

Current Regulatory Issues in Energy Markets

Winter Outlook Seminar 2014

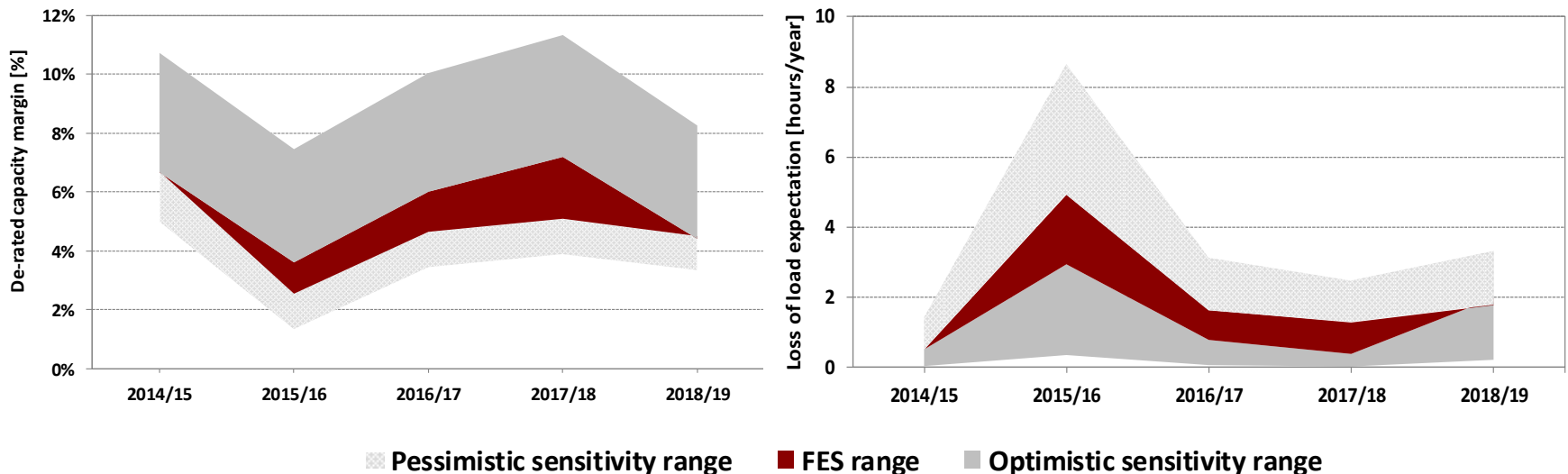
Emma Kelso
28 October 2014

ofgem

- Electricity: Margins are tightening and the outlook uncertainty has increased but National Grid has the tools to manage the system
- Gas: Outlook for gas security of supply is healthy despite the Russia/Ukraine situation as supply comes from a variety of sources
- Ofgem's wholesale and retail market policies aimed at enhancing security of supply and promoting a well functioning market
- Focus on monitoring: Retail Market Reform, Liquidity and REMIT

Security of supply outlook: electricity

- Electricity Outlook up to winter 2018/19 – Capacity Assessment 2014
 - Risks to security of our electricity supplies are expected to increase in the next two years before improving in the later years of our analysis (absent new balancing services)
 - New balancing services designed by NG and approved by Ofgem from 2014/15 will decrease significantly risks of supply disruption until the capacity market comes into effect
- Uncertainty: Difficult to form a best view – NG Future Energy Scenarios range with sensitivities



- The margins for winter 2014/15 are now lower than expected in the report due to latest events
 - The new balancing services ensure that the risk to customer disconnections remains low and within the security standard set by the Government
 - Significant upside

Additional tools to manage lower electricity margins from this winter. Ofgem has approved two services:

Demand side balancing reserve (DSBR)

Customers contracted to reduce electricity consumption during times of high demand on weekday evenings in the winter in return for a payment.

Supplemental Balancing Reserve (SBR)

Power stations contracted to be available on winter weekdays between 6am and 8pm and held in reserve **outside market.**

