



ofgem

Promoting choice and value for
all gas and electricity customers



Ofgem
Ofgem Corporate Strategy
2004-2007
Corporate
Strategy
2004-2007

Foreword

We were grateful for the many detailed and thoughtful responses received on the draft Strategy, which was published for consultation in January 2004.

The contributions have been helpful in preparing the final version of the Strategy. In particular, we are placing greater emphasis on prioritisation and cost control, consistent with our commitment to the principles of better regulation. Where we did not follow the suggestions made, we have, as promised, provided some explanation on our website.¹

In parallel, we are also publishing a further consultation document: Ofgem's draft Corporate Plan.

The Corporate Plan is of key importance in that it sets out in more detail the workstrands, projects and resources that are needed to breathe life into our strategic ambitions. Comments are welcome on the draft Corporate Plan before the deadline of April 23 2004.

The Strategy itself remains firmly based on the need for continuity, coherence and predictability in the way we regulate. We remain committed to the principles of better regulation: proportionality, accountability, consistency, transparency and targeting. Within the inevitable

constraints of time and our limited resources, we will test policies in an open and rigorous fashion against the evidence and arguments provided, and explain the reasons for the approach we have chosen.

We intend actively to examine where we can further withdraw from regulating the energy industry, provided it would be in the best interests of consumers. We shall also make full and vigorous use of our enforcement powers under energy and competition legislation, thereby demonstrating our determination to keep our markets competitive and to ensure that companies comply with their licence obligations.

The seven themes we identified in our consultation document remain. Together, they identify our priorities for the coming three years. They are motivated by our wish to demonstrate continuity, coherence and predictability in the way we discharge our statutory responsibilities.

Our organisation

The new senior management team has completed its review of the organisation, following an extensive internal and external consultation process. The new structure reflects the seven themes and will, we believe, allow us to operate more efficiently, more cost-effectively and to prioritise our work.

¹ <http://www.ofgem.gov.uk>

Foreword (continued)

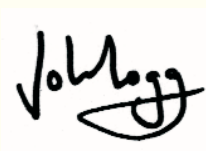
We have also committed to operating within a significantly reduced budget for 2004-2005 a cut from £36m to £34m - representing a reduction of six per cent from 2003-2004 (eight per cent in real terms).

This year, Ofgem will carry out the price reviews for the electricity distribution network operators (DNOs). From April 2005, Ofgem too will operate under an RPI-X budget cap. This commitment and the organisational changes will, we hope, demonstrate that we intend to take seriously not only what we do but also how we do it.

The new organisation comprises four policy divisions (Markets, Corporate Strategy, Networks, and Corporate Affairs), which provide a clear focus and commitment to:

- markets, bringing together wholesale, retail, and metering
- a long-term strategy, by providing the opportunity for strategic thinking on European and environmental issues, as well as other important issues

- our important network and price control functions, and
- provide for effective enforcement.



Sir John Mogg
**Chairman of the Gas and Electricity
Markets Authority**



Alistair Buchanan
Chief Executive of Ofgem

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1. Introduction

- 1.1** We received 30 detailed and thoughtful responses to the consultation on the draft Strategy. They have informed the final Strategy and the draft Corporate Plan which is published in parallel with this document for consultation. Where we have not followed respondents' suggestions, we have explained why.²
- 1.2** There are busy times ahead for Ofgem, with the possibility of more enforcement action, the proposed sale of gas distribution networks, merger activity and more intense activity at the European level. The latter includes the modernisation of European competition laws and the negotiation and implementation of gas and electricity legislation. There is also much detailed work associated with creating a competitive wholesale electricity market across Great Britain, the provisions for which are established in the new Energy Bill currently going through Parliament.

Ofgem's statutory responsibilities

- 1.3** Ofgem's principal objective is to protect the interests of consumers present and future, wherever appropriate by promoting effective competition.³ We must also have regard to:
- the need to ensure that all reasonable demands for electricity and, so far as is economical, gas are met

² in a document available from the corporate planning section of the Ofgem website

³ Ofgem's powers are provided for under the Gas Act 1986 and the Electricity Act 1989, as amended by the Utilities Act 2000 (itself amended by the Sustainable Energy Act 2003). It also has powers under the Competition Act 1998 and the Enterprise Act 2002.



(Ofgem's statutory responsibilities continued)

- the need to ensure that licence holders are able to finance their obligations, and
- the interests of those consumers who are disabled or chronically sick, of pensionable age, on low incomes, or living in rural areas.

1.4 We are also required to carry out our functions in the manner which we consider best calculated to:

- promote efficiency and economy
- protect the public from dangers, and
- secure a diverse and viable long term energy supply.

1.5 Furthermore, we must have regard to the impact of the gas and electricity industries on the environment, and to the Government's recently re-issued social and environmental guidance.

