

## Foreword

Ofgem operates under the direction and governance of the Gas and Electricity Markets Authority which makes major decisions and sets policy priorities for Ofgem. This document sets out Ofgem's priorities and the resources needed to implement them over the next three years. It is the Authority's statement of its aims and describes the main work programmes that have been designed to deliver its objectives.

All Ofgem's actions are determined by its statutory duties, which are wide and varied. One purpose, however, predominates – everything Ofgem does is designed to protect and advance the interests of consumers, present and future. Ofgem acts, wherever appropriate, through promoting effective competition, and regulates only where necessary.

Much of Ofgem's forthcoming work will be set against a background of increasing integration between the gas and electricity industries. This is the result of the growing importance of dual fuel offerings in the domestic market, the likelihood of increasing demand for gas for electricity generation in the longer term and the consequential daily interactions between operating gas and electricity transmission networks.

The rapid development of competition and regulation has produced great benefits for British consumers of gas and electricity:

- there is now genuine competition throughout the gas and electricity supply chains – from the production and wholesale trading of gas and electricity, and the provision of services such as meter reading and gas storage, through to the retail market, where domestic and industrial customers are able to choose from a variety of suppliers
- domestic prices have fallen in real terms by around a third – 37 per cent for gas since 1986 and 28 per cent for electricity since 1990
- British prices for domestic and industrial customers are now among the lowest in Europe
- lower energy prices resulting from competition and effective regulation have lifted around one million households out of fuel poverty since 1996 – by far the biggest single contribution to tackling this scourge
- Britain enjoys generous capacity margins in generation and more diverse energy supplies today than ever before, and
- competition has developed to allow Ofgem to withdraw from many areas which it previously regulated or where it controlled prices.

Ofgem has withdrawn from nearly 70 per cent of the activities subject to regulation at the time of privatisation.

Since Ofgem was formed in 1999, it has completed 32 price control reviews. These have resulted in customer savings of around £20 off the typical annual household energy bill.

None of the price-regulated companies has experienced problems in raising capital in debt or equity markets and corporate transactions have taken place at a premium to regulatory value. Nor has regulation led to under-investment: over £30 billion has been invested in the national transmission and local distribution networks since 1990.

Efficiency gains in generation, transmission and distribution in the decade since privatisation have not only reduced costs but have also benefited the environment.

### Developing the three year plan

This is the first time that Ofgem has developed a three year plan – a move that has been widely welcomed.

Work to develop the plan began in July 2001 with an invitation to interested parties to set out their views on Ofgem's future priorities. In December 2001, the Gas and Electricity Markets Authority published a draft plan for consultation. As part of the consultation, Ofgem hosted meetings with representatives of key audiences to discuss its priorities. Written submissions were also received.

The final plan takes account of these contributions. Consultees' comments, together with a response to the key and recurring points made, are available on the Ofgem website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)).

### The three year plan

This plan shows how Ofgem will continue to work to foster competition, replacing traditional regulation with a greater reliance on competition powers to ensure competition remains effective. This is what would be expected of an organisation whose principal objective is to protect consumers' interests, wherever appropriate by promoting effective competition.

The document also sets out five themes that will drive Ofgem's work over the next three years to meet its principal objective and its other statutory duties.

## Themes

- Making markets work effectively
- Regulating monopoly businesses intelligently
- Securing Britain's gas and electricity supplies
- Meeting Ofgem's social and environmental responsibilities, and
- Developing Ofgem's effectiveness and efficiency.

Within the context of these general themes, the Gas and Electricity Markets Authority has also identified four priorities for Ofgem.

## Priorities

### 1. Bringing more competitive prices and greater choice to electricity consumers in Scotland

Electricity is traded in Scotland on the basis of administered arrangements that date from privatisation and are time-limited. These arrangements do not allow Scottish customers to benefit directly from Scotland's significant generating resources or from the competitive wholesale market that is now established in England and Wales. They also do not provide a long term basis for the Scottish electricity industry, in particular access to markets in England and Wales for Scottish electricity generation. Ofgem is working on a major programme of reform to establish trading and transmission arrangements on a British-wide basis. This will bring greater competition to the wholesale market in Scotland. These reforms require primary legislation.

### 2. Ensuring that competition continues to benefit all gas and electricity customers

With competition now established in the supply market and in most of the wholesale market, Ofgem's priority is to ensure that competition continues to work effectively for all domestic and business customers. Ofgem will do this by monitoring market developments and, where necessary, enforcing compliance with licence obligations, competition and general consumer law. Ofgem will also continue to monitor and develop work under its Social Action Plan which is aimed at helping the most vulnerable customers who suffer fuel poverty.

### 3. Taking action to help Government meet wider environmental targets at the lowest cost to energy customers

Ofgem's actions and those of the industry it regulates have an important impact on the environment. Consistent with its principal objective to protect

the interests of consumers present and future, Ofgem will seek opportunities to act in relation to the gas and electricity supply chain where there is synergy between its economic, social and environmental objectives.

Ofgem will also work to assess the environmental implications of its policies and take action to maximise the benefits, and minimise any adverse effects, they may have on the environment, wherever possible.

In electricity transmission and distribution, Ofgem will aim to reduce gas and electricity losses and remove regulatory barriers that may prevent the development of smaller electricity generation embedded in the distribution network. More resources will be committed to fulfilling Ofgem's executive responsibilities to administer Government schemes and initiatives, current examples of which are the Climate Change Levy and the Renewables Obligation. Another important area of work will be on energy efficiency. Ofgem will administer the Government's Energy Efficiency Commitment which represents a threefold increase on previous energy efficiency programmes.

It is for Government, and not the regulator, to set environmental targets and to determine the measures to achieve them. Ofgem will, however, work to help inform these decisions and advise on the most effective means to achieve environmental targets at the lowest cost to energy customers.

#### **4. Ensuring that there are the right signals and incentives for efficient long term investment in Britain's gas and electricity networks**

A further priority will be to continue work on a number of fronts to ensure that operators of the national transmission and local distribution networks have the right signals and incentives for efficient long term investment. This work is important to decisions about investment in the future shape and operation of networks in response to changing patterns of demand and system use.

Efficient investment is also important to ensuring long term security of supply, quality of service improvements, effective asset management and improved environmental performance.

Ofgem has worked to develop the successful RPI-X form of price regulation. New System Operator incentive regimes are already being implemented and reforms to the arrangements for access to, and the allocation of, capacity on networks are under way. Ofgem will continue work in this priority area to ensure timely and efficient investment.

### The Performance and Innovation Unit's (PIU) energy review

The PIU energy review report raises important issues for energy customers, with whom Ofgem is primarily concerned, as well as for wider environmental objectives. Ofgem will play a full and constructive part in the debate on the PIU's recommendations and, in particular, in response to the consultation and White Paper which Government has signalled.

### Ofgem's costs

On the basis of its present tasks, Ofgem expects its expenditure to reduce over the three years of this plan. If the Government gives the Authority new responsibilities, funding will need to be reviewed.

Throughout the period of this plan, Ofgem will continue to aim to deliver best value for money by controlling its costs carefully and managing its resources efficiently.

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# 1. Themes for Ofgem's work in 2002-2005

- 1.1** There are five themes that will drive work over the next three years in support of Ofgem's primary aim to protect consumers' interests, wherever possible by promoting effective competition, and only where necessary through regulation.

## Themes

- Making markets work effectively
- Regulating monopoly networks intelligently
- Securing Britain's gas and electricity supplies
- Meeting Ofgem's social and environmental responsibilities, and
- Developing Ofgem's efficiency and effectiveness.

## Making markets work effectively

- 1.2** Competition in Britain's gas and electricity markets has provided the stimulus for investment to secure gas and electricity supplies and to improve quality of service. It has also delivered lower prices to domestic and business customers.
- 1.3** In those parts of the gas and electricity market where competition is established and effective, Ofgem will withdraw from regulation and will rely increasingly on competition powers to regulate companies' behaviour and protect domestic and industrial customers' interests.
- 1.4** A key theme for Ofgem's work over the next three years is to continue to make markets work effectively. This will be done by:

## Developing, monitoring and enforcing rules for competitive markets

- 1.5** At the retail level, Ofgem's work will focus on ensuring that the benefits of competition are realised for all customers, large and small, across all income groups, and on all tariffs. Ofgem will regularly monitor developments in the supply market, where necessary enforcing licence requirements, competition and general consumer law.
- 1.6** In addition, Ofgem will work closely with energywatch to act, where appropriate, on customer complaints and to tackle any issues or practices that undermine consumer confidence.

- 1.7** In the wholesale market, Ofgem will continue its important work in determining whether proposed changes should take effect to the Codes<sup>1</sup> that govern access to, and use of, the gas and electricity transmission systems and arrangements for system balancing.
- 1.8** Ofgem will also continue its regular surveillance of market developments and participant behaviour, where necessary enforcing licence obligations and competition law to ensure that markets operate competitively.
- 1.9** In this important work, Ofgem has a range of powers under the Competition Act 1998, the Gas Act 1986 and the Electricity Act 1989 (as amended by the Utilities Act 2000). Ofgem will not hesitate to use these powers where necessary.

#### Extending competition where it is restricted

- 1.10** Ofgem will work to bring more competition to activities where this is at present restricted.
- 1.11** Key examples include the important work, extending over several years, to introduce British-wide reforms to the electricity trading and transmission arrangements, which will bring more competitive arrangements to the wholesale market in Scotland. Other examples include developing competitive markets in the provision, maintenance and use of meters, and in gas and electricity connections.

#### Industrial restructuring

- 1.12** Many changes have occurred, and are likely to continue, in the structure of the gas and electricity industries. This requires Ofgem, often against tight timetables set by the Office of Fair Trading (OFT) or the European Commission, to advise on mergers and any conditions governing mergers. This work is, by its nature, unpredictable and likely to be a continuing call on Ofgem resources.

<sup>1</sup> In electricity, the Balancing and Settlement Code (BSC) and Connection and Use of System Code (CUSC). In gas, Transco's Network Code.