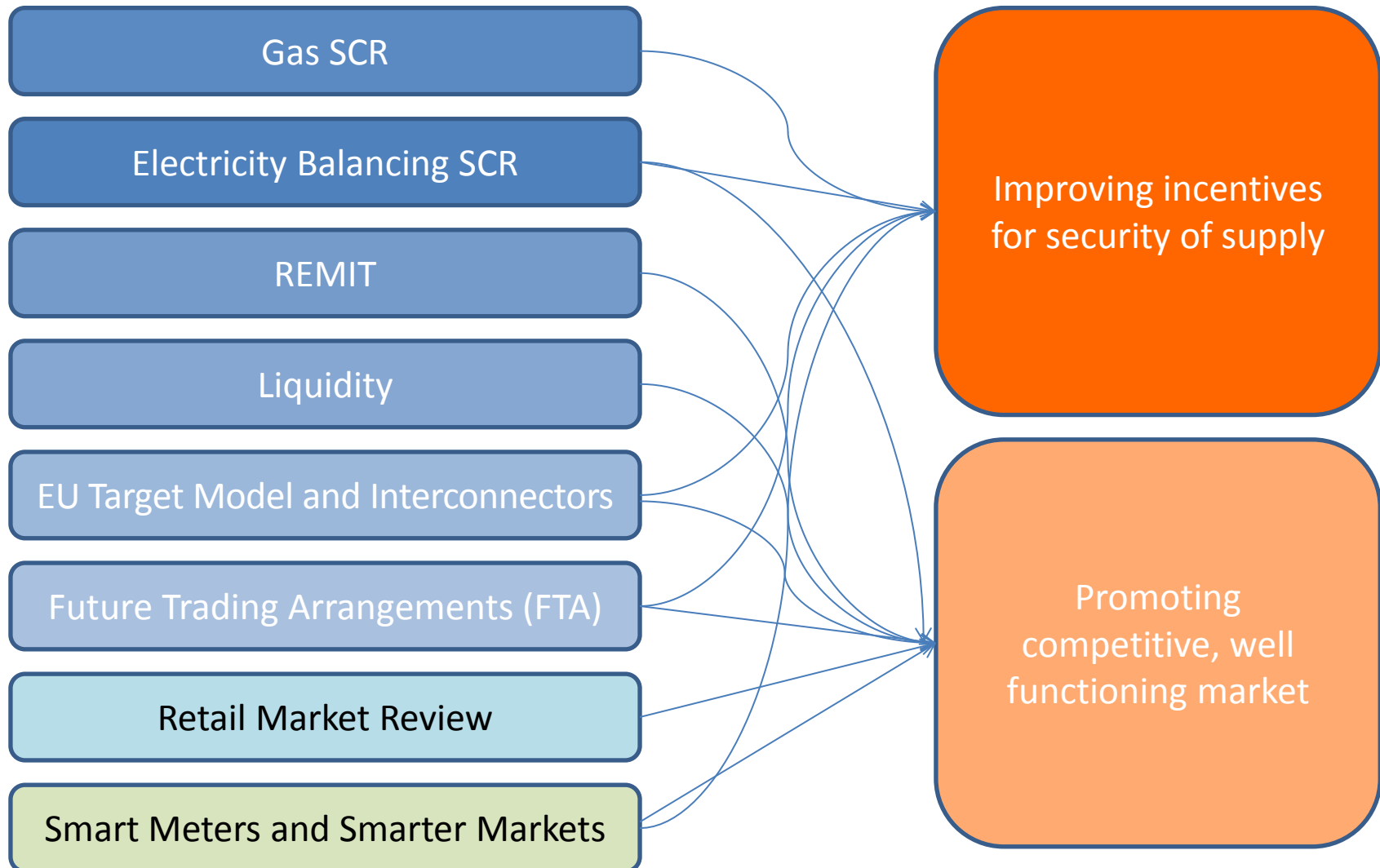
- These services can only be used by National Grid in the rare event that:
 - It needs **more** power/demand response to keep supply and demand in balance
 - This **cannot** be provided by the market
- For winter 2014/15 National Grid has:
 - **Run** a DSBR pilot in the summer which will allow learning through the use of these services
 - **Run** a SBR tender in autumn as a precautionary measure due to recent market developments
 - **Contracted 1100MW** of additional reserve capacity for this winter following these tenders.
- Ofgem ensures value for money for consumers by only allowing National Grid to recover costs for these services if they are consistent with the approved methodologies that:
 - **Estimate** the volume requirement
 - **Describe** the procurement process
 - **Set out** the process that to warm and dispatch the service providers

Security of supply outlook: Gas

- Gas storage stocks in GB are at their highest levels ever. This healthy storage picture is repeated in Europe, where storage levels are at very high levels compared to the historic averages
- However, storage is only one part of the picture. GB has a diverse range of sources of supply, including domestic production, pipelines from Norway, Belgium and the Netherlands, and liquefied natural gas terminals
- The healthy supply outlook has helped push gas prices lower despite the uncertainty created by the Russia/Ukraine situation
- Both National Grid's Winter Outlook analysis and DECC's stress-test submission to the Commission have highlighted the resilience of the GB system
- If disruption were to occur, it is likely the impact to GB security of supply would be indirect in all but the most extreme circumstances, and would be to prices rather than disruptions

