

Consultation on a Proposed Income Adjusting Event submitted by National Grid Electricity Transmission plc in relation to the 2015-17 Electricity System Operator Incentives Scheme

Consultation

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Overview:

This document requests views on an application for an Income Adjusting Event (IAE) submitted by National Grid Electricity Transmission (NGET) as the electricity system operator (SO). The application refers to the target year 2016-17, which is part of the 2015-17 incentive scheme.

NGET submitted a notice for an IAE on 24 May 2016 relating to the procurement of additional Black Start capability. NGET is seeking the adjustment of the Black Start target within the SO incentive scheme by £113m to reflect the cost of contracting additional providers of this service.

NGET's notice, redacted to remove information which may or does seriously prejudice a party, is published alongside this document. We will also make an information request to NGET to provide further information and evidence to support the application. The results of this request, where non-confidential, will be published when available.

The document outlines the process which the Authority must follow in assessing this request and details the questions on which views would be particularly welcome.

Context

National Grid Electricity Transmission plc (NGET) is the electricity system operator (SO) for Great Britain. It is responsible for balancing the electricity system by ensuring that generation on the national electricity grid matches demand on a second by second basis. To do this, the SO buys and sells energy and procures balancing services (also called Ancillary Services). It also provides valuable information to market participants, such as forecasts of wind generation. These actions are incentivised under the Balancing Services Incentive Scheme.

Ofgem regulates the actions of the SO to ensure its operational costs are optimised, delivering value for money to the consumer. Building on statutory obligations which require the SO to act in an economic, efficient, and co-ordinated manner, we have historically driven the performance of the SO and shaped aspects of its behaviour through incentives.

Included within these Ancillary Services is Black Start. Black Start is the process used to recover from an event that results in the shutdown of large parts (or all) of the transmission system. Isolated power stations are started individually and gradually reconnected in order to re-energise the system.

Associated documents

Notice on proposed IAE submitted by NGET on 2015-17 incentive scheme:
<https://www.ofgem.gov.uk/publications-and-updates/notice-and-consultation-proposed-income-adjusting-event-submitted-national-grid-electricity-transmission-plc-relation-2015-17-electricity-system-operator-incentives-scheme>

Approval of revision to National Grid Electricity Transmission's Black Start cost target:

<https://www.ofgem.gov.uk/publications-and-updates/approval-revision-national-grid-electricity-transmissions-black-start-cost-target-2>

Electricity System Operator incentives 2015-17: Final Proposals:

<https://www.ofgem.gov.uk/publications-and-updates/electricity-system-operator-incentives-2015-17-final-proposals>

Electricity System Operator Incentives 2011-13: Income Adjusting Events Determination:

<https://www.ofgem.gov.uk/publications-and-updates/electricity-system-operator-incentives-2011-13-income-adjusting-events-determination>

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Executive Summary

Introduction

NGET is responsible for balancing the electricity system on a continuous basis. The costs that NGET incurs in carrying out this role are passed through to users of the system via balancing services use of system (BSUoS) charges. Consumers see these costs reflected in their electricity bills. In recent years, BSUoS costs have totalled about £850 million per annum. Ofgem sets System Operator (SO) incentive schemes to encourage NGET to carry out its role efficiently. This forms part of our work to deliver lower bills than would otherwise be the case.

Black Start is the process used to recover from an event that results in the shutdown of large parts (or all) of the transmission system. Isolated power stations are started individually and gradually reconnected in order to re-energise the system. NGET has an obligation under the Grid Code to incorporate Black Start capability into the system through the procurement of service providers, and an obligation to put in place Local Joint Restoration Plans with relevant parties. NGET procures its Black Start service in line with a published Black Start policy¹, which sets out the minimum requirements for the service as a whole and for service providers.

Black Start is incentivised under the Balancing Services Incentive Scheme (BSIS).² In March 2016, we issued a mid-scheme update³ that increased the Black Start target for 2016-17 from £22.35m to a maximum of £34.74m. This was to address the need to procure additional service providers and to reflect changing market conditions.

After the deadline for the mid-scheme review application had passed, NGET signed additional contracts with Drax and Fiddler's Ferry for Black Start services. Ordinarily we would not disclose Black Start service providers, but these contracts were made known by the companies themselves and NGET as the SO, and were widely reported in the trade and national press. Under BSIS, NGET is entitled to apply for the SO incentives to be revised so as to allow them to recover these costs if they were beyond NGET's reasonable control and were caused by an unforeseen event. This is known as an Income Adjusting Event (IAE).