Themes

1.6 The seven strategic themes were widely supported in the consultation and they will serve as the key focus to our work. However, while some respondents argued for a further stage of prioritisation between the themes, we believe that it is difficult to raise any one above the others, not least given the close interrelationship that exists between them.

1.7 Some of the themes are new and some are well-established, thereby underlining our desire to combine a continuity of regulatory approach with some new thinking. Since the

consultation was undertaken, a major organisational and budgetary review has been carried out. The new structure reflects the themes and will provide a more focused approach to delivery. The draft Corporate Plan similarly reflects the themes, and demonstrates our operational prioritisation, as does the cut in the number of deliverables from 51 to 43. Comments on the draft Corporate Plan are welcome by April 23 2004, for finalisation by May 2004.

Budgetary control

1.8 As we have explained in the foreword, we shall continue to focus on controlling our costs. We have already committed to a 2004-2005 budget that is six percent below 2003-2004. Later this year the Audit Committee of the Authority will undertake a detailed scrutiny of our cost base and from April 2005 we will work under an RPI-X budget cap. Given the intensification of our workload this will not be easy.

Better regulation

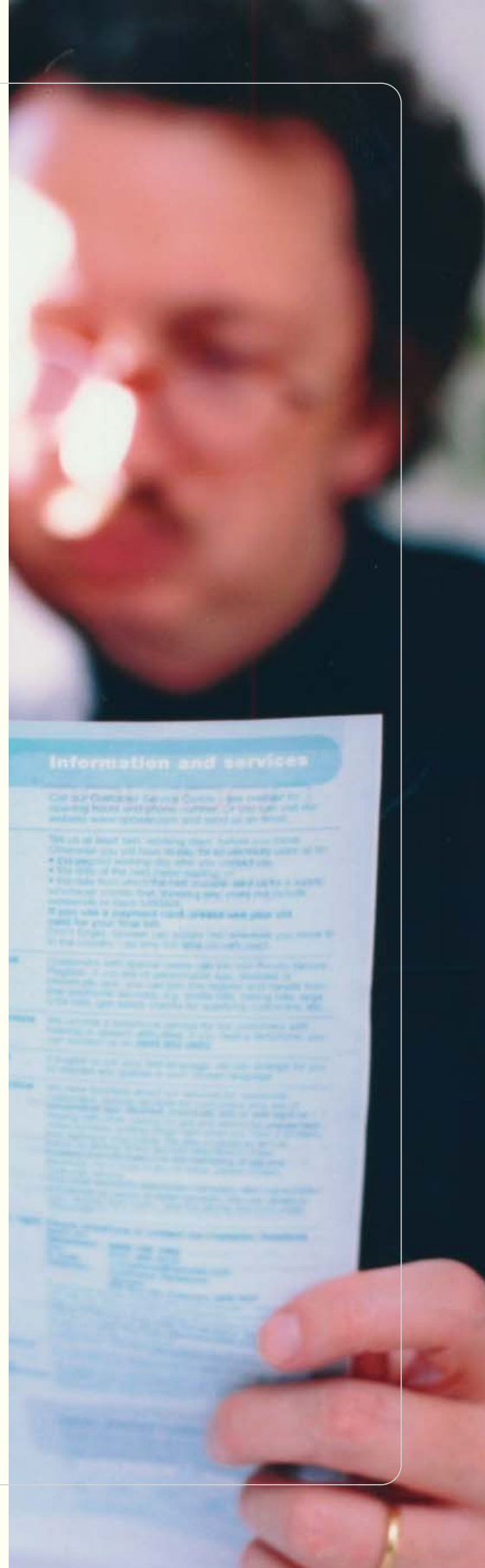
1.9 We will also place particular emphasis on better regulation and its key principles of proportionality, accountability, consistency, transparency and targeting. The Government has recently responded to a report by the Better Regulation Task Force on independent regulators. In virtually all respects, Ofgem has met the Task Force recommendations. We are, however, now reviewing those that remain to consider their appropriate application to our work.

2. Creating and sustaining competition

- 2.1** Where competition is established, we will make sure that it continues to work well for all consumers. Where it is not yet established, we shall, wherever appropriate, work to introduce and sustain it. We shall seek to introduce competition only where we consider that this will be an effective way of protecting consumers' interests. In line with the principles of better regulation, any important proposal we make will be underpinned by a regulatory impact assessment (RIA), weighing costs and benefits (quantitatively wherever practical), and providing a means for interested parties to provide comments and challenge our assumptions.
- 2.2** Reflecting the emphasis we place on creating and sustaining competition, the benefits of a consistent approach and the need for cost-effective monitoring of markets, our recent organisational changes have brought together activities relating to competitive markets, and markets where competition has recently been introduced, within the Markets division.

