values for first round projects. It was agreed by the Authority that certain decisions should be taken, under delegated authority through the authority vested in the Chief Operating Officer and the Director of Regulatory Services. The Authority agreed that there would be value in setting up a Tender Review Committee for key selection decisions, as an internal Ofgem committee, and approved its membership and terms of reference, as proposed. The Authority noted that governance arrangements would relate only to decisions on the tender process and the granting of licences: oversight and annual approval of tender governance arrangements would continue to be exercised by the Authority, with the involvement and advice of the Authority's Offshore Transmission Committee. A proposed increase in the membership of Non-Executive Members of the Committee to three was agreed.

Market power concerns in the wholesale electricity sector

30. A paper under this item provided an update on the options for addressing market power concerns in the wholesale electricity sector against the background of a

Competition Act 1998 investigation initiated in 2008; and the results of the consultation exercise, launched in March 2009, after that case had been closed. The consultation had proposed ways forward for tackling undue exploitation of market power in the GB sector, seen as important for protecting the interests of all electricity consumers. The Authority's preferred mechanism at the time – the introduction of a broad licence condition (the MPLC) applicable to all generators – had been indicated.

31. The paper now proposed, after consideration of consultees' responses, that a form of MPLC should be developed and included an analysis of the possible routes forward for implementation; and the design principles which might apply. The Authority accepted that the prospects for action under a Collective Licence Modification for introducing a market power licence condition were poor; and (given that legislation would be needed in any event if an appeal mechanism were to be included) that other legislative routes should now be explored, including liaison with DECC on the options for primary legislation.

European energy policy: Third Package

32. A short paper, for information, on the EU's Third Energy Package, recently agreed and expected to be adopted shortly, was tabled. This covered the main elements of the Package for seeking further liberalisation of the European energy markets; and the key issues arising for the implementation of its provisions in Great Britain and the likely timing and transitional provisions.

Independent DNOs

33. The Authority noted a brief trailer paper on independent network operators, for gas and electricity, recalling the commitment in the Corporate Strategy and Plan 2009-2014 to keep under review the relevant market and regulatory arrangements, and highlighting matters of current interest. It was proposed that the Authority should review a fuller analysis in the Autumn.

Vulnerable customer disconnections

34. A trailer paper was provided for the Authority on the review being undertaken, together with Consumer Focus, on vulnerable customer disconnections. Action was designed to ensure that suppliers had adequate processes in place to protect vulnerable customers from disconnection, and the workstreams being pursued were described. It was agreed that further proposals should come to the Authority for decision at its July meeting.

Other business and date of next meeting

35. The Authority was briefed on the main issues arising in the proposed Centrica transaction with EDF/BE as submitted to the OFT on 8 June, involving a proposed acquisition by Centrica of a 20% stake in the EDF subsidiary company which now owned BE. The Authority agreed that the Chairman and the Chief Executive would agree any written submission to OFT.
36. The next Authority meeting would be held at Ofgem on **16 July at 8.15 am**.

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	

Those attending

Charles Gallagher	(all items)
David Ashbourne	(")
Rachel Fletcher	(DPCR5) (SP losses)
Mark Cox	(")
Kieran Donoghue	(")
Chris Watts	(")
Nicola Cocks	(")
Declan Tomany	(SP losses)
Maxine Frerk	(Probe issues) (Direct debits)
Jude Cummins	(")
Emma Kelso	(")
Richard Hall	(")
Louise van Rensburgh	(Smart meters)
Roy Field	(Offshore transmission regime)
Bob Hull	(" " ")
Stephanie McGregor	(" " ")
Edward Ntephe	(" " ")
Sam Cope	(" " ")
Ian Marlee	(MPLC)
Duncan Sinclair	(")
Coleen Hanley	(")
Ben Woodside	(")
Leonie Bensted	(")
Michael Brocklehurst	(Legal Adviser to the Authority)
Dr Tony Burne	(Secretary to the Authority)