

## Corporate Strategy and Plan 2006-2011

**Document Type: Consultation**

**Ref: 13/06**

**Date of publication:** 13 January 2006

---

**Overview:**

In August 2005, Ofgem published an open letter seeking views on the key challenges and priorities for the next five years. This document sets out our proposed strategy, developed in the light of the responses to this letter, and provides stakeholders and interested parties with a further opportunity to comment.

The Authority will publish its final Corporate Strategy and Plan by the end of March 2006.

**Contact name and details:** Andrew MacFaul, Head of Better Regulation and Co-ordination

**Tel:** 020 7901 7083

**Email:** [andrew.macfaul@ofgem.gov.uk](mailto:andrew.macfaul@ofgem.gov.uk)

**Team:** Corporate Affairs Division

---

**Deadline for response:** 27 February 2006

**Target audience:** All stakeholders and licensees

**Ofgem, 9 Millbank, London SW1P 3GE**

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

## Context

Each year Ofgem publishes a Corporate Strategy setting out our work programme and budget for the next five years.

## Associated Documents

- Ofgem Corporate Strategy and Plan 2005-2010, March 2005 (Ref. No. 106/05)  
[http://www.ofgem.gov.uk/ofgem/documents/corp\\_plan\\_2005\\_2010.pdf](http://www.ofgem.gov.uk/ofgem/documents/corp_plan_2005_2010.pdf)
- Corporate Strategy initial consultation letter, August 2005 (Ref. No. 185/05)  
[http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/12131\\_CSconsultation.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/12131_CSconsultation.pdf)
- Responses to initial consultation letter (Ref. No. 185/05)  
[http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/corporateplanning&levelids=,1\\_11359#top11359](http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/corporateplanning&levelids=,1_11359#top11359)

## Table of Contents

Foreword	1
Introduction	3
1. Creating and sustaining competition	4
2. Regulating network monopolies	8
3. Helping protect the security of Britain's energy supplies	11
4. A leading voice in Europe	15
5. Helping to protect the environment	17
6. Helping to tackle fuel poverty	21
7. Better regulation	23
Appendix 1 - Consultation Response and Questions	26
Appendix 2 - Ofgem's Statutory Responsibilities	27
Appendix 3 – Deliverables and Performance Indicators 2006-2007	28
Appendix 4 - Ofgem budget 2006-2010	34
Appendix 5 - Glossary	38
Appendix 6 - Feedback Questionnaire	40

## Foreword

This document sets out Ofgem's proposed Corporate Strategy over the next five years to 2011.

The Strategy is being developed in challenging and changing times for energy consumers and the energy sector.

The faster than expected decline in North Sea gas production has seen the margin of gas supply over demand for this winter, and next, tighten and prices increase. Major price rises have been felt by all consumers but it has been a particularly difficult time for industry and business, who are major users of energy, and for the fuel poor.

Pressure on prices should ease over the next two to three years as £6 billion of infrastructure investment allows Britain to draw on new gas supplies from imported sources. During this period of transition, Ofgem's focus will also be on working wherever we can, both here and in continental Europe, to ensure that markets operate efficiently and effectively for consumers.

The Government's 2006 Energy Review will assess progress against the 2003 White Paper goals and consider whether further measures may be needed to achieve them. As well as security of supply, environmental concerns will be a key consideration of the Energy Review as of the Climate Change Programme and Stern reviews. Within its statutory responsibilities, Ofgem intends to play a full part in these reviews, contributing our expertise in energy markets and on measures to deliver reliable, sustainable and affordable energy supplies.

We are at a crucial stage in the development of liberalised energy markets across Europe. In October 2005, the Commission identified 'serious malfunctions' in EU energy markets. 2006 may well prove decisive in whether or not these problems are tackled successfully and the goal of fully liberalised energy markets is realised. Here too, Ofgem will be taking a leading role on behalf of consumers.

