

March 2000

Office of Gas and Electricity Markets

Plan and Budget

April 2000 – March 2001

Executive summary

Everything that Ofgem does is designed to protect and advance the interests of consumers by promoting the choice and value available to gas and electricity customers.

This Plan and Budget sets out Ofgem's priorities for the financial year April 2000 – March 2001 against this overall aim. It also explains the programmes which we have to implement these priorities and the resources which we plan to devote to them. The Plan and Budget has been agreed following wide consultation with those affected by our work.

Ofgem's priority areas for the coming year are:

Social and environmental action

Price regulation and, increasingly, the development of competition in gas and electricity supply have brought considerable benefits to customers through lower prices. Ofgem will be taking action, working with government, industry and others, to ensure that the benefits of competition reach low income and disadvantaged customers who need it most. Ofgem will also be working to ensure that customers are properly protected. Under this priority area, we will also identify our role and take action to meet the important environmental objectives and targets which the government has set.

Competition in wholesale markets

Energy costs represent the largest part of customers' final bills. A major part of Ofgem's work is on developments which will create the conditions under which competition in wholesale gas and electricity markets can develop effectively. A big and important part of this programme last year and in the coming year is the introduction of New Electricity Trading Arrangements (NETA).

Price controls

Where competition is not feasible or not sufficiently effective price controls will remain necessary. In the past year, price controls for the Public Electricity Suppliers' (PESs') electricity distribution and supply businesses, for Scottish transmission and for British Gas Trading (BGT) have combined to protect customers from excess prices. In practice, we

expect competition to deliver lower prices than those set in supply price controls. Price control reviews will continue in the coming year alongside a new programme of work to enhance the well-established RPI-X form of price regulation.

Competition and industrial structures

Ofgem will work to establish the industrial structures which promote competition. A key aspect of this work will be the separation of the PESs' supply and distribution businesses. Enforcement action against anti-competitive behaviour under the powers of the new Competition Act 1998, and work to consider the impact of mergers and acquisitions will be important to securing an environment in which competition can develop.

Establishing Ofgem by combining the Offices of Gas and Electricity Supply

To meet these priorities Ofgem will continue to create an organisation with the governance, structure and standards to attract and retain high quality staff, and to build the confidence of those whom we regulate and on whom our work has an impact.

Ofgem will report on progress in meeting each of these priorities in its Annual Report.

Contents

	Page
1. Introduction	1
◆ Outline of this document	1
◆ Details of the plan and budget and Ofgem's response to the consultation	2
2. Ofgem themes and priorities for 2000/2001	3
◆ Social and environmental action	3
◆ Competition in wholesale markets	9
◆ Price controls	13
◆ Competition and industrial structure	16
◆ Establishing Ofgem by combining the Offices of Gas and Electricity Supply	20
3. Resources forecast	24
4. Annexes	
Annex 1: Ofgem's priorities for the year 1999/2000	25
Annex 2: Ofgem organisational chart	
Annex 3: Ofgem regulatory standards	26
Annex 4: List of respondents to consultation on Ofgem draft plan and budget	28
Annex 5: Glossary of key terms	31

1 Introduction

Outline of this document

- 1.1 Chapter two sets out Ofgem's themes and priorities for the coming financial year (April 2000 to March 2001) and the key programmes and milestones associated with each, together with a brief overview of the organisation and resources required to meet them.
- 1.2 The milestones include an indication of timings by quarter of the financial year, as follows:
 - Q1 – April to June 2000
 - Q2 – July to September 2000
 - Q3 – October to December 2000
 - Q4 – January to March 2001
- 1.3 Chapter three contains details of the financial resources that Ofgem will require to meet its priorities for the coming year.
- 1.4 Annex 1 sets out the priorities for 1999/2000.

Annex 2 explains the structure and organisation of Ofgem.

Annex 3 outlines the regulatory standards which Ofgem has established and by which it operates.

Annex 4 contains a list of those who responded to the consultation. The consultation was supplemented by two public meetings, one in London and one in Glasgow. We are grateful to all those who attended the meetings and wrote in with their views.

Annex 5 contains a glossary of key terms.

Details of the Plan and Budget and Ofgem's response to the consultation

- 1.5 The final version of the Ofgem Plan and Budget 2000/2001 is available on the Ofgem website: www.ofgem.gov.uk.
- 1.6 Copies of the submissions on the draft Plan and Budget are also available on the website together with Ofgem's response to the key issues which were raised by respondents.
- 1.7 If you wish to discuss this document, in the first instance please contact:

Agnes Tomlinson

Corporate Planning

Stockley House

130 Wilton Road

London

SW1V 1LQ

Telephone number: 0207 932 5821 (London) or 0121 456 6259 (Birmingham)

Email: agnes.tomlinson@ofgem.gov.uk

2 Ofgem themes and priorities for 2000/2001

2.1 Ofgem's themes and priorities for 2000/2001 are:

- ◆ Social and environmental action
- ◆ Competition in wholesale markets
- ◆ Price controls
- ◆ Competition and industrial structure
- ◆ Establishing Ofgem by combining the Offices of Gas and Electricity Supply

2.2 These priorities build on those which were set for 1999/2000 and which are set out in Annex 1. We see advantage in this continuity. The establishment of consistent priorities provides greater transparency and certainty to those whom Ofgem regulates and allows us to maintain a focus on the policy issues which will secure real benefits for gas and electricity customers.

Social and environmental action

Overview

2.3 In excess of four million households, more than one in five of all households in Great Britain, suffer from fuel poverty. It is a particular problem for pensioners, who make up almost half the fuel poor, and for single parents.

2.4 Those in fuel poverty stand to benefit most from Ofgem's price control work, from the establishment of a more competitive energy sector in general, and from the actions to bring competition to the generating sector in particular. But Ofgem is also concerned to support these general initiatives with particular work aimed at helping the fuel pool.

