

Current Regulatory Issues in Energy Markets

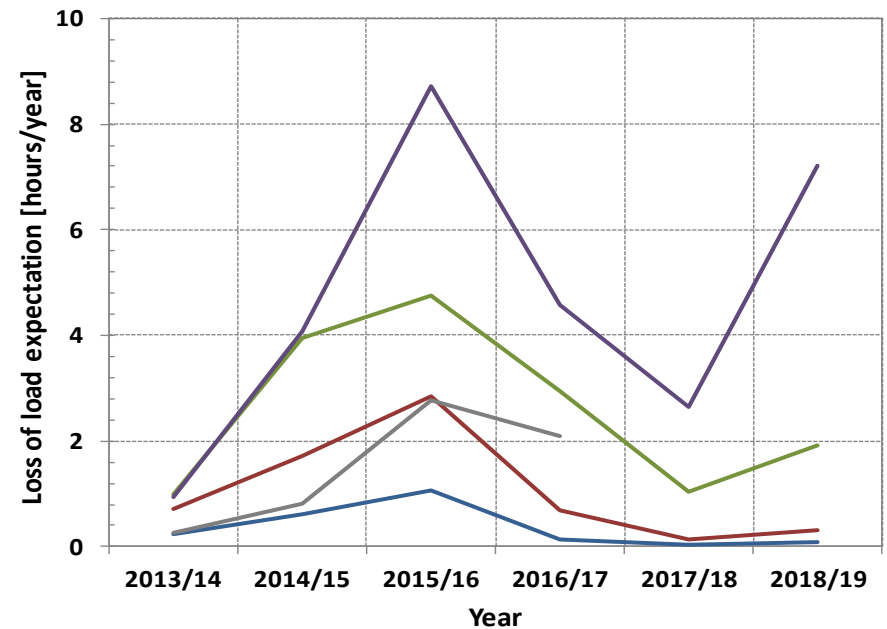
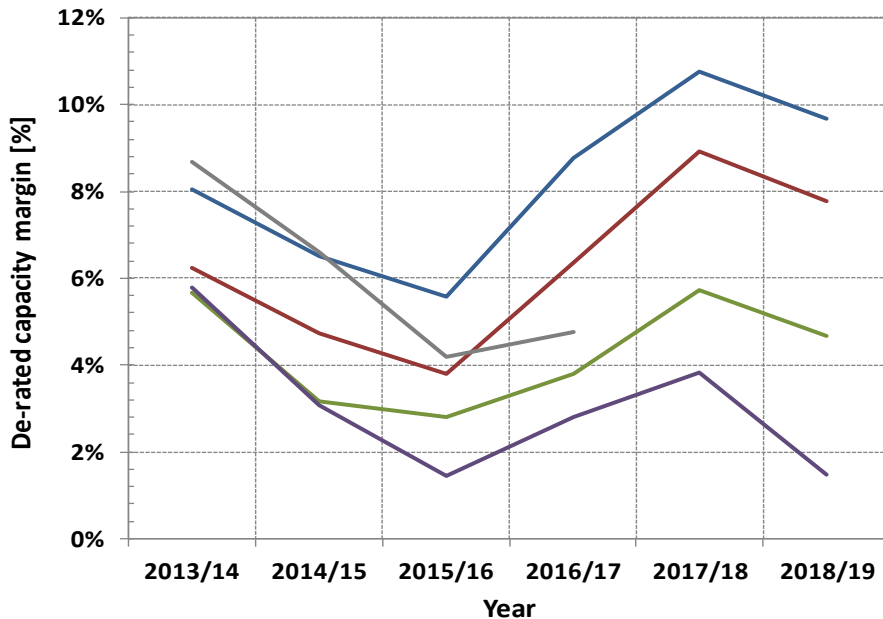
Winter Outlook Seminar 2013

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ofgem

- Market tightening and risks to security of supply gaining increasing attention
- Ofgem's wholesale market policies aimed at enhancing security of supply and promoting a well functioning market
- Final retail reform proposals announced, implementation has begun
- Smart meter rollout programme ongoing

- Electricity Outlook – Capacity Assessment Reference Scenario
 - Risks to security of supply increasing faster than expected in our 2012 report
 - Risks potentially decreasing in the second half of the decade
- Uncertainty: Difficult to form a best view - Reference Scenario with sensitivities



— National Grid's Gone Green 2013 Scenario
— Low Supply Sensitivity

— Reference Scenario 2013
— High Demand Sensitivity

— Reference Scenario 2012

Our 2012 gas security of supply report highlighted a range of risks to security of supply.