## Regulating monopoly networks intelligently

- 1.13** Where competition is not possible or not sufficiently well developed, Ofgem protects consumers' interests by regulating the monopoly companies that run the national transmission and local distribution networks in England, Scotland and Wales.
- 1.14** The traditional form of RPI-X price regulation has served Britain's gas and electricity consumers well. It has led to lower prices and improved standards of service, while securing a significant increase in network investment.

## Developing the regulation of monopoly networks

- 1.15** Over the last two years, Ofgem has worked on reforms to network access arrangements and to the way network capacity is allocated. These reforms are designed to give transmission companies stronger signals to enable them to invest in an efficient and timely way. This is important to ensuring long term system security and quality of service. It is also important to decisions on the future shape and operation of networks needed to take account of rapidly changing patterns of demand and system use.
- 1.16** In recent price reviews and through system operator incentive schemes, Ofgem has built substantially on RPI-X price regulation. It has developed new incentives and defined new customer outputs and performance standards. These reforms will deliver more efficient investment and improved quality of service.
- 1.17** In recent price reviews Ofgem has also increased the incentives on companies to reduce distribution and transmission losses. This should encourage efficiency and have wider environmental benefits.
- 1.18** Over the next three years, Ofgem will progress its work to develop the regulation of monopoly networks, building on RPI-X and participating in reforms to electricity transmission network access and capacity allocation arrangements. Work will centre on meeting five key objectives:
- improving the signals and incentives for efficient investment in national transmission and local distribution networks
  - improving the quality of service on networks, particularly local distribution networks
  - encouraging best practice in asset risk management
  - improving incentives to reduce distribution and transmission losses, and
  - ensuring that there are fair and transparent incentives for distributed generation<sup>2</sup>.

<sup>2</sup> Distributed generation is smaller forms of generation such as solar, wind and domestic Combined Heat and Power (CHP) which connects to the distribution network.

## Securing Britain's gas and electricity supplies

**1.19** Ofgem has important statutory duties relating to security and diversity of supply. These matters always receive careful consideration.

**1.20** At present, there are generous capacity margins in electricity generation. Interruptions of gas and electricity supply are even more rare today than before privatisation, and investment in all parts of the gas and electricity supply chains has been high. Work to maintain high levels of security of supply influences many aspects of Ofgem's work and will continue to be a priority. This will include:

- ensuring that markets continue to operate competitively, allowing price signals to emerge to indicate the need for new investment
- developing the regulatory framework for national transmission and local distribution networks to improve incentives for efficient investment and system operation
- helping develop arrangements for the balancing of Transco's National Transmission System (NTS) to ensure that supply continues to meet demand on the day, and
- assisting the Department of Trade and Industry (DTI) in developing a European regime for liberalised gas and electricity markets. The rules governing the transmission of gas and electricity, whether within national networks or by interconnectors, affect British supplies and prices. Developing these rules will be important.

## Meeting Ofgem's social and environmental responsibilities

**1.21** Reconciling Britain's social, environmental and competitiveness goals is a major challenge for Government. For its part, Ofgem has important social and environmental duties in relation to energy policy, secondary to its principal objective to protect the interests of consumers, present and future, where appropriate by promoting competition.

**1.22** Ofgem believes that the promotion of competition and the use of targeted regulation, where necessary, can be and, in many instances, is complementary to a coherent environmental policy. Where there are tensions between its objectives, Ofgem is committed to making decisions after carefully assessing the positive and negative economic, social and environmental effects of different options, within the context of the hierarchy of objectives and duties set out in the legislation.

**1.23** Ofgem believes it is important that there is clarity of roles in environmental policy, and will look to ministers to set environmental policies where these will have significant financial implications. Ofgem will contribute to their implementation in the most cost-effective manner.

### Social action

**1.24** The biggest contribution that Ofgem can make to tackling fuel poverty is to ensure that energy prices are as competitive as possible. As well as continuing its work to meet this objective, Ofgem will also take action under its Social Action Plan to progress other contributions to tackling fuel poverty. For example:

- encouraging companies to continue to develop innovative services and tariffs for vulnerable customers
- enforcing licence obligations to improve the services, information and advice that companies provide to vulnerable customers
- administering the Energy Efficiency Commitment (EEC), which will target help in providing warmth and comfort at priority groups, and
- working with Government and other parties to research the causes of fuel poverty and to pursue measures, where appropriate, to address them.

### Environmental action

**1.25** Over the next three years, Ofgem will fulfil the commitments already identified under its Environmental Action Plan to tackle a range of environmental issues that span the gas and electricity supply chain:

- **in generation** – Ofgem will continue to promote a competitive generation market and ensure that the New Electricity Trading Arrangements (NETA) operate fairly for all types of generation. Ofgem will also encourage emissions trading as an efficient means of complying with environmental standards
- **in transmission and distribution** – Ofgem will work to reduce electricity losses and ensure a fair and transparent regulatory regime for the development of distributed generation, and
- **in supply** – Ofgem will fulfil its executive responsibilities to administer aspects of the Government's Climate Change Programme: the Energy Efficiency Commitment, the Renewables Obligation in England, Scotland and Wales, the Fossil Fuel Levy, and the exemption from the Climate Change Levy for renewables.

**1.26** Ofgem will also develop work under the Environmental Action Plan to meet three key aims:

- to pursue opportunities where there is synergy between its economic, social and environmental objectives
- to assess the environmental implications of its policies and take action to maximise their benefits and minimise their adverse effects, consistent with its statutory duties, and
- to inform wider Government decisions about future environmental targets and the most effective means to achieve them.

**1.27** Ofgem will consult on developments to its Environmental Action Plan to incorporate further work in this area.

#### Developing Ofgem's efficiency and effectiveness

**1.28** In 2002/3 Ofgem's budget will be £36 million. This represents around 0.1 per cent of industry turnover. Ofgem's costs need to be seen in this context and against the background of the benefits it brings.

**1.29** Ofgem will continue over the next three years to improve the efficiency and effectiveness of its work. Key priorities will include:

- attracting and retaining high calibre staff
- setting out clearly the rationale for its proposals and involving others creatively and effectively in their development
- communicating plans and proposals in a user-friendly way
- continuing work to de-personalise regulation, and
- giving value for money by controlling costs carefully and managing resources efficiently.

## 2. Making markets work effectively

### Wholesale markets

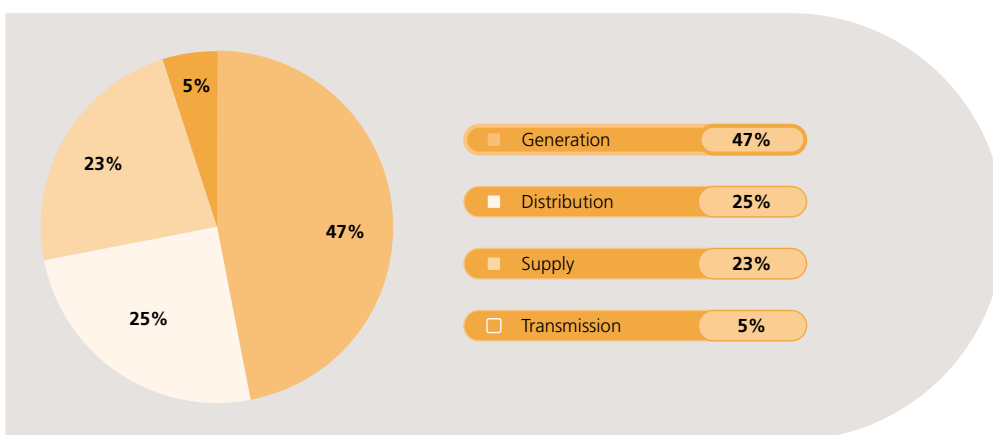
#### Objectives

- To improve the efficiency and competitiveness of the wholesale gas and electricity markets throughout Great Britain.
- To monitor the operation of wholesale gas and electricity markets and take appropriate enforcement action where there is evidence of market abuse.
- To support the Government in its work to develop competition in the offshore gas industry and in energy markets across Europe.

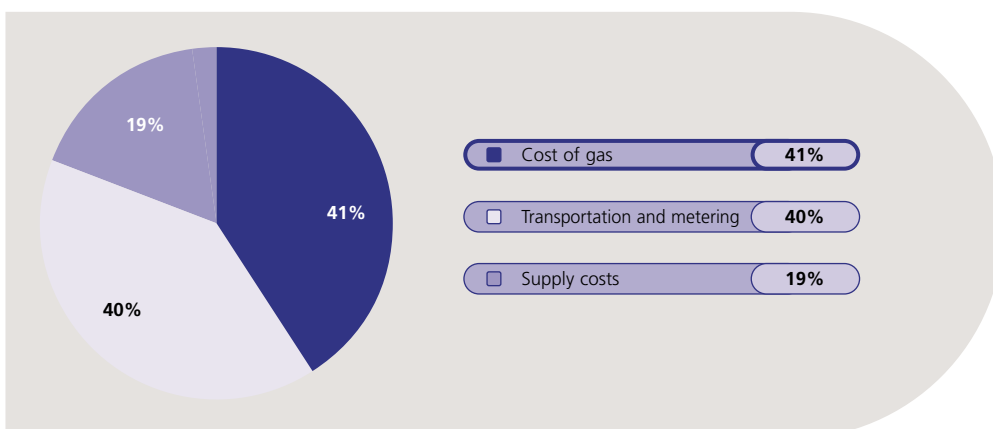
#### Background

**2.1** The costs of wholesale gas and electricity account for almost half of domestic customers' bills – more for business customers' bills. A great deal of Ofgem's work is, therefore, focused on ensuring that the wholesale gas and electricity markets operate competitively.

Breakdown of domestic electricity bill



Breakdown of domestic gas bill



## Electricity

### England and Wales

- 2.2** In England and Wales, the New Electricity Trading Arrangements (NETA) were successfully introduced in March 2001. Evidence of the first year of NETA shows wholesale prices around 40 per cent below those under the former Electricity Pool.
- 2.3** NETA has also brought significant improvements in market liquidity and, for the first time since privatisation, forward price signals have emerged to help indicate the need for future plant investment, which is important to ensure long term security of supply.
- 2.4** The balancing market has also developed rapidly since NETA Go-Live as generators, suppliers, traders and customers have gained greater experience of operating in the new market, and as Ofgem-approved modifications to balancing and settlement rules have taken effect. Key developments since Go-Live include:
- a significant reduction in price volatility in the balancing market
  - a significant fall in the spread between system sell and system buy prices
  - a greater opportunity for major users of electricity to enter the market, and
  - improved arrangements to allow smaller generators to aggregate their output to sell it more competitively.