In the UK and across the EU, steps are also being taken to promote better regulation. Ofgem is committed to better regulation - regulating only where necessary and operating transparently and firmly within our statutory remit for the benefit of consumers and business. We will also continue with initiatives, including the present 'new look' consultation document, to improve accessibility for all our stakeholders.

In developing our corporate strategy so far our watchwords have been consistency, coherence and predictability. In a period of major change they remain our fundamental objectives whilst we adapt policy in response to new challenges and policy initiatives from Government and the EU. We propose to maintain the seven corporate themes which have driven our work to protect consumers. However, we intend to revisit this strategy later in 2006, in particular in the light of the Energy Review and progress on the EU's liberalisation strategy.

We invite your views on our proposals. We also hope that that you will join the Authority's first public session on 23 February to debate this strategy and our projects for the coming year.

A handwritten signature in black ink, appearing to read 'John Mogg'. The signature is stylized with a large 'J' and a prominent 'M'.

**Sir John Mogg**  
**Chairman, Gas and Electricity Markets Authority**

A handwritten signature in black ink, appearing to read 'Alistair Buchanan'. The signature is written in a cursive style.

**Alistair Buchanan**  
**Chief Executive, Ofgem**

## Introduction

### Questions

→ **There are no specific questions raised by this section.**

In August 2005, Ofgem published an open letter seeking views on the key challenges and priorities for the next five years. The responses to this letter are on our website. The present document sets out our strategy, developed in the light of the responses to that letter, and provides stakeholders and interested parties with a further opportunity to comment. Appendix 1 gives details of how to respond to this consultation.

Ofgem's remit is to protect the interests of consumers where appropriate by promoting competition. If competition cannot protect the interests of consumers then regulation may be necessary. Ofgem also has a range of important secondary duties, including promoting security of supply, having regard to the environment and sustainable development, paying particular attention to the needs of vulnerable consumers. We must also have regard to guidance issued by the Secretary of State on social and environmental matters. Further details of these statutory objectives and duties are set out in appendix 2.

The strategy has been based around the following seven themes:

1. Creating and sustaining competition,
2. Regulating network monopolies,
3. Helping protect the security of Britain's energy supplies,
4. A leading voice in Europe,
5. Helping protect the environment,
6. Helping to tackle fuel poverty, and
7. Better regulation/improving Ofgem's efficiency and effectiveness.

Respondents to the August 2005 letter endorsed these themes. Work in these areas is discussed in more detail in the sections that follow.

Appendix 3 sets out Ofgem's deliverables and performance indicators for 2006-2007, which provide the practical targeting of activities to achieve the more broadly stated objectives of the seven themes. Appendix 4 gives budget details for the rest of the RPI-3 cost control period.

Appendix 5 contains a glossary of terms used in the present document and appendix 6 provides details of how to give feedback to Ofgem on the manner in which this consultation has been conducted, should you wish to do so.

## 1. Creating and sustaining competition

1.1. We will continue to monitor retail and wholesale energy markets. If we identify problems we will take any necessary steps to address them. Increasingly, we look to rely on self-regulation or general competition and consumer protection law wherever possible.

### Questions

- 1. Does this theme remain valid?
- 2. Have we identified all the relevant issues within the theme?
- 3. Is Ofgem's approach to the challenges ahead the right one?

### Introduction

1.2. Wholesale energy costs and suppliers' business margins make up around 70 per cent of a typical consumer's energy bill. It is therefore essential that competition continues to function effectively and provides competitively priced energy and secure supplies to consumers. The importance of competitive wholesale markets to security of supply is discussed in the section on helping protect the security of Britain's energy supplies.

1.3. Ofgem monitors the wholesale and retail markets to make sure they remain competitive. Ofgem also assesses whether market rules are adapting to changing circumstances and are continuing to promote and sustain competition. Market monitoring also informs other areas of Ofgem's work such as that on European affairs, merger advice and environmental policy. Ofgem has powers under the Competition Act, and other legislation, to tackle anti-competitive behaviour.

