

Minutes of a Meeting of the Gas and Electricity Markets Authority

Thursday, 15 June 2017 at 8.15 am

9 Millbank, London

Apologies for absence

1. No apologies were received.

Minutes of the Authority meeting held in May 2017

2. The minutes of the meeting held on 18 May 2017 were agreed to subject to some small amendments.

Introductory remarks by the Chairman

3. The Chairman noted that declarations of interest were recorded from a Member who was a non-executive director of the Low Carbon Contracts Company.
4. The Chairman reported on meetings since the last meeting, including meetings with senior industry representatives.

Report by the Chief Executive

5. The Chief Executive reported on discussions and correspondence with Ministers, senior civil servants and other senior stakeholders and gave an update on trends and developments in the sector including the differential between dual fuel tariffs and the cheapest deal for customers paying by direct debit and that it had been one of the highest months for switching energy suppliers which was felt to have been partly driven by price rises.
6. The CEO updated the board on developments from each of the divisions in Ofgem including a special mention for the successful 'go live' of Project Nexus which was the culmination of a lot of hard work. The partner responsible for this project, Rob Salter-Church was commended by the Authority for his drive and skill in making this a success.
7. The CEO gave an update on the Northern Ireland RHI Inquiry including reporting on the preparation of his own witness statement for the inquiry and that some individual members of staff, both current and former, had received notices from the inquiry team. Work was underway to support these members of staff. Many documents had been provided to the Inquiry.

8. The Authority agreed to a monthly standing item on this issue in the CEO report, with specific agenda items quarterly, although noted that if any significant items arose between the quarterly items they should be added to the agenda.
9. The Authority discussed a range of scenarios and actions that could be taken to improve the retail energy market in the event that there was no legislation forthcoming, and gave particular focus to the issue of vulnerable consumers.

Report by the Chief Operating Officer

10. The COO reported on a fall in headcount, although noted a higher than usual number of vacancies being filled. This is largely driven by the re-balancing of staff to Glasgow.
11. The report included a section listing the areas scheduled for internal audit which will come quarterly to the Authority as part of the COO report.
12. The COO reported on the second staff pulse survey and some additional workshops that had taken place to understand the results. It was important for SLT to be visible to staff at all levels and for Ofgem's vision to be articulated through regular conversations with line managers.
13. The COO gave an update on the roll out of updated IT equipment to staff which would be completed soon and provided an update on IT security, finance and corporate affairs.
14. She reported on performance and delivery, including an assessment of progress against the Forward Work Programme milestones.
15. The COO also gave an overview of internal audit activity and assurance planning in Ofgem E-serve. This was comprehensive and had raised some themes and issues to be addressed. The Authority agreed that the COO of Ofgem and the COO of E-serve should continue to implement this work to ensure that robust assurance mechanisms are in place. The Authority agreed that updates should be provided regularly.

Annual Report of the Audit and Risk Assurance Committee to the Authority

16. The Chair of the Audit and Risk Assurance Committee (ARAC) reported on the programme of work over the last 12 months to provide assurance on matters that ARAC or the Authority consider may put at risk or affect the achievement of the organisation. He reported that there is a good overall risk management and control environment

17. He made clear that the accountability for this assurance is not delegated to ARAC but instead ARAC provides a degree of comfort that the matters are being addressed fully and in line with requirements. He reported that the external audit had resulted in a recommendation to the Comptroller and Auditor General that he should certify Ofgem's 2016-17 financial statements with an unqualified audit opinion, without modification.
18. The Chair of ARAC reported that the internal audit had identified some areas for improvement in some processes and procedures and he was confident that the COO was actively addressing these and that the Authority should therefore be reassured that appropriate action was being taken to minimise risk.
19. He also drew the attention of the Authority to the Governance section of the Annual Report and Accounts.
20. Following discussion the Authority approved the Annual report of ARAC.

Overview of joint Energy Systems and Networks future-focused work

21. The Senior Partner for Energy Systems provided a context to the rapidly changing energy market to set the scene for a discussion on the strategy to regulate it effectively in the future.
22. He spoke of the shift from a centrally dispatched and fossil fuel driven system to one of intermittent and increasingly distribution-connected generation with much more renewable technologies. This was driven by a few factors, such as decarbonisation and the impact of rapid technological change.
23. The Authority discussed how changes in the rules and regulations covering networks and systems should be considered and communicated as part of a holistic set of changes. The Authority discussed the likely significant benefits for consumers and their changing position in relation to the system.
24. The Authority considered it would be important to begin to discuss these big changes with consumers and other stakeholders, and noted that more could be done to share the possibilities, choices and trade-offs that would arise.
25. The Authority asked the team to work up a holistic narrative and report back.