2.5 Ofgem's aim is to identify how, within the range of measures being taken by government, by industry and by others, we can encourage effective action to deal with fuel poverty.

Ofgem's new emphasis on the problems of the fuel poor is reflected in the Social Action Plan developed in 1999 and published in March 2000, and in the Energy Efficiency Standards of Performance for electricity and gas which were proposed in October 1999 and finalised in March 2000. These initiatives are examples of the vehicles through which Ofgem will respond to the government's social and environmental guidance to be issued under the Utilities Bill. Advancing these proposals will remain a priority for Ofgem, as will ensuring that suppliers of both electricity and gas operate to high standards and that customers are properly protected.

- 2.6 Customer complaints arising from the opening of competition in the gas and electricity markets remain a concern, although the numbers must be considered in the context of the millions of customers who have taken advantage of the newly competitive markets to switch supplier. Ofgem will continue to dedicate significant resources to investigating complaints and taking action where necessary. We will also work to resolve the underlying issues which give rise to complaints and will ensure that barriers to customers benefiting from competition in electricity and gas supply are removed.
- 2.7 Ofgem will also devote resources to the definition of Ofgem's future responsibilities once the Utilities Bill is enacted.
- 2.8 Much of Ofgem's work affects the environment and the new environmental guidance which government will give under the Utilities Bill will make this an even more central part of Ofgem's work. We will develop an Environmental Action Plan under which we will co-ordinate and where necessary develop our work in this area. This plan will, for example, include work to ensure that barriers to renewable generation and combined heat and power (CHP) in the electricity market are brought down as a contribution to meeting government targets for renewable and CHP production. It will also address work with government to implement new ways of supporting renewable projects.

Delivering Ofgem's commitment to social and environmental action

The Social Action Plan

- 2.9 The plan sets out a major programme of work to address the needs of the fuel poor in partnership with government and the fuel industries.

- 2.10 During 2000 we will implement the first part of the plan. This will include new licence conditions requiring suppliers to offer payment methods that best suit customers' needs. There will also be new requirements relating to pre-payment meter services, including a cap on the charge which electricity suppliers can make to customers for pre-payment meter services. The plan will also address the impediment to customers who are in debt transferring to a new supplier.
- 2.11 A major focus during the year will be advancing with customer and other interest groups a better understanding of the ways in which the industries relate to customers in financial difficulty and other disadvantaged groups, including the elderly and those with disabilities.

Key milestones:

- ◆ Implement social obligation licence conditions: Q1
- ◆ Agree proposals for a modified licence condition on customers in debt wishing to change supplier: Q1
- ◆ Review pre-payment meter infrastructure arrangements: Q2
- ◆ Publish initial company monitoring reports required under the Social Action Plan: Q3
- ◆ Publish a public report reviewing the implementation of the Social Action Plan: Q4

Helping customers to have a real choice between energy suppliers

- 2.12 The roll-out of domestic competition in electricity supply was completed in 1999.
- 2.13 During 2000 Ofgem will concentrate on ensuring that the processes that have been put in place by the industry continue to work well and address problems such as erroneous transfers of customers to new suppliers. Ofgem will conduct a major review of the customer transfer process and will make recommendations for improvements. We will also review the working of the marketing licence condition and investigate suppliers whose performance is unsatisfactory. A major focus for the year will be to look at how suppliers can give clearer price information to enable customers to make straightforward comparisons between suppliers. We are working with other regulators to share best practice in this important area.

Key milestones:

- ◆ Review of suppliers' marketing licence conditions: Q1
- ◆ Publish initial consultation on the transfer process review: Q2
- ◆ Implement new price comparison requirements: Q3
- ◆ Publish conclusions on transfer process review: Q4

Customer protection

- 2.14 Ofgem has proposed further tightening of the standards in the electricity distribution businesses: for example, new standards to reduce the loss of supply through distribution faults and a review of customers payments in the event of loss of supply. These will be implemented as part of the PESs distribution price controls from April 2000. Looking ahead, work on improving customer standards will be developed in close partnership with the work to review information and incentives. This work (which falls within the area of price controls) will look at the incentives on companies to improve quality of service and supply, and will review the measures to be applied in the first instance to the electricity distribution businesses. In the longer term the principles which underpin this work may be applied to other businesses regulated by Ofgem.
- 2.15 Ofgem has been working closely with the Department of Trade and Industry (DTI) on the Utilities Bill. In particular, we have proposed new standard licence conditions and changes to the licence regime to meet the new requirements for customer protection in the Bill. We will also work with the Office of Fair Trading (OFT) to implement the new enforcement powers given to us under the Unfair Terms in Consumer Contracts Regulations 1999.
- 2.16 Safety is of paramount concern. We will continue to work with Health and Safety Executive (HSE) on safety issues during the year. Ofgem is also concerned to ensure that electricity and gas meters meet specifications, and that gas quality falls within defined parameters.

Key milestones:

- ◆ Begin implementation of Unfair Terms in Consumer Contracts Regulations: Q1
- ◆ Implement new customer standards applied to electricity distribution businesses: Q1

- ◆ Issue new standard licences to take account of new customer protection requirements in the Utilities Bill: Q3 (dependent on Utilities Bill timetable)

Environment

- 2.17 During 2000 Ofgem will develop an Environmental Action Plan. The plan will aim to set out the political background to the environmental issues which we are addressing globally, nationally and locally. It will define Ofgem's role vis-à-vis that of other relevant players; look at the environmental impact of Ofgem's activities across all our divisions; and identify initiatives to support our environmental work in the future.
- 2.18 During 1999 Ofgem proposed new standards on energy efficiency for all gas and electricity suppliers. The standards will be implemented during 2000. We will advise the Department of the Environment Transport and the Regions (DETR) on the implementation of new standards which, it is proposed, will be set by government under the Utilities Bill. We will also continue to keep the development of renewable and CHP generation under review (including the maintenance of the publicly available database which lists CHP schemes), and will aim to address any remaining barriers to entry to the market by these technologies. We will also work with government on the development and implementation of new means to support renewable generators and monitor the development of "green tariffs" in the supply market. This work will be co-ordinated within the Environmental Action Plan.