Wholesale markets

- 2.3** The wholesale electricity market in England and Wales has been highly competitive since the introduction in March 2001 of new electricity trading arrangements. We shall continue to place strong emphasis on effective wholesale market monitoring, notably to deter any behaviour by companies that might harm consumers, for example, by heightening threats to security of supply, or damaging competition. As industry structures



(Wholesale markets continued)

and company strategies evolve, and external influences such as environmental legislation change, such targeted and effective monitoring will be crucial. The new Markets division's responsibilities will provide efficient and cost-effective monitoring of both wholesale and retail markets.

- 2.4** When enacted, the Energy Bill currently before Parliament will, together with the full co-operation of the energy industry, extend the present electricity trading and transmission arrangements in England and Wales to Scotland, thereby creating common arrangements across Great Britain. We shall commit the resources necessary to the delivery of a single electricity market across the whole of Great Britain in April 2005.
- 2.5** The special features of energy markets (notably the need for supply and demand to be matched over short timescales), together with our established expertise, make Ofgem the most appropriate competition authority to monitor these markets. Wherever evidence of market abuse is found, we will take effective action, by using our competition or regulatory powers, particularly to enforce companies' compliance with their licence and statutory obligations, including the Competition Act 1998. The bringing together of the enforcement responsibility within the new Corporate Affairs division will ensure that we do this quickly and effectively and follow due process in any action that we take.

- 2.6** Companies and consumers may propose changes to the industry agreements that sit at the heart of the electricity and gas markets. Market evolution often requires the industry to make modification proposals, and Ofgem to approve or reject them and explain our decisions clearly. Proper governance of the modification process is essential to ensure that changes promote competition and take consumers' interests fully into account. Ofgem will publish RIAs in respect of important changes.
- 2.7** With the Department of Trade and Industry (DTI), Ofgem will also seek to improve access to wholesale market information, particularly in relation to offshore gas production.

Retail markets

- 2.8** We continue to believe that competition offers the best protection for the interests of energy consumers. This motivated Ofgem's decision to remove the remaining retail price controls in March 2002. We will continue to take action to remove any barriers that prevent the further development of retail competition, and work to ensure that all consumers, particularly the most vulnerable, have access to the benefits it brings.

(Retail markets continued)

- 2.9** We remain committed to withdrawing from regulation of retail markets where appropriate. Retail competition at the domestic level continues to mature, although incumbents are still dominant, and the number of consumer complaints to energywatch remains high. Where necessary, therefore, specific regulation of certain aspects such as marketing will continue, given ongoing consumer concerns. Ofgem remains committed to ensuring that all consumers - particularly those who are the most vulnerable - not only have the right to take advantage of supply competition, but do indeed benefit from competition. We shall review how consumers can find the information they need to be able to make informed choices. In some areas, for example, in respect of vulnerable consumers and the provision of consumer information, further targeted regulation may be required. In others, we may find the simplification, or even cessation, of Ofgem's involvement to be in consumers' best interests. In line with our commitment to better regulation, we will review whether supply licence conditions could be better targeted or work more effectively through co-regulation. We will also continue to monitor the development of competition, including reviewing the impact on consumers of brand independence between suppliers and electricity distributors.
- 2.10** We want all consumers to be aware of their right to switch supplier, and to be able to exercise this right easily and quickly. We shall identify possible improvements in the way the market works, in particular by improving the process for consumers to switch from one supplier to another. Close collaboration with energywatch is critical, notably in dealing with any consumer concerns it identifies, and in developing consumer awareness of the benefits of switching - building, for example, on initiatives such as our 'Switched On' educational resource for schools.
- 2.11** Again, as part of our commitment to better regulation, and in order to retain and improve consumers confidence in the competitive market, we shall examine closely how suppliers market their services. We will do this by focusing on consumers' experience of dealing with companies. We will also maintain a close dialogue with representatives of industrial, commercial and domestic consumers, particularly in relation to market investigations.

Industry structures

2.12 The structure of the gas and electricity industries continues to evolve through mergers, acquisitions and divestments, and in response to Ofgem's work to create and sustain effective competition. We shall keep under review the structure of gas and electricity markets in terms of its impacts on consumers and competition. Companies and capital markets must retain the freedom to seek and adopt innovative and more efficient corporate structures, where these continue to support effective competition. Mergers and other corporate restructurings can produce synergies and efficiency savings that will directly benefit consumers. However, mergers and acquisitions can also lead to a degree of consolidation that might result in a substantial lessening of competition. Where regulated network businesses are involved, mergers could also reduce, or even eliminate, our ability to use comparative information to improve efficiency when setting price controls.

2.13 With this in mind, we shall examine how markets evolve by:

- assessing merger and acquisition proposals in order to advise the relevant competition authorities
- examining whether structural changes to introduce competition or to make it more effective would be in consumers' best interests, and
- developing the ways we analyse the incentives that result from consolidation and vertical relationships, and continuing to monitor companies' behaviour.