Proposals

On 24 May 2016 we received a notice for an IAE from NGET. In this notice, NGET proposed that its income be adjusted by £113m to account for the cost of contracting for additional Black Start capability with Drax and Fiddler's Ferry.⁴ NGET argues that

¹ Available at <http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=7054>

² BSIS is a two-year scheme (2015-17) where NGET is measured against a cost target receiving a reward/penalty when actual costs are below/above the target.

³ Available at <https://www.ofgem.gov.uk/publications-and-updates/approval-revision-national-grid-electricity-transmissions-black-start-cost-target-2>

⁴ These contracts followed NGET's call for expressions of interest

these costs were caused by the unforeseen announcement of closure or mothballing by a number of thermal power stations in February 2016 due to unfavourable market conditions.

The process of assessing a notice of an IAE

Under the IAE application process, we are required to assess whether the event or circumstance which led to NGET incurring additional cost was unforeseen and led to costs beyond NGET's reasonable control. The cost must also be above the threshold of £10 million.

Our assessment is on NGET's ability to recover the full cost of these contracts through BSUoS, not on the appropriateness of the contracts signed. These have been concluded and are in force.

In making our assessment we are required to consider: the foreseeability of the event; the causality between the event and the costs incurred; the extent to which NGET had control over the costs incurred; and to exercise the discretion of the Authority.

We must then consider: whether any or all of the costs were caused by an IAE; whether the event or circumstance has had an impact above a threshold amount of £10m for IBC_t; ⁵ and whether the amount of the proposed income adjustment ensures that the financial position and performance of the licensee are the same as if the IAE event had not taken place.

We are required to publish NGET's notice. We have the discretion to redact the notice by balancing the need for disclosure against the risk of prejudicially harming parties. We are also required to consult on the IAE.⁶ Finally, the Transmission Licence grants us the right to seek further information to help us make a decision.

Next steps

This consultation closes on 6 July 2016. We must issue our decision by 24 August 2016 (3 months after receipt of the notice). We will review the responses to this consultation and consider them prior to issuing this decision. Details for responding can be found in Appendix 1 of this document.

(<http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=45483>) and bilateral negotiation with the parties expressing interest.

⁵ In general terms this is the cost of balancing the system by the SO. It is more precisely defined in SpC4C.11 of the NGET's electricity Transmission Licence special conditions.

⁶ We are required to consider whether conducting an Impact Assessment (IA) is necessary. In this event, we consider that it would be impractical given the IAE process timescales to conduct an IA. We publish our reasons in Chapter 2.

1. Summary of Proposals

Chapter Summary

This chapter provides further detail on NGET's Income Adjusting Event notice.

Question box

Question 1: Do you believe that the event submitted by NGET as an Income Adjusting Event constitutes an Income Adjusting Event?

- Do you consider the proposed IAE to constitute force majeure as defined in the BSC or in the CUSC?
- Do you believe that the event submitted by NGET was unforeseen? Please provide evidence to support your view where possible.
- Do you believe that the proposed IAE costs were beyond the reasonable control of NGET?

Question 2: Assuming the event is an IAE, do you consider that any or all of the costs set out in NGET's notice were caused by the relevant IAE?

- Are there any additional interactions between costs incurred that need to be taken into account?
- Do you consider that NGET acted economically and efficiently in procuring Black Start in this event?

Introduction

1.1. NGET has submitted an IAE application under Special Condition 4C of its Transmission Licence. This process exists to provide protection for both NGET and customers when unforeseen events occur that result in increased or decreased costs to the SO. This application relates to the procurement of additional Black Start capability in February 2016 following a series of plant closure and mothballing decisions.

1.2. In its application, NGET has claimed that the announcement of closure by coal fired generating plant in February 2016 caused it to have to procure additional Black Start capability, resulting in an unexpected cost of £113m.

1.3. As we are entitled to do under Special Condition 4C.18, we will request further information from NGET in some areas. Our request will include further evidence to assess NGET's conclusion that it could not have foreseen the closure or mothballing of these stations, justifications for contracting with these particular providers as opposed to alternatives, and an explanation of any contingency planning it had in

place. We will publish any additional non-confidential material provided to us. However, we have chosen to publish this consultation alongside the notice received from NGET to give stakeholders the maximum opportunity to comment.

1.4. As part of our standard processes, we have considered whether it was appropriate to conduct an Impact Assessment (IA) on this decision. We discuss the reasons we are not conducting an IA on Chapter 2.

Black Start

1.5. Black Start is the process used to recover from an event that results in the shutdown of large parts (or all) of the transmission system. Isolated power stations are started individually and gradually reconnected in order to re-energise the system.