Key milestones:

- ◆ Implement new Energy Efficiency Standards of Performance: Q1
- ◆ Revise codes of practice on energy efficiency advice: Q1
- ◆ Prepare Environmental Action Plan: consultation Q1; publish plan Q3 (dependent on Utilities Bill timetable).

Complaint handling

- 2.19 In 1999 electricity complaints to Ofgem increased from 682 in January to 2,502 in December. The number of complaints from gas customers over the same period fell from 3474 in January to 1,658 in December. The key concerns are problems with transfers,

direct selling and account disputes. The policy priorities identified above are intended to address the main areas of customer concern.

- 2.20 During 2000 we will review our complaint handling activities. The new Gas and Electricity Consumer Council (GECC) will, when the Utilities Bill is effective, inherit many of Ofgem's responsibilities for dealing with customer complaints. Ofgem will work with those planning for the new council and the existing electricity and gas consumer bodies, to develop new complaint procedures which provide effective redress for customers and ensure that Ofgem is kept fully informed of customer concerns. We will seek to minimise the inevitable disruption caused by the transition to new arrangements.

Key milestones:

- ◆ Establish memorandum of understanding with GECC: Q1
- ◆ Joint working with GECC in preparation for transition: Q1 onwards (dependent on Utilities Bill timetable)
- ◆ Complete transfer of responsibilities to GECC: not later than Q4 (dependent on Utilities Bill timetable)

Organisation and resources

- 2.21 Social and environmental considerations cut across all of Ofgem's work with the lead responsibility falling to the Customers and Supply Division.
- 2.22 This division has wide responsibilities for customer protection and social and environmental action and has a team of over 200 staff. Of these, 120 operate from the 14 regional offices, the functions of which will be transferred to the GECC. The total cost for 2000/2001 is estimated as £9.7 million (including a consultancy budget of £1 million).

Competition in wholesale markets

Overview

- 2.23 Bringing effective competition to both the electricity and the gas wholesale markets remains a major objective for Ofgem, reflecting the fact that energy costs represent the largest single component in customers' final bills. This is a particular concern in the wholesale electricity market, where effective competition has been manifestly lacking, and where large reductions in input costs over the past decade have not been reflected in the generators' output prices.
- 2.24 The approaches adopted by Ofgem to gas and electricity wholesale markets share common principles. They are designed to produce prices which respond to competitive pressure, and do not seek to produce any particular price level. There is a recognition that there needs to be a separate identification and pricing of energy on the one hand, and of transmission system capacity on the other. In terms of market behaviour, participants must not abuse a position of substantial market power, including setting at risk the efficient balancing of the system.
- 2.25 In 1999/2000 Ofgem contributed to the introduction of new wholesale trading arrangements for gas, including an independently operated screen-based on-the-day commodity market and the auctioning of entry capacity on the National Transmission System. Ofgem has also published proposals, endorsed by the government, for a fundamental change in electricity trading. Implementing the New Electricity Trading Arrangements (NETA) from autumn 2000 involves a very large programme of work by all interested parties including the industry, Ofgem and the DTI and is a very high priority for Ofgem.
- 2.26 In Scotland, Ofgem also intends to implement policies to promote effective competition in wholesale electricity trading in place of the current essentially administered arrangements. Ten years ago Scottish domestic electricity prices were lower than those in England and Wales; now they are five per cent higher. A review of wholesale trading arrangements, and of charges for use of the interconnector and transmission system, will bring significant benefits to Scotland.

- 2.27 Ofgem will seek to ensure that policies for electricity and gas transmission being developed in Europe evolve in a way which promotes competition and efficiency and are compatible with the solutions to wholesale trading which are now being developed in Britain.

Delivering Ofgem's commitment to extending competition in wholesale markets

Attacking abuse of substantial market power

- 2.28 Past trading behaviour by major electricity generators over the last nine years has led to proposals to introduce new licence obligations designed to prevent certain generators from abusing a position of substantial market power. Some of the licensees accepted the proposals but others rejected them, leading to a reference to the Competition Commission. This inquiry will take up a significant amount of Ofgem resource in 2000/2001. In any event, throughout 2000/2001 there will be a continuing need to review the behaviour of the major generators in the electricity wholesale markets.

New Electricity Trading Arrangements (NETA)

- 2.29 The objective of the NETA programme is to implement new trading arrangements from autumn 2000. This is a big and important project. It involves planning, managing, procuring and delivering the new systems, codes, contracts, organisation and governance arrangements. By the end of 1999 service providers had been selected for the system design and implementation phases of the project.
- 2.30 A particular challenge is the management of the decision to allow the new arrangements to "go live". That decision requires assurances that all the interdependent systems are ready. Many of those fall outside the immediate responsibility of the NETA programme but are essential to the successful delivery of the new trading arrangements. The identification, monitoring and eventual confirmation of all the necessary milestones is a major function.
- 2.31 There are key interactions with the work which is being carried out elsewhere in Ofgem on the Utilities Bill, the transmission services incentives and the transmission price control. Achieving the target dates will require timely action by many outside Ofgem, in particular, it will require the Utilities Bill to receive Royal Assent before the summer recess.

Key milestones:

- ◆ Establish the Balancing and Settlement Company: Q2
- ◆ Agree Balancing and Settlement Code: Q2
- ◆ Start trialling, testing and commissioning: Q2
- ◆ "Go live" with new trading arrangements: Q3
- ◆ Establish a core Ofgem team to take forward the development, refinement and modification of new trading arrangements: Q3

Trading arrangements in Scotland

2.32 Ofgem will work to implement a more competitive electricity market in Scotland, including a thorough review of the wholesale trading arrangements, as well as the charges for use of the interconnector and transmission system. The aim is to remove barriers to competitive trade throughout Great Britain. This work will continue throughout the year with the aim of defining new trading arrangements from April 2001.