Metering and connections

2.14 Following our consultation, there were some concerns expressed about the recent introduction of greater competition into the metering and connections markets. Competition is still in the early stages of development. The industrial and commercial metering market is becoming more competitive, and competition is beginning to emerge in domestic metering. It is of central importance that the necessary industry processes are in place to support competition, and that price controls remain where competition is not yet effective. We are also sensitive to the calls for more to be done to encourage innovative metering, given its potential social and environmental benefits, and we shall work with the industry to identify any potential barriers.

3. Regulating network monopolies

- 3.1** Ofgem regulates the level and structure of the prices charged for using the monopoly gas and electricity networks. To allow us to work more efficiently and cost-effectively, and to promote consistency of treatment, the regulation of the distribution and transmission network owners has now been brought together within the new Networks division. New five-year price controls on electricity distribution network operators will take effect in April 2005. We intend to align the timing of the gas and electricity transmission price controls across the whole of Great Britain, with the new controls taking effect from April 2007. Separate controls for the individual gas distribution networks will be introduced, and we have proposed that the next gas distribution price control should take effect from April 2008.
- 3.2** Across all network sectors, we remain committed to incentive regulation as the best way of protecting the interests of consumers. We shall, wherever practicable, focus on regulating outputs rather than inputs, concentrating on what companies deliver in terms of service to their customers, rather than on how they deliver it. Companies must, of course, meet their statutory and licence obligations. If they do so and at the same time out-perform their price control targets, they should earn higher returns. Conversely, those companies that do not meet their obligations run the risk of financial penalties, and those that under-perform risk earning lower returns.



3.3 Incentive regulation works best when the regulator establishes a clear, transparent and predictable framework that is not too rigid in the face of uncertainty. This approach allows the companies room to manage and innovate without the regulator being overly prescriptive or intrusive. Our approach to network regulation will, nonetheless, evolve, reflecting our desire to:

- adopt a consistent approach across the networks, and apply simple solutions where these are effective
- improve incentives to invest while promoting efficiency
- make network operators more responsive to the changing needs of their customers
- maintain network security of supply, and
- meet new challenges such as renewables and distributed generation.

Incentives to invest

3.4 In response to the Government's policies designed to drive up the use of renewable generation, and as a result of our increased reliance on gas imports in the next decade, significant network investment will be needed. We are already working on improved investment incentives for electricity distribution network operators, to encourage the growth of distributed generation, for electricity transmission in respect of new renewable generation and, for gas transmission, to respond to major investments in Liquefied Natural Gas (LNG) import terminals and new interconnectors. We will also seek reform to the arrangements for rights to gas

network exit capacity, to make them more responsive to network customer demands.

3.5 In gas transmission, since 2002 there have been stronger financial incentives on National Grid Transco (NGT) to invest in response to signals from its customers of demand for new entry capacity. These new arrangements are designed to provide NGT with better information and incentives to encourage a rapid response to its customers' changing requirements.

3.6 In electricity transmission, under the proposed arrangements for a single electricity market, NGT will be responsible for operating the electricity transmission system for the whole of Great Britain. We shall review and develop schemes to put in place longer-term incentive arrangements that provide a stable framework to allow NGT and the other transmission owners to invest, innovate and reduce costs. It will be particularly important to introduce arrangements to take account of the increase in renewable generation required to meet the Government's environmental objectives.

3.7 Many of the proposed renewable generation projects are in geographically remote areas and may require significant transmission investment to transport electricity to consumers. We shall be guided by our statutory responsibilities to ensure that necessary and efficient investment is made in a timely manner, minimising the risk that consumers may have to pay for unused transmission assets. Future price controls on electricity transmission will need to provide incentives for efficient investment.

(Incentives to invest continued)

When investment is required in the near future but was not taken into consideration in setting the current price controls, we are developing mechanisms to meet such challenges quickly and effectively.

- 3.8** The new incentive framework in electricity distribution is intended to encourage electricity distribution companies to invest efficiently in the reinforcement of their networks, and to develop and apply innovative solutions to reduce the costs of doing this. Reforms to the arrangements for distribution charges have also been proposed in order to provide fairer charges for new generators. This combination of measures is needed to encourage the efficient connection of new renewable and Combined Heat and Power (CHP) generators.


Responsive to customers

- 3.9** Consumers' interests are at the heart of our statutory responsibilities. These interests will continue to be protected by measures in the monopoly network price controls that encourage improvements in efficiency. Since privatisation, such measures have proved extremely effective in reducing charges paid by consumers. Improved incentives for the network operators to improve service to their customers are also being developed, and are likely to be an increasingly important theme of future price controls. In electricity distribution, for example, our approach has focused on the number and duration of interruptions to consumers' supply. We are also conducting research into network customers' attitudes towards quality of supply, and their willingness to pay for improvements in, for example,

network reliability and resilience. We will continue to investigate the introduction of clearer incentives for improved performance in the event of severe weather. In gas distribution, we will introduce a new quality of service incentive scheme for implementation in April 2005.