Strategy for regulating the future energy system

26. The Authority considered a paper setting out some future-focused strategy work aimed at ensuring that the regulatory and market arrangements for the GB electricity and gas industry are appropriate given possible future developments.
27. The objective for such regulation in the context of the energy system transition was discussed and, recognising the importance of articulating this properly, several suggestions were made to improve its clarity. The Authority considered it important to include reference to the two main drivers of change; reducing carbon emissions and technological developments. It is also important that the regulatory system both provides consistency and allows a degree of flexibility in response to market developments.
28. The Authority considered a number of potential work streams that had been identified to address gaps in the regulatory regime that have developed with market change. The impact of each was considered in order to determine which should be the priority areas to explore and analyse in the next phase of work.
29. The Authority discussed the four proposed work streams: network investment risk; improving signals for electricity network usage; ensuring that system operators and network owners deliver the most efficient outcomes for the system as a whole; and scoping our role in cyber resilience.
30. The Authority noted that the work stream on improving signals was complex and that there were many competing views in the sector. Fairness was discussed and it was noted that this should be considered from the perspective of various types of network users including: active and passive consumers; those encouraged to invest; and those who wished to disconnect from or reduce their use of the energy system.
31. The role for Ofgem in cyber resilience was discussed; thought should be given to the nature of this role and the relationship with the Government and other parties.
32. The Authority discussed various work streams that had not been prioritised at this time including locational marginal pricing, institutional changes, and a complete reform of the licencing framework although it was noted that market developments could bring some of these back into consideration in the future.
33. Communicating the strategy was discussed and the Authority considered it important to make progress on this work alongside the RIIO 2 work as soon as practical.
34. Following discussion the Authority agreed:

- The objective for regulation subject to requested changes and a further review following the meeting;
- the priority work areas for the next phase of work, and those areas that are not to be prioritised at this time; and
- to publish a document outlining the objective and the priority work areas.

Embedded Benefits: Final decision on CMP264/265

35. The Authority considered a paper setting out an update of the analysis conducted on the CUSC modifications CMP 264/265, following the consultation on the Authority's minded to position which had been published in March. This related to changes to the Transmission Network Use of System (TNUoS) Demand Residual (TDR) payments to sub-100 MW Embedded Generation.
36. A significant amount of work had taken place since the consultation and the team had fully assessed all the responses to the consultation, had met many stakeholders and respondents since the closing date and had taken on board additional material raised through these meetings and through other letters. They had worked with the Office of the Chief Economist to update the modelling work in light of all the evidence received and develop a robust impact assessment. In addition, the Authority had received legal advice on the issues.
37. The Authority discussed this at length and fully considered the arguments against the minded to position to test whether any evidence or information would cause a change in approach. The Authority considered whether to delay the decision until a holistic review of network charging has been carried out; whether the security of supply would be adversely affected by the minded to position; whether locational signals need to be reviewed or reformed before making this decision; whether other elements should be included in the avoided GSP costs; whether the minded to position was consistent with the Security and Quality of Supply Standard; and the issue of grandfathering.
38. The Authority discussed the "value of x", which are the various proposed levels of payment that could be made to smaller embedded generators to better reflect the benefits that they bring to the system, and which would replace the payment of the TDR. The Authority noted the changes to the methodology from National Grid could lead to improvements to calculating the "value of x".

39. The Authority considered a summary of the responses to the consultation and a full set of responses was made available for reference.
40. After discussion the Authority determined that:
 - None of the evidence substantively changed the view that reform is needed
 - None of the evidence indicated that the "value of x" should be different to the minded to decision of avoided GSP costs;
 - None of the evidence indicated that different transitional arrangements should be accepted.
- Therefore the Authority agreed that the 'minded to' decision remained the best approach and decided to approve the code modification WACM 4.
- The Authority delegated the final sign off of the Impact Assessment, decision letter and summary of responses, and the decision on the consequential and enabling modifications to the CUSC and BSC to Frances Warburton, the Partner for Energy System Integration, in consultation with Andrew Wright, the Senior Partner for Energy Systems.

Targeted Charging Review of residual network charges, storage charging and arrangements for smaller embedded generation.

41. The Authority considered a paper covering the proposed Significant Code Review (SCR), to determine whether to proceed with it and if so the scope of the review and how to take forward the necessary work.
42. The team updated the authority on the responses from the consultation, noting strong support for the work stream.
43. The Authority considered whether to include work on storage charges in the SCR. Consultation responses had indicated more concerns with this element of the work than had been anticipated. There was concern from some parties that the proposals would single out storage for favourable treatment. The Authority considered that the system of charges currently disadvantages storage and that the proposals were designed to create a more level playing field and encouraged the team to progress with this work outside the SCR.
44. The Authority discussed the proposal to establish a Charging Co-ordination Group to ensure efficient and effective coordination of changes to network charging arrangements. The view was that the membership of this group should be representative of the different parties that connect to the network. The Authority considered selection of membership to be important and provided a steer that this work should be able to function at a reasonable pace, allowing engagement with established and new entrants

and ensuring that those representatives operated in the collective interest rather than their own specific interest.