Key milestones:

- ◆ Review of Scottish trading arrangements : Q2

New Gas Trading Arrangements (NGTA)

2.33 A significant development in the wholesale gas supply market - the on-the-day commodity market (OCM) - was successfully introduced on 1 October 1999.

2.34 The OCM, combined with the introduction of auctions of transmission entry capacity on Transco's transmission system, formed the basis for the NGTA. These will be reviewed and extended in 2000, and modifications will be agreed and implemented.

2.35 Further work on Transco's system operator incentive schemes, long term investment incentives and introducing revised exit capacity arrangements will be carried out in 2000/2001. In addition to work on the NGTA, Ofgem proposes to review the present governance arrangements of the Network Code.

Key milestones:

- ◆ Implement further revisions to trading arrangements: Q1 and Q3
- ◆ Review of OCM: Q1
- ◆ Review Network Code governance arrangements: consultation Q1; decision Q3
- ◆ Implement New Transco system operator incentives and review the NTS capacity regime: Q3

National Grid Company (NGC) system operator incentives

2.36 With the introduction of the NETA, NGC's existing system operator incentives will need to be reviewed and replaced. New governance of its connection and use of system arrangements will also be implemented, facilitating the introduction of a new regime for the sale of capacity on NGC's transmission system. Ofgem will seek to introduce more market-based solutions for system balancing, the sale of capacity rights and the management of constraints.

Key milestones:

- ◆ Review NGC system operator incentives: interim proposals Q1; decision Q3
- ◆ Review of NGC capacity regime: consultation Q1; proposals Q3

Organisation and resources

2.37 Competition in wholesale markets is largely the responsibility of the Competition and Trading Arrangements Division.

2.38 The NETA team involves around 25 people and has a total forecast budget of £17.0 million for 2000/2001 of which £15.6 million is consultancy and contractors costs. This budget has risen from the costs presented in the draft budget but the increase will be fully recovered from NGC. The full NGC recharge is expected to be around £9.4m.

2.39 Other aspects of competition in wholesale markets are dealt with by a team of 38 staff, with a total budget of around £3.8 million of which consultancy is just under £2 million.

Price controls

Overview

- 2.40 Where competition is not feasible or is not yet sufficiently effective, price controls are applied to protect customers from excessive prices.
- 2.41 From April 2000 price controls will apply in the following areas:

Activity	Last review	Next review
Electricity Distribution	1999	2004
Electricity Transmission in England and Wales	1996	2000
Electricity Transmission in Scotland	1999	2004
Gas Transportation and Distribution	1997	2001
Electricity Supply	1999	2001 (see 2.45 below)
Gas Supply	1999	2000 (see 2.45 below)

Note: In general, price controls become effective from 1 April in the year following a review.

Enforcing these price controls is in itself a major stream of work for Ofgem every year.

- 2.42 Ofgem expects price controls to continue in the natural monopoly areas of transportation, transmission and distribution. The completion of NGC's price control review and the preliminary work on Transco's next review will form an important part of Ofgem's work in 2000.

- 2.43 In addition, Ofgem is undertaking in 2000 a major review of the information required to monitor the performance of the electricity distribution companies. This work will be complemented by a review of the regulatory accounts produced by these companies.
- 2.44 The information review accompanies a detailed examination of the appropriate incentive regime to apply to these companies, particularly from 2005 onwards, in order to ensure an appropriate balance between quality of service and price, and to reduce the uncertainty and gaming presently associated with price reviews.
- 2.45 The supply controls in electricity and gas only apply in areas of the market where competition is not yet fully developed. Competition is already proving the most significant driver of customer prices and Ofgem is keen to withdraw from overt price setting at the time of the next reviews in both electricity and gas.
- 2.46 A condition for removing supply price controls is that competition is sufficiently developed to protect customers' interests. Ofgem will spend time in 2000 to ensure that barriers to competition are reduced. Subject to satisfactory progress in removing these barriers, it is Ofgem's firm intention to withdraw price controls.

Delivering Ofgem's commitment to review price controls

Managing the impact of the price control programme for 1999/2000

- 2.47 All 31 price controls proposed in 1999/2000 have now been accepted by the companies: 14 electricity distribution controls for the PESs; 14 supply price controls for the PESs; two Scottish transmission price controls; and BGT gas supply price control. The companies' acceptance of these price controls means that a potentially demanding programme of work to manage references to the Competition Commission has been avoided. This is encouraging and allows resources to be dedicated to other price control work and to the information and incentives programme, which will develop and improve the well-established RPI-X form of price regulation.

Review of National Grid Company (NGC) price control

- 2.48 During 2000, Ofgem will review the existing price controls for NGC. This has a deep policy interrelationship with the review of NGC's system operator incentives, which forms part of the work programme for the Competition and Trading Arrangements Division. The price control review is expected to be completed in autumn 2000.

Key milestones:

- ◆ Draft proposals: Q1
- ◆ Final proposals: Q2
- ◆ Implementation: Q4

Transco price control review

- 2.49 The BG Transco price control review is due for completion in autumn 2001 and implementation in April 2002. Work will take place during 2000 to develop the form and structure of the next price control to ensure it provides appropriate incentives on Transco.

Key milestones:

- ◆ Review Transco price control - background consultation: Q1
- ◆ Obtain business plan from Transco for next price control period: Q3
- ◆ Initial thoughts consultation document: Q4

Review of the information and incentive principles of price controls

- 2.50 As part of the present electricity distribution price control review, Ofgem has announced a project to review the information requirements and incentives applicable to the RPI-X form of price regulation. In particular Ofgem intends to introduce additional mechanisms to strengthen the incentives on the electricity distribution businesses in relation to the quality of supply. A first stage in this work will be to review the way the outputs from these businesses are measured. This will run throughout 2000/01 and is due for completion in March 2002. Simultaneously, and in conjunction with the work programme

on information and incentives, there will be a review of regulatory accounts for the gas and electricity industries, with the aim of making these more relevant and useful for all parties.