1.6. NGET has an obligation under the Grid Code⁷ to ensure sufficient Black Start capability is available and to set Local Joint Restoration Plans with relevant parties (including Transmission Owners and Distribution Network Operators). NGET procures its Black Start service in line with a published Black Start policy,⁸ which sets out the minimum requirements for the service as a whole and for service providers. NGET's policy involves a zonal approach, which divides the country into sub-regions that must all have sufficient Black Start capability in place.

1.7. A Black Start service provider must be able to start up and provide electricity to the transmission system without an external power supply. This is usually through the use of an on-site auxiliary generator that can power up main blocks of generation. The main unit(s) is then used to energise part of the Network Electricity Transmission System within two hours of instruction from NGET. The service provider must be able to accept instantaneous loading of demand blocks ideally in the range of 35 to 50MW and must be able to control frequency and voltage levels during this process.

1.8. Black Start is incentivised under BSIS. In March 2016, we issued a mid-scheme update that increased the Black Start target for 2016-17 from £22.35m to a maximum of £34.74m.⁹ This was to address the need to procure additional service providers and due to changing market conditions. Traditional Black Start service providers are running increasingly infrequently in the energy market due to low wholesale prices and low spreads. This is particularly true in summer.

⁷ As set out in Grid Code CC6.3.5

⁸ Available at <http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=7054>

⁹ Available at <https://www.ofgem.gov.uk/publications-and-updates/approval-revision-national-grid-electricity-transmissions-black-start-cost-target-2>

1.9. To ensure the ability to provide the Black Start service within two hours of instruction from NGET, providers must be 'warm' and ready to generate. If equipment is not running and 'cold', it must be restarted gradually and very slowly. Therefore plant may need to be warmed in order to be ready to provide the required Black Start service.

The SO incentive scheme

1.10. We set financial incentives on NGET to encourage them to minimise the costs of operating the transmission system. The main incentive on the SO is BSIS. BSIS includes a single target for all the costs the SO incurs in ensuring that the system is kept in balance, whether these actions are required to balance energy or to manage transmission constraints. It also incentivises the SO on the costs it incurs to be ready to respond in the event that there is a need to re-energise the entire system in part or full.

1.11. The current BSIS runs for a two-year period from 2015 to 2017. The assumptions used to set the target (including the agreement of which ones are defined ex-post) are defined at the start of the scheme. If the SO spends less than the target it is allowed to keep 30% of that underspend. Conversely, if the SO spends more than the target, it has to incur 30% of that overspend. NGET's performance under the scheme is limited to \pm £30 million per year.

1.12. While the mechanisms described above are expected to account for the expected range of uncertainty, BSIS includes a mechanism to deal with unforeseen events. In those instances, and subject to certain conditions being met, NGET may apply for an adjustment to its income under the income adjusting event mechanism.

Income Adjusting Events

1.13. The Balancing Services Activity Revenue Restriction on External Costs (Special Condition 4C) of NGET's Transmission Licence is designed to ensure that actual revenues of the electricity SO do not exceed the maximum allowed revenues that we set. Actual revenues are collected by NGET through balancing services use of system (BSUoS) charges.

1.14. IAEs are intended to provide protection for both NGET and customers when events (as defined above) occur that result in increased or decreased costs to the SO.

1.15. Paragraphs 4C.13-25 of Special Condition 4C of NGET's electricity Transmission Licence contain provisions for NGET or any other party, as per the Balancing and Settlement Code (BSC) to provide a notice to Ofgem where it believes an IAE has occurred. The provisions define an IAE as:

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- 1.15.1. an event or circumstance constituting force majeure under the BSC;
 - 1.15.2. an event or circumstance constituting force majeure under the Connection and Use of System Code (CUSC);
 - 1.15.3. a Security Period;¹⁰ or
 - 1.15.4. an unforeseen event or circumstance other than those listed above which leads to consequences beyond the reasonable control of the licensee which is, in the opinion of the Authority, an income adjusting event and is approved by it as such in accordance with Part E2 of this condition.
- 1.16. Under Special Condition 4C.22, the Authority shall determine:
- 1.16.1. whether any or all of the costs and/or expenses given in a notice pursuant to Special Condition 4C.15 or 4C.16 were caused by an Income Adjusting Event;
 - 1.16.2. whether the event or circumstance has increased or decreased the value of IBC_t by more than the threshold amount of £10 million;
 - 1.16.3. whether the amount of the proposed income adjustment ensures that the financial position and performance of the licensee are, insofar as is reasonably practicable, the same as if that Income Adjusting Event had not taken place, and if not, what allowed value of income adjustment would secure that effect.
- 1.17. Under the IAE provisions included within Special Condition 4C, the Authority has until three months after the date of receipt of an IAE notice to make its determination (in this case 24 August 2016). The full amount of income adjustment would be allowed in the case that the Authority has not made its determination by this time. This is not the case if the Authority has given notice that the information provided by NGET and other parties is not sufficient to make its determination ahead of the required date.