### Scotland

- 2.5** Electricity wholesale market reforms were not extended to Scotland. As a consequence, wholesale prices are not as competitive as those in England and Wales. Ofgem has begun work to achieve British-wide reforms that will bring the benefits of NETA to the Scottish wholesale market. These reforms require primary legislation.

## Gas

- 2.6** Ofgem has been working with Transco, producers, shippers and major energy customers to develop the arrangements for keeping the National Transmission System (NTS) in balance.
- 2.7** Recent market developments have, as Transco acknowledges, put pressure on the existing arrangements for gas balancing. These developments include greater within-day profiling of gas inputs to the NTS, increasing price convergence between the gas and electricity markets, the growth of

gas-fired generation, the introduction of NETA and increasing trade with other European countries.

- 2.8** An effective regime for balancing is essential to ensure that supply meets demand on the day, in a way that does not put system security at risk and that ensures the costs of balancing are efficient and are met fairly by shippers whose actions give rise to these costs.

### *Influencing activity offshore and in Europe*

- 2.9** Ofgem has no regulatory, and limited information gathering, powers offshore. Within this limitation, it has continued to work with the Department of Trade and Industry (DTI) and other agencies to ensure offshore arrangements that encourage a competitive gas wholesale market.
- 2.10** Another of Ofgem's priorities has been to influence developments in Europe to ensure that they are pro-competitive and in the best interests of British customers. Working with the DTI, the European Commission and other European regulators, Ofgem has contributed to developing policy on European electricity and gas liberalisation and on gas and electricity interconnectors.

### *Monitoring and compliance*

- 2.11** Ofgem has reorganised resources to place a greater emphasis on its monitoring and compliance work so as to ensure that the new gas and electricity trading arrangements remain competitive and free from abuse.

## *Overview – 2002-2005*

### *Electricity*

- 2.12** Ofgem will help to ensure that NETA beds down by determining whether proposed changes to the balancing and settlement rules should be allowed.
- 2.13** It will also continue to review and report on the impact of NETA. This work will include:
- further consideration of NETA's impact on Combined Heat and Power (CHP) and renewable generators, as well as work to encourage the development of consolidation services. Ofgem will act, wherever necessary, to ensure that NETA operates fairly for all generators
  - further consideration of how NETA is working for larger customers who are participants in the new market. Ofgem will take action, where necessary, to facilitate demand-side participation, and
  - publishing the first annual review of NETA.

**2.14** Ofgem will work to create British Electricity Trading and Transmission Arrangements (BETTA). As well as working to prepare for legislation, Ofgem will develop the reforms required to bring BETTA into effect. These include:

- the development of British-wide trading, balancing and settlement arrangements
- the development of British-wide transmission access and losses arrangements, and
- the creation of an independent British-wide System Operator function and new licensing arrangements.

### *Gas*

**2.15** Ofgem will participate in the development of the gas balancing regime, by continuing to work closely with Transco, shippers, producers and customers, to determine the best means to ensure that the balancing regime can take account of changing market developments while ensuring system security is maintained.

**2.16** Ofgem will contribute to the Network Code modification review group that has been established to look at the problems with present balancing arrangements and to develop Code modifications to cover them. At present, Ofgem considers that reforms should include:

- shorter balancing periods (less than 24 hours)
- sale of system linepack, and
- incentives for shippers to improve the information flows to Transco on which it bases daily balancing actions.

### *Influencing actions offshore and in Europe*

**2.17** In the offshore area, Ofgem will:

- continue its work with the DTI and other agencies to promote offshore arrangements that encourage a competitive wholesale market in Britain.

**2.18** At a European level, Ofgem will:

- encourage further liberalisation in Europe through liaison with other European regulators and institutions
- promote policies and ensure that, where possible, European proposals and decisions are in line with those policies. If successful, this will lead not only to increased competition in Europe but also to more competitive prices for domestic and business customers in Great Britain



- work with Government and European institutions to develop policy on the regulation of new interconnectors aimed at achieving consistent regulation of all interconnectors and a more competitive market for building them, and
- report its work in Europe and through the Council of European Regulators (CEER).

### *Governance, monitoring and compliance*

- 2.19** Ofgem will continue its important work in the process to modify the Balancing and Settlement Code (BSC), Network Code and Connection and Use of System Code (CUSC).
- 2.20** Ofgem will continue its daily monitoring of wholesale gas and electricity prices and other market surveillance work.
- 2.21** Where necessary, Ofgem will investigate any anti-competitive behaviour and will use its powers to enforce licence conditions and competition law to ensure that wholesale markets operate competitively.
- 2.22** Ofgem will agree a concordat with the Financial Services Authority (FSA) to ensure clear responsibilities and arrangements for information exchange, which will help both organisations in their work to tackle any incidents of market abuse.

## **Retail markets**

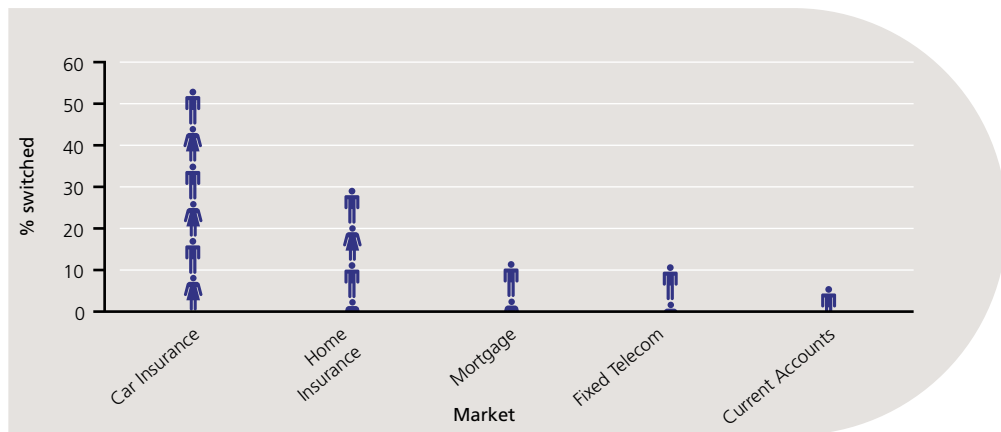
### *Objectives*

- To ensure that competitive retail markets continue to work effectively for domestic and business customers, by monitoring and enforcing compliance with licence obligations, competition and consumer law.

### *Background*

- 2.23** The gas and electricity retail markets have been fully open to competition since 1999. 37 per cent of domestic gas and 38 per cent of domestic electricity customers have exercised their choice to switch suppliers.
- 2.24** These rates are higher than in many other competitive markets in Britain. Switching rates among lower income customers are broadly the same as rates for customers in other income brackets. The rate of switching among customers on prepayment meters (PPM) is the same as for customers on standard tariffs.

Number of customers who have switched suppliers in different markets



Source: DTI Research on switching suppliers report, July 2000

- 2.25** With competition established in the supply market, Ofgem has removed the remaining price controls on domestic gas and electricity suppliers and is now using a combination of competition law, licence obligations (for example, those governing marketing and customer transfers) and general consumer law to protect customers' interests.
- 2.26** To make it easier for domestic customers to benefit from, and have confidence in, the competitive market, Ofgem has worked to improve the customer transfer process. All energy suppliers have signed a voluntary charter, developed by Ofgem and energywatch, that makes it easier for customers to switch back to their previous supplier if they have been transferred in error.
- 2.27** Ofgem has also extended the marketing licence condition by a further two years and has begun research to look more closely at customers' experience of marketing and to identify industry best practice.
- 2.28** Evidence collected up to 2000 suggested that the industrial and commercial market was effectively competitive and, in the light of this, Ofgem ceased systematic collection of data about these markets. Recent competition concerns from industrial customers, however, have prompted Ofgem to strengthen its monitoring work in this market.
- 2.29** Up to 2001, Ofgem provided information to domestic customers on the range of tariffs and competitive offers in the supply market, as well as general advice on how to switch supplier. The statutory responsibility to provide this service to consumers has now passed to energywatch.

## Overview – 2002-2005

### *Monitoring and compliance*

**2.30** In future, Ofgem's work will centre on monitoring domestic and industrial customers' experience of the competitive supply markets, taking action where necessary to ensure that competition is working effectively.

**2.31** In the competitive market for domestic customers, work will focus on:

- monitoring suppliers' behaviour and, as part of this work, reviewing the factors affecting any differentials between prepayment meter (PPM) and other customer tariffs
- continuing work to remove any remaining barriers to competition in the supply markets that affect domestic customers, in particular the right of suppliers to block domestic customers who are in debt from switching supplier
- continuing to review compliance with the erroneous customer transfer charter and its impact on reducing customer transfer complaints
- completing research on customer experience and industry best practice in marketing, where necessary proposing amendments to the marketing licence condition
- regularly reviewing trends in energywatch complaints data and assessing the need for specific action against suppliers
- working with energywatch to deal with issues arising from market monitoring and complaints analysis to find a solution to the underlying causes of customer complaints, and
- researching those parts of the domestic supply market where switching activity is below average, for example among older customers, those living in rural areas and those for whom English is not their first language, and working with customer groups to help improve information and advice for these customers.

**2.32** In the competitive market for industrial customers, work will focus on:

- monitoring suppliers' behaviour
- continuing work to remove the barriers to competition, for example the right of gas suppliers to block industrial customers who wish to change supplier, and
- conducting reviews of the competitive market and, where necessary, considering further action to ensure that the market works effectively. For example, following concerns expressed by some business customers about the electricity transfer process, Ofgem will be working with industry to

review the way information held on distributors' systems is made available to customers. Ofgem will also review the process for the appointment of supplier agents and the transfer of standing data.

### *Enforcement*

**2.33** Ofgem will take action, where necessary, under the Competition Act and Gas and Electricity Acts using the full range of powers (including, when granted, the power to impose financial penalties) to enforce compliance. Ofgem will continue to report any action it takes.