1.4. Effective competition in both wholesale and retail (including metering services) markets is important to protect the interests of consumers. Competitive markets will, over time, provide more innovation, better services and lower prices than prescriptive regulation. This approach is also central to the principles of better regulation.

1.5. Looking ahead, there may be scope to rely more on competition rather than regulation so that wholesale and retail markets become increasingly like normal commodity and service industry markets. However, in considering the case for doing so, recognition would be given to certain factors that may make energy markets different. For example, in retail markets, suppliers' own behaviour, notably their ability to establish effective self-regulation, will be an important factor in this assessment.

1.6. Against a background of a market characterised by significant vertical integration, we will focus also on ensuring that there are no significant barriers preventing new entry to retail energy supply, electricity generation and gas storage.

## **The Next Two Years**

1.7. As competitive markets continue to evolve, Ofgem will need to react to changing circumstances and so the issues described below will represent only a proportion of our work to create and sustain competition. Other areas of possible work include further Competition Act investigations and advising the Office of Fair Trading, Competition Commission or the European Commission on energy sector mergers.

### *Monitoring Energy Markets*

1.8. Since last winter, prices in wholesale gas markets have been much higher and much more volatile. Higher prices in part reflect the decline in gas supplies from the North Sea and the higher costs associated with importing gas. While this may provide some explanation for higher price levels, there is still an ongoing need to ensure that price movements reflect underlying supply and demand conditions and are not being manipulated either in Great Britain or by events or arrangements in continental Europe.

1.9. Given that a significant proportion of electricity generation is gas-fired, high wholesale gas prices tend to increase the price of electricity. The pressure on gas and electricity prices should ease in the next two to three years as over £6bn is invested in new gas infrastructure that will allow us to import more gas through new pipelines to Norway, the Netherlands and from North Africa, the Caribbean and the Middle East in the form of Liquefied Natural Gas (LNG). There are also plans for investment to double our gas storage capacity that will help to manage peak winter demand as production from the North Sea continues to decline.

1.10. During this difficult period Ofgem has focused on: providing more and better information to the market and customers on available supplies, increasing transparency, reviewing market rules and improving awareness among business customers on the possible scenarios and options available, given the difficulties they face in managing higher energy prices. This should help facilitate any necessary demand side response and build consumer confidence in the effectiveness of the market. Ofgem has also been working with the European Commission to identify and tackle behaviour or arrangements that are distorting the trade of gas and electricity between Member States and causing higher prices in Britain.

1.11. A single British wholesale electricity market was established on 1 April 2005, extending to Scotland the wholesale market arrangements that have applied in England and Wales since 2001. Ofgem will closely monitor the British market to ensure that the arrangements are working properly and the benefits are being passed to customers. In particular, given the nature of the transmission network in Scotland, it will be important that network constraints can be managed efficiently. This should provide signals to encourage timely, economic and efficient investment in transmission network reinforcement.



*Incentives for Efficient System Balancing*

1.12. The transmission system operator manages any supply and demand imbalances on a day-to-day basis and deals with any network constraints. Ofgem will be reviewing the incentive schemes for the system operator in gas and electricity, which aim to give network operators incentives to invest efficiently and reduce the costs of system balancing. Ofgem is in the process of setting the incentive scheme in electricity for 2006-2007. For 2007-2008 and beyond the work on system operator incentives will be closely co-ordinated with the work on the transmission price control review, described in the section on regulating network monopolies.

*Transparency*

1.13. In 2005, Ofgem clarified the way in which potential modifications to industry codes in relation to the transparency of gas markets would be assessed. Shortly it will be necessary for us to consider further a proposal by energywatch to publish more information. In consultation with market participants, Ofgem will review the levels of information provided to the gas market in order to assess the potential benefits of the release of additional information. Proposals should be published in the first half of 2006.