¹⁰ As defined in the Fuel Security Code.

NGET's Income Adjusting Event notice

NGET's proposals

1.18. In its 24 May 2016 notice, NGET has proposed that its income be adjusted by £113m to account for the cost of contracting for additional Black Start capability with Drax and Fiddler's Ferry. In its view, this is due to the unforeseen event of a large number of thermal power stations announcing their intention to either close or mothball due to unfavourable market conditions in February 2016. The notice has been published alongside this document with redactions made where appropriate.

Our approach to redacting information

1.19. In making redactions we have had to balance a number of factors. These are set out in Special Condition 4C.21 of NGET's Transmission Licence:

1.19.1. the need to exclude from disclosure, so far as is reasonably practicable, information whose disclosure the Authority considers would or might seriously prejudicially affect the interests of a person to which it relates; and

1.19.2. the need to consider the extent to which the disclosure of information is necessary for the purposes of enabling parties to fully assess the event to which the notice relates.

1.20. In forming our view on the information which should be redacted, we have taken advice from DECC on what information is sensitive for security reasons. We have also contacted the organisations to which the information relates and taken their views into account in forming our judgment. It is worth noting that we would not normally disclose the name of parties which had been awarded contracts, but feel this is justified on this occasion because the information was put into the public domain by those parties.

NGET's proposals (continued)

1.21. NGET analysed the potential impact of these closures on its Black Start strategy and concluded that a minimum of two additional units were required in the northern half of England to maintain a robust Black Start capability. In view of this, NGET issued a call for expressions of interest and negotiated bilaterally with the parties that responded, resulting in one year contracts being agreed with Drax and Fiddler's Ferry.

1.22. NGET's notice outlines that the call for expressions of interest enabled a competitive process resulting in the lowest possible contract value, while reflecting the locational and technical requirements of the Black Start policy. Further, it notes

that the contracts have been structured to return money to consumers where the providers generate in excess of the level required for warmth under the Black Start policy and to minimise potential market distortions.

1.23. NGET has declared that the closure and mothballing announcements of thermal plant in February 2016 were unforeseen as it occurred at an earlier point than expected under the Future Energy Scenarios. In its view, this was because the extent of the effect of unfavourable market conditions was unforeseen. This meant that at the time of the mid-scheme update in December 2015, closures could not have been anticipated.

1.24. The notice further outlines that the decisions to close made by the boards of the power stations constituted an event beyond the reasonable control of the licensee. These decisions were made on the basis of the unfavourable market conditions described above.

NGET's justifications

1.25. NGET has set out its justification as to why the total sum of £113m is in its view the least-cost option for procuring the necessary level of Black Start capability. This is because it believes the offers received from Fiddler's Ferry and Drax were the most economic (including consideration of technical compatibility). NGET has presented the results of its cost-benefit analysis in assessing the costs. Using a publically available study which identifies a value of £67,760 for Value of Lost Load (VoLL) per MWh,¹¹ NGET showed that Fiddler's Ferry and Drax had benefits to the system of up to £1.4bn and £1bn respectively. This is on the basis of their technical contributions to the Black Start strategy.

Conclusion

1.26. NGET's notice details that rapidly evolving market conditions and the deteriorating economics of coal power stations have placed NGET in a position where it was forced to act in order to ensure sufficient Black Start capability was available. To not have done so, NGET argues, would have led to a failure to meet obligations to maintain Black Start capability and to ensure an ability to recommence restoration processes within two hours of de-energisation in a manner consistent with NGET's Black Start policy.

1.27. As per Special Condition 4C of NGET's Transmission Licence, the Authority has three months to make its determination on the award of the costs of the IAE applied for by NGET. To do this, the Authority will take account of the process set out in

¹¹ As calculated by London Economics in a July 2013 study (link). The study found VoLL to be £16,940/MWh for an hour-long interruption, but to rise to £67,760/MWh for a four-hour interruption.

Special Condition 4C Part E. Therefore, we request your views on the following questions to assist with these assessments:

1.28. Question 1: Do you believe that the event submitted by NGET as an Income Adjusting Event constitutes an Income Adjusting Event?

1.28.1. Do you consider the proposed IAE constitutes force majeure as defined in the BSC or in the CUSC?

1.28.2. Do you believe that the event submitted by NGET was unforeseen? Please provide evidence to support your view where possible.