### *Supplier failure*

**2.34** As competition continues to intensify, it is possible that there may be supplier failures. Using the experience of customers, industry and other parties, Ofgem will continue to refine its procedures for dealing effectively with a supplier failure to protect the interests of both domestic and business customers.

### *Customer contact*

**2.35** Ofgem will also continue to work closely with energywatch and other organisations representing domestic and industrial customers' interests to help meet the common goal of delivering a better deal for all gas and electricity customers.

## **Industrial structures**

### *Objective*

- To establish industrial structures that promote competition in energy supply and services.

### *Background*

### *Metering*

**2.36** Ofgem plays an important role in encouraging appropriate industrial structures that provide the right environment for competition to flourish and deliver the best deal for both domestic and business customers.

**2.37** To meet this objective, Ofgem has worked on a major programme to separate the supply and distribution businesses of the 14 former Public Electricity Suppliers (PESs). This work, which is aimed at enabling all suppliers to have equal access to the distribution network, is now far advanced.

- 2.38** Competition in metering services can deliver significant benefits to customers, including lower prices through reductions in the £800 million annual cost of metering. More competitive arrangements can also bring improvements in the standards of service and can stimulate the development of 'smart' meters. In the long term, these could bring further social and environmental benefits by helping to give customers more control over the use of gas and electricity and providing alternatives to existing prepayment meters.
- 2.39** Ofgem has published a metering strategy with the objective of securing competition in gas and electricity metering services, as well as encouraging innovation.
- 2.40** A key element of this strategy is Ofgem's work to support industry discussions on reviews to electricity and gas metering arrangements aimed at overcoming barriers to effective competition.

### *Connections*

- 2.41** The costs of new connections to gas and electricity supplies are about £400 million a year – £300 million for electricity and around £100 million for gas connections. These costs are borne by customers.
- 2.42** Competition in this area will benefit customers by putting pressure on prices, improving quality of service, and encouraging innovation. In gas, progress has been made to introduce a registration scheme of qualified Utility Infrastructure Providers (UIPs). In electricity, work is under way through an electricity connections steering group to take forward Ofgem's proposals to facilitate competition.
- 2.43** While competition is flourishing in certain areas, such as gas connections for new housing developments, barriers still exist for lower value and simple one-off domestic gas connections and for electricity connections generally.

### *Corporate transactions work*

- 2.44** Ofgem has continued important work in considering proposals for business transactions and new financial models, providing advice to the Office of Fair Trading (OFT) and the DTI and liaising with the European Commission on how to protect customers' interests. Where possible, Ofgem has also developed its policy on corporate transactions to help companies understand the likely regulatory issues.

## Overview – 2002-2005

### *Metering*

- 2.45** Under the metering strategy, Ofgem will continue its work to enable shippers, suppliers and customers to have a choice of metering and meter reading services.
- 2.46** As part of its work on the metering strategy, Ofgem will continue to support the Review of Gas Metering Arrangements (RGMA) and comparable industry processes to review electricity metering arrangements.

### *Connections*

- 2.47** Ofgem will continue work to introduce increased competition in connections. Evidence suggests that customers could save up to 20 per cent on the present cost of connection work if competition is effective.

### *Corporate transactions work*

- 2.48** Giving advice on mergers and acquisitions is by its nature difficult to predict in terms of volume and complexity. It is, however, likely to be a continuing call on Ofgem resources. This is important work because, by developing a policy on and advising the OFT and the European Commission about such transactions, Ofgem ensures that it can effectively regulate licensees following any merger activity.

### *Monitoring and compliance*

- 2.49** Ofgem is committed to monitoring developments in the emerging metering and connections markets. It will undertake regular reviews to assess progress towards competition and, where necessary, to take action to facilitate competition.

### 3. Regulating monopoly networks intelligently

#### Objectives

- To regulate monopoly businesses through price controls to ensure that consumers receive a high quality and reliable service at a reasonable price.
- To ensure compliance with existing price controls, including quality of service incentive schemes and consumer standards of performance.
- To review the price control framework to ensure a consistent approach, where relevant, in all future monopoly price control reviews.
- To develop the price control framework and continue work on reforms to electricity transmission network access arrangements to ensure:
  - improvements in the signals and incentives for efficient investment in national transmission and local distribution networks
  - improvements in the quality of service on networks, particularly local distribution networks
  - best practice in asset management
  - incentives to reduce distribution and transmission losses, and
  - fair and transparent arrangements for distributed generation.

#### Background

- 3.1** Where competition is not possible or not sufficiently developed, Ofgem continues to regulate through price controls and incentive schemes to ensure that customers receive value for money and a secure and reliable service. This applies to the monopoly businesses that run the pipes and wires bringing gas and electricity to homes and businesses.
- 3.2** Ofgem has significantly developed the traditional RPI-X form of price regulation. It has developed new incentive regimes for more efficient investment, set new quality of supply standards and guaranteed outputs for customers, and developed incentives to improve environmental performance and reporting.
- 3.3** In gas, as part of the Transco System Operator incentives scheme, Ofgem has put forward proposals to change the way producers and shippers signal their requirements for access to the national gas transmission network through long term entry capacity auctions. It has also put forward proposals to strengthen the commercial incentives on Transco to respond in a timely way to these signals.

- 3.4** In electricity, the current arrangements for access to National Grid Company's (NGC) transmission network are flawed in a number of ways. They do not provide effective signals for future network investment to secure long term supply or to take account of changing patterns of demand and system use. Furthermore, the costs of network constraints are not met by those who cause the constraint but are spread across all users.
- 3.5** On average, about two per cent of all electricity in England and Wales is lost as heat as it is transported on the transmission system, with considerable variation. NGC has estimated that generation situated far from demand can have losses of up to six per cent. This is neither economic nor good for the environment. Substantial savings can be made by the correct siting of generation capacity relative to demand.
- 3.6** Ofgem has been working with industry and customers on reforms to the electricity transmission arrangements to produce stronger signals and incentives for future investment and to encourage the location of generating plant closer to demand, which will help reduce losses.

#### Overview – 2002-2005

- 3.7** Ofgem will continue its important work to develop the regulatory framework for national transmission and local distribution networks. This is a priority for Ofgem and is vital to meeting its statutory duties to ensure security of supply.
- 3.8** A general review of the price control framework will be undertaken to ensure that it continues to support Ofgem's statutory objectives and that, where relevant, the framework is consistent across the gas and electricity industries.

#### *At the national transmission level*

- 3.9** Ofgem will implement the new System Operator incentives regimes for Transco and National Grid Company (NGC) to improve the efficiency with which they operate the national transmission systems, reduce the costs associated with those activities, and improve the signals and incentives for efficient long term investment.
- 3.10** Ofgem will also participate in the introduction of new transmission access and losses arrangements for NGC's transmission system. Whatever reforms are eventually agreed, they must reduce transmission losses and enable accurate signals to be given about the costs of entry to the system at different locations, which will help NGC to invest in the right place and at the right time to ensure long term security of supply.



- 3.11** The detail of the reforms will be for industry and customers to take forward and develop by a variety of means, including modifications to the Balancing and Settlement Code (BSC) and Connection and Use of System Code (CUSC).
- 3.12** Work will also start on the Scottish electricity transmission price controls due for review in 2005. This work will reflect the outcome of the British Electricity Trading and Transmission Arrangements (BETTA) project.
- 3.13** Preparatory work for the next NGC price control will also begin at the end of the period of this plan.

#### *At the local distribution level*

- 3.14** In electricity, Ofgem will be working in 2002 with the Distribution Network Operators (DNOs), suppliers, generators and consumers to agree the objectives and structure for the next price control review in 2005. Work will focus on, among other things, how investment at the local distribution level is best incentivised at a time when future investment requirements are uncertain and being shaped by new considerations, such as the development of distributed generation.
- 3.15** The first year of this work will also see a review being carried out into losses on distribution networks and how they might best be reduced. Seven per cent of electricity is lost as it is transported on local distribution networks.
- 3.16** Work will continue on the review of the structure of charges for electricity distribution companies. This work will link closely with the work on distributed generation and will also cover issues concerning access to the electricity distribution networks.
- 3.17** In gas, work will be undertaken on the separation of price controls for Transco's Local Distribution Zones (LDZs). This could result in more cost-reflective charges and regional price differences. This review will raise important issues for customers that will require careful consideration.
- 3.18** Ofgem is also developing new customer standards to reduce the number and duration of customer interruptions and new incentives to meet them.

#### *At national and local levels*

- 3.19** Work will be undertaken to manage and encourage industry best practice in asset risk management. Work to develop the requirements for medium term and environmental reporting will also be carried out.

### *Independent Gas Transporters (IGTs) and Electricity Distributors*

- 3.20** Ofgem will also review the regulation of IGTs. These local network monopolies, which serve around 250,000 customers, are not, at present, subject to price controls. It will be important to assess whether the existing regulatory arrangements adequately protect consumers' interests.
- 3.21** Ofgem can now license new electricity distribution companies to own and operate newly built distribution networks. Ofgem will develop an appropriate regulatory regime to protect consumers connected to a newly licensed network.

### *Monitoring and compliance*

- 3.22** Ofgem will continue its work to monitor monopoly network operators' compliance with price controls and the licence conditions that apply to transmission and distribution businesses.
- 3.23** An important part of this work is monitoring compliance with new customer standards of performance and quality of service incentive schemes. For example:
- new incentive arrangements to improve quality of supply on the electricity distribution networks, developed under the Information and Incentives Project, and its equivalent for gas, when that is finalised, and
  - new compensation arrangements for electricity customers who suffer multiple interruptions to supply and for gas customers who suffer disruptions to supply.