The UK has a market-based system for ensuring gas security which has repeatedly shown itself able to cope with unexpected infrastructure failures and severe weather

Policy goals



Objectives

- Incentivise an efficient level of **security of supply**
- **Reform current arrangements** where 'cash-out' price is frozen on entering an emergency to provide more effective price signals

Conclusions (published 23 September 2014)

- **Strengthen price signals** by unfreezing cash-out in an emergency to ensure we can attract imports when needed most
- **Strengthen incentives** on shippers by making cash-out cost reflective by ensuring customer interruptions priced and paid for (VoLL for domestic consumers; DSR mechanism for large consumers)
- **Transfer risk** of an emergency from consumers to shippers who are better placed to manage the risk

Timings

- Cash-out reform implemented 1 October 2015
- Demand-side response mechanism target winter 2016/17

Interactions

- Interaction between gas and electricity security of supply with expected increase in gas fired power stations

Electricity Balancing SCR

Objectives

- Incentivise **efficiency in balancing and security of supply**
- **Reform current arrangements** to make cash-out price more reflective of the costs of balancing

Key Considerations in Scope

- Making **cash-out prices marginal**
- Including a **cost for disconnections into cash-out prices** (VoLL pricing)
- Improving the way reserve cost is allocated by using a **reserve scarcity pricing function**
- Moving to a **single cash-out price regime**

Timings

- Final Policy Decision published 15 May 2014
- Two code modifications raised by National Grid to implement
- Strongly urged industry to implement in phases with full package in place by winter 18/19

Key Interactions

- Interaction between gas and electricity security of supply with expected increase in gas fired power stations for electricity needs
- Interaction with Capacity Mechanism

Regulations

- EU Regulation on wholesale energy market integrity and transparency came into effect December 2011. Applies to trading in wholesale energy products that are not financial instruments under financial legislation
- Ofgem has specific Civil powers to monitor, investigate and enforce. We will be consulting on new guidelines procedures and penalty policies this Autumn
- DECC has recently consulted on granting Ofgem Criminal powers to enforce against Market Manipulation and Insider Trading breaches: If accepted, could take effect early 2015