Organisation and resources

- 2.51 Price control work is a major part of the activity for the Regulation and Financial Affairs Division.

Including enforcement, the incentives initiative and technical advice required for price controls, the work involves a team of around 27 staff.

A further team of 52 delivers Ofgem's statutory requirements for gas and electricity meter testing and gas quality standards.

The total budget is around £5.5 million, of which consultancy is just over £1.6 million.

Competition and industrial structure

Overview

- 2.52 Establishing appropriate industrial structures, which promote rather than obstruct competition, is central to all that Ofgem seeks to achieve. It is now widely accepted, for example, that the substantial benefits brought about by competition in gas supply, estimated by the National Audit Office to have benefited British consumers by some £1 billion annually, would have been impossible without the separation of the gas transmission business (now within BG plc) from the gas supply business (now within Centrica plc).
- 2.53 The past year has been marked both in Europe generally and in Britain in particular by a series of transactions which have led to a significant degree of vertical integration, as well as the creation of some large supply groupings, offering both gas and electricity. These transactions, more of which seem likely, raise important issues on which Ofgem needs to be able to respond rapidly in giving advice to the Director General of Fair Trading and to the Secretary of State for Trade and Industry. Equipping Ofgem to be able to advise on merger proposals and to deal with financial restructurings is a priority.

- 2.54 There is also important work on promoting competition. This will include the measurement of the effectiveness of competition in gas and electricity supply (with its implications for whether price controls are needed) and the separation of the distribution from the supply businesses of the PESs, which will involve substantial work on licences under the Utilities Bill. The work will also include the separation of potentially competitive businesses, including meter provision, meter operation and meter reading in both gas and electricity, and the gas and electricity connections business, from those monopoly transmission or distribution businesses with which they have been associated historically.
- 2.55 Ofgem also expects to see a significant increase in its investigations and enforcement work under the new Competition Act 1998 which takes effect in March 2000.
- 2.56 The assessment and monitoring of competition in the supply of both gas and electricity will remain an important task. Although both the gas and electricity supply markets have been marked by quite dynamic competition, with rapid and substantial movement away from the incumbent suppliers (a switch by February 2000 of 26 per cent in gas and approaching 13.5 per cent in electricity), the effects of this, particularly on different consumers, need to be reviewed. In particular, it will be necessary to continually review the effects of the dominance of British Gas Trading, which has more than 70 per cent of domestic gas supply.

Delivering Ofgem's commitment to develop industrial structures which promote competition

Separation of distribution and supply businesses

- 2.57 This involves substantial work on licences in conjunction with DTI and work on the Utilities Bill. During 2000 we will further develop licence proposals in discussion with the industry, consumer groups and other interested parties. We will work to establish compliance and monitoring arrangements, the policing of disputes and the development of new industry practices where required.

Key milestones:

- ◆ Agree PES compliance plan: Q1

- ◆ Receive first compliance reports: Q1
- ◆ Implement separate licences for electricity supply and distribution: Q2 (dependent on Utilities Bill timetable).
- ◆ Issue report on initial review of implementation: Q3

Assessing competition in supply

- 2.58 Ofgem will also review the domestic and non-domestic markets in both gas and electricity supply to monitor and assess the development of competition.
- 2.59 Ofgem is presently leading work with other utility regulators to help identify the criteria for testing the transition from pre-competitive to competitive markets. This work will continue to be developed throughout 2000/2001.

Key milestones:

- ◆ Report on developments in competition in gas and electricity supply: Q3
- ◆ Report on joint regulatory group's findings: Q4

Assessing competition in connections

- 2.60 Connections is an emerging competitive market which will continue to require regulatory action to ensure that competition develops in an effective way. Ofgem will assess the development of competition in these services on an on-going basis during 2000/01. Ofgem will act to ensure that both price and non-price barriers to the development of competition are removed.
- 2.61 Ofgem will also continue to assess the regulation of Independent Public Gas Transporter (IPGT) charges, to ensure that regulation is transparent and provides the appropriate level of protection for consumers.

Key milestones:

- ◆ Decision document on competition in electricity connections: Q1

- ◆ Report on developments in competition in gas and electricity competition: Q4

Assessing competition in metering

- 2.62 Competition in metering continues to require regulatory action to ensure its further development. By April 2000 work should be largely completed on the splitting of Transco's single price control into three separate price controls covering metering, meter reading and transportation. This will prevent the possibility of Transco subsidising its metering businesses from its transportation business.
- 2.63 Transco's split price control, together with related obligations in both gas and electricity licences, provide the basis for competition to develop. Ofgem will monitor developments closely, and take action where necessary. Ofgem will be particularly interested in the development of competition in non-half hourly metering and data services, where competition will be introduced for the first time during 2000/01.
- 2.64 Ofgem will come forward with proposals early in the financial year which will set out a strategy for developing metering and a timetable for action.

Key milestones:

- ◆ Implementation of Transco's split price control: Q1
- ◆ Report on developments in competition in gas and electricity metering and meter reading services: Q3

Deregulation of gas storage

- 2.65 Ofgem has proposed auctioning liquefied natural gas (LNG) storage capacity and subsequently allowing capacity to be traded on a secondary market. Efforts will continue to be made to deregulate the remaining elements of gas storage, and to monitor developments in those parts of the market that have recently been deregulated.