## 4. Meeting Ofgem's social and environmental responsibilities

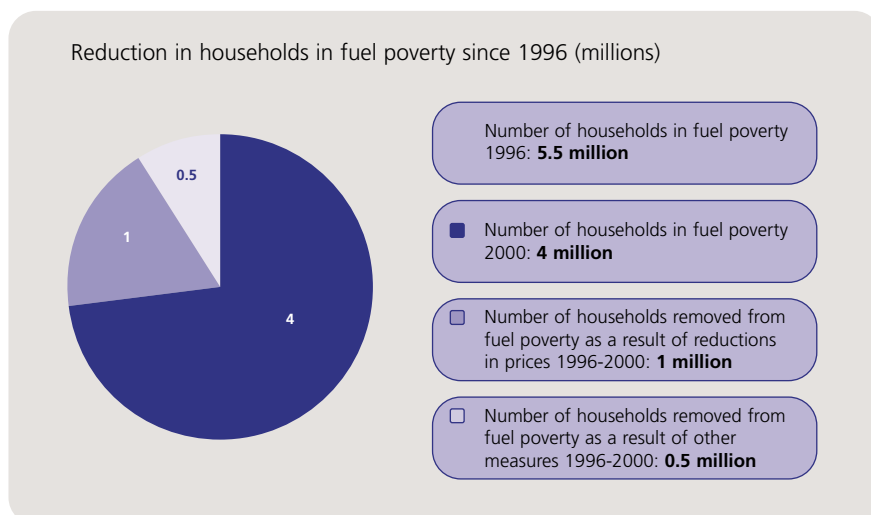
### Social action

#### Objective

- To ensure that vulnerable customers share fully in the benefits of competition and regulation.

#### Background

- 4.1** Four million households in the United Kingdom are in fuel poverty, defined as the need to spend more than 10 per cent of household income to keep satisfactorily warm. The Government has set a target to end the blight of fuel poverty for vulnerable households by 2010 and a Fuel Poverty strategy is in place to meet this target.
- 4.2** Low incomes, poor housing conditions and energy costs cause fuel poverty. Ofgem has a clear role to play in respect of energy costs and has a further role to play, particularly through its work on energy efficiency, in helping to improve housing conditions.



- 4.3** In March 2000, Ofgem published a Social Action Plan which identified actions to help the fuel poor. Under the plan Ofgem works:
- to encourage industry initiatives designed to lower the cost of keeping warm
  - to identify barriers to disadvantaged customers taking part in the competitive market and to work to remove those barriers

- to develop and approve gas and electricity suppliers' codes of practice, and to monitor performance against them, and
- to promote and guide research into the causes of fuel poverty and take action, where appropriate, to address them.

**4.4** One of the most important impacts of Ofgem's work has been the stimulus it has given to a number of energy companies to develop new services and tariffs for the fuel poor. Ofgem will continue to monitor the development of these initiatives and will work to encourage new ones.

**4.5** The second annual review of the plan was published in March 2002. It confirmed that competitive gas and electricity prices remained a most effective way of lifting customers out of fuel poverty, with customers across all income groups benefiting from competition.

### *Monitoring and compliance*

**4.6** Ofgem has also begun work to monitor and report companies' compliance with their social obligations.

### *Overview – 2002-2005*

**4.7** The main objective of Ofgem's social action work over the next three years will be to ensure that vulnerable customers can benefit fully from the competitive gas and electricity markets.

**4.8** In addition, to its general work through competition and regulation to ensure that prices are as competitive as possible, Ofgem's work under the Social Action Plan will be its main contribution to tackling fuel poverty and helping to meet the Government's targets.

**4.9** Ofgem has also identified a number of specific projects. These include:

- working with energywatch to produce best practice guidelines for companies on debt management and prevention, as well as working towards reducing the practice of debt blocking, where energy suppliers refuse to transfer customers in debt – a practice that does not exist in any other market
- producing guidelines for companies on how to provide better energy efficiency advice to those in fuel poverty
- ensuring that the Fuel Direct scheme works effectively and working to develop an electronic interface between the Benefits Agency and suppliers

- making life easier for prepayment customers by ensuring that customers have full information on the operation and relative costs of prepayment meters, by reviewing the infrastructure that underpins their provision, by promoting alternative payment methods and, in line with the metering strategy, facilitating the development of ‘smarter’ meters, and
- helping to tackle the problems of fuel poverty in rural areas and addressing the particular needs of customers for whom English is not their first language and older people by promoting further research and working with agencies and groups representing customers’ interests to improve access to the competitive market.

### *Monitoring and compliance*

**4.10** A key strand of Ofgem’s work will continue to be monitoring compliance with suppliers’ Codes of Practice to ensure that companies meet their social obligations and provide improved services to vulnerable customers.

**4.11** Ofgem will continue to report information gathered through this monitoring work and, where necessary, will enforce licence obligations. This information contributes to the Government’s indicators that are being used to monitor the Fuel Poverty strategy.

### **Environmental action**

#### *Objectives*

- To assess the environmental implications of Ofgem’s policies and where possible maximise their benefits, and take action to minimise any adverse effects.
- To pursue policies where there is synergy between economic, social and environmental objectives.
- To administer the executive responsibilities in relation to the environment given to Ofgem by Government.
- To fulfil the commitments set out in Ofgem’s Environmental Action Plan.
- To contribute to the wider debate on energy policy, in order that the Government’s environmental targets are met at the lowest cost to customers.

#### *Background*

**4.12** Ofgem was given revised environmental duties under the Utilities Act 2000. In August 2001, Ofgem published an Environmental Action Plan which set out how it will meet its statutory duties and have regard to the environmental impact of its work across the gas and electricity supply chain.

**4.13** The Environmental Action Plan highlighted the principles on which Ofgem bases its actions. These are:

- *environmental sensitivity*

Ofgem, while principally an economic regulator, is sensitive to the environmental effects of its actions and of the industries that it regulates.

- *coherence*

Ofgem will treat environmental issues coherently across the range of its decision-making. Its policies will seek to maximise synergy between its economic, environmental and social objectives, and to ensure that its activities do not cause unintended environmental harm.

- *role of ministers and environmental regulators*

Ofgem will look to ministers and other government bodies with direct environmental responsibilities to take the lead on environmental policies where action would have significant financial implications. When called on to do so, and where it is compatible with its statutory duties, Ofgem will implement these policies in the most efficient manner.

- *market imperfections*

Ofgem will seek to identify market imperfections that cause environmental harm. It will work to reduce or eliminate those that lie within its sphere of influence, and alert those responsible for environmental regulation to those issues that fall outside Ofgem's scope.

**4.14** Based on these principles, the plan identified work on a number of priorities that span the gas and electricity supply chain:

- **in generation** – Ofgem will continue to assess the effects of the New Electricity Trading Arrangements (NETA) on renewables and Combined Heat and Power (CHP) generation and take action where necessary to ensure that NETA operates fairly for all types of generation. Ofgem will also continue to promote a competitive generation market and encourage emissions trading as an efficient means of complying with environmental standards
- **in transmission and distribution** – Ofgem will work to reduce electricity losses and remove barriers so that the regulatory regime for distributed generation, i.e. smaller forms of generation embedded in the distribution networks, is fair and transparent, and

- **in supply** – Ofgem will fulfil its executive responsibilities to administer aspects of the Government's Climate Change Programme, including the Energy Efficiency Commitment, the Renewables Obligation in England, Scotland and Wales, the Fossil Fuel Levy and the exemption from the Climate Change Levy for renewables.

### Overview – 2002-2005

**4.15** During the next three years Ofgem will continue work under its Environmental Action Plan. This influences many aspects of Ofgem's work.

### *Reducing losses*

**4.16** About nine per cent of electricity is lost as it is transported on the national transmission system and local distribution networks. This is neither efficient nor good for the environment. Ofgem will be taking forward important work to reduce these losses by improving the efficiency of transmission and distribution systems, and developing signals and incentives to encourage supply and demand to be located closer together.

### *Facilitating the development of distributed generation*

**4.17** An important strand of work will be to develop a fair and transparent regulatory regime for distributed generation. This work includes removing regulatory barriers that may unfairly prevent the development of distributed electricity generation, while at all times safeguarding the operation of competitive markets and the distribution system to secure supply.

**4.18** Interim proposals will be implemented in 2002. A further work programme will be undertaken leading up to the next distribution price control review in 2005 to consider the need for changes to incentives on distribution companies. Ofgem will also continue its work with the Distributed Generation Co-ordinating Group (DGCG), which it co-chairs with the DTI.

### *Administering the Energy Efficiency Commitment and promoting energy efficiency advice*

**4.19** Another important area of work will be on energy efficiency. Ofgem will administer the Government's Energy Efficiency Commitment, which represents a threefold increase on previous energy efficiency programmes. Gas and electricity suppliers will contribute around £150 million each year (for three years) towards delivering energy efficiency measures to households. Half of the energy benefits resulting from this must be targeted at the fuel poor. This work is an important contribution to the Government's Fuel Poverty Strategy and Climate Change Programme.

**4.20** In addition, Ofgem will promote the provision of energy efficiency advice to industrial customers by ensuring that suppliers introduce and comply with a new Code of Practice similar to the suppliers' Code for domestic customers. Ofgem will also issue guidelines on providing energy efficiency advice to those in fuel poverty.

#### *Administering executive duties in relation to renewables and CHP*

**4.21** Ofgem will continue to administer the exemption for renewables from the Climate Change Levy, issuing Levy Exemption Certificates (LECs) for output from qualifying generators on a monthly basis.

**4.22** Ofgem will administer the Renewables Obligation in England, Scotland and Wales. This work involves issuing Renewables Obligation Certificates (ROCs) for output from qualifying generators on a monthly basis and maintaining a register of all transfers of ROCs.

**4.23** Ofgem will continue to administer the Fossil Fuel Levy, setting the rate annually and collecting funds on a monthly basis. Finally, Ofgem will continue to maintain the database of installed CHP.

#### *Developing the Environmental Action Plan*

**4.24** Over the next three years, Ofgem will develop its work under the Environmental Action Plan with the continuing aim of:

- assessing the environmental implications of its policies and taking action, consistent with its statutory duties, to maximise their benefits, and minimise their adverse effects
- pursuing opportunities where there is synergy between its economic, social and environmental objectives, and
- informing wider Government decisions about future environmental targets and the most effective means to achieve future environmental targets at the lowest cost to customers.

#### *Monitoring and compliance*

**4.25** Ofgem will continue to monitor suppliers' obligations to provide advice on energy efficiency. It will also provide guidance on the marketing of green energy supplies to domestic customers.