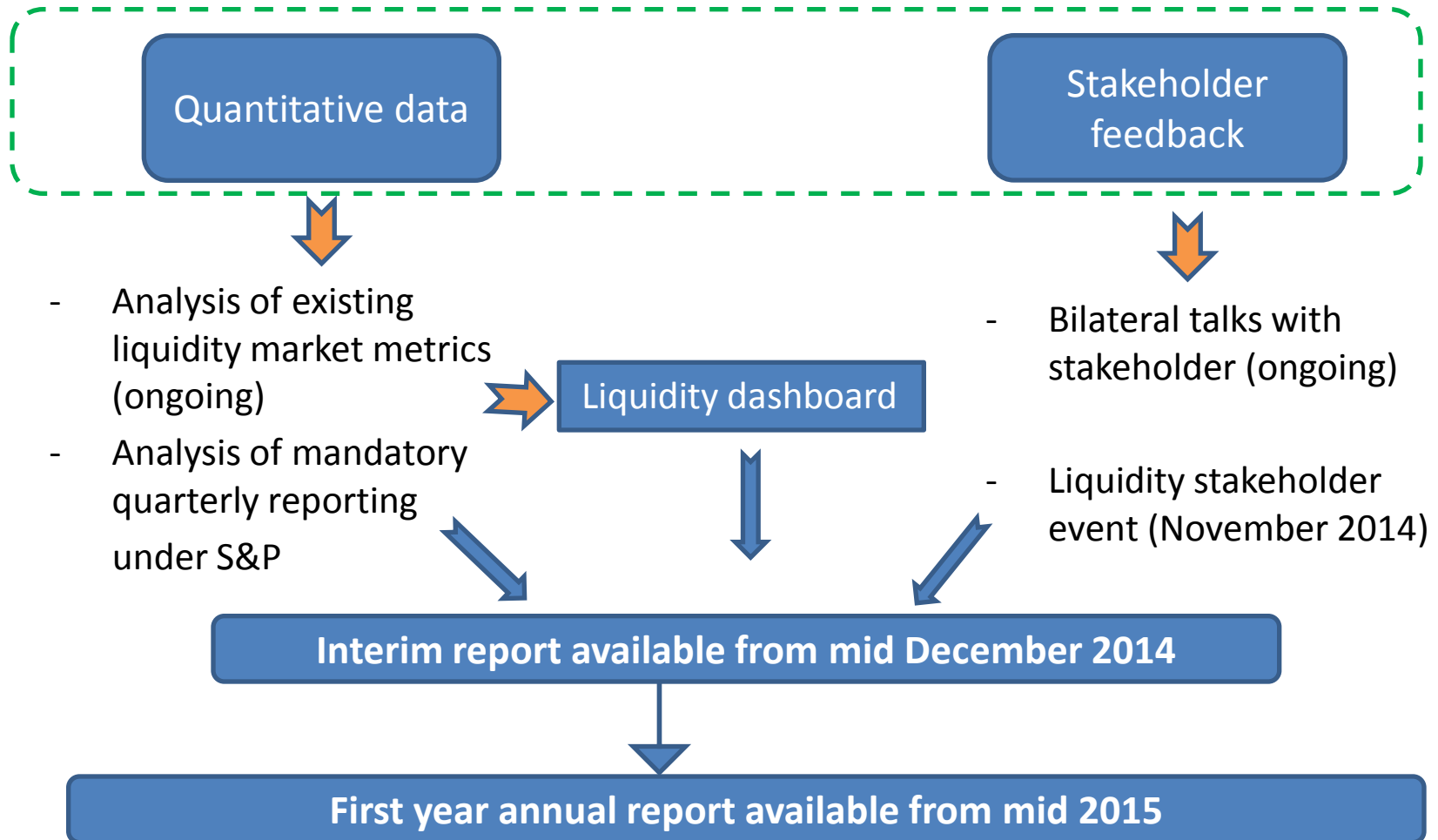
Developments

- In July, Ofgem published open letter summarising the findings of our review of inside information notifications. Market participants may wish to consider further
- Implementing Act text agreed 3 October. Expect to take effect end 2014. Reporting of standardised contracts to start 9 months after that
- ACER consulted on reporting manuals and procedures – to be released as soon as possible, but at least when the Implementing Acts take effect
- Ofgem to open Registration this year – further information to be released soon
- Active monitoring and investigation continues – email Market.Conduct@ofgem.gov.uk if you identify any unusual activities

- Cap and floor regime for new electricity interconnectors
 - Objective: Provide a clear regulatory framework for investors that facilitates timely delivery of efficient interconnectors
 - Five projects are currently being assessed as part of the cap and floor process, in addition to the Nemo project, for which our decision will be published shortly
 - Consultation on the need for and impact of these projects is due by spring 2015
- Internal Energy Market
 - Gas network code (NC) development/implementation significantly further ahead than electricity
 - Gas: NGG implemented Congestion MP; TSOs developing proposals to implement remaining NCs
 - Electricity: ACER has recommended 8 network codes (out of 10); no NC has been adopted
 - We are working with industry to identify the best way of implementing the rules in full and on time

Liquidity – monitoring and analysis

- Qualitative and quantitative monitoring of the progress of liquidity under Secure and Promote



- The FTA project and FTA Forum aims to:
 - Provide a focal point for stakeholders to engage on matters affecting trading arrangements
 - Ensure that trading arrangements remain robust to future developments
- Following prioritisation discussions with industry at the Forum, two workstreams initiated:

WS1: Locational Pricing

- Scoping out the challenges and dependencies of any changes to bidding zones
- Draft analytical frameworks, based on the requirements set out in the draft European network code (CACM)

WS2: Longer Term Market Arrangements

- Analysis of future challenges to the MA and consider whether MA need to change to remain effective.
- Provide direction to our short-medium term policy work ('future-proofing').

Next FTA Forum meeting due November, with a focus on Long Term developments. All FTA material is on FTA micro-site on the Ofgem website

- RMR rules aim to make the market simpler, clearer & fairer for consumers
- Finalised a large set of rules in 2013 with implementation in Aug 2013-June 2014
- Evaluation framework under progress
 - First year evaluation findings available from summer 2015

Simpler Market

- Limit suppliers to four core tariffs and simpler tariff structure to avoid confusion and enable comparisons.
- Balance innovation with complexity



Clearer Market

- We introduced **new communication tools** to help consumers engage with the market. We also made sure **existing communications** more useful and **engaging**