Key milestones:

- ◆ Implement LNG storage auctions before the beginning of the next storage year: Q1

Competition Act 1998 – guidance and decisions

- 2.66 Throughout 2000/2001, Ofgem can expect to receive requests for guidance and decisions, and notifications for exemptions, under the Competition Act 1998. Certain complaints may lead to investigations to which significant levels of resource will need to be diverted. Moreover, information may come to light which leads Ofgem to initiate its own investigation under the Competition Act 1998. The conclusions of initial investigations under the Act may well result in appeals to the Competition Commission. Such appeals will need to be fully resourced.
- 2.67 In addition there will be work in co-ordinating Ofgem's approach to the new powers available under the Competition Act 1998 and those envisaged by the Utilities Bill.

Organisation and resource

- 2.68 The work on competition and industrial structure cuts across the Ofgem organisation with the Customers and Supply Division taking the lead on co-ordinating the work on transactions and the Competition and Trading Arrangements Division leading on the assessment and promotion of competition.
- 2.69 In broad terms estimated resources for this work are around 52 staff, a total budget of £2.3 million including a consultancy budget of less than £0.5 million.

Establishing Ofgem by combining the Offices of Gas and Electricity Supply

Overview

- 2.70 An effective and efficient organisation underlies all Ofgem's policy objectives. To achieve this Ofgem must look not only to its structure and organisation but also to the standards by which it will work. Important progress has been made in both of these areas during the year.
- 2.71 Ofgem is now organised to address issues across both gas and electricity in new management divisions, rather than on separate industry lines. There is a structure of corporate governance, based on a Management Board which has a majority of independent

non-executive members and on a Management Committee comprising the Director General, three Deputy Director Generals and the Chief Operating Officer (see annex 2). There is also an Audit Committee of three of the independent members of the Management Board.

2.72 The structure is designed to meet a number of important aims:

- ◆ to respond to questions affecting both gas and electricity on an integrated basis, not by industry sector;
- ◆ to respond to questions that are likely to become increasingly important in the next decade, including customer protection, and the social and environmental agenda;
- ◆ to create a management structure with clear responsibilities and delegation of authority. The Management Committee is central to this; and
- ◆ to ensure that regulation of gas and electricity draws on a full range of advice and experience, and is seen as the work of the organisation, not simply that of a single regulator. The establishment of the Management Board is designed to ensure this.

2.73 Ofgem has also established its own regulatory standards to ensure effectiveness, accountability and professionalism in the way in which it develops its structure and procedures internally and in the way in which it manages its relations externally (see annex 3).

2.74 Considerable progress has been made towards establishing the combined office of Ofgem in London. However, there remains a heavy work programme to complete this task.

Delivering Ofgem's commitment to combine the Offices of Gas and Electricity Supply

Resourcing

2.75 Ofgem has recruited extensively to obtain the right skill mix and to replace staff who have been lost in the move from Birmingham to London. After the transfer of relevant

responsibilities to the GECC the core staff complement will be in the region of 400 (London, Leicester and Glasgow). To determine the right level of resource for the long term, and the correct balance between staff and consultants, Ofgem is undertaking a strategic resourcing review.

Key milestones:

- ◆ Complete majority of recruitment programme: Q1
- ◆ Complete strategic resourcing review: Q2

New working practices

- 2.76 There is an opportunity to establish new working practices in Ofgem including a more effective consultation process, more effective team-working and better ways of communicating with those affected by Ofgem's work and decisions.

Key milestones:

- ◆ Work is ongoing to establish and develop new working practices. This will be largely completed at the time of the move to the new premises: Q2
- ◆ Work is in hand to develop new standards for communication. A new public affairs programme will be implemented: Q1

Europe, Scotland and the regions

- 2.77 Ofgem already has contact with key players in Europe but plans to co-ordinate this work better internally and to devote more resources to it in order to follow and influence developments which have an impact on the energy market in Great Britain.
- 2.78 To reflect the importance of Scotland to Ofgem's work, and to ensure that Scottish needs are fully reflected in Ofgem's work, the work of the Glasgow office of Ofgem, managed by the newly appointed Deputy Director General (Scotland), is being integrated with that of the policy divisions in London.
- 2.79 When the Utilities Bill is enacted, responsibilities for electricity consumer representation currently handled by Ofgem will pass to GECC. Preparing for this, which affects the

existing regional Electricity Consumers' Committees and has major implications for Ofgem's regional office staff, is a major objective.

Key milestones:

- ◆ Complete transfer of responsibilities to GECC: not later than Q4 (dependent on Utilities Bill timetable)

Ofgem premises

2.80 New head office premises will provide accommodation more suited for the project work which typifies Ofgem's activity. The relocation, and the establishment of a working environment which encourages new working practices, is a major operation. It is also necessary in order to rationalise the number of Ofgem premises throughout the country with the aim of maintaining one office in London, Glasgow and Leicester.

Key milestones:

- ◆ Complete move into new Ofgem head office: Q3
- ◆ Rationalise the number of Ofgem premises: Q4

Organisation and resources

2.81 The main responsibility for establishing Ofgem and combining the offices of Gas and Electricity Supply falls to the Operations Division.

2.82 Resources comprise around 125 staff (including staff specifically involved in legal services, public affairs, HR, finance, IT and premises management) a total budget of around £30m of which £14.9m relates to merger costs. This does not take account of the merger costs associated with the transition from the regional offices to the GECC, the timing and scale of which have yet to be finalised. The total also includes a £3.4m contingency for possible expenditure against demand-led work such as Competition Commission references, industry restructuring, and Competition Act Investigations.

