Minutes of a Meeting of the Gas and Electricity Markets Authority

Thursday 13th October 2011 at 8.00 am

Ofgem, 9 Millbank, London SW1P 3EG

Introductory remarks by the Chairman

1. There were no apologies for absence. The Chairman noted the interest of a Member whose institution was in receipt of some funding from the energy industry; and that of another Member who was providing help to a company advising on complaint handling: should their future work involve the energy sector, the Member would not take part. Both Members agreed to keep the Ofgem briefed on any changes and perceived conflicts arising.

2. The Chairman and the Legal Adviser noted that a number of small changes were needed to the membership provisions for Enforcement Committees, following recent personnel changes and promotions. These were explained to and agreed by the Authority.

3. The Authority noted that an internal audit review of Authority governance procedures was taking place, conducted by Deloitte.

4. The Chairman noted that NEDs’ views on the current working of remote access IT systems were being reviewed by the Secretary, who would be in touch further, in due course.

5. There was potentially a need for an additional meeting of the Authority in November, in the light of developments in particular on aspects of DECC energy policies and their implications for Ofgem. Members would be alerted accordingly.

Minutes of the Authority Meeting held on 15th September, 2011

6. The minutes of the previous meeting were approved, it being agreed that some minor drafting changes could be taken forward before the minutes were published.

Reports from the Chief Executive, Senior Partners and MD E-Serve

7. Briefing was provided by the Chief Executive, Senior Partners and the MD E-Serve. The Chief Executive’s briefing drew out some of the implications of a reference of the operation of the energy markets to the Competition Commission.
8. The briefing from Sustainable Development Division noted the current position on the Energy Best Deal, funded by suppliers, and carried forward in partnership between Ofgem and Citizens Advice, providing advice on energy matters. Some 94,000 people had benefitted through frontline advisers, with almost a third then taking action to secure a better energy deal, by contacting existing suppliers or by switching. The scheme would see increased funding and activity in its next phase, with all suppliers contributing.

9. On the Competition landscape, it was understood that the outcome of Ministerial consideration was due later in the month. Work continued on the consumer landscape reform proposals, and respective roles on advocacy and enforcement investigation. Further reports would come to the Authority, including on the implications for Ofgem, in due course. There was growing interest in HMG’s Red Tape challenge, from Parliamentary and industry viewpoints, and Ofgem would continue to liaise with DECC on departmental progress.

10. The Authority was presented with its regular report from Markets Division, with information on oil and gas prices and their movements; the position on gas storage; and the make-up of UK gas supplies. On electricity, the UK power curve had shown a recent decline, in response to falling gas prices. The forward curve showed cheaper UK prices compared to Continental prices though reversals in relative price positions towards Winter 2012. Data were presented on wind generation curtailment since the Spring.

11. On the Winter Outlook, National Grid had recently published their analysis. From this, it was noted that gas demand was predicted to be marginally less than in Winter 2010/11, when weather corrections were applied, with a response to higher prices and continuing energy efficiency. Power generation demand was likely to reduce peak demand for gas. Supply flexibility – and the use of import capacity and storage draw-down – was forecast to follow the experience of 2010/11.

12. NG foresaw an increase in assumed electricity availability on last year’s figure, allowing for some plant capacity reductions. The main increases were in CCGTs and a predicted increase in wind generation. Figures for a one year in 20 demand pattern would require some imports from interconnectors to Continental Europe. On balance, the NG view was that Winter 2011/12 should be manageable for both gas and electricity.

13. Information was provided on the statutory Security of Supply report, under which DECC and Ofgem informed Parliament annually on security of supply matters. This would note the many changes under consideration for the future of the electricity market, and the outlook for the gas market which looked well supplied in the near term, though there were some longer term uncertainties on which Ofgem would be working, including on
the Significant Code Reform processes in changes in cash out, as recently discussed and agreed by the Authority. An accompanying risk assessment would also be published in November.