**4.26** Ofgem will monitor output measures from the gas and electricity distribution companies. It will also work with the Environment Agency and the Department for Environment, Food and Rural Affairs (DEFRA) to establish best practice for companies reporting environmental performance.



## 5. Developing Ofgem's efficiency and effectiveness

### Objectives

- To attract and retain high calibre staff.
- To set out clearly the rationale for its proposals and involve others creatively and effectively in their development.
- To communicate plans and proposals in a user-friendly way.
- To continue work to de-personalise regulation.
- To give value for money by controlling costs carefully, and managing resources efficiently.

### Background

- 5.1** Ofgem is governed by the Gas and Electricity Markets Authority and its powers are provided under the Gas Act 1986 and the Electricity Act 1989, as amended by the Utilities Act 2000. The Authority determines strategy and decides on major policy issues. It is made up of non-executive and executive members, with a majority of non-executive members.
- 5.2** Much has been achieved in the period since July 1999 when OFFER and Ofgas were merged to establish Ofgem. A new governance structure has been introduced and some staff and functions have been transferred to energywatch.
- 5.3** Ofgem has continued work in a number of areas to attract, develop and retain the calibre of people it needs to achieve the organisation's objectives. Recent work has included new reward and learning and development strategies. Staff numbers, which at the time of merger were 380 (excluding staff transferred to energywatch), are now at around 330 and Ofgem expects that number to reduce further. Ofgem has also worked to reduce the use of external contractors.
- 5.4** Ofgem has improved the way the organisation is structured and has reviewed a number of key work processes. It has invested in the retention of corporate knowledge and continues to improve the way it communicates and presents its work.
- 5.5** Ofgem continues to ensure that costs are controlled carefully and resources are managed efficiently. Recommendations from an efficiency review of regulators commissioned by HM Treasury in 1999-2000 have, where

appropriate, been implemented. Work is also under way to outsource Ofgem's technical services, based at Leicester.

### *The way forward*

- 5.6** Developing Ofgem as an efficient and effective regulator is important in building the confidence of those on whom its work has an impact. Ofgem will continue to improve the way it works, building on the progress that has been made since it was created in 1999.

### *Staff development*

- 5.7** Ofgem will continue to recruit, and work to retain, good staff.
- 5.8** Over the next three years, Ofgem expects that total staff numbers will reduce year-on-year. Its continuing emphasis will be on quality rather than quantity.

### *Justifying, consulting on and communicating Ofgem's work*

- 5.9** Ofgem is committed to constant improvement in the way it consults and involves people in its work. To this end, Ofgem will publish a statement setting out the standards it will follow when consulting on policy proposals.
- 5.10** The statement will include an explanation of the rationale for policy proposals that Ofgem will use. It will include, wherever possible, the costs and benefits associated with proposals.
- 5.11** Ofgem will work to explain its plans and proposals in a user-friendly way – in policy documents, through factsheets, the website and other communications vehicles.
- 5.12** Ofgem will continue to report its progress against the deliverables in this plan and will report any changes to priorities and timetables.

### *De-personalising regulation*

- 5.13** The Gas and Electricity Markets Authority has now fully settled into its role. The skills and experience of the five executive and six non-executive members who form the Authority are bringing real value to Ofgem's work.
- 5.14** The Authority continues to represent a welcome means towards de-personalising the regulatory process – a priority that will continue throughout the next three years.

## Costs

### Background

**5.15** In 2002-2003 Ofgem's costs will be £36 million. These represent around 0.1 per cent of industry turnover.

**5.16** Ofgem has made preliminary budget projections to 2004-2005, in order to increase transparency.

**5.17** The indicative budgets are as follows:

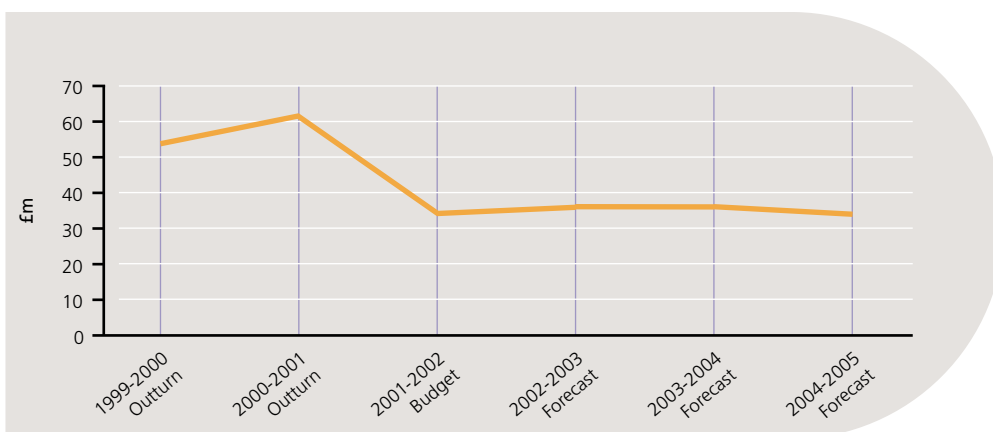
£m

2002-2003	2003-2004	2004-2005
36.0	36.0	34.0

**5.18** Budgets for all three years are based on 2002 prices. The figures make assumptions about the likely future volume of work, some of which will of course be determined by factors outside Ofgem's control.

Ofgem trend in spend

— Total administration costs



**5.19** The projected budget for 2002-2003 shows an increase of 5.7 per cent over approved expenditure for 2001-2002. Apart from inflation, other drivers for this increase include work on the priority projects: BETTA, monitoring and enforcing competition, work under the Environmental Action Plan and on efficient network investment, as well as the cost of implementing Ofgem's new reward strategy. These increases are offset by reductions in other areas that have been made to achieve efficiency savings, as well as the completion of major projects such as the Transco price control work.

**5.20** In addition to the costs attributed to the work set out in this plan and, identified more specifically, in the appendices, Ofgem also incurs costs associated with its Technical directorate (£2.3m in 2002-2003), its Leicester laboratories (£1.6m in 2002-2003) and its Glasgow office (£1.0m in 2002-2003).

**5.21** Indirect costs associated with support functions within Ofgem are apportioned to individual projects and activities (see Appendix 1).

Support costs in 2002-2003 are planned to be as follows:

— Human resources	£1.5m
— Finance	£0.7m
— Accommodation & running costs (utilities, service charges etc.)	£7.0m
— Legal	£1.3m
— Communications	£1.2m
— IT	£1.4m

**5.22** Ofgem's three main areas of spend over the period of this strategy continue to be related to staff, contractors and accommodation costs.

### *Pay*

**5.23** Ofgem's new reward strategy is beginning to take effect with the organisation attracting high quality staff.

**5.24** Overall, staff numbers (the nominal head count) are projected to fall from 334 in 2001-2002 to 300 in 2004-2005.

### *Contractors*

**5.25** The cost of contractors has reduced. It currently stands at £8.9m in 2001-2002 and is forecast to fall by a further 27 per cent to £6.5m by 2004-2005. This is in line with Ofgem's stated desire to reduce dependency on contractors.

### *Accommodation*

**5.26** The cost of accommodation and general running costs remain fairly constant over the period of this plan at around £7.0m. Apart from its headquarters at Millbank, Ofgem operates a site at Leicester, which incorporates a laboratory and archive, and an office in Glasgow. Ofgem is also seeking to dispose of the OFFER headquarters at Birmingham.

### *Contingency*

**5.27** A contingency has been included in the budget for the three years of the plan. This amounts to £2.3m in 2002-2003. For the remaining two years £3m has been allowed. This contingency provides funding for unforeseen work, some of which will be determined by factors outside Ofgem's control. The contingency also makes provision for the cost of the annual pay award to Ofgem staff.

## Appendix 1 Report against 2001-2002 key deliverables

Ofgem's Plan and Budget for 2001-2002 published a number of key deliverables to be achieved in each quarter. Listed below are details of Ofgem's performance in meeting those deliverables. The deliverables are listed by the quarters in which they were due to be completed. Each deliverable is recorded as either achieved on target, achieved late, delayed (not yet completed) or no longer applicable.

In 2001-2002 a number of major pieces of work arose that were not identified in the Plan and Budget. The assessment below does not take into account the impact of these unforeseen areas of work. For example, the review of smaller generators under the New Electricity Trading Arrangements (NETA), Ofgem's input into the Performance and Innovation Unit (PIU) energy review and the collapse of Enron.

	No. of deliverables	Achieved on target	Achieved late	Delayed (not yet completed)	N/a
Q1	22	12 (55%)	8 (36%)	2 (9%)	–
Q2	11	4 (36%)	2 (18%)	5 (45%)	–
Q3	15	6 (40%)	3 (20%)	4 (27%)	2 (13%)
Q4	17	6 (35%)	–	10 (59%)	1 (6%)
Total	65	28 (43%)	13 (20%)	21 (32%)	3 (5%)

Q1 – April to June 2001

Q2 – July to September 2001

Q3 – October to December 2001

Q4 – January to March 2002

### Quarter 1

#### Deliverables

#### Progress Report

Implement Environmental Action Plan following publication (from Q1)

Achieved quarter 2

Accredit generators whose output qualifies for exemption from the Climate Change Levy (CCL)

Achieved by target date

Issue certificates for qualifying renewable electricity generated for CCL exemption

Achieved by target date

Respond to initial recommendations of the Government working group on distributed generation

Achieved by target date

Publish draft proposals under Transco price control review

Achieved by target date

Publish initial proposals on structure of electricity distribution charges	Work on hold due to revised work priorities – revised timetable agreed for 2002-2003
Publish initial proposals on incentive regimes under Information and Incentives Project (IIP)	Achieved quarter 2
Consult on revised regulatory accounting licence conditions, including regulatory accounting guidelines, for the electricity distribution businesses	Regulatory accounting guidelines published July 2001. Consultation on revised licence conditions delayed to 2002-2003 due to delay in the Collective Licence Modifications process
Complete review of effect of NETA on smaller generators	Achieved quarter 2
Publish responses to British Electricity Trading and Transmission Arrangements (BETTA) proposals	Achieved by target date
Consult on proposals for Anglo-Scottish interconnector auctions	Achieved quarter 3
Publish final proposals on long term investment signals	Achieved by target date
Publish initial proposals on exit and interruptibles capacity regime	Achieved quarter 2
Carry out survey of electricity and gas retail supply	Achieved quarter 2
Publish decision document on improving customer transfers	Achieved by target date
Publish consultation document on supplier failures	Achieved by target date
Complete preparation of statutory instruments and orders resulting from the introduction of the Utilities Act (subject to the Department of Trade and Industry [DTI] timetable)	Achieved quarter 2
Modify standard licences for all licensees (subject to DTI timetable)	Achieved quarter 2