Local gas distribution

- 3.10** NGT owns and operates the national gas transmission system and all eight local gas distribution network (DN) businesses in Great Britain. Last year, NGT announced proposals to sell one or more of the DNs, an action which requires the Authority's approval.
- 3.11** Ofgem has identified potentially significant benefits for consumers from more diverse ownership of the DNs. However, a number of concerns have been expressed by industry and some customers about the potential costs and benefits of the proposals. We are currently establishing a better understanding of these issues. We are also developing the regulatory, commercial and operational arrangements that would support a DN sale. As Ofgem announced in November 2003, the planned sale of DNs must demonstrate concrete benefits to consumers before it can go ahead, and a provisional cost – benefit analysis will be considered by the Authority in April 2004. The Authority will decide if it appears to be in consumers interests to allow work on the sale to continue and, if so, a series of RIAs will be issued concerning the commercial and regulatory structure of the industry, with the objective that all significant decisions on these matters should be made by the end of summer 2004.



4. Helping protect security of Britain's energy supplies

- 4.1** Since privatisation, security of supply has been maintained at a high level by historic and international standards, while the quality of supply in electricity has been improved. There have been no interruptions of firm loads due to insufficient generating capacity or gas supplies. Similarly the reliability of networks remains high. Nevertheless, given recent experience in Great Britain and internationally, there have been considerable concerns expressed, most recently in the report of the Trade and Industry Select Committee on network resilience.
- 4.2** Security of supply requires:
- sufficient electricity generation, gas production and storage capacity to meet peak demands
 - sufficient network capacity to transport gas and electricity to consumers, and
 - effective balancing arrangements to ensure that the system operator can keep the system in balance over the short-term.
- 4.3** There is an important judgement to be made between the costs and benefits of improving security of supply. No energy supply system can deliver absolute security at all times. While we must avoid any hint of complacency, we must avoid the risk that consumers are required to pay excessive costs to 'gold plate' infrastructure.

Informing the debate

- 4.4** Security of supply is a strategic priority for Ofgem. We have pursued a consistent approach over several years, based on the belief that a combination of competitive wholesale and retail energy markets, statutory and licence obligations, and appropriate incentive arrangements for network operators, is the best way of maintaining security of supply.
- 4.5** Security of supply is a policy concern that runs across the whole of our organisation. Our role is to contribute to an informed and reasoned policy debate, and to provide reliable information and analysis for an open debate on how competitive energy markets and effective network regulation can continue to promote security of supply. Bringing together our retail and wholesale market monitoring activities and our security of supply team within our Markets division will facilitate this. In the Joint Energy Security of Supply (JESS) working group, the DTI and Ofgem assess security of supply and, every six months, publish forward-looking indicators. Ofgem will continue to publish retrospective reports twice yearly, setting out levels of security achieved, relevant events and any lessons learned. We shall also assess the impact of important policy initiatives on security of supply through our RIAs.

Making markets work

- 4.6** Markets have worked well in delivering security of supply. There has been significant investment in Great Britain's energy sector since privatisation, particularly in recent years. Indeed, in recent months companies brought significant amounts of mothballed electricity generation back onto the system in response to higher prices and lower forecast reserve margins during the 2003 winter months.
- 4.7** The gas market has also responded to the challenges posed by declining UK gas production. Companies have announced plans to invest in new storage facilities, and new LNG terminals and new pipelines to import gas from continental Europe and other countries. In relation to the wholesale markets, and within our statutory responsibilities and other relevant obligations, we will consider appropriate changes to the market rules and industry codes that improve security of supply. We shall also ensure that companies behave in a manner consistent with market rules, their licence obligations, and general competition law.

4.8 We shall continue to monitor, with the DTI, security of supply indicators to see that markets are delivering the investment required. Potential problems and possible improvements to the existing arrangements, including rule changes that would improve security of supply, will be identified. We should, however, reiterate a point made in our earlier consultation document - we have no evidence to support the argument that capacity payments are necessary to promote, or would be cost-effective at increasing, security of supply. Moreover, gas and electricity consumers can themselves make a contribution to security of supply by responding to price signals and reducing demand, particularly during periods of peak demand. Over time, their contribution may be of increasing importance.

Network investment

4.9 Adequate network capacity is needed to transport available supplies to consumers. Ofgem will improve the information available to network operators on which to base their assessment of the need for new investment. We shall also improve the financial incentives on network owners to invest quickly and efficiently to meet these needs, and develop incentives to maintain the quality of supply on their networks.

4.10 Innovative new arrangements are now in place or being actively considered. They include auctioning of long term rights to gas network entry capacity to improve the information available to NGT about the need for new capacity. Arrangements such as these enhance security of supply by reducing the risk of network constraints and reducing the time it takes NGT to deliver extra capacity. We will consider whether the provision of information can be improved in other areas.

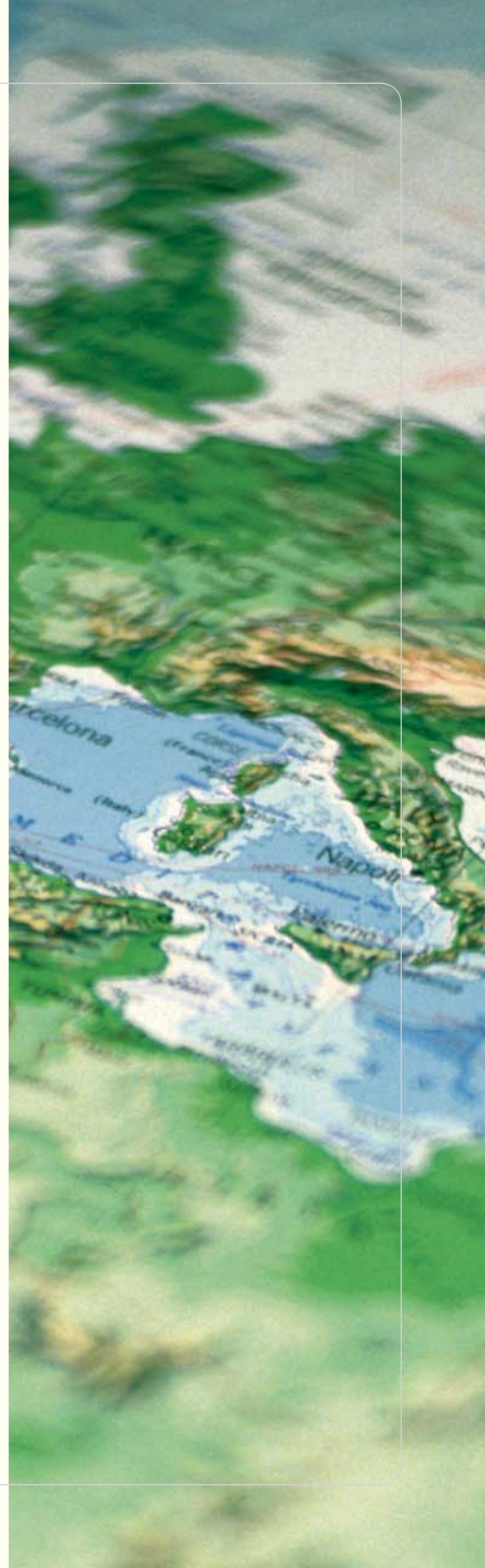
4.11 For electricity, the challenges of accommodating significant volumes of renewable generation over the next few years will require us to work with all stakeholders. We shall improve the incentives on the transmission companies and the distribution network operators not only to invest efficiently in extra capacity but also to improve the quality of information on which such investment decisions are based.

4.12 Cost-reflective network charging is important in order to encourage all network customers to consider how using the networks at peak periods can be avoided to ease the pressure on security of supply and adding to the need for network investment.

5. A leading voice in Europe

Influencing and shaping the debate

- 5.1** European energy markets and EU regulatory policy have an increasing influence on energy markets and consumers in Great Britain. Our broad objective remains to assist in developing genuinely competitive European electricity and gas markets as quickly as is feasible, bringing price and security of supply benefits to consumers in Great Britain.
- 5.2** Prices in the wholesale gas market in Great Britain are driven by those in continental Europe, where competition is not yet fully developed. Recently, prices have been rising, affecting both gas and electricity consumers, since gas-fired power stations have a significant share of the generation mix. Also, the commercial and physical links between the gas markets in Great Britain and continental Europe will be strengthened significantly by plans for major new gas pipelines and LNG import terminals. This underlines the importance of our efforts to bring about reforms within the EU as a way of enhancing competition in European gas markets.
- 5.3** In addition, the England–France electricity interconnector plays a significant role in the electricity market, particularly at peak periods during winter. New electricity interconnectors have also been proposed.



5.4 New EU legislation, specifically for gas and electricity, but also dealing with environmental policy, will require implementation in the next few years. Proposals on security of supply have also recently been made. This legislation will have a significant impact on the way we regulate gas and electricity markets in Great Britain and, perhaps of even greater long-term significance, will be the new regulatory machinery this legislation establishes at the European level.

5.5 Ofgem's objective will be to engage more fully with other EU regulators and the European Commission, in addition to continuing our close work with the DTI on European energy issues. This higher profile of European policy is reflected in the new Corporate strategy division.

5.6 We continue to work closely with the DTI to make sure that the rapidly emerging energy legislation is consistent with Great Britain's needs. The European Commission has very recently established an advisory group of energy regulators (ERGEG), whose membership is identical to the Council of European Energy Regulators (CEER). Ofgem's Chairman has been appointed as a vice-chairman. In providing overall co-ordination and direction to the major efforts now underway in many technical groups for both electricity and gas, this group will play an increasingly fundamental and important role in the exercise of the Commission's regulatory powers. It must have the resources and expertise to provide timely and credible advice, and to consult

actively with the market on its work. It will benefit from a significant investment of resource and expertise by Ofgem.

5.7 We shall work to influence key Member States' implementation of European legislation and regulation to ensure that there is effective access to continental gas and electricity networks, and that, for Great Britain, markets are recognised as delivering security of supply more effectively than centralised arrangements. Given an increasing reliance on interconnectors, the interests of consumers in Great Britain are directly affected, to a greater extent, by the way in which European legislation and regulation is implemented in other Member States. Many of the companies active in Great Britain's energy markets have significant interests elsewhere in Europe or beyond, and EU market structures must not undermine liberalisation efforts.

6. Helping protect the environment

- 6.1** In 2003, the Energy White Paper outlined the Government's objectives for energy policy and set the UK on a course to reduce carbon dioxide emissions by 60 per cent by 2050. A key element in delivering this commitment will be the EU's greenhouse gas emissions trading scheme. Ofgem's statutory responsibilities include having regard to the impact of gas and electricity industries on the environment, and to the recently re-issued social and environmental guidance from the Secretary of State for Trade and Industry. This sets our work in the context of the broader environmental and social policy. This includes, in particular, the Climate Change Programme, designed to implement the UK's Kyoto commitments, and the Sustainable Development Strategy. We also have an important role to play in administering major Government programmes designed to achieve these targets and to improve domestic energy efficiency.
- 6.2** Ofgem's work on the environment and on European issues is brought together within the new Corporate Strategy division. A senior-level external group (the Environmental Advisory Group) provides advice on our environmental priorities. Its members include senior industry figures, representatives of green groups and academics. Monitoring environmental outputs as part of the regulatory process is of major importance. We will continue to improve the environmental analysis that informs our own policy decisions, as well as the wider environmental debate within Government. In this, our panel of environmental economists will play an important role.



The low-carbon economy

- 6.3** Ofgem will continue to encourage the delivery of future environmental policy in a form compatible with competitive energy markets. We shall encourage environmental improvements in ways that secure good value for money for consumers. We shall continue to advise ministers on the design and implementation of emissions trading schemes - not only the EU-wide greenhouse gas emissions trading scheme, but also schemes for sulphur dioxide and oxides of nitrogen.
- 6.4** There are clearly major challenges for the electricity networks to accommodate and make use of new renewable and CHP generation in an efficient manner, and our response to these has been discussed above (see page 12). In addition, we shall, with the DTI, develop a licensing scheme for off-shore transmission cables to connect off-shore renewable generation to the on-shore transmission network.
- 6.5** Ofgem will work with Government on the scale and scope of the new Energy Efficiency Commitment (EEC). This aims to reduce emissions of carbon dioxide from domestic household energy consumption, and, together with other social programmes, to reduce the numbers in fuel poverty. We will also contribute to Government work on reviewing the Renewables Obligation.

- 6.6** Government environmental programmes - the Renewables Obligation, the exemptions from the Climate Change Levy for renewables and CHP, the Renewables Guarantees of Origin, the EEC and the CHP database - will be administered as efficiently and effectively as possible.

Environmental Action Plan

- 6.7** Ofgem's Environmental Action Plan has been reviewed annually since it was first published in 2001. We shall now take forward several significant initiatives to improve consumer awareness of the environmental consequences of their energy use. In co-operating with the DTI on the implementation of EU requirements, we shall identify the best way of disclosing to consumers the sources of the electricity they consume. We will also explore with suppliers different ways of better informing their customers about their energy use, and we shall evaluate the effects of this.
- 6.8** We shall pay particular attention to the results of the second survey on the quality of energy efficiency advice provided by energy suppliers to their customers, recognising that, if energy prices continue to rise, the benefits to consumers of investing in energy efficiency to reduce their energy bills will also increase. We shall update our green supply guidelines to take account of recent developments in the renewables market, and seek to have these offerings independently accredited.

- 6.9** Following consultation on a major pilot project in which suppliers are permitted to offer domestic consumers energy service packages linked to longer term supply contracts than are possible under the normal 28-day rule arrangements, we will evaluate its benefits, balancing the need for appropriate safeguards to consumers, with the need to allow companies sufficient encouragement to offer energy services to the market.
- 6.10** More generally, we shall explore the potential for improving the ease with which consumers can benefit from responding to prices, for example, by reducing their use of electricity during peak periods when prices are high. We shall also study the potential for reducing losses from the electricity transmission and distribution networks.



7. Helping tackle fuel poverty

- 7.1** Ofgem has a specific duty to have regard to the interests of vulnerable consumers - those who are disabled or chronically sick, of pensionable age, living on low incomes, or in rural areas. The recently re-issued social and environmental guidance from the Secretary of State for Trade and Industry includes specific reference to the Government's fuel poverty strategy, which aims to eliminate fuel poverty among vulnerable households by 2010, and all households by 2016.
- 7.2** The Social Action Plan provides the framework within which we shall take forward our work. Good progress has been made on debt and disconnection, payment methods, special services for vulnerable consumers, and energy efficiency advice. We shall now act to:
- remove any barriers to innovative metering that could lower the costs for consumers with prepayment meters
 - mount a joint initiative with utility companies and consumer groups on payment methods for consumers on benefits
 - follow up earlier work with suppliers to reduce the incidence of self-disconnection
 - improve the provision of energy efficiency advice, particularly to those who would benefit most, and
 - monitor the effectiveness of companies' debt prevention strategies.

Energy prices

7.3 During a period of falling prices, there has been considerable progress in tackling fuel poverty in recent years - numbers in fuel poverty fell from 5 million in 1996 to an estimated 2.5 million in 2002. However, even small increases in energy prices - and future increases could well be significant - could, in the absence of other action, increase the number of households in fuel poverty. We must act to ensure that all parties maintain their focus on competitive energy markets and efficient network operation to avoid a resurgence of fuel poverty. In developing new policies, we will pay particular attention, in our RIAs, to assessing their impacts on vulnerable consumers.

7.5 In all of this work, the active involvement of industry is essential. We shall intensify our co-operation to identify imaginative solutions, and encourage the development of best practice, for example in developing new tariffs for vulnerable consumers. We shall also complete collaboration with suppliers and distributors on the provision of special services to these consumers.

7.6 We will encourage the Government to develop cost-effective energy efficiency schemes to help reduce fuel poverty. We shall use our expert knowledge of the sector to target support to where it is most needed and can be used most effectively .

Working with Government, industry and energywatch

7.4 With industry and energywatch, we shall consider ways of measuring the risk of consumers slipping into debt to energy suppliers. Where that is not possible, we will explore how such debt can be managed sensibly and efficiently, using available opportunities to switch supplier. We will collaborate closely with energywatch to improve the way advice about the benefits of switching can be targeted to help vulnerable consumers. In addition, we shall explore ways of improving their access to energy efficiency advice and to measures already available from suppliers at no cost that allow vulnerable consumers to have warmer homes.

8. Improving Ofgem's efficiency and effectiveness

8.1 Some companies - our licence fee payers - have suggested that Ofgem's direct costs are too high and that we employ too many staff. Although our direct costs remain relatively small - £34 million in 2004-2005 - in relation to the responsibilities we discharge, and the size of the companies and industries we regulate, we recognise that our work imposes costs on the industry and on consumers. We therefore reviewed the way we organise ourselves, and introduced a new structure which will allow Ofgem to reduce its running costs without compromising the quality of our work. In addition, a detailed audit of Ofgem's cost base will take place during 2004, and will be verified by the Authority's Audit Committee. We will also commit to an RPI-X budget cap for five years from April 2005.

8.2 We also recognise that we impose indirect costs on companies, including costs associated with engaging with, and responding to, Ofgem consultations. We will therefore examine how to improve the consultation, reporting and review processes we have in place - continuing to work openly and transparently, since consultation is a key component of our decision-making process. We will seek to make our publications more concise, clearer and better focused.

(Improving Ofgem's efficiency and effectiveness continued)

We shall also seek to engage industry and consumers in our RIA process, since it is these stakeholders who are often better placed to provide information on likely implementation costs. Our decisions must continue to be based on the most reliable information, with supporting evidence and objective analysis.

8.3 It is, however, the decisions that we make that have the most significant financial implications for the industry, rather than Ofgem's direct or indirect costs. High quality decision-making based on sound, well-researched analysis, the firm commitment to our statutory responsibilities, the principles of better regulation, and the attraction and retention of high quality staff, are key.

8.4 We remain committed to bringing best practice to all that we do and delivering value for money. We shall regularly review the way we prioritise our work. As part of that commitment, we will spend no more in 2004-2005, than the £34 million proposed in our March 2003 Corporate Plan (a six per cent reduction from 2003-2004, or an eight per cent reduction in real terms). The draft 2004 Corporate Plan that is published with this Strategy for consultation, ending April 23 2004, contains details of our workplan and priorities.

8.5 The creation of our new Corporate Affairs division will allow us to maintain a proper focus on our internal decision-making processes, including the formal decisions taken by the Authority. We are also working with the DTI on Government proposals to introduce an efficient and proportionate appeals mechanism through the Energy Bill.



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