14. The Authority was brought up to date with the latest plans for the DECC programme on the roll-out of smart meters and the regulatory implications for Ofgem. Plans were in place for a consultation paper on the potential scope of reform of the electricity cash out arrangements as part of Ofgem’s work on Significant Code Reviews. There were also DECC planned consultations on licence conditions to address market abuse at times of transmission constraint.

15. Finally, and on liquidity, the Authority noted that one company had acted to put all its day ahead trades through the N2EX auction processes. The Authority would be briefed on this and the wider package under development to address liquidity issues at its December meeting.

16. A brief from Smarter Grids and Governance/Distribution Division noted the close working with GDNs on the RIIO criteria and their importance for company Business Plans. The Ofgem/DECC Smart Grid Forum was making good progress, commissioning studies from Forum members, and was looking at future network use scenarios, and the potential role and benefits of smart grids. Meetings were being taken forward with DNOs and those representing distributed generation interests, and were focussed on potential service improvements on issues such as connections processes and their timing. Consultations now in hand were considering the future governance and ownership arrangements for Xoserve, the data systems provider for the gas industry on gas balancing and transportation billing, and the changing needs from the introduction of smart meters. Recommendations would form part of the RIIO-GD1 package in due course.

17. The briefing from Smart Grids and Governance/Transmission Division explained progress on the agreed one year roll-over of TPCR4, such that the next transmission price control could fully reflect the new RIIO framework. Final proposals would be put to the Authority in November. Analyses were being updated in the light of revised cost forecasts from the companies. In respect of the National Grid Gas insulated switchgear cartel case, and the NG legal action to recover damages in the light of the Commission’s rulings, Ofgem’s request for sight of the pleadings - and notice of a possible intervention in the light of these - had been submitted to the High Court.

18. On the TransmiT project, the weekly industry working meetings were now ending. Considerable headway had been made on technical issues, and working papers had been published. Ofgem’s consultants were completing
modelling studies on potential charging systems. The Authority would be further briefed in November, prior to an end-year consultation exercise.

**Report of the Group Finance Director**

19. From his report, the Group Finance Director focussed on the following issues:

- The present financial overview, including spend in relation to budget
- The higher spend now anticipated on projects such as EMR and the Ofgem impact of the EMR package, plus training and recruitment which would rise in response to increasing staff numbers
- Staff in post figures, and recruitment plans for Q3
- Projected turnover for the year
- The work of the Team, experimental at this stage, following inputs from the Senior Management Team and the Audit Committee, on internal performance monitoring within Ofgem. This covered the measures being developed on four of the themes of the Corporate Plan and some related key performance indicators
- An analysis of the delivery of all major projects across Ofgem, their current status and the plans to consult the Authority

20. The Authority welcomed this report, noting especially the valuable work on KPIs. The progress of work on these should be reported regularly to the Audit Committee and also to the Authority.

**Retail Market Review**

21. At this item, the Authority considered a presentation covering a range of detailed proposals for action following the Retail Market Review. The Authority recalled from previous analyses its conclusion that there were a number of interrelated features which reduced the effectiveness of competition. These included the so-called “sticky customer” issue, tariff complexity, a number of structural market features, and the behaviour and strategies of the major suppliers. Overall, there had been disappointing responses from suppliers and insufficient beneficial change following the Ofgem Probe and its proposed remedies.

22. The Authority first reviewed progress since March which had included consultation and engagement with key stakeholders; extensive consumer research and testing; design work aimed at simplifying tariffs; further work on Probe remedies; and the drafting of impact assessments. The objectives remained the enhancement of competition; improvements in consumer
confidence; the promotion of innovation; and the protection of vulnerable and disengaged customers.

23. The Authority considered a range of detailed proposals from the Executive on tariff comparability for both standard and non-standard products, all aimed at giving consumers a clearer choice than from among the 400 or so tariffs currently offered. Under core proposals each supplier would be required to offer just one standard tariff for each type of payment. With the standard charge set by Ofgem, suppliers would be able to vary only the unit price, so enabling better comparison. The proposals also covered measures to allow customers the choice of more innovative tariffs, with suppliers being required to express prices using standardised price information to assist effective comparison.