3 Resources Forecast

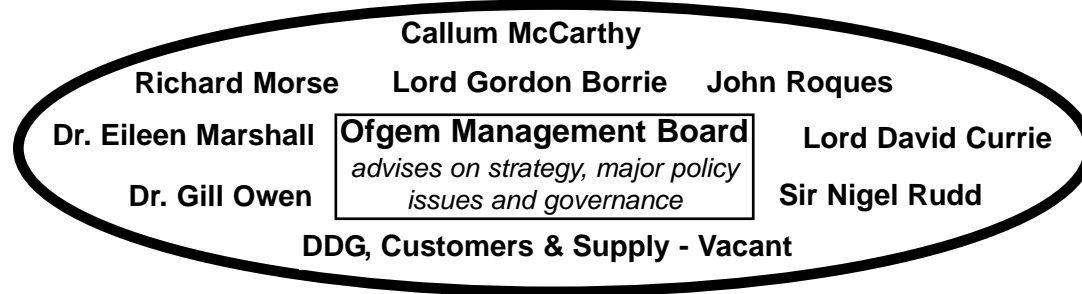
- 3.1 Ofgem, as a non-ministerial government department, is funded by the exchequer through a parliamentary vote (currently there are two votes: OFFER and Ofgas). The costs incurred by the organisation are subsequently recovered through licence and other fees charged to the industry.
- 3.2 The total expenditure of Ofgem in 2000/2001, including the costs of NETA and the merger is forecast at £68.3 million (1999/2000 £51 million).
- 3.3 Ofgem's budget has risen from £64.5 million reported in the draft budget to £68.3 million. This is entirely due to additional NETA work (£3.8 million) which will be fully recovered from NGC.
- 3.4 Excluding NETA and merger costs, the 2000/2001 forecast expenditure is £36 million (1999/2000 £34 million).
- 3.5 These forecasts are likely to be affected by Ofgem's success or otherwise in recruiting new staff; the associated transfer of some work from consultants to internal staff; the arrangements made for the transfer of consumer responsibilities from Ofgem to the GECC as a result of the Utilities Bill; and the amount of demand-led work such as work on proposed mergers or response to requests for investigations under the Competition Act 1998.
- 3.6 Ofgem trend in spending:

COMBINED (Offer and Ofgas)					
(£ 000)	1996/7	1997/8	1998/9	1999/00	2000/1
STAFF	9,704	10,017	11,393	12,550	17,091
CONSULTANTS	6,230	7,046	10,102	17,337	25,192
OTHER	7,167	12,706	16,905	21,262	26,058
TOTAL SPEND	23,101	29,769	38,400	51,149	68,341
LESS NETA	0	0	2,630	10,677	17,000
LESS MERGER	0	0	0	6,000	14,907
NET TOTAL SPEND	23,101	29,769	35,770	34,472	36,434
% CHANGE		28.9%	20.2%	-3.6%	5.7%

Annex 1

Ofgem's priorities for the year 1999/2000 were as follows:

- ◆ Establishing Ofgem by combining the offices of gas and electricity supply
- ◆ A new emphasis on the social dimension of Ofgem's work
- ◆ Creation of a new wholesale market for both electricity and gas
- ◆ Price reviews for the 14 Public Electricity Suppliers and British Gas Trading
- ◆ Work on the industrial structure of the two industries
- ◆ Monitoring the gas and electricity industries' preparations for the millennium



Ofgem Management Committee
decides on all matters relating to strategy, policy, management and resources

Director General
Callum McCarthy

Deputy Director General
 Customers & Supply
Vacant

Deputy Director General
 Competition & Trading
 Arrangements
Dr. Eileen Marshall

Deputy Director General
 Regulation & Financial Affairs
Richard Morse

Chief Operating Officer
Gill Whittington

Deputy Director General Scotland
Charles Coultard
 0141 331 1772

Company Secretary
William Sprigge
 020 7932 1670

General Counsel
Charles Bankes
 020 7932 1641

Director - Public Affairs
Sarah Harrison
 020 7932 5877

Customers & Supply

Director - Supply & Development
Pam Barrett
 020 7932 5891

Director - Retail Markets
Rosalind Cole
 020 7932 1644

Director - Regions
David Hauser
 0121 456 6201

Director - Consumer & Environmental Affairs
Virginia Graham
 020 7932 1639

Competition and Trading Arrangements

Director - Competition
Nick Fincham
 020 79321652

Director - NETA Programme
Brian Saunders
 0207 874 1601

Director - Trading Arrangements
Stephen Smith
 020 7932 5927

Regulation & Financial Affairs

Senior Financial Advisor
Peter Bucks
 020 7932 6367

Director - Price Control 2
Justin Coombs
 020 7932 1605

Director - Price Control 1
Andrew Walker
 0121 456 6241

Director - Technical
Brian Wharmby
 020 7932 5895

Director - Europe, Information & Incentives
Joanna Whittington
 020 7932 5873

Ofgem Operations

Director - Finance
Roy Field
 020 7932 1610

Director - Human Resources
Jack Wheale
 (May 2000)
 020 7932 1687

All above can be contacted via email: firstname.surname@ofgem.gov.uk

Annex 3

Ofgem regulatory standards

Our standards are the principles by which we aim to work in regulating the electricity and gas industries.

Competition

We seek to achieve effective competition wherever possible throughout all parts of the electricity and gas industries. We shall bring this about by actively:

- ◆ Removing barriers to entry, including changing the industry structure; and
- ◆ Regulating the behaviour of organisations with market power.

Regulation

We shall regulate the areas of the electricity and gas industries where competition is not effective, in line with our statutory powers, to protect the interests of customers. To do this we shall:

- ◆ Set price controls which give incentives to improve efficiency;
- ◆ Set standards of service as a means of ensuring reliability and value for money; and
- ◆ Settle disputes.

Enforcement

We shall monitor the industry and enforce regulation for the benefit of customers, and be seen to do so. To do this we shall:

- ◆ Collect and publish market information;
- ◆ Maintain regulatory effectiveness through a combination of influence, incentives, intervention and legal action; and
- ◆ Make regulation simple and not require over-elaborate and expensive maintenance.

Effectiveness

We aim to regulate effectively and in a consistent way, so that customers, shareholders and others understand our position. To do this we shall:

- ◆ Be clear about our direction, principles and priorities, and set these out clearly and publicly;
- ◆ Act quickly in line with these principles as issues arise;
- ◆ Seek a reputation for impartiality and independence; and
- ◆ Ensure that neither we, nor those whom we regulate, are overloaded by our work.