GB

- UKCS gas production forecast to decline, increasing import dependency
- Uncertainty around future role of gas in the generation mix

Europe

- Demand uncertainty driven by policy and economics
- Import dependence set to increase
- Pipeline gas remains main source, but LNG becoming increasingly important

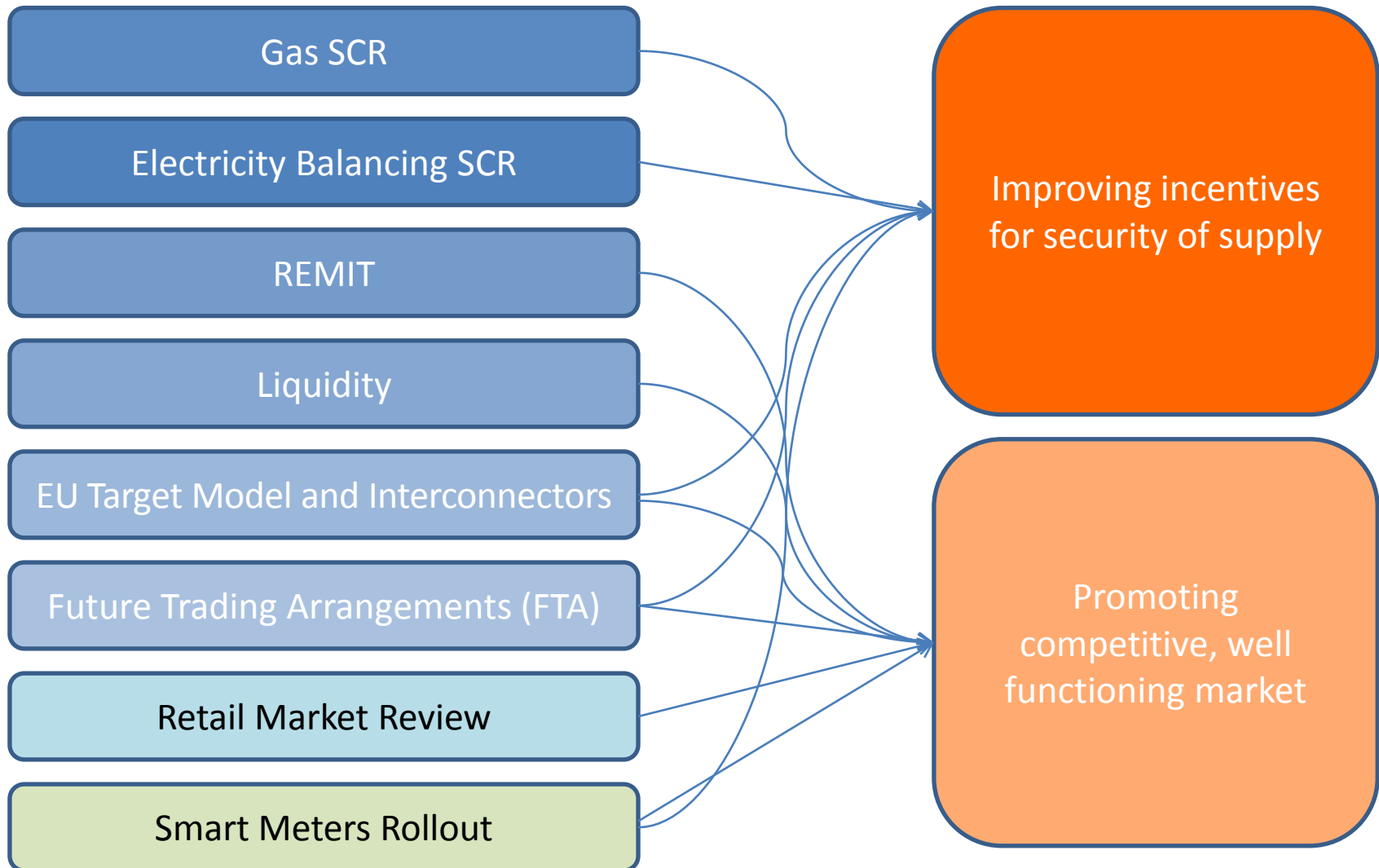
Global

- Demand due to increase dramatically in coming decades
- Supply side uncertainty on the potential of US gas exports
- LNG markets become increasingly tight until new liquefaction facilities come online from 2014

... but noted that the risk of supply disruption to firm customers remains low.

Our overall view of the gas market outlook remains consistent with our 2012 review

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

Key Considerations in Scope