24. On information, the proposals would also encompass more prescriptive regulation of bills, annual statements and notifications about price increases. The development of these measures would be thoroughly tested with consumer interests. There would be proposals for the creation of an energy label for every tariff, giving consumers the information they would need to make comparisons. Further, Ofgem would seek new powers, it was proposed, to provide for customer redress - such that compensation could be provided when licence conditions and other obligations had been breached by suppliers. It was also suggested that Government should give to Ofgem the responsibility for running the Confidence Code for price comparison websites, to ensure consistent and reliable advice online, and the ability to report company performance. Further work was proposed with HMG to see what additional steps might be taken to protect vulnerable customers.

25. In debate, the Authority reaffirmed the overall direction of travel of the Review and its conclusions, and the specific measures developed. It supported the proposed communications plan and the immediate launch of the outline proposals. Each was seen as a proportionate response in dealing with a number of aspects of needed reform to create a simpler and more competitive energy market. The Authority concluded also that a reference to the Competition Commission for a Market Investigation Review remained an option should it be considered that the remedies were unlikely to prove effective.

26. The Authority noted that detailed proposals to reform the energy market to help the business sector would be published in November; that further decisions on increasing liquidity in the electricity wholesale market were being prepared for discussion and decision in December; and that the New Year would see the findings of an independent report into energy company reports and their transparency. The Authority offered its congratulations to
the teams across Ofgem who had worked hard on both the Review and on the proposed steps to take forward its recommendations.

Quarterly Review

27. The Authority was briefed on the content of the Electricity and Gas Supply Market Report, due to be published soon. Wholesale energy costs had continued to rise – particularly for gas, with the price of Winter gas for 2011/12 projected to be some 40% higher than for last Winter. Increases had been driven by global rises in oil and gas prices. An analysis of the net margin on supply for typical standard tariff, dual fuel customers indicated a figure of approximately £125 per customer for the year from October 2011, a significant rise compared to the net margin indicator released in June by Ofgem. Current Ofgem projections suggested that, due to the persistence of high forward wholesale energy costs, net margins would start to decline gradually over the coming months. The Authority discussed the findings and the communications plans, the link to the Retail Market Review, and work in train on forensic analysis of company accounts commissioned by Ofgem. The planned Energy Summit organised by No 10 for the following week was also noted.

Strategy and Policy Statement

28. At this item, the Authority was informed about the discussions with DECC on the development of a Strategy and Policy Statement (SPS) - which would replace existing social and environmental guidance - and how this would work in practice. A number of issues were noted concerning the relationship between the SPS and Ofgem’s Principal Objective and statutory duties, and its role as a National Regulatory Authority. It was agreed that these should be pursued with DECC.

European Developments: Duties and Powers

29. The Authority considered the key changes to its powers and duties, as a “National Regulatory Authority”, under the EU’s Third Package Directives. The EU measures were currently being transposed into domestic legislation. These would herald some important changes to the Authority’s decision-making, including on GB licence and code modifications, and in respect of market arrangements, including:

- The strengthening of licence modification powers with the ability to settle and impose changes, but subject to ex post appeal. These new powers apply to all licence conditions whether or not they related to regulatory tasks under the Third Package

- Ofgem would also have powers to take enforcement action against breaches to the European Gas and Electricity regulations and would need
to ensure compliance with binding decisions of ACER (or of the EU Commission) under the ruling Directives.

- NRA decisions must now also be consistent with Ofgem’s new duties to promote cross border trade and to promote regional and pan European gas and electricity market integration. Ofgem’s decisions would require explicit consideration of the cross-border impacts.