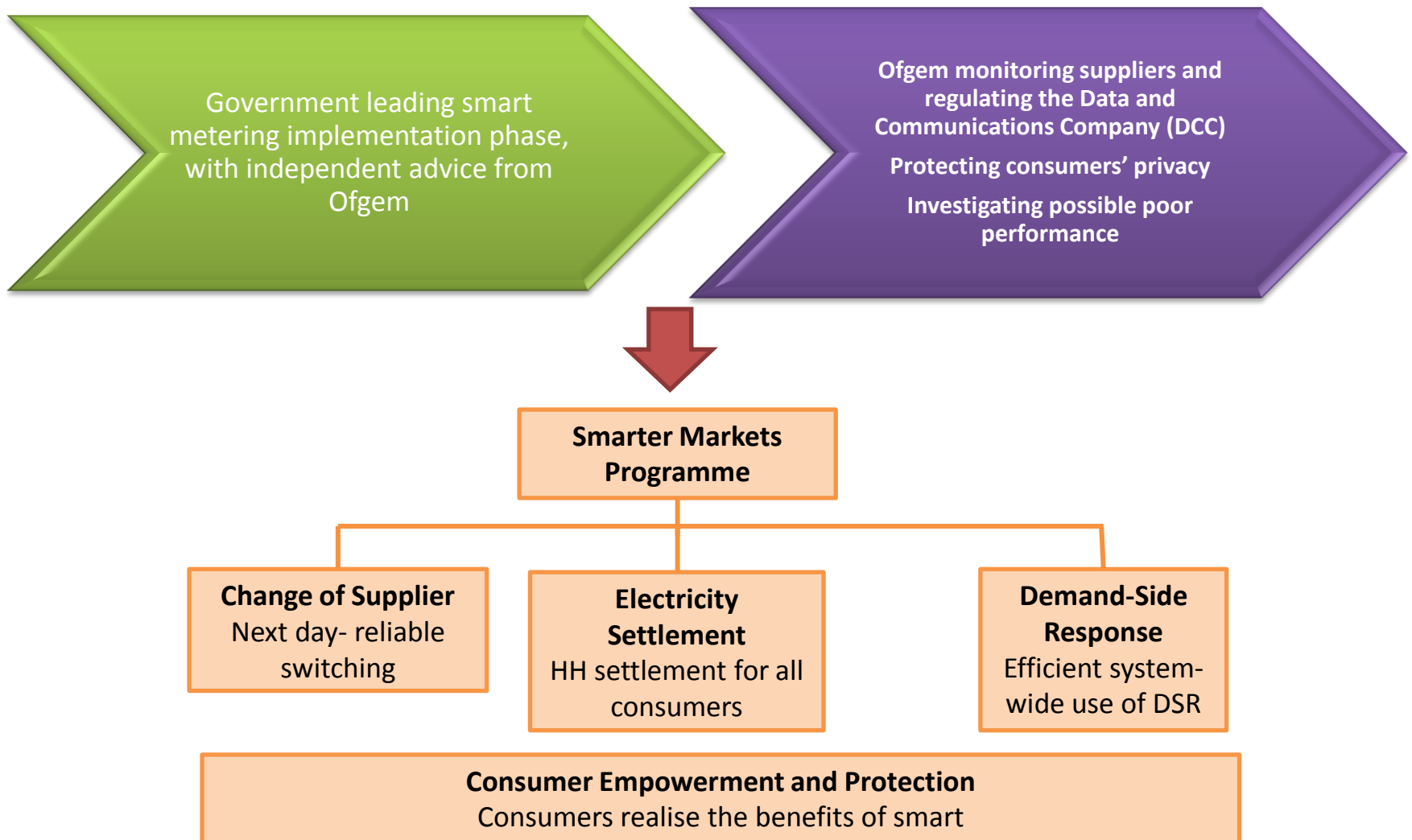


Fairer Market

- **Standards of Conduct** requirement for supplier to treat customers fairly – consumer interaction and additional **consumer protection measures** for domestic and non-domestic consumers



Smart Meters and Smarter Markets



- Electricity: Margins are tightening and the outlook is uncertain but National Grid has the tools to manage the system
- Gas: outlook is healthy
- We continue to closely monitor developments in security of supply and their potential impacts on consumers, including emerging opportunities (eg D side)
- Ongoing work across the supply chain aimed at promoting security of supply and competitive, well functioning markets
 - Focus on monitoring of implemented policies
- Flexibility: key challenge and opportunity going forward

Ofgem is the Office of Gas and Electricity Markets.

Our priority is to protect and to make a positive difference for all energy consumers. We work to promote value for money, security of supply and sustainability for present and future generations. We do this through the supervision and development of markets, regulation and the delivery of government schemes.

We work effectively with, but independently of, government, the energy industry and other stakeholders. We do so within a legal framework determined by the UK government and the European Union.