1.28.3. Do you believe that the proposed IAE costs were beyond the reasonable control of NGET?

1.29. Question 2: Assuming the event is an IAE, do you consider that any or all of the costs set out in NGET's notice were caused by the relevant IAE?

1.29.1. Are there any additional interactions between costs incurred that need to be taken into account?

1.29.2. Do you consider that NGET acted economically and efficiently in procuring Black Start in this event?

2. Reasons for not carrying out an Impact Assessment

Chapter Summary

This chapter sets out our reasons for not conducting an Impact Assessment on the Income Adjusting Event proposal by NGET.

2.1. Under Section 5A of the Utilities Act, we have a legal duty to carry out an IA, where we are proposing to do anything in relation to our functions and it appears that the proposal is important. We also publish IA guidance¹² setting out our view of best practice on deciding when to conduct an IA and our approach to it. We have considered the need to, and practicality of, carrying out an IA in light of this guidance.

2.2. We are first required to consider whether the Authority's decision on the proposal is important. We assess four criteria to help determine importance. Each is assessed in turn below:

2.2.1. *Whether the event constitutes a major change in the activities carried out by the Authority* – given the IAE process is a well-established part of the regulatory framework, we do not consider this to be the case.

2.2.2. *Whether there is a significant impact on persons engaged in the shipping, transportation or supply of gas, the generation, transmission, distribution, or supply of electricity, or in connected commercial activities* - In our view, there is evidence to suggest that the decision is important under this criterion. The value of the contracts is £113m. Were the Authority to determine that some or all of these costs were not recoverable, there would be significant impact on NGET. Similarly the potential impact on the charges paid by generators and suppliers seem to us significant.

2.2.3. *Whether there is a significant impact on consumers and/or the general public in Great Britain or part of Great Britain* – We think that this criterion is also met. Were our decision to incentivise an under procurement of Black Start capability to be in place, there could be an impact on the ability to restore the transmission network (in total or at a regional level) which could impact consumers and the public. The costs involved would also lead to a small increase in the price of electricity.

¹² <https://www.ofgem.gov.uk/publications-and-updates/impact-assessment-guidance>

2.2.4. *Whether there are significant effects on the environment* - We also considered the impact on the sustainability of the energy system and on the environment. Our decision on the amount of the IAE is independent of NGET's decision on which power station to contract for Black Start services. As such, our decision to grant or not grant an IAE will not have an impact on the sustainability of the energy system. However, we note that the recent contracts were awarded to more carbon intensive generators.

2.3. Our policy also contains an exception to the need to carry out an IA if it appears to the Authority that the urgency of the matter makes it impracticable. As we have explained elsewhere in this document, we have a fixed three month time period, including consultation, in which to reach a decision on whether to approve or reject the IAE. If we don't make a decision within this time period, the IAE is deemed approved.

2.4. Conducting an IA would require an additional consultation. We do not consider that it would be practicable to run two consultations during the available period as this would compress the time we have to assess NGET's application.

2.5. In addition, were we to conduct an IA, the majority of the information in the analysis would have to be redacted due to its sensitive nature. This would significantly reduce market participants' ability to understand and comment on our analysis. As such, we feel that carrying out an IA would not be practicable.

2.6. Nevertheless, we have attempted to give interested parties the maximum time to comment on whether the notice constitutes an IAE. To do that, we are publishing our consultation document alongside the IAE notice while, in parallel, requesting additional information from NGET (which we will publish, where non-confidential).

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Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 6 July 2016 and should be sent to:

Johannes Pelkonen
System Balancing
9 Millbank, London SW1P 3GE
020 3263 2718
soincentive@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website <http://www.ofgem.gov.uk>. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Any questions on this consultation should be directed to:

Tom Corcut
Head of System Balancing
9 Millbank, London SW1P 3GE
020 3263 2718
soincentive@ofgem.gov.uk

CHAPTER: One

Question 1: Do you believe that the event submitted by NGET as an Income Adjusting Event constitutes an Income Adjusting Event?

- Do you consider the proposed IAE to constitute force majeure as defined in the BSC or in the CUSC?
- Do you believe that the event submitted by NGET was unforeseen? Please provide evidence to support your view where possible.
- Do you believe that the proposed IAE costs were beyond the reasonable control of NGET?

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Question 2: Assuming the event is an IAE, do you consider that any or all of the costs set out in NGET's notice were caused by the relevant IAE?

- Are there any additional interactions between costs incurred that need to be taken into account?
- Do you consider that NGET acted economically and efficiently in procuring Black Start in this event?

Appendix 2 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk