

# Ofgem Proposed Corporate Strategy 2003 - 2006



Promoting choice and value for all gas and electricity customers

## Foreword

Protecting and advancing consumers' interests is at the heart of everything Ofgem does. This Corporate Strategy sets out proposals for the work Ofgem plans to do over the next three years to meet our principal objective to protect the interests of consumers, wherever appropriate by promoting effective competition.

We are now seeking your views on these proposals. Do you think we have got our priorities right? Do you think we are devoting the right resources to those priorities? Are there areas where we need to do more? And, given our statutory duties, are there areas from which we should withdraw?

As always, Ofgem's work falls into two broad categories. These are making competitive markets work successfully and regulating effectively the natural monopolies, which run the pipes and wires. The Strategy identifies new and important features in both these categories.

**Competitive markets** - for the first time ever, we have a genuinely competitive market in wholesale electricity which has brought significant benefits to customers and serves to meet our principal objective. The market has evolved substantially since it began some 18 months ago. We expect the trading arrangements to be developed further in the light of experience so that they continue to be competitive and electricity supplies remain secure.

On the retail supply side, for both gas and electricity, we need to facilitate the development of the already strong competitive offerings so customers are able to take advantage of them easily and with confidence.

**Monopoly networks** - RPI-X regulation has proved highly effective, delivering lower prices, greater investment in the networks, security of supply and companies which are attractive to investors. We need to build on this success so that we can meet the new challenges which face us and the companies we regulate.

These challenges include the 'rewiring' of Britain needed to take account of the Government's targets for renewables and Combined Heat and Power generation, and strengthening the incentives on both gas and electricity networks for more efficient system operation and long-term investment.

We are presenting these proposals at a time of change and uncertainty as the Government develops its energy policy for the forthcoming White Paper.

The issues the White Paper will consider are short and long-term security of supply, the trade-offs between environmental, social and economic aims and the balance between competition and regulation. These issues are central to Ofgem's work and we will act to deal with them to the extent that they lie within our powers and duties, which were helpfully extended earlier in 2002.

As always, we will seek to work effectively and professionally. Exposing our plans for comment and criticism, and seeking your help in improving them, is an important part of that process.

**Callum McCarthy**

Chairman of the Gas and Electricity Markets Authority  
Chief Executive of Ofgem

# Table of Contents

<b>Themes</b>	2	<b>Helping to tackle fuel poverty ...</b>	15
<b>Making competitive markets work successfully</b>	3	<b>... and meeting environmental objectives</b>	17
Wholesale markets	4	Influencing Ofgem's work	18
Retail markets	6	Wholesale market	18
Industry Structures	7	Transmission and distribution networks	19
<b>Regulating monopoly businesses effectively</b>	8	Retail market	19
A changing scene	8	<b>Appendix One</b> Corporate plan deliverables 2003-2004	20
Developing regulation	9	<b>Appendix Two</b> Developing Ofgem's efficiency and effectiveness	27
Electricity	10	<b>Appendix Three</b> Indicative costs for 2003-2006	29
Gas	11	<b>Appendix Four</b> Ofgem corporate structure	31
Quality of supply	12		
Compliance	12		
<b>Securing Britain's gas and electricity supplies</b>	13		
Making markets work and regulating monopoly businesses	13		
Influencing	14		

# Protecting consumers, both present and future, is at the heart of **everything** Ofgem does.

This means working on behalf of consumers to secure gas and electricity supplies which are **competitively priced, reliable, safe** and, where consistent with these aims, cause as little harm as possible to the **environment**.

Against this background, the themes which will continue to **drive Ofgem's strategy over the next three years** are:

**Making competitive markets work successfully**

**Regulating monopoly businesses effectively**

**Securing Britain's gas and electricity supplies**

**Helping to tackle fuel poverty and meeting environmental objectives**

Views are invited on this Proposed Strategy. Responses are requested by **14 February 2003**, and should be sent to:

**Gill Whittington, Chief Operating Officer, Office of Gas and Electricity Markets, 9 Millbank, London SW1P 3GE** email: [gill.whittington@ofgem.gov.uk](mailto:gill.whittington@ofgem.gov.uk)

Ideally, responses should be sent electronically. Unless marked clearly as confidential, all responses will be published on Ofgem's website. If you have any questions on the Proposed Strategy, please contact **Chris Chapman** email: [chris.chapman@ofgem.gov.uk](mailto:chris.chapman@ofgem.gov.uk) or Tel: **020 7901 7456**

# Making competitive markets work successfully

## Ofgem priorities for 2003-2004:

- Taking action in competitive wholesale markets to help secure supplies and enable market players to **operate effectively**
- Making sure that competition in the retail markets continues to work for the **benefit of all consumers**
- Bringing more competitive prices and greater choice to **Scottish electricity customers**

Competition is now established in the **gas and electricity wholesale and retail markets**. As well as bringing considerable benefits to domestic and business consumers, competition has enabled Ofgem to withdraw from directly regulating many parts of the market which were subject to regulation at the time of privatisation.

Going forward, Ofgem's role in these sectors is to monitor market developments and to act, where necessary, to **safeguard consumers' interests, secure supplies** and ensure **competition works effectively**.

To meet this objective, Ofgem will continue to enforce compliance with licence conditions, codes of practice, competition and consumer law, drawing, where necessary, on powers now available under the Gas Act 1986, Electricity Act 1989 and Competition Act 1998.

Industry restructuring is a natural response to developing competition as companies seek to adjust to changing market conditions. In the coming year, Ofgem will be paying particular attention to recent commercial trends towards **vertical integration** and **consolidation**, so that the interests of consumers are protected and the development of competition is not hindered.

Ofgem will continue its work to test and develop Supplier of Last Resort (SoLR) arrangements, which have been strengthened in recent years, to protect customers by **securing supplies** in the event of company failure. It will also keep under review its capability to respond to company failures within the wholesale gas and electricity markets.

## Wholesale markets

### Electricity

The wholesale electricity market in England and Wales now operates much like any other market.

The majority of electricity (more than 97 per cent) is traded bilaterally, where prices are agreed between the parties involved: generators, suppliers and customers, or through power exchanges. A forward price curve, going out 2-3 years, is also helping to signal short and longer term capacity requirements.

Less than 3 per cent of electricity is traded through balancing arrangements, including the balancing mechanism, which exists to ensure that supply meets demand on a second-by-second basis. These arrangements are governed by a set of rules contained in the Balancing and Settlement Code (BSC) and administered by Elexon.

Against this background, Ofgem's continuing role is to consider and approve **changes to the BSC and to the Connection and Use of System Code (CUSC)**, which governs access to, and use of, the England and Wales transmission system, so that participants can operate effectively and supplies are efficiently maintained.

**In Scotland**, where wholesale competition is not yet fully established, Ofgem's priority will be to continue work with the Department of Trade and Industry (DTI) on the joint programme to extend trading arrangements in England and Wales to the Scottish market, to create a British electricity wholesale market.

These reforms require **primary legislation** to be passed in the 2002-2003 Parliamentary session to meet an implementation date of April 2004. If legislation is not forthcoming in this session, Ofgem will need to review the timetable, as well as consider alternative mechanisms, to bring more competition to the Scottish electricity market.

In the meantime, Ofgem will continue work on the measures required to bring reform into effect. These include:

- developing British-wide trading, balancing and settlement arrangements
- developing British-wide connection and use of system arrangements, and
- creating an independent British-wide system operator function and new licensing arrangements.

- Wholesale electricity costs make up about 40 per cent of domestic bills
- British-wide reforms will strengthen competition and increase pressure on prices, particularly in Scotland

- Lower energy costs will help reduce fuel poverty which affects 1 in 3 Scottish households
- Scottish generators, traditional and renewable, will benefit from access to a wider British market

## Gas

As in electricity, the gas wholesale market is fully competitive and operates like any other market.

The majority of gas is traded bilaterally between producers, shippers and customers, with a small amount being traded in the system balancing arrangements.

The balancing arrangements, as well as access to, and use of, the gas transportation system, are governed by **Transco's Network Code**. Again, Ofgem's continuing role is to consider and approve changes to the Code so that market participants can operate effectively and supplies are efficiently maintained.

Ofgem has no regulatory, and limited information gathering, powers offshore. Within this limitation, Ofgem will continue to work with the Department of Trade and Industry (DTI) to ensure that arrangements in the **offshore gas production industry** encourage a competitive gas wholesale market.

## Wholesale market surveillance

In both wholesale electricity and gas markets, and for related activities such as gas entry capacity and storage, Ofgem will continue to monitor market developments to identify and take action against any **anti-competitive behaviour** by market participants and to agree any necessary changes to the gas and electricity **market rules**.

Ofgem will also develop its market surveillance activities in response to changes in the trading arrangements, such as the introduction of new arrangements for transmission access in electricity.

## Gas and electricity markets across Europe

The operation of electricity and gas markets across Europe have a direct effect on developments in British markets and ultimately on British consumers.

Ofgem will continue to support the UK Government, and to work with the Commission and other European regulators, to promote the development of effective **Europe-wide trading and transportation arrangements**, and to assist in the implementation of relevant European legislation.

- Wholesale gas costs make up 45 per cent of domestic bills

## Retail markets

Competition is now established in the gas and electricity retail (supply) markets.

Residual controls on the prices suppliers charge their customers were lifted earlier in 2002. This action has not resulted in the immediate price hikes that were feared by some at the time.

As competition in the retail market develops, Ofgem's continuing priority is to **monitor** its progress, where necessary, **enforcing** licence obligations, competition and consumer law, so that all consumers continue to benefit.

Ofgem's work in the retail sector will be concentrated on two fronts.

### Industry processes

Ofgem will review the **industry processes** which underpin the operation of the competitive market for domestic and business customers.

Customers have a right to expect that the process for changing from one supplier to another is both **honest and efficient**. Misselling and erroneous transfers can harm consumers and undermine confidence in the competitive market.

That is why Ofgem will continue to work with industry and consumers to seek improvements in the marketing and customer transfer processes, as well as to tackle remaining barriers which prevent customers participating in the market.

### Retail market surveillance

Ofgem will continue regular market surveillance, taking action where necessary to enforce company compliance.

This involves work to monitor domestic and business **customers' experience** of the competitive market. In this area, Ofgem will work closely with **energywatch** whose complaint handling work provides important experience and evidence to underpin enforcement action.

The effect of pricing strategies and the behaviour of **former monopoly suppliers** (British Gas and the one-time regional electricity companies) have always been subject to close market surveillance. In the coming year, Ofgem will take any action necessary to prevent abuse of their remaining market power.

- Retail competition continues to develop rapidly
- More than 90 per cent of people have found switching very easy, or easy
- 160,000 customers are switching supplier every week
- Anyone switching away from a former monopoly supplier today can save up to 22 per cent



## Industry structures

Ofgem will continue work to promote industry structures which facilitate, and do not inhibit, the development of effective competition.

Under its **metering strategy**, Ofgem will support and monitor the development of metering competition which will promote greater choice, reduced costs, improved quality of service and innovation.

During the transitional period, until competition is fully effective, many of the existing services will continue to be provided by the monopoly businesses and are subject to price controls. Ofgem will be working to determine the appropriate price control arrangements from April 2005, as part of the distribution price control process.

Work which reviews the underlying costs of **prepayment meters** and researches the social and environmental benefits which might be gained from the use of 'smarter' **metering technology** will also be progressed.

Ofgem will promote and monitor the development of **competition in connections** which should benefit customers by putting pressure on prices, improving quality of service and encouraging innovation.

While competition flourishes in some areas, such as gas connections for new housing developments, barriers still exist, particularly for smaller one-off gas connections and for electricity connections involving 'live working'. Ofgem will progress work to help remove these barriers.

Ofgem will continue its work to protect customer interests in **mergers and acquisitions** through its advice to the Office of Fair Trading (OFT) and European Commission on competition issues. Ofgem will also continue to set out its policy on corporate transactions and financial restructuring to help companies understand the likely regulatory issues.

- Competition in metering services can benefit customers through lower prices by reducing the £800 million annual cost of metering

- Costs of new connections to gas and electricity supplies are about £400 million a year - £300 million for electricity and about £100 million for gas. These costs are borne by customers

# Regulating monopoly businesses effectively

## Ofgem priority for 2003-2004:

- Enabling Britain's transmission and distribution companies to **manage their networks economically** and **invest efficiently** to meet future security of supply and environmental objectives

Where competition is not practicable, Ofgem will continue to regulate through price controls and incentive schemes so that customers receive value for money and a secure and reliable service.

This approach applies to the monopoly businesses that run the pipes and wires bringing gas and electricity to homes and businesses.

## A changing scene

Britain's gas and electricity network businesses are facing a time of **considerable change**.

Demand for gas, from local and imported sources, is increasing with implications for the level of network capacity that will be required to transport gas to meet demand and secure supplies.

In electricity, the Government's environmental targets are stimulating the growth of distributed generation. This has implications for the number of connections to Britain's national transmission and local distribution networks and, in turn, for network access arrangements and investment needed to accommodate these connections in response to demand.

The lower voltage local distribution networks will need to respond flexibly to the increase in distributed generation and over time may need to actively manage electricity flows in a similar way to existing transmission networks.

- Ofgem has significantly developed the way in which monopoly networks are regulated:
  - new incentive regimes for more efficient investment
  - new quality of supply standards and guaranteed outputs for customers, and
  - stronger incentives to improve environmental performance and reporting.

## Developing regulation

**RPI-X price regulation** has served Britain's gas and electricity customers well. It has led to lower prices and improved standards of service, while securing a significant increase in network investment.

Ofgem has done much to build on RPI-X and is committed to continuing its work to develop a framework for network regulation which is capable of accommodating future demands and changes efficiently and effectively. Work is already underway and will be progressed in the period of this strategy, in particular in the build up to the next distribution price control in 2005.

As Ofgem develops the regulatory framework to meet its principal objective of protecting consumers' interests, it will be important to:

- reward **efficient investment** made in response to actual demand and **efficient operation** of the networks
- enable investment and system operation arrangements to enhance **security of supply** and **quality of service**

- develop arrangements that accommodate growth in distributed generation associated with the Government's **environmental objectives and targets**
- work with the Health & Safety Executive (HSE) so that **safety** priorities are comprehensively addressed and HSE's requirements are financed efficiently, and
- where appropriate, achieve **consistency** in the regulatory arrangements applying to gas and electricity transmission and distribution networks.

# Electricity

## National transmission

The existing arrangements for access to **National Grid Company (NGC) electricity transmission** network can be improved in a number of ways. At present, they do not provide firm access rights for users or effective signals to NGC of customers' future network requirements, which are important for long-term security of supply.

Ofgem will progress work with the industry on new **transmission access arrangements** to give customers' firm access rights, and NGC accurate signals.

In conjunction with these arrangements, Ofgem will implement a new regime for **NGC's system operator incentives**. These will enable more efficient system operation by encouraging NGC to respond quickly and efficiently to signals of its customers' demands. This proposed new incentive regime also achieves consistency with the arrangements that now exist for Transco's National Transmission System (NTS).

Ofgem will additionally be looking at the arrangements for connecting to NGC's system and will continue work with industry on new incentives arrangements to reduce **transmission system losses**.

Work will start on the **Scottish electricity transmission price controls** due for review in 2005. This work will reflect the outcome of the project aimed at introducing British-wide electricity transmission and trading arrangements. Preparatory work for the next **NGC price control** due in 2006 will also begin in 2004.

## Local distribution

In the build up to the **2005 distribution price control**, Ofgem will work with Distribution Network Operators (DNOs), suppliers, generators and customers to review how efficient investment is best incentivised at a time when future requirements are uncertain, and are being shaped by new considerations, such as the development of distributed generation needed to help meet environmental targets.

This important and substantial programme of work for the next price control review will also consider new arrangements for **access and use of system charges**, as well as proposals to improve efficiency by reducing **system losses**.

- Constraints on the electricity transmission system currently cost £20-25 million a year
- The costs of these constraints are not met by those who cause them but are spread across all users of the system
- Costs could increase to between £40-45 million a year if system flows change through the introduction of British-wide trading and transmission arrangements and greater trade with Europe

## Gas

### National transmission

Ofgem will continue to monitor how effectively Transco invests in the NTS in response to the economic signals which result from short-term capacity auctions, as well as from the long-term capacity auctions which commence in 2003.

### Local distribution

Work will continue to introduce **separate price controls** for Transco's eight regional distribution networks from April 2004.

Separate price controls will protect customers in the event that Transco decides to sell off one or more of its regional networks, create greater management focus on distribution and promote efficiency savings which can be shared with customers. They will also allow Ofgem to compare the performance of regional networks, so enabling more effective regulation.

Following work on price control separation and regulation of Independent Gas Transporters (IGTs) it will be necessary to review the structure of Transco's **distribution and connection charges**.

### IGTs

Ofgem will continue work to review the regulation of IGTs. These local network companies, which serve about 250,000 customers, are not, at present, subject to price controls nor are they subject to industry-standard customer transfer processes. The work will assess whether the existing regulatory arrangements adequately protect customers' interests.

## Quality of supply

Ofgem will continue its work to monitor compliance with, and improve, **customer standards of performance** and **quality of service** incentive schemes. In particular, Ofgem will consider:

- how to integrate quality of service incentives into the next distribution price control review
- how best to develop equivalent arrangements for Transco, and
- how well companies respond to gas and electricity customers who suffer interruptions to supply.

In addition, Ofgem will continue its work to review and encourage the development of best practice in **asset risk management**. DNOs have a primary responsibility to ensure reliability and security of supply as well as to safeguard ongoing performance for the longer term.

## Compliance

Ofgem will monitor monopoly network operators' compliance with existing price controls and licence conditions.

# Securing Britain's gas and electricity supplies

## Ofgem priorities for 2003-2004:

- Taking action in competitive wholesale markets to help **secure supplies** and enable market players to operate effectively
- Enabling Britain's transmission and distribution companies to manage their networks economically and invest efficiently to meet future **security of supply** and environmental objectives

Ofgem has important statutory duties relating to security of supply which inform everything it does.

Ofgem will continue to take these duties into account in every aspect of its work in order to help maintain high levels of service quality and system security.

## Making markets work and regulating monopoly businesses

Ofgem has done much in the last three years to improve wholesale market competitiveness and network regulation. As well as bringing considerable economic benefits, these changes have resulted in a significant strengthening of the signals and incentives required for long term investment in infrastructure and capacity.

## Markets

Ofgem's work on security of supply is firmly underpinned by regular monitoring and market surveillance which helps to provide important **early warning** of barriers which may prevent a timely response to market signals, including new plant and gas storage investment.

In this area, Ofgem works closely with the DTI and other relevant Government departments through the **Joint Energy Security of Supply (JESS) group**. Ofgem will continue to contribute to the development of this group's important work.

- Since privatisation, more than £30 billion of investment has been made in Britain's gas and electricity networks
- Companies have not reported difficulty in raising debt or equity capital to finance their regulated businesses
- Britain has a generous margin of generation capacity over demand

## Networks

Ofgem will continue to **build on the RPI-X** price control mechanism to develop stronger incentives for efficient and timely long-term investment.

It will also continue important work to develop gas and electricity **system balancing incentives** so that arrangements operate efficiently and effectively.

## Influencing

Beyond the operation of the gas and electricity industries, Ofgem will also continue its work with Government and the European Commission to influence factors which can also have a bearing on security of supply priorities. For example, improvements to the planning process to enable gas storage capacity to be developed, and open access to Europe's gas and electricity networks.



## Helping to tackle fuel poverty ...

### Ofgem priority for 2003-2004:

- Making sure competition in the retail markets continues to work for the **benefit of all** customers

In addition to meeting its first duty to protect consumers, Ofgem has responsibilities to consider the specific interests of customers who are disabled or chronically sick, of pensionable age, on low incomes or living in rural areas.

It must also take account of the **social and environmental guidance** issued by the Secretary of State which invites Ofgem to have regard to the Government's Fuel Poverty Strategy.

Ofgem's main contribution to tackling fuel poverty is through its work to **reduce consumers' energy costs** which, alongside low incomes and poor housing, are the principal causes of **fuel poverty**.

It will continue its work to reduce energy costs by promoting competition, regulating monopoly network companies and progressing specific measures under its **Social Action Plan**.

- Number of households in fuel poverty in 1996 was 5.5 million
- Number of households removed from fuel poverty as a result of lower prices between 1996-2000 was 1 million
- Number of households in fuel poverty in 2000 was 4 million

Work under the Social Action Plan will focus on:

- raising awareness of the **Priority Service Register** (PSR)
- helping **customers living in rural areas** and **those for whom English is not their first language**, and
- helping customers on benefits to continue to have access to affordable energy with the arrival of the **Universal Bank** and **new benefit payment arrangements**.

In addition, Ofgem will, through its ongoing market surveillance work:

- **monitor** how competition is developing for consumers, and
- work to **tackle concerns and barriers** which may continue to prevent some customers from taking advantage of better deals.

An important feature of an effective competitive market is **access to reliable and good quality information** which consumers can use with confidence to make choices between competing offers.

While the principal responsibility to provide consumer help and advice lies with **energywatch**, Ofgem places an obligation on suppliers to provide information on a range of special measures and tariffs, and will continue important work to **monitor and test** the quality of this, where necessary taking action to improve company performance.

## ... and meeting environmental objectives

### Ofgem priorities for 2003-2004:

- Enabling Britain's transmission and distribution networks to manage their networks economically and invest efficiently to meet future security of supply and **environmental objectives**
- Taking action in competitive wholesale markets to help secure supplies and enable **market players to operate effectively**

Ofgem's actions, and those of the industry it regulates, have an impact on the environment. It will continue to take action where it can to help the Government meet wider environmental targets at the lowest cost to energy consumers.

The framework for Ofgem's work to meet environmental objectives is established by its principal objective and other statutory duties.

Ofgem also has to take account of the **social and environmental guidance** issued by the Secretary of State which invites Ofgem to have regard to the Government's Climate Change Programme.

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 for customers or for industry.

Within these constraints, Ofgem is working to ensure that in all its policies it takes account of, and where possible minimises, any adverse impact on the environment.

- The Government's Climate Change Programme aims to reduce emissions of all greenhouse gases by 12.5 per cent and of CO<sub>2</sub> by 20 per cent by 2010

- The programme has been set up to ensure the UK meets, and for CO<sub>2</sub> gases exceeds, its commitments under the Kyoto Climate Change Protocol

## Informing Ofgem's work

Much of Ofgem's environmental work is taken forward under its **Environmental Action Plan**.

Under the Plan, Ofgem will improve the way in which it informs its work.

- Decisions and policies will be **assessed** in the light of their environmental implications and this process will be made more transparent.
- A programme of **research** into environmental issues is under way to help to inform policy options, as well as the wider environmental and energy debates.
- Independent and external guidance will be contributed by the recently appointed **Environmental Advisory Group**, and from a **panel of environmental economists**.

## Wholesale market

Ofgem will work with the Environment Agency and other regulators to encourage greater use of **emissions trading** or other flexible economic instruments as efficient means of complying with environmental standards imposed under EU legislation.

Ofgem will continue to administer key parts of the **Government's Climate Change Programme**. This includes the Renewables Obligation to promote renewables, the Climate Change Levy (CCL) exemptions for renewables and for good quality CHP, and the Fossil Fuel Levies.

Ofgem will also work with **renewable and CHP generators** to tackle remaining barriers and promote measures which enable them to **participate effectively** in the competitive wholesale market.

## Transmission and distribution networks

Establishing a non-discriminatory and transparent regulatory regime for **distributed generation** will be a continuing priority for Ofgem, in particular in the build-up to the next distribution price control in 2005.

This important and substantial programme of work will be supported by the Distributed Generation Co-ordinating Group (DGCG) which Ofgem co-chairs with the DTI, and the related Technical Steering Group (TSG).

Work under way to develop incentives to **reduce transmission and distribution system losses** should not only produce savings, but also bring environmental benefits through reductions in carbon emissions. These can be achieved by improving the efficiency of the transmission and distribution systems and, in the longer term, by the more efficient siting of generation capacity relative to demand.

In addition, Ofgem's continuing work with the DTI to create **British-wide transmission and trading arrangements** will address key differences between the systems in Scotland and in England and Wales which, if not tackled, will create barriers to the development of renewable generation in Scotland.

## Retail market

Energy efficiency makes a major contribution to reducing consumers' energy costs, as well as to meeting environmental objectives. Ofgem will continue to promote the efficient use of energy right along the supply chain.

As part of this, Ofgem will continue to administer the Government's **Energy Efficiency Commitment** and work with the Department for the Environment, Food and Rural Affairs (Defra) to evaluate the programme.

Ofgem will also review the progress companies are making towards meeting the good practice guidelines aimed at improving how they target energy efficiency advice at customers. Ofgem will continue to **monitor and test** suppliers' performance in this area.

Ofgem will also progress work begun under its research programme to raise **consumer awareness** about energy use.

- Nearly 10 per cent of all electricity is lost as heat as it is transported on national transmission and local distribution networks

- By reducing losses from the distribution system from the present 7 per cent to 5 per cent, carbon dioxide emissions in Great Britain could be reduced by 3.5 million tonnes

## Appendix 1. Corporate plan deliverables 2003-2004

### Making competitive markets work successfully

#### Wholesale markets

Activity	Action	Delivery Period
Electricity trading arrangements	Manage the process and provide policy input and take decisions on modifications to the Balancing and Settlement Code (BSC)	on-going
Gas trading arrangements	Manage the process and provide policy input and take decisions on modifications to the Network Code	on-going
	Review of gas storage and related areas	Q2
Modifications to the Network Code and Independent Gas Transporter (IGT) Codes	Manage the process and provide policy input where appropriate on modification proposals	on-going
Market surveillance	Monitor wholesale gas and electricity markets and provide regular internal reports	on-going
British Electricity Trading and Transmission Arrangements	Extend the trading and transmission arrangements in England and Wales to the Scottish market to create British trading and transmission arrangements	on-going

## Retail Markets

Activity	Action	Delivery Period
Compliance	Monitor and, where necessary, investigate misselling under new enforcement procedures finalised in August 2002	on-going
	Final proposals for improvements to the marketing licence condition to make investigation more effective	Q2
Market infrastructure	Start review of problems and possible solutions in industry processes supporting customer transfers and billing	Q1
	Report on effectiveness of industry arrangements for dealing with erroneous transfers	Q3
	Final proposals for solutions to problems with industry processes supporting customer transfers and billing	Q4
Supply competition and deregulation	Publish results of competitive market review of Industrial and Commercial (I&C) markets	Q1
	Publish review of competition in domestic markets	Q3
	Commence new review of I&C markets	Q4

## Industry structures

Activity	Action	Delivery Period
Corporate transactions	Consult interested parties and provide advice to the Office of Fair Trading (OFT) within the relevant statutory timetable	on-going
Metering	Industry implement business processes that support a competitive metering market	Q3
Connections	National roll out of 'live' working relating to new connections on greenfield housing estates	Q3

## Regulating monopoly businesses effectively

### General

Activity	Action	Delivery Period
Developing price controls	Publish document outlining principles for monopoly regulation	Q1
Finance and compliance	Resolve disputes and determinations	on-going
	Compliance with price controls	on-going
	Introduce Regulatory Accounting Guidelines and annual reporting on regulatory accounts	on-going

### Gas (transmission)

Activity	Action	Delivery Period
Transco National Transmission System (NTS)	Consider proposals for unbundling Liquefied Natural Gas (LNG) arrangements	Q1
	Review Transco's capital expenditure programme	Q3
	Review Transco's System Operator (SO) incentives and consider other incentive initiatives	Q4
	Review, develop and consult on Transco's NTS new exit regime	Q4
	Provide policy input and take decisions on modifications relating to Transco's NTS connection/use of system policy	on-going



## Regulating monopoly businesses effectively (continued)

### Electricity (transmission)

Activity	Action	Delivery Period
National Grid Company's (NGC) transmission system	Review NGC's SO incentives and consider other incentive initiatives	Q2
	Encourage the development of transmission access arrangements	Q3
	Provide policy input and take decisions on amendments relating to NGC's connection/use of system policy	on-going
Modifications to the Connection and Use of System Code (CUSC)	Manage the process for amending CUSC and provide policy input to determine proposals made	on-going

### Gas (distribution)

Activity	Action	Delivery Period
Quality of service (Gas Transporters (GTs))	Audit report on Transco's system for measuring output measures	Q3
	Publish annual report on GTs' quality of service	Q3
Distribution (gas)	Publish final proposals - IGT charging	Q1
	Publish final proposals - Local Distribution Zone (LDZ) separation	Q1
	Consult on structure of gas distribution charges	Q3

## Regulating monopoly businesses effectively (continued)

### Electricity (distribution)

Activity	Action	Delivery Period
Quality of service (Distribution Network Operators (DNOs))	Survey customers' views on quality of telephone response	on-going
	Publish annual report on DNOs' measurement systems and accuracy of reporting	Q2
	Publish annual report on DNOs' quality of service, including standards of performance and output measures	Q3
Distribution price control review	Publish initial consultation on distribution price control review	Q1
	Distribution price control review update	Q3
	Publish second consultation on distribution price control review (including final proposals on an incentive regime for distributed generation)	Q3
	Publish policy document on distribution price control review	Q4
Distribution policy	Consult on reducing losses on distribution networks	Q1
	Publish decision on distribution losses	Q2
	Publish final proposals on structure of distribution charges	Q1
	Publish final proposals on Independent Electricity Distributors	Q3

## Securing Britain's gas and electricity supplies

Activity	Action	Delivery Period
Security of Supply	Participate in Joint Energy Security of Supply (JESS) meetings with the DTI and produce the bi-annual JESS report.	on-going

**Ofgem has important statutory duties to secure Britain's gas and electricity supplies. Ofgem will continue to take these duties into account in all the work detailed in this Appendix.**

## Helping to tackle fuel poverty and meeting environmental objectives

Activity	Action	Delivery Period
Social Action Plan (SAP)	Publish SAP Annual Review	Q4
	Undertake and publish monitoring report on Priority Service Register (PSR)	Q3
	Publish quarterly statistical monitoring reports on social obligations	on-going
Environmental Action Plan (EAP)	Publish EAP Annual Review	Q1
	Introduce environmental implications in the rationale of all Ofgem policy documents	Q1
	Issue decision document on fuel mix and consumption data disclosure on bills/websites etc.	Q3
Distributed Generation	Publish a clear work programme for incorporating Technical Steering Group (TSG) workstream recommendations into Government and Ofgem policy	Q1
	Present an annual report on Distributed Generation Co-ordinating Group (DGCG) activities to ministers and the Authority.	Q4

## Helping to tackle fuel poverty and meeting environmental objectives (continued)

Activity	Action	Delivery Period
Renewables	Complete the first annual settlement of the Renewables Obligation (RO) and Renewables Obligation Scotland (ROS)	Q3
	Calculate and collect the 'Buy-out' funds, and recycle them to suppliers in Great Britain	Q3
	Issue the first annual report on the RO/ROS	Q4
	Continue to issue Renewables Obligation Certificates (ROCs) and Levy Exemption Certificates (LECs) monthly, in a timely and accurate manner	on-going
	Update the Register of ROC ownership, five days after notification of change of ownership	on-going
Fossil Fuel Levy	Set the Fossil Fuel Levies annually, in a timely and accurate manner, and communicate them to the public	on-going
	Collect the levy associated income monthly, in a timely and accurate manner	on-going
Combined Heat & Power (CHP)	Draft, consult on and finalise procedures for administering exemption for Good Quality Combined Heat and Power (GQCHP) from the Climate Change Levy (CCL)	Q1
	Issue GQCHP LECs monthly, in a timely and accurate manner	on-going
Energy efficiency	Publish evaluation reports on aspects of Energy Efficiency Standards of Performance (EESoP) 1,2 and 3 with Energy Savings Trust (EST)	Q1
	Issue first annual report on Energy Efficiency Commitment (EEC)	Q2
	Issue quarterly updates on schemes submitted and approved and the progress of suppliers against the target	on-going

## Appendix 2. Developing Ofgem's efficiency and effectiveness

### Developing Ofgem's efficiency and effectiveness

Since 1999-2000, when Ofgem was established, considerable progress has been made to improve working practices and manage costs efficiently. By 2003-2004, the costs of Ofgem will have fallen by 17 per cent and staff numbers by 19 per cent (excluding NETA).

These efficiencies have been delivered by effective resource management and careful cost control.

A recent example of how Ofgem works to achieve this is the implementation of its decision to outsource technical services previously provided by a 30-strong team based in Leicester. The new arrangements will ensure that Ofgem continues to enjoy the highest quality technical advice delivered more cost-effectively and efficiently than before.

#### **Ofgem will continue to improve the way it works with a focus on:**

- attracting and retaining high calibre staff
- setting out clearly its proposals and the reasons behind these
- communicating plans and decisions in a user-friendly way and involving others creatively and effectively in the development of these, and
- delivering against its corporate strategy.

### Background

Ofgem's net costs for 2003-2004 are forecast to be £36.0m. Ofgem has also projected indicative budgets for 2004-2005 and 2005-2006 in order to provide transparency to industry and licence fee payers of likely future costs. The indicative budgets are:

	2003-2004	2004-2005	2005-2006
£m	36.0	34.0	34.0

The above figures are broken down in more detail by theme and project in Appendix 3.

In preparing budget projections, Ofgem has maintained the indicative budgets presented in last year's corporate plan but in so doing has managed to contain expected inflation throughout the period of the plan. Ofgem has undertaken a rigorous appraisal of its proposed future work activity in order to contain costs and ensure that efficiency savings are made.

If Ofgem is given new or additional work or duties, these would clearly have to be reflected in new priorities, and would result in a different budget, some of which may be determined by factors outside Ofgem's control.

The two key areas of spend for 2003-2004 relate to the British Electricity Trading and Transmission Arrangements project (£4.9m) and distribution price control (£2.7m).

## Support functions

Costs associated with the support functions of Ofgem are apportioned to individual projects and activities. Support costs in 2003-2004 are estimated as follows:

■ Human resources	£1.4m
■ Accounts	£0.7m
■ Accommodation & running costs	£6.0m
- utilities, rental & service charges	£9.5m
- less property related income	(£3.5m)
■ Legal	£1.9m
■ Communications	£1.3m
■ IT	£1.4m

As in previous years, Ofgem's three main areas of spend continue to be those related to staff, accommodation and contractors.

## Staff

Staff numbers are continuing to fall. Current projections estimate that staff numbers will fall to 275 in 2005-2006. Ofgem has been able to contain additional work placed on it by Government without the need to increase overall staff numbers.

## Contractors

Although the cost of contractors is forecast to fall over the three year period to £5.4m, it is expected that contractor costs will increase in 2003-2004 due to work on British electricity trading and transmission arrangements and the distribution price control.

## Accommodation

Ofgem expects to contain rent increases through efficiency savings and is continuing its policy of disposing of surplus property. Ofgem has recently disposed of part of its estate at Leicester, inherited from DTI, and will seek to dispose of the remainder of its Leicester-based land and buildings following the outsourcing of the metrology function.

## Contingency

A contingency has been included in the budget projections. This amounts to £1.6m in 2003-2004, £2.0m in 2004-2005 and £2.5m in 2005-2006. The contingency is included to cover unforeseen work, some of which will be determined by factors outside of Ofgem's control.

## Appendix 3. Indicative costs for 2003-2006

### Ofgem 3 year budget

(£000)	2003-04 Total	2004-05 Total	2005-06 Total
<b>Promoting Competition</b>	<b>21,990</b>	<b>17,350</b>	<b>18,180</b>
British electricity trading and transmission arrangements	4,890	420	210
Electricity trading arrangements	2,140	2,070	2,270
Market surveillance	1,930	1,900	2,080
Gas trading arrangements	1,910	1,860	1,540
Industry codes	1,660	1,730	1,960
Europe	700	740	820
Supply competition & deregulation	1,870	1,950	2,150
Market infrastructure	1,140	1,190	1,270
Customer contact	780	810	910
Supplier failure & licensing	720	760	850
Compliance	1,000	1,030	1,160
Coordination & strategy	1,180	1,230	1,390
Metering	1,400	1,200	1,060
Connections	670	460	510

### Ofgem 3 year budget

(£000)	2003-04 Total	2004-05 Total	2005-06 Total
<b>Regulating Monopolies</b>	<b>10,560</b>	<b>12,970</b>	<b>11,580</b>
IGT	270	170	200
LDZ separation	200	190	420
NGC price control review	230	1,720	1,160
Transco price control review	340	850	3,040
Distribution policy	1,110	900	490
Scottish transmission price control review	400	410	0
Development price control	2,670	3,700	520
Regulatory finance	970	910	1,130
Quality of service	1,650	1,630	1,910
Technical	2,180	2,120	2,340
Metrology	540	370	370

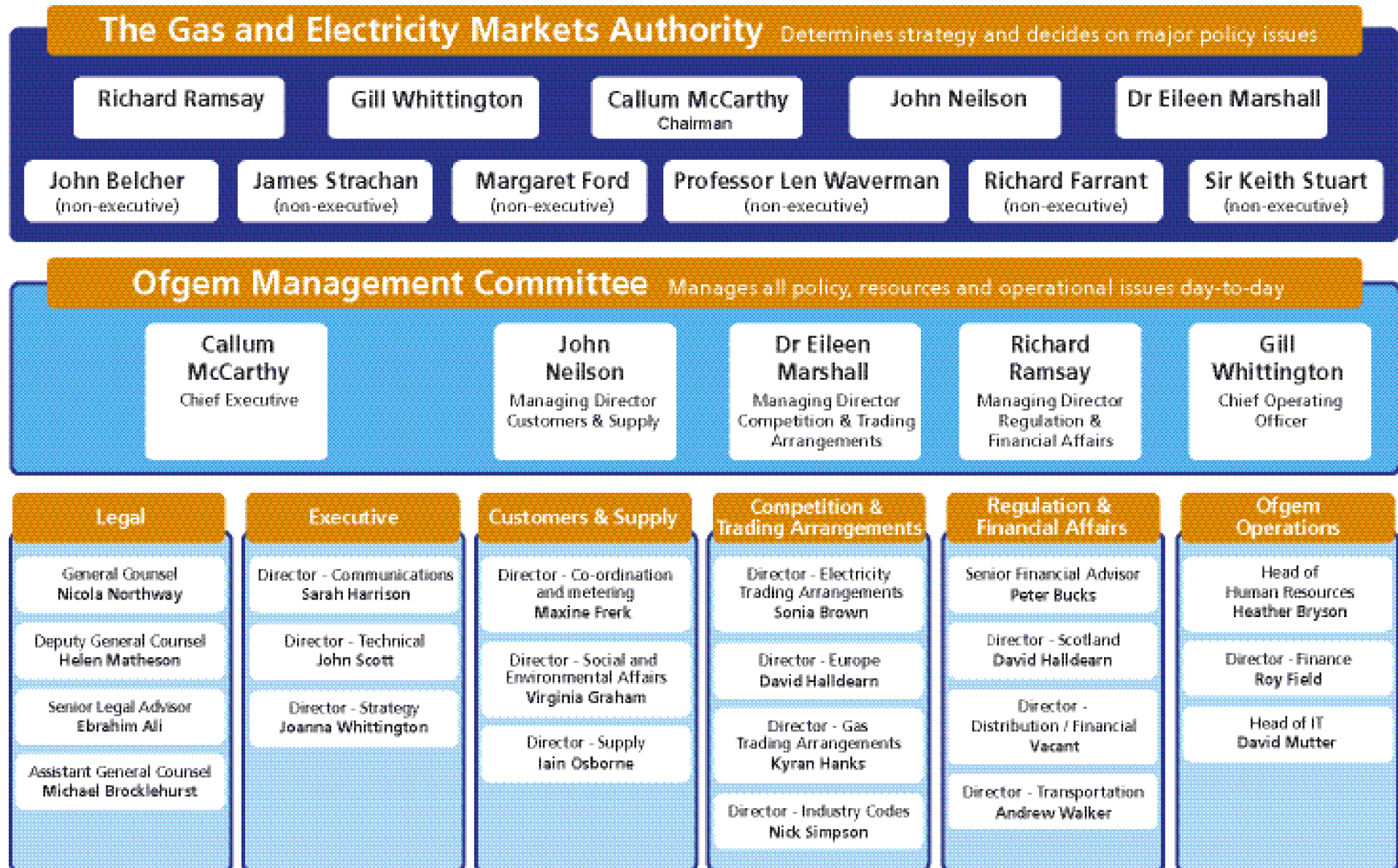
Indicative costs for 2003-2006 (continued)

<b>Ofgem 3 year budget</b>			
	<b>2003-04</b>	<b>2004-05</b>	<b>2005-06</b>
<b>(£000)</b>	<b>Total</b>	<b>Total</b>	<b>Total</b>
<b>Social &amp; Environment</b>	<b>4,320</b>	<b>4,060</b>	<b>4,440</b>
Social Action Plan	730	710	800
Environmental Action Plan	580	620	680
Renewables	1,060	910	940
Fossil Fuel Levy	170	180	230
Energy Efficiency	630	640	720
Combined Heat and Power	660	480	520
Distributed Generation	490	520	550
<b>Other costs</b>	<b>3,280</b>	<b>3,620</b>	<b>4,000</b>
Scotland Office	380	370	400
Depreciation	1,300	1,250	1,100
Contingency	1,600	2,000	2,500
<b>Total Costs</b>	<b>40,150</b>	<b>38,000</b>	<b>38,200</b>
<b>Non-licence fee income</b>	<b>(4,150)</b>	<b>(4,000)</b>	<b>(4,200)</b>
Property	(3,470)	(3,750)	(3,950)
Renewables / CHP	(680)	(250)	(250)
<b>Net cost to licence payers</b>	<b>36,000</b>	<b>34,000</b>	<b>34,000</b>

<b>Trends in staff numbers and contractor costs</b>					
	<b>2001-02</b>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>	<b>2005-06</b>
<b>(£000)</b>	Budget	Plan	Forecast	Forecast	Forecast
Staff numbers	334	320	300	290	275
Staff costs	14,416	14,400	14,500	15,300	15,500
Contractor costs	8,901	7,900	8,800	6,500	5,400



## Appendix 4. Ofgem corporate structure



For more information, visit our website at:

[www.ofgem.gov.uk](http://www.ofgem.gov.uk)



**The Office of Gas and  
Electricity Markets**

**Ofgem Headquarters**

9 Millbank, London SW1P 3GE  
**Tel** 020 7901 7000 **Fax** 020 7901 7066

**Ofgem Scotland**

Regents Court, 70 West Regent Street, Glasgow G2 2QX  
**Tel** 0141 331 2678 **Fax** 0141 331 2777