- The need for NRAs to consult and cooperate with other NRAs and with ACER

- New and enhanced monitoring functions, including on TOs’ investment plans, market transparency and market opening/competition, at both wholesale and retail level

- Increased emphasis concerning the independence of EU NRAs from Governments, to provide for the impartial and transparent exercise of powers, and the taking of autonomous decisions. Thus, NRAs may not seek or take direct instructions from government or any other body when carrying out their regulatory tasks, though Governments may set overall energy policy, offer general guidelines to NRAs, and set certain public service obligations.

30. The Authority expressed its appreciation for this briefing, discussing some of the fundamental changes in prospect. These would include the implications for decisions on GB trading and transmission arrangements and interconnector policies, and charging regimes. The Authority noted that work was in hand with GB stakeholder interests, with a significant number of meetings completed to date, to explain these important developments and their impacts. Regional or bilateral contacts with EU Members States were addressing cross-border impacts. The active role being played by the Chairman and senior Ofgem officials at ACER and in its working groups was also much welcomed. The work within Ofgem to explain these changes and promote new ways of working was noted.

E-Serve Quarterly Report

31. The Authority was presented with the Quarterly Report from E-Serve, plus a briefing from the Chairman of the E-Serve Programmes Committee, Jim Keohane, recording the main issues discussed at the Committee’s first meeting on 12 October. The Authority noted the key developments within E-Serve as follows:

- Work on the implementation and further development of the offshore tender regime remained on track, with the issue of three licences for tender Round 1; Tender Round 2 was underway; and consideration of the future tender and regulatory regime was making good progress.
- Options for the support that E-Serve might be able to provide for the DECC’s planned Electricity Market Reforms was under consideration
- All deliverables required for the Stage 1 launch of the Renewable Heat Incentive had been achieved, on time, and as required.
- On the Energy Company Obligation, it was understood that DECC were to undertake a market test of the administration options
- The half-yearly update on the Community Energy Saving Programme had been published in early September, with data on parties’ savings against overall CESP target savings of CO₂
- Some 80,000 installations had registered by the end of Q2 under the Feed-In Tariffs scheme, about the double the forecast number. This volume - and the subsequent series of legislative changes – were making significant demands on Ofgem E-Serve’s resources and points had been raised with the Department
- leave for appeal in the JR decision had been submitted, as agreed at the Authority’s September meeting

32. The Authority thanked the MD/E-Serve and his Teams for this report of good progress, and the series of supporting analyses, noting the current pressures, and offering its congratulations on the high delivery being achieved.

**Independent Directors: potential changes to the ring fence conditions of Network Operator licences**

33. The Authority recalled its discussions, following the financial crisis of 2008, on a review of the management of financial risk among network operators including further consideration of the ring fence provisions, and their current fitness for purpose. These had been in place since the mid-1990s, with the network licences setting a number of provisions designed to insulate licensed businesses from inappropriate external pressures; and to protect business assets paid for by consumers. A series of improvements had been now proposed, in the light of the review and Authority guidance, and two consultations had followed on revised proposals, the last with illustrative draft licence modifications.

34. The Authority noted the main elements of the proposed changes which covered: disposal of relevant assets; availability of resources for network operations and related compliance; ultimate controller obligations; restrictions on indebtedness and the payments/transfers which could be made to network company affiliates; and the requirement for two sufficiently independent directors (SIDs), as a new licence condition.
35. The last of these proposals had given rise to significant and opposing comment by some network operator interests. In debate, the Authority examined the arguments for and against the SID proposals, looking at factors including their value, impact, risk, the practice among other regulators, Company law and external advice, the EU aspects, and the roles of all directors as a whole on network licensee Boards.

36. The Authority agreed the recommendations made to it by the Executive for improvements to the ringfence conditions and concluded that Ofgem should work them up further for implementation with effect from April 2013.

**National Grid Gas: Revenue Drivers**

37. The Authority was briefed on requests which had been put to National Grid Gas for potential new connections to the National Transmission System (NTS) in the South East of England. If all such proposed projects were to come about, there would need to be significant NTS reinforcement. New NTS capacity would be allocated through auctions with NGG remunerated for the provision of new capacity through a revenue driver based on the ex-ante estimate of efficient costs.