- **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 customers paid for involuntary curtailment
- **Transfer risk** of an emergency from consumers to shippers who are better placed to manage the risk

Timings

- Implementation by 2015/16
- Recently consulted on potential introduction of demand side response tender
- Following further discussion with stakeholders we will make a decision early next year

Key Interactions

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

Objectives

- Incentivise an efficient level of **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

- Implementation by 2015/16
- Published our draft policy decision in July and are consulting until 22 October
- Final policy decision expected in spring 2014

Key Interactions

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

- EU Regulation on wholesale energy market integrity and transparency that came into effect in December 2011
- Applies to trading in wholesale energy products that are not financial instruments under financial legislation
- We have been granted specific powers to monitor, investigate and enforce:

MONITORING

- “Regulated Persons” must **retain relevant telephone calls & electronic communications for up to 6 months** (subject to extension)
- Power to request information and documents for monitoring purposes

INVESTIGATION

- Require information
- Enter premises (warrant)
- Require attendance at “interview”
- Skilled persons report

OUTCOMES

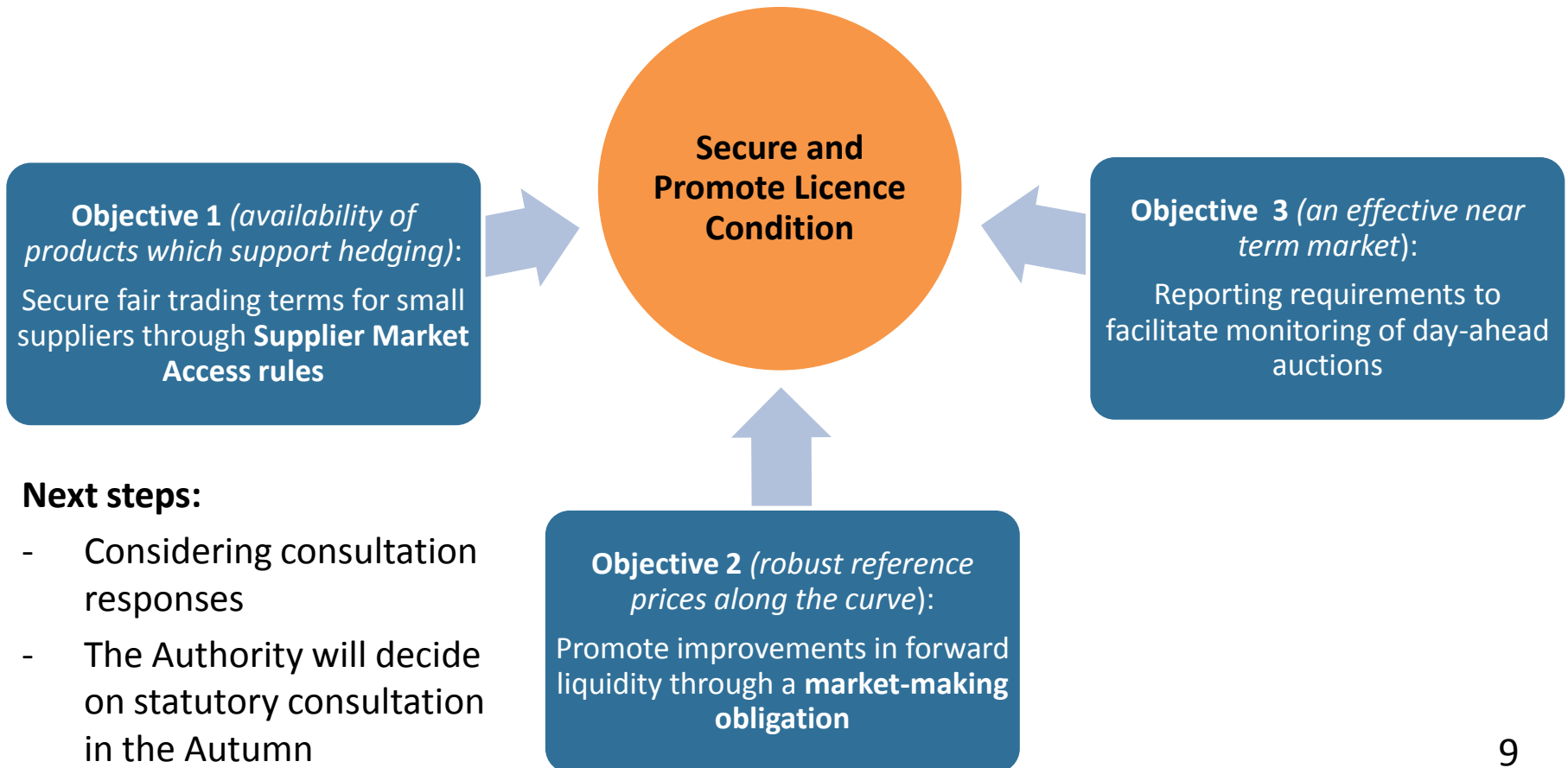
- Injunction
- Court-ordered restitution
- Ofgem-ordered restitution
- Censure
- Unlimited penalty