Implement, where appropriate, the recommendations of the Treasury's efficiency review of all regulators (from Q1)	Achieved by target date
Implement learning and development and reward strategies (from Q1)	Achieved by target date
Implement strategy to build Ofgem's corporate knowledge (from Q1)	Achieved by target date
Implement corporate communications strategy to support priorities for 2001-2002 (from Q1)	Achieved by target date

## Quarter 2

Deliverables	Progress Report
Develop new Codes of Practice for electricity consumer issues	Achieved by target date
Agree concordat with the Environment Agency (EA) and the Scottish Environment Protection Agency (SEPA)	EA concordat agreed. SEPA concordat delayed
Publish final proposals under Transco price control review. Implementation planned for April 2002	Achieved by target date
Publish final proposals on structure of electricity distribution charges	Work on hold due to revised work priorities – revised timetable agreed for 2002-2003
Implement revised regulatory accounting licence conditions, including regulatory accounting guidelines, for the electricity distribution businesses	Delayed to 2002-2003 due to delay in the CLM process
Consult on regulatory accounting guidelines for the National Grid Company (NGC) and the Scottish transmission businesses	To be published Q1 2002-2003. Delayed due to discussions with the companies concerned
Publish final proposals on Anglo-Scottish interconnector auctions	Achieved quarter 3
Publish decision document on exit and interruptibles capacity regime	Achieved by target date

Review regulatory regime in retail supply	Delayed – rescheduled in 2002-2003 timetable
Publish second consultation paper on business separation licence changes	Achieved by target date
Publish metering policy proposals	Achieved by quarter 3

### Quarter 3

#### Deliverables

#### Progress Report

Disseminate and act on the results of the seven research projects under Social Action Plan	Achieved quarter 4
Accredit generators whose output qualifies for the renewables obligation	Achieved by target date
Issue certificates for qualifying renewable electricity generated for renewables obligation	Achieved by target date
Put in place programme of work to respond, as appropriate, to recommendations of Government working group on distributed generation	Achieved by target date
Publish final proposals on incentive regimes under IIP project	Achieved by target date
Issue regulatory accounting guidelines for NGC and the Scottish transmission businesses	Delayed, expected Q2 2002
Set framework for new transmission access regime	Proposals document published in February 2002. Industry taking work forward through governance arrangements
Publish recommendations for revising regulatory regime in retail supply	Delayed – rescheduled in 2002-2003 timetable
Publish initial proposals on price regulation of the former Public Electricity Suppliers (PESs) supply businesses	Achieved by target date
Publish initial proposals for future regulation of marketing	Achieved quarter 4
Publish decision document on supplier failures	Decision document no longer required



Publish final proposals on business separation licence changes	Achieved quarter 4
Publish metering decision document	Superseded by six monthly metering strategy update papers
Complete review of Technical directorate	Delayed – phase 2 commenced Q4
Consult on Plan and Budget	Achieved by target date

#### Quarter 4

<b>Deliverables</b>	<b>Progress Report</b>
Publish proposals on reducing debt blocking	Delayed, expected Q2 2002
Publish second annual report on the Social Action Plan	Achieved by target date
Publish first annual report under the Environmental Action Plan	Delayed, expected Q1 2002
Publish guidelines on best practice on energy efficiency advice	Delayed, expected Q1 2002
Finalise procedures for implementing the new Energy Efficiency Commitment programme	Achieved by target date
Carry out initial consultation and survey about Independent Gas Transporters (IGT) regulation	Achieved by target date – commenced February 2002
Complete review of NETA	Deliverable inaccurate. Unable to undertake end of year review within year. Scheduled for Q2 2002
Implement new NGC System Operator incentives	Achieved by target date

Publish interim proposals on reforms required to implement BETTA (timing dependent on agreement of transmission access arrangements)	BETTA implementation proposals published December 2001. Further paper Q1 2002.
Implement exit and interruptibles capacity regime	Delayed – pending implementation of licence condition
Begin phased implementation of new gas balancing arrangements	Delayed due to further discussion with industry
Publish final proposals on price regulation of the former PES supply businesses	Achieved by target date
Publish decision document on future regulation of marketing	Delayed, expected Q3 2002
Implement business separation licence conditions	Achieved by target date
Implement conclusions from review of Technical directorate	Delayed – phase 2 commenced Q4
Obtain Investors in People accreditation	Delayed, expected Q1 2002
Publish Plan and Budget	Delayed, expected Q1 2002

## Appendix 2 Detailed deliverables and indicative costs for 2002-2003

### Making markets work more effectively

Activity	Action	Delivery period
<b>1. Wholesale market</b>		
Electricity trading	Publish a review of the New Electricity Trading Arrangements following the first 12 months of operation	Q2
	Contribute to development of the Department of Trade and Industry drafting instructions to Parliamentary Counsel for British Electricity Trading and Transmission Arrangements (BETTA) legislation	Q2
	Produce detailed descriptions of System Operator and Transmission Access Operator arrangement under BETTA	Q2
	Produce draft BETTA documentation	Q4
Gas trading arrangements	Continue to participate in the development of the gas balancing regime	ongoing
Market governance	Take part in the process for modifications to the Balancing and Settlement Code, Connection and Use of System Code and Network Code, and take decisions on code modifications	ongoing
Market surveillance	Monitor wholesale energy markets and take appropriate enforcement action when there is evidence of licence or competition law infringements	ongoing
Security of supply	Participate in DTI/Ofgem's Joint Energy Security of Supply Working Group	ongoing
Liaise with other European regulators	Support the development of competitive energy markets and promote Ofgem policies across Europe in relation to liberalisation	ongoing
	Monitor proposed interconnector projects	ongoing
	Provide advice to the DTI on proposals with a negative impact on the UK	ongoing

Offshore	Continue work with the DTI and other agencies to promote offshore arrangements that encourage a competitive wholesale market in Britain	ongoing
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## 2. Retail markets

Activity	Action	Delivery period
Monitoring domestic retail	Report on competition in domestic retail supply markets (prepayment meters and where switching activity is low)	Q2 & Q4
	Report on implications for supply competition of entry of new electricity distribution businesses	Q4
	Implement improvements to the markets for customer transfer process	Q4
	Implement customer contact plan	ongoing
	Publish review of Erroneous Customer Transfer (ECT) Charter	Q3
	Publish consultation on marketing licence condition	Q3
	Final proposals for focus of regulation of supply markets	Q4
	Report on competition in industrial and commercial retail supply markets	Q3
	Carry out test of Ofgem's and the industry's arrangements to manage supplier failure	Q2

## 3. Industrial structures

Metering	Update papers on progress under the Metering Strategy	Q2 & Q4
	Support for industry reforms to gas metering arrangements	Q4
Connections	Undertake dispute resolutions and determinations	ongoing
Corporate transactions	Publish consultation documents on proposed mergers and acquisitions	ongoing

and submit reports to the Office of Fair Trading (OFT) as required

Implement the decisions of the Secretary of State in relation to mergers and acquisitions ongoing

#### 4. Security of Supply

##### Indicative costs

This table identifies the direct costs associated with an area of work together with an appropriate allocation of indirect costs associated with support functions.

	2002-2003		
	£'000s		
	Direct	Indirect	Total
<b>Wholesale markets</b>			
BETTA	2,370	970	3,340
Gas trading arrangements	1,040	970	2,010
Electricity trading arrangements	1,130	800	1,930
Market surveillance	710	630	1,340
Connection and Use of System Code	230	320	550
Balancing and Settlement Code	190	250	440
Gas Network Codes	290	480	770
Europe	350	320	670
<b>Total</b>	<b>6,310</b>	<b>4,740</b>	<b>11,050</b>
<b>Retail markets</b>			
Retail competition regulation (I&C)	300	340	640
Retail competition regulation (domestic)	320	410	730
Market infrastructure	290	490	780
Customer contact and compliance	540	800	1,340
Licensing and supplier failure	510	670	1,180
<b>Total</b>	<b>1,960</b>	<b>2,710</b>	<b>4,670</b>
<b>Industrial structures</b>			
Metering	630	640	1,270
Co-ordination and corporate transactions	500	600	1,100
Connections	190	380	570
<b>Total</b>	<b>1,320</b>	<b>1,620</b>	<b>2,940</b>

Some projects in Chapter 3 are included in these costings. Gas trading arrangements includes costs for Transco SO Incentives. Electricity trading arrangements includes costs for NGC SO Incentives and transmission access and losses.

## 5. Regulating monopoly networks intelligently

Activity	Action	Delivery period
Development of price regulation generally	Consult on general price control issues to assist in the development of the price control framework and the distribution price control	Q1
Transmission, Electricity	Implement the NGC System Operator incentives scheme, subject to NGC consent	Q1
	Continue to participate in the development of new transmission access and losses arrangements for implementation in 2003-2004	ongoing
Transmission, Gas	Implement the Transco Price Control and accompanying System Operator (SO) incentives scheme, subject to Transco consent	Q2
Distribution, Electricity	Develop objectives and structure for next price control	Q3
	Report on quality of supply output measures and medium term performance information	Q2
	Publish final proposals on structure of electricity distribution charges	Q4
	Consult on distribution losses	Q2 & Q4
	Consultation on the regulation of Independent Electricity Distributors	Q2
Distribution, Gas	Further consultation on the separation of Local Distribution Zones (LDZ) price controls	Q3
	Consult on development of the quality of supply incentive scheme for LDZs	Q4
	Decision document on IGT charging	Q3
Asset risk management	Conduct surveys and publish results	Q3
Price control compliance, all industries	Ensure compliance with price controls through monitoring of performance and deal with disputes and determinations	ongoing

## Indicative costs

This table identifies the direct costs associated with an area of work together with an appropriate allocation of indirect costs associated with support functions.