Accountability

We believe that as a public body we have a duty to account for our actions. We also believe that clear accountability will enhance our authority as a regulator. To do this we shall:

- ◆ Communicate effectively with the outside world – customers, interest groups and the electricity and gas industries.
- ◆ Present our objectives and work transparently and in good faith; and
- ◆ Involve both customers and the electricity and gas industries, and be accessible to them.

Professionalism

We believe that high internal standards, consistently achieved, will enhance our authority as a regulator. To do this we shall:

- ◆ Operate efficiently and competently in all our work;
- ◆ Actively innovate in the way we regulate, and find ways to ‘work smarter’;
- ◆ Build on current constructive working relationships with all interested parties; and
- ◆ Keep in close touch with developments in the market and its regulation, including internationally.

Annex 4

List of respondents to consultation on Ofgem draft Plan and Budget – November 1999:

Alliance Gas Ltd

Amerada Hess Gas Limited

Aquila Energy Limited

Association of Electricity Producers (AEP)

BOC Gases

BP Amoco

British Energy

British Gas Trading (Centrica)

CBI (Industrial Policy Group)

Centrica

Consumers' Association

Corgi (The Council for Registered Gas Installers)

Department of the Environment, Transport and the Regions

Department of Trade and Industry

East Midlands ECC

Electricity Consumers' Committee South West Region

Electricity Consumers' Committee for South Wales

Electricity Consumers' Committees - Yorkshire Region

Elf Gas and Power Ltd

Energy Intensive Users Group

Energy Saving Trust

Gas Consumers Council

Gas Forum

ICI Chlor-Chemicals Business

Liberal Democrats

London Electricity

Major Energy Users' Council

MEB Midlands Electricity

Midlands Region Electricity Consumers' Committee

Mobil Gas Marketing (UK) Limited

National Federation of Consumer Groups (NFCG)

National Power

NEA (National Energy Action)

NECC

North of Scotland Electricity Consumers' Committee

OFWAT

POWERGEN

Public Utilities Access Forum

Quantum Gas Management

RNIB

Scottish Consumer Council

Scottish Power

Scottish and Southern Energy plc

SEEBOARD plc

Shell Gas Direct Limited

Shell UK Limited

Slough Heat & Power Limited

TESCO

Transco

TXU Europe

UKOOA

Unison Scotland

Warwick Business School

Western Power Distribution

Yorkshire Electricity

Annex 5

Glossary of key terms

BG plc Formerly British Gas plc, BG plc includes Transco, the regulated pipeline company and overseas exploration and production interests.

BGT British Gas Trading Ltd, formerly part of British Gas plc, now part of Centrica plc. BGT supplies gas to three-quarters of domestic users throughout Great Britain.

CHP Combined heat and power. A system of local electricity generation where the waste heat produced by generation, often hot exhaust gases, is used to provide warmth – frequently by heating water for central heating systems.

Competition Act The Competition Act 1998 prohibits anti-competitive agreements and the abuse of market dominance.

Distributor The company that distributes electricity within the local PES area. Under present licensing arrangement the local PES provides distribution and supply (see PES).

Electricity Act The Electricity Act 1989 sets out the framework to electricity regulation.

Gas Act The Gas Act 1986 sets out the framework for on-shore gas regulation.

GECC Gas and Electricity Consumer Council. Created by the Utilities Regulation Bill and replaces the Electricity Consumers Committee.

Interconnector The linking of separate electricity or gas supplies. Electricity interconnectors link Britain and France, and Scotland with England and Wales. Gas interconnectors link Britain with Belgium and The European gas network, and run from Scotland to Northern Ireland and to the Republic of Ireland.

NETA New Electricity Trading Arrangements (see RETA)

Network Code A set of business rules agreed by Transco and gas shippers, which enables shippers to use Transco's pipeline network on a fair and equal basis. Shippers must sign up to the Network Code before they can use the Transco system.

NGC National Grid Company plc – the company that owns and operates the high voltage electricity transmission system in England and Wales, mostly carried on pylons.

Ofgem The Office of Gas and Electricity Markets is headed by the Director General of Gas and Electricity Supply, who regulates gas and electricity supply and is responsible for the introduction of competition into the supply of electricity and gas.

PES Public Electricity Supplier – the 14 companies in England, Wales and Scotland that, from privatisation in 1989 until 1998, had a monopoly of electricity and distribution in their designated areas.

Pool The arrangement whereby electricity supply and demand is balanced and tracked over a 24-hour period. Generators are paid a market clearing price dependent on the national load. NETA, which is more demand focused, is expected to replace the Pool next year.

REC Regional Electricity Company. The 12 former monopoly electricity companies in England and Wales (see PES).

RETA Reform of the Electricity Trading Arrangements. The process – still going on – of setting up an alternative market for buying and selling electricity in place of the existing Pool system.

RGTA Reform of the Gas Trading Arrangements – involving an on-the-day commodity market for gas and the auctioning of input capacity to the national transmission system.

Shipper A gas shipper's licence enables the holder to arrange with a transporter for gas to be introduced into, conveyed by and taken out of the pipeline system. Ofgem licences all shippers.

Supplier The company that arranges for electricity or gas to be supplied to a customer's meter and bills the customer. Ofgem licenses all suppliers.

Transco An operating division of BG plc which owns and operates most of the gas pipeline systems throughout England, Scotland and Wales. It is regulated by Ofgem.

Transmission The movement of electricity at high voltage from a generator to a sub-station. High voltage cables are normally suspended from pylons.

Transporter A holder of a public gas transporter's licence, issued by Ofgem, is able to operate a pipeline system for the conveyance of gas. A transporter cannot hold a licence as a shipper or supplier of gas.

Utilities Bill The Utilities Bill was announced in the Queen's Speech to Parliament on 17 November 1999. It enhances the power of regulators.