45. The Authority discussed the principles used to guide this review. The Authority advised the team to flesh out the point that innovation was an important consideration in this and that our approach should be dynamic so as to ensure that the charging regime didn't distort opportunities for innovation.
46. Following discussion the Authority agreed:
 - that the team should proceed with the proposed Significant Code Review on residual electricity network charges and other embedded benefits; and
 - that the specific issues with charging arrangements for storage should be addressed outside the SCR.

Enhanced System Operator

47. The Authority considered a paper setting out the proposed arrangements for separation of the SO within the National Grid group to manage conflicts between the Electricity System Operator and Transmission Owner roles. This followed a consultation on the roles Ofgem had proposed for National Grid and the key requirements for separation that was published in January alongside a joint statement from BEIS, Ofgem and National Grid plc.
48. This paragraph has been removed as it contains market sensitive information.
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State of the Market Report – Key messages

51. The Authority was given a first draft executive summary of a new annual 'State of the Market' report that Ofgem is due to publish for the first time in Autumn 2017. This was one of the recommendations from the CMA.
52. The Authority considered the nature of the report and asked the team about consistency with the original CMA recommendation, recognising that the scope of the report may develop in future years. The report should bring a range of analyses into one place to inform a variety of stakeholders and provide an independent and robust view of the market.

53. Following discussion the Authority noted the direction of travel of the report and gave positive feedback on its content and tone. The Authority supported the proposal to publish the report alongside some factsheets to enable more people to engage with the findings, and asked that the report contain a mix of explanatory text and useful graphs and infographics that could speak for themselves.

EDP Annual Report

54. John Swift QC, chair of the EDP, accompanied by three other members of the panel, gave an overview of the previous year's work. This was the third annual report of the EDP. There had been fewer cases than in previous years but this was not felt to be unusual, but merely a reflection that the schedule of enforcement cases was not uniform.
55. The EDP chair talked about the engagement between the EDP and members of Ofgem in developing policy, including in relation to the move to principles based regulation and on changes to the Enforcement processes. This was felt by EDP members to be extremely beneficial.
56. He reported on the change in composition of Settlement Committees since the previous year and said that it was working well.
57. The Authority discussed the fact that the EDP had worked on a case for the Civil Aviation Authority and asked if that arrangement was likely to be replicated with other regulators. The EDP is willing to discuss this further with any regulator who would be interested.
58. Following discussion the Authority approved the EDP annual report and agreed for a version of it to be published.

Health and Safety Update

59. The Authority noted the paper and it was agreed that a full report should come to the Authority annually, and that any significant issues should be raised as part of the COO report when necessary.
60. The Chair of ARAC noted that a health and safety update was discussed by ARAC quarterly.

Information paper – Decision Log update

61. The Authority noted the paper.

Date of next meeting

62. The next meeting of the Authority would be on **Thursday, 13 July 2017** at 9 Millbank. It would be preceded by an away day on 12 July.

Those present

David Gray
Dermot Nolan
Nicola Hodson
Christine Farnish
David Fisk
Rachel Fletcher
Paul Grout
Jim Keohane
Keith Lough
Andrew Wright

Those attending

Jonathan Brearley
Martin Crouch
Chris Poulton
Paul Heseltine

Others present

David Ashbourne (Legal Adviser to the Authority)
Wendy Watson (Secretary to the Authority)
Mark Wiltsher (Associate Director, Communications) Paragraphs 1 - 34
Ben Woodham (Executive Adviser to Chief Executive)
James Kilmartin (Head of External Relations) Paragraphs 1 – 20 & 35 - 62
Anna Saksonov (Assistant legal adviser to the Authority) Paragraphs 21-62

For specific agenda items

Name	Subject	Paragraphs
Sukhinder Lalli	CEO report	7-8
James Robinson	“ “	
Mark Mills	“ “	
Frances Warburton	Overview of joint ES/Networks work and Strategy for regulating future energy system	21-34
Andy Burgess	“ “	
Marcia Poletti	“ “	
Frances Warburton	Embedded Benefits & Targeted Charging Review	35-46
Cathryn Scott	“ “	“ “
Andrew Self	“ “	

Internal Only

Judith Ross	"	"	
Philippa Pickford	Enhanced System Operator		47-50
Steven Becker	"	"	" "
Paul O'Donovan	"	"	" "
Joe Perkins	State of the Market		51-53
Maureen Paul	"	"	" "
John Swift	EDP Annual Report		54-58
Andrew Long	"	"	" "
Trevor Jones	"	"	" "
Stuart McIntosh	"	"	" "
Pamela Taylor	"	"	" "
James Waugh	"	"	" "
Carola Geist-Divver	"	"	" "