Regulating Monopolies	2002-2003		
	£'000s		
	Direct	Indirect	Total
IGTs	280	370	650
LDZ separation	290	180	470
NGC price controls (TO costs only)	0	0	0
Transco price controls (TO costs only)	0	0	0
Distribution policy	690	560	1,250
Scottish transmission price control	250	200	450
Development price control	360	200	560
Regulatory finance	570	480	1,050
Quality of service	540	180	720
Transmission access and losses (costs included in electricity trading arrangements)	–	–	–
<b>Total</b>	<b>2,980</b>	<b>2,170</b>	<b>5,150</b>

## 6. Social action

Activity	Action	Delivery period
Social action	Publish debt management and prevention guidance	Q2
	Publish proposals on reducing debt blocking depending on the outcome of the current industry trial	Q2
Energy efficiency	Publish guidelines on energy efficiency advice for the fuel poor	Q2
Reporting progress	Publish annual report on progress and priorities under the Social Action Plan	Q4

## 7. Environmental action

Activity	Action	Delivery period
Generation	Continue to support the Environment Agency in work to develop emissions trading	ongoing
Distributed generation	Review options for domestic and micro-Combined Heat and Power	Q4
	Implement interim changes to connection charging regime	Q1
Supply	Produce guidance on green supply	Q1
Renewables	Issue first Renewables Obligations Certificates	Q2
	Implement Renewables Obligations Certificates transfer registry	Q2
Energy efficiency	Issue procedures manual on administering Energy Efficiency Commitment	Q1
	Prepare model code of practice on energy efficiency advice on industrial and commercial customers	Q1
Reporting progress	Publish report on evaluation of Energy Efficiency Standards of Performance (EESoP) 3 Programme	Q4
	Issue guidance to electricity companies on protection of amenities statements	Q1
	Publish annual report on progress and priorities under the Environmental Action Plan	Q4



### Indicative costs

This table identifies the direct costs associated with an area of work together with an appropriate allocation of indirect costs associated with support functions.

Social and Environment	2002-2003		
	£'000s		
	Direct	Indirect	Total
Social Action Plan	310	390	700
Fossil Fuel Levy	200	50	250
Energy efficiency	450	270	720
Renewables	650	340	990
Environmental Action Plan	240	250	490
Distributed generation	320	160	480
<b>Total</b>	<b>2,170</b>	<b>1,460</b>	<b>3,630</b>

The resources shown here represent what will be needed to co-ordinate Ofgem's work programme on the Environmental Action Plan and on distributed generation. Many other Ofgem staff will be involved and their resources are shown in other parts of this document.

### 8. Developing Ofgem's efficiency and effectiveness

Activity	Action	Delivery period
Attract and retain high calibre staff	Implement Ofgem recruitment and retention strategies	ongoing
	Implement learning and development strategy to secure Investors in People accreditation	ongoing
Ofgem's proposals	Implement revised Ofgem consultation best practice guidance, including improved rationale	Q1
Strategy	Contribute to the follow-up to the Performance and Innovation Unit report/Government White Paper	ongoing

## Appendix 3 Indicative costs for 2002-2005

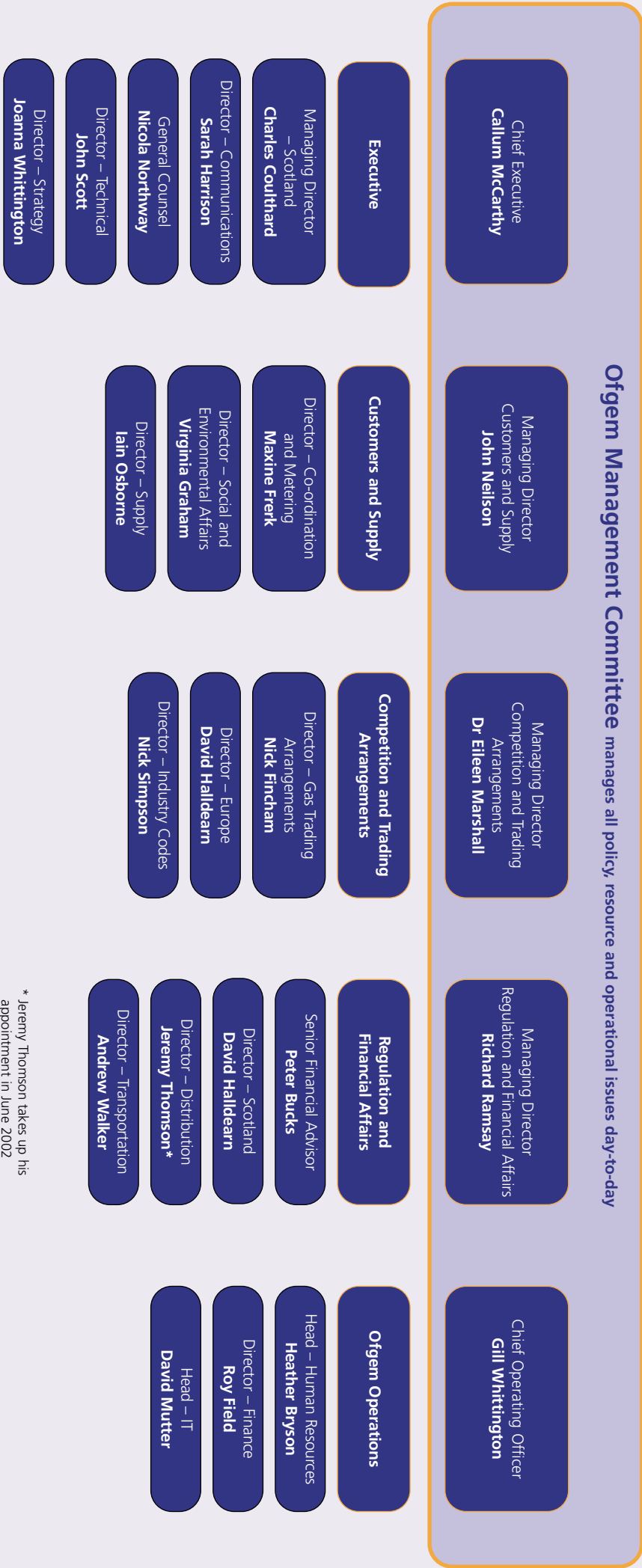
	Ofgem three year budget				
	2002-2003			2003-2004	2004-2005
	Direct	Indirect	Total	Total	Total
<b>Promoting Competition</b>	<b>9,590</b>	<b>9,070</b>	<b>18,660</b>	<b>16,990</b>	<b>13,290</b>
BETTA	2,370	970	3,340	4,400	1,500
Gas trading arrangements	1,040	970	2,010	1,200	900
Electricity trading arrangements	1,130	800	1,930	1,290	890
Market surveillance	710	630	1,340	1,200	1,200
Connection and Use of System Code	230	320	550	500	500
Balancing and Settlement Code	190	250	440	500	600
Gas Network Codes	290	480	770	700	700
Europe	350	320	670	600	600
<b>Wholesale markets</b>	<b>6,310</b>	<b>4,740</b>	<b>11,050</b>	<b>10,390</b>	<b>6,890</b>
Retail competition regulation (I&C)	300	340	640	500	400
Retail competition regulation (domestic)	320	410	730	400	400
Market infrastructure	290	490	780	800	900
Customer contact and compliance	540	800	1,340	1,000	1,100
Licensing and supplier failure	510	670	1,180	1,000	1,000
<b>Retail markets</b>	<b>1,960</b>	<b>2,710</b>	<b>4,670</b>	<b>3,700</b>	<b>3,800</b>
Metering	630	640	1,270	1,200	1,000
Co-ordination and corporate transactions	500	600	1,100	1,100	1,200
Connections	190	380	570	600	400
<b>Industrial structures</b>	<b>1,320</b>	<b>1,620</b>	<b>2,940</b>	<b>2,900</b>	<b>2,600</b>

	Ofgem three year budget				
	2002-2003			2003-2004	2004-2005
	Direct	Indirect	Total	Total	Total
<b>Regulating Monopolies</b>	<b>2,980</b>	<b>2,170</b>	<b>5,150</b>	<b>6,610</b>	<b>8,010</b>
IGTs	280	370	650	700	400
LDZ Separation	290	180	470	900	0
NGC price controls (TO costs only)	0	0	0	210	1,610
Transco price controls (TO costs only)	0	0	0	0	300
Distribution policy	690	560	1,250	1,200	800
Scottish transmission price control	250	200	450	400	300
Development price control	360	200	560	1,400	2,500
Regulatory finance	570	480	1,050	1,000	1,200
Quality of service	540	180	720	800	900
Transmission access and losses (costs included in electricity trading arrangements)	–	–	–	–	–
<b>Social &amp; Environment</b>	<b>2,170</b>	<b>1,460</b>	<b>3,630</b>	<b>3,200</b>	<b>3,200</b>
Social Action Plan	310	390	700	700	700
Fossil Fuel Levy	200	50	250	200	200
Energy efficiency	450	270	720	600	600
Renewables	650	340	990	700	700
Environmental Action Plan	240	250	490	500	500
Distributed generation	320	160	480	500	500
<b>Other</b>	<b>1,580</b>	<b>1,700</b>	<b>8,560</b>	<b>9,200</b>	<b>9,500</b>
Scottish office	400	620	1,020	1,000	1,000
Technical	1,180	1,080	2,260	2,200	2,700
Laboratories (Leicester)			1,620	1,800	1,800
Depreciation			1,400	1,200	1,000
Contingency			2,260	3,000	3,000
<b>Total</b>			<b>36,000</b>	<b>36,000</b>	<b>34,000</b>

#### Trends in staff numbers and contractor costs

	2001-2002 Plan	2002-2003 Forecast	2003-2004 Forecast	2004-2005 Forecast
Staff numbers	334	320	317	300
Staff costs	13,416	13,400	13,400	12,800
Contractors	8,901	7,900	7,700	6,500

# Appendix 4 Ofgem corporate structure



\* Jeremy Thomson takes up his appointment in June 2002