DECISION MAKING

- Notice

We will publish our decision on our REMIT penalties and procedures guidelines this autumn

- We have been concerned that poor liquidity in the electricity wholesale market is forming a barrier to entry and competition in generation and supply
- In June, we published our final proposals for a ‘Secure and Promote’ licence condition to improve liquidity

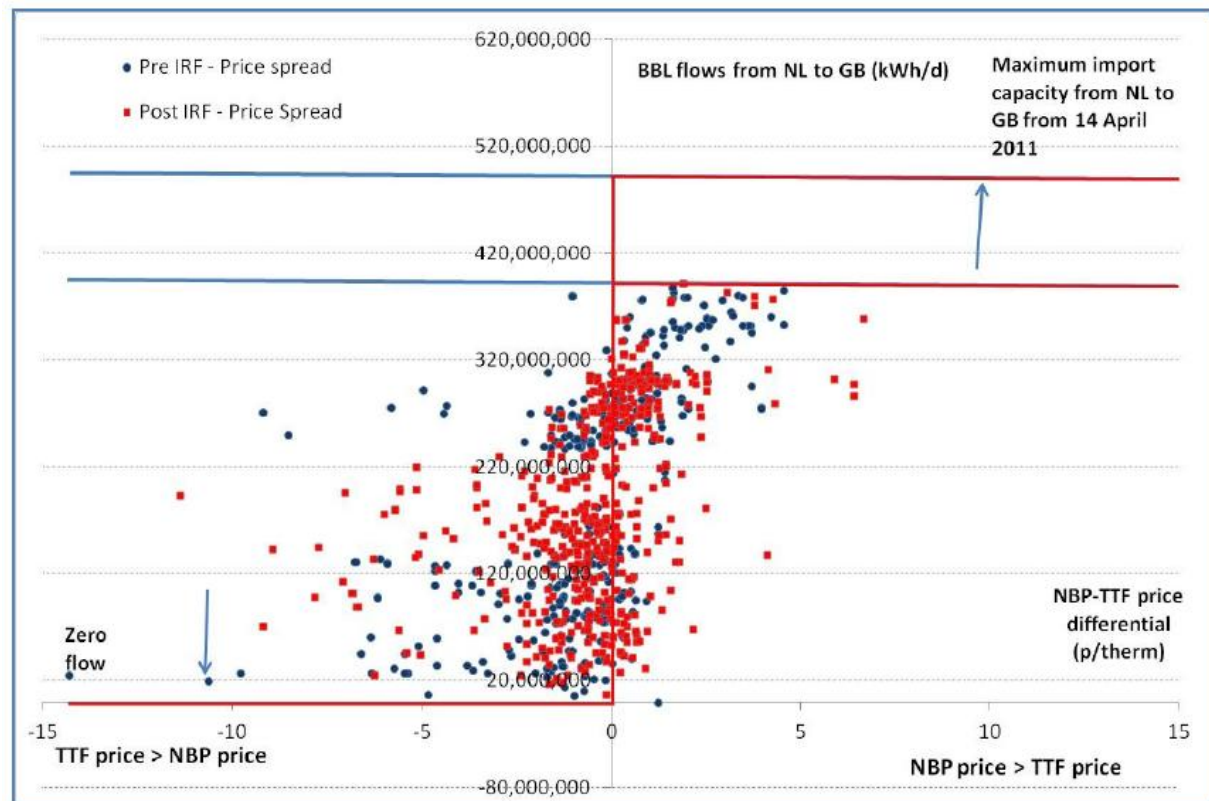


EU and interconnectors

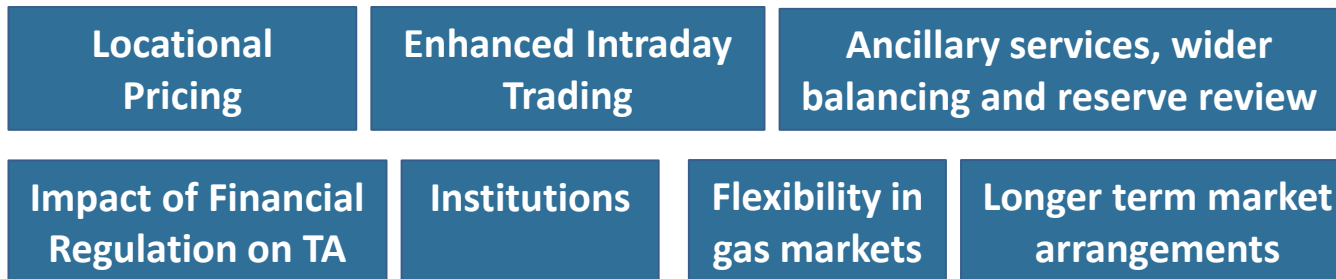
- European network code implementation ongoing. In tandem with this;
- Ofgem published analysis in October 2012 and July 2013 examining gas interconnectors between GB and Belgian and Dutch Markets (which included tight conditions in March 2013)
- IUK was generally price responsive, but sometimes without full utilisation
- BBL did not always respond appropriately and not fully utilised in March

Next steps:

- The gas network codes of Congestion Management Policies (CMP) and Capacity Allocation Mechanisms (CAM) will mostly resolve remaining capacity utilisation issues
- Work on the gas interconnectors and the Network Code on Tariffs, has led us to undertake a review of the Gas Transmission Charging Regime in GB