38. The Authority was informed on a consultancy study of NGG’s analyses of the reinforcement work needed and the proposed costs, and also their potential consumer impacts. The Authority agreed, as a reserved matter, the recommendation that Ofgem should consult on the proposal to include the necessary revenue drivers in NGG’s transporter licence. This would allow shippers to bid for incremental capacity in the March 2012 quarterly auction. The Authority also noted that associated revenues would go to NGG only if firm user commitments were obtained for the additional capacity, at auction.

**RIIO-Transmission: Energy companies’ Business Plans**

39. The Authority was consulted on transmission owners’ business plans in the context of the RIIO-T1 price control round, including the results of engagement with the companies on the details of their plans and the work of the Authority’s Price Control Committee. This covered summaries of the key assessment criteria – dealing with process issues, outputs, and their delivery, resources and efficient expenditure, efficient financial costs, and the way in which business plans proposed to deal with risk and uncertainty. The Authority was also briefed on the fast-tracking processes for business plans - this incentive being designed to encourage the submission of quality business plans - and Ofgem’s initial assessments as to suitability for this treatment.
40. The Authority agreed that, on the basis of the analyses at this stage of the development of TOs’ business plans, and with a range of issues still in discussion with each TO, none of the plans was at present ready to be recommended and confirmed immediately for fast-tracking procedures. All TOs had responded positively to early Ofgem feedback and this was to be welcomed. However, a number of outstanding issues would need to be taken forward with the companies to satisfy the key assessment criteria. Two companies were nonetheless recommended for retention and consideration in the fast-track process, and the reasons were explained. The Authority proposed that the RIIO-T1 Committee of the Authority should continue its work and advise further on these issues, with a view to publication of the results of initial assessments at the end of October.

Report from the Audit Committee and Risk Workshop

41. At this item, the Authority received a short report from the Chair of the Audit Committee. She noted that the Committee had received and debated updates on the extranet security breach earlier reported to the Authority, from Ofgem’s IT team, on the companies potentially affected, and with advice from Internal Audit. The Authority agreed the proposals for strengthening IT security capacity as devised by management and outlined to the Committee.

42. The Committee had considered the various assurance measures and reviews, over the preceding 12 month, in respect of the Renewable Heat Incentive scheme being administered by E-Serve, noting the main area of risk as being payment volumes. Further audits would be taken forward by Deloittes. Following the useful Risk Workshop in Glasgow, an updated Strategic Risk Footprint had been produced, as shown. The Committee had noted a report from the Head of Internal Audit, a recent NAO report on Smart Meters, and had considered and agreed the reporting arrangements between itself and the new E-Serve Programmes Committee.

HVDC: “Western Bootstrap” cable

43. The Authority had reached a “minded to” position, at its July meeting, to allow efficient cost recovery for construction works on the Western HVDC link from 2011/12 under the Transmission Investment Incentives. This was subject to considering responses to consultation, positive conclusions from continuing project assessment and the satisfactory resolution of a number of licensing and planning matters. There was now further supporting evidence to underpin the initial view that TOs should be enabled to maintain their current programmes for delivering the link in 2015. Funding proposals were not yet ready for consideration, but would be developed, if the Authority maintained its view, including on the levels of funding and appropriate incentive mechanisms to minimise costs.
44. The Authority confirmed its agreement in principle on efficient cost recovery, noting the progress made in respect of each of the conditions set earlier. It agreed the case for delivering the Western HVDC link in 2015 noting the expected consumer benefit, as indicated by the available Cost Benefit Analysis, and the greater risks to consumers if the investment in the link were delayed rather than delivered ahead of need. The Authority hoped that the TOs would now make progress towards contract awards to enable the planned 2015 delivery of this project.

Green Deal

45. Under this item, the Authority considered the key issues for Ofgem arising from the Government’s Green Deal proposals, to be carried forward via supply licence modifications, industry agreements and in consumer codes. DECC were planning to consult on proposals in October. A number of issues had arisen concerning future enforcement of the proposed Green Deal Arrangements (GDAA) between providers and suppliers, the impact of the proposals on small suppliers, undue price discrimination, and on switching and customer information on bills and annual statements. The Authority noted these and agreed that discussions should continue with DECC on the underlying policy issues at stake before proposals were put to consultation.

Offshore Cost Savings

46. A update was provided for the Authority setting out current analyses of the estimated overall savings which could be achieved in the first round of tenders, this being an important indicator of the expected benefits from running competitive tenders for a 20 year tender revenue stream (as compared to equivalent onshore transmission costs). The methods and calculations had been subjected to external consultancy review, and the Authority’s Offshore Committee had considered the results. The Authority noted the emerging results and the further detailed analysis in train. NAO would be involved in a later review before planned publication of final projected savings figures at the end of the first tender round in 2012.

Offshore Transmission Coordination Project

48. The Authority was provided with an update on the costs and benefits of coordinated network development in respect of offshore assets, possible barriers, and measures to address those barriers. The work provided a basis for contributions to EU consideration of the development of a North Sea Grid, through the North Sea Countries’ Offshore Grid Initiative. The paper noted the work and proposals of National Grid (as NETSO) and compared estimates of cost savings for radial connections as opposed to fully meshed solutions. The Authority looked forward to further advice, including that of its Offshore Committee, in due course. [It noted the current view that flexible and
incremental approaches to network development appeared to have benefits over large-scale meshed networks planned, at the outset].

**Smart Metering Spring Package: Non-Domestic Customer Protection**

49. Details were provided to the Authority, for information, on the proposed approach to protecting the interests of non-domestic customers in response to early moves from suppliers to install smart meters. The Authority recalled that the Spring Package dealt with steps to protect principally domestic customers for example against remote disconnection. There were, however, a number of areas where there could be harm to non-domestic customers and hence the need for proportionate safeguards. Specifically, it had been suggested that the present requirements on provision of notice before disconnection or requiring pre-payment measures should apply equally to non-domestic customers, as well as the provision of rapid re-connection and compensation for disconnections made in error.

50. In response to consultations, and the evidence available, Ofgem favoured a self-regulatory approach to secure these protections in the non-domestic sector in respect of any early moves by suppliers to install smart meters. This would be complemented by increased monitoring, and information gathering from suppliers in respect of business customers. Guidance would be issued and the package of measures reviewed in 12 months. The Authority supported the steps being taken.

**Enforcement cases**

51. At this item, the Authority considered and noted its monthly schedule of enforcement cases and the progress of each case under review.

**Other business and date of next meeting**

52. There was no other business. The next Authority meeting would be held on **Thursday 24 November in Cardiff**, starting at 8.15 am, and preceded by a Dinner for senior contacts in Wales on Wednesday 23rd November at 7.00 pm.

**Those present**

The Lord Mogg (Chairman)
Alistair Buchanan (Chief Executive)
Stuart Cook
David Harker
Sarah Harrison
Those attending

David Pimm (all items)
Rachel Fetcher ("")
Hannah Nixon ("")
Ian Marlee ("")
Michael Brocklehurst (Legal Adviser to the Authority)
Dr Tony Burne (Secretary to the Authority)
Emma Kelso (RMR)
Sarah Cardell ("") (Europe)
Paul Huffer ("")
Philip Cullum ("")
Megan Forbes ("") (SPS)
Nicola Cocks ("")
Joanna Whittington (SPS)
Andy McFaul ("")
Martin Crouch (Europe)
Pamela Taylor ("")
Anna Saksonov ("")
Mike Jenner ("")
Bob Hull (E-Serve QR)
Charles Hargreaves
Matthew Harnack
Paul Darby (Network Revenue Drivers)
Peter Trafford (RIIO)
Paul O'Donovan (NGG: Revenue Drivers)
Bogdan Kowalewicz
Jennie Griffiths (RIIO-T1)
Iain Morgan
Chris Watts
Stuart Featham