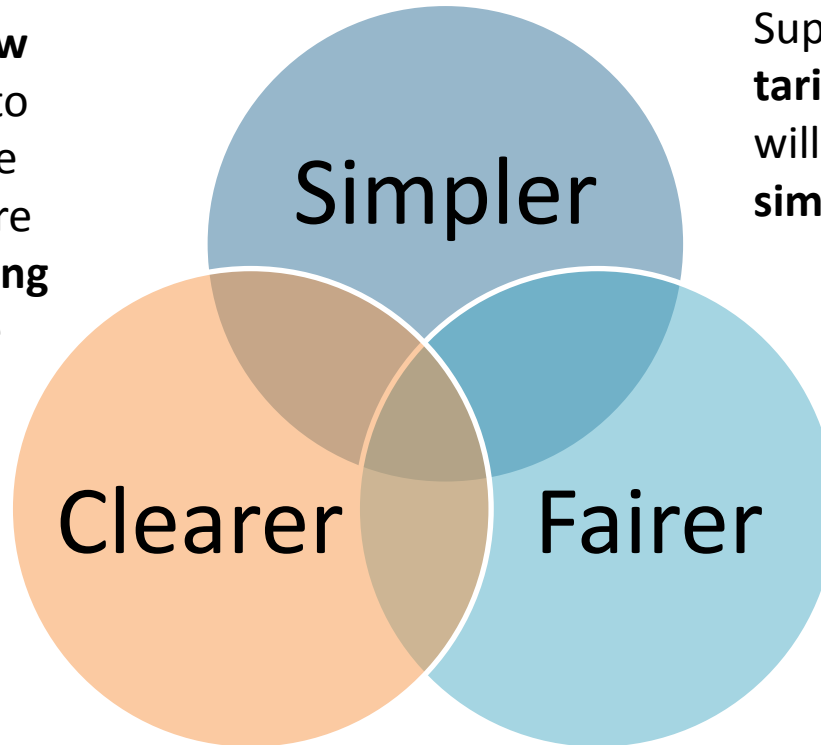


- February 2013, open letter asking market participants if we should create a high level design for future electricity trading arrangements (TA)
- We have opened an FTA forum which will:
 - Provide a focal point for stakeholders to engage on matters affecting trading arrangements
 - Build consensus on principles of the trading arrangements – underpin investor certainty
 - Scope out TA issues and set out priorities – legal “must do” driven by EU Target Model (market coupling, splitting consideration) and sustainability “enablers” (ie incorporation of renewables and DSR in market)
 - Ensure consistency between network (ITPR) and market changes
- The forum has led to the following workstreams being considered:



Retail Market Review

We are introducing **new communication tools** to help consumers engage with the market. We are also making sure **existing communications** more useful and **engaging**



Suppliers will be **limited to 4 tariffs** per type, and there will be new measures to **simplify tariff structures**



We have introduced new **enforceable Standards of Conduct**, and additional **consumer protection measures** for domestic and non-domestic consumers

Tariff information

Standard Variable Tariff (SVT)				Fixed Rate Variable Tariff (FRVT)			
Unit	Rate	Start Date	End Date	Unit	Rate	Start Date	End Date
Daytime	10.50	1/1/2010	31/12/2010	Daytime	10.50	1/1/2010	31/12/2010
Evening	10.50	1/1/2010	31/12/2010	Evening	10.50	1/1/2010	31/12/2010
Night	10.50	1/1/2010	31/12/2010	Night	10.50	1/1/2010	31/12/2010
Weekend	10.50	1/1/2010	31/12/2010	Weekend	10.50	1/1/2010	31/12/2010
Standing Offer	10.50	1/1/2010	31/12/2010	Standing Offer	10.50	1/1/2010	31/12/2010

Frequently asked questions

- What is a tariff?
- What is the Tariff Comparison Tool (TCT)?
- How to use the Tariff Comparison Tool (TCT)?
- How to use the Tariff Comparison Tool (TCT)?





Government leading
Smart Metering
implementation
phase, with
independent advice
from Ofgem



Ofgem monitoring
compliance with
regulatory
framework;
enforcing if
appropriate

- Licence obligation on suppliers to roll-out smart meters by 2020 - some already started
- DECC granted Data and Communications Company (DCC) licence to Capita (Sep 2013) – manages link between SMs and authorised parties
- Data and Communication contracts awarded – link SMs to authorised data users
- Smart Energy Code introduced – governs relationship between DCC & users
- Ofgem monitoring supplier roll-out – consulted on our approach July 2013
- Consumer protections put in place by DECC and Ofgem to ensure consumers are protected eg during installation and in control of their meter data

Promoting security of supply and competitive, well functioning markets

- Our 2013 Capacity Assessment highlighted tightening margins, and our 2012 gas security of supply report highlighted a wide range of risks in the gas market
- We are prepared for greater volatility in near term wholesale prices if there are unplanned outages at key pieces of infrastructure, or demand is unexpectedly high
 - These price movements are the best signal to the market when a reaction is necessary
 - This was seen in March this year, when markets reacted strongly to price signals following an unplanned outage at the IUK interconnector
- 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:
 - Reforms across wholesale markets
 - Retail market reform
 - Smart meter rollout

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.