*Metering*

1.14. Policy on metering competition starts from the assumption that competition is the best form of consumer protection. However, in the light of many concerns about the lack of innovation in this area to date and strong interest in the potential environmental benefits, Ofgem has been carrying out a review of the effectiveness of the current arrangements and of the costs and benefits of smarter forms of metering in gas and electricity. 2006 will be an important year for metering as we take forward the conclusions of that review, using consultations and seminars to present our analysis and consider what, if any, role Ofgem should play in facilitating smarter metering. We will also be reviewing whether competition is sufficiently developed in this market to warrant the lifting of the existing metering price controls.

1.15. Later in 2006 we also expect to reach conclusions on two metering related Competition Act investigations, one concerning gas metering services and the other concerning the provision of meter reading services.

*Customer Disputes*

1.16. Following a Supercomplaint by energywatch on billing, Ofgem asked industry to set up an independent dispute resolution body to enable the relatively small proportion of customers who had suffered as a result of billing problems to obtain redress and, where appropriate, compensation. This self-regulatory solution was acknowledged by the Better Regulation Task Force as a good example of better regulation in practice. We will work with industry to ensure these proposals are implemented by July 2006.

*Supply Licence Review*

1.17. The review of supply licences will provide an opportunity, consistent with better regulation, to develop a set of clear and simple licence obligations which provide proportionate protection for customers and do not act as a barrier to entry for new suppliers. This is expected to lead to further deregulation in retail markets, but with an acknowledgement of the need to ensure, in particular, that vulnerable customers remain protected.

1.18. We intend to publish initial proposals in July 2006 and final proposals in November 2006. We intend that any licence changes will take effect in April 2007.

**A Five Year View**

1.19. Although it is difficult to predict the evolution of a competitive market, the next five years are likely to bring a number of challenges and opportunities for the further development of wholesale and retail markets. For instance, while capital market competition and mergers can be important drivers of efficiency, it is essential that mergers and acquisitions do not lessen the competitive pressures on energy companies. Ofgem will continue to review the implications of corporate transactions on competitiveness and to advise the relevant competition authorities where necessary.

1.20. In the provision of bulk supplies of gas, electricity generation, wholesale energy markets and retail energy markets, competition will continue to evolve. Active surveillance and monitoring will continue to be required to ensure that the commercial frameworks within which the industry operates continue to promote and encourage competition.

1.21. In taking forward work on retail markets, Ofgem will continue to promote competition while at the same time having regard to our duties relating to sustainable development, the environment and protecting vulnerable consumers.

## 2. Regulating network monopolies

2.1. We use incentive regulation to keep the costs of network monopolies down and to encourage improvements in quality of service. We are developing our approach to ensure that regulation is sufficiently flexible to accommodate changing patterns of supply such as renewable generation and new gas import terminals.

### Questions

- 1. Does this theme remain valid?
- 2. Have we identified all the relevant issues within the theme?
- 3. Is Ofgem's approach to the challenges ahead the right one?

### Introduction

2.2. In general it is not practicable to have competition in distribution or transmission activities. Regulation is therefore necessary to protect the interests of consumers. Regulation encompasses price controls on network charges, issues arising from the structure of network charges, quality of service, financial ring-fencing of network businesses and protecting security of supply. Matters relating to security of supply are dealt with in more detail in the section on helping protect the security of Britain's energy supplies.

2.3. Across all network sectors, Ofgem remains committed to incentive regulation as the best way of protecting the interests of consumers. Each network business must meet its statutory and licence targets and obligations. If they do so, they should be able to earn higher returns. Those companies that fail to meet their obligations run the risk of financial penalties, and those that under-perform in relation to their price control targets should earn lower returns. This approach encourages efficiency and over the longer term ensures that prices to consumers are no higher than is necessary.

2.4. Over time the regulatory framework will need to evolve to meet new challenges. Nevertheless, the following basic principles are likely to remain important:

- transparency and predictability,
- consistency in approach across the networks where appropriate,
- applying simple solutions where they are effective,
- improving incentives on network operators to invest efficiently and quickly in response to their customers' needs,
- making network operators more responsive to the changing needs of their customers,
- encouraging the development and adoption of innovative technologies where this will result in more efficient and effective solutions,
- encouraging cost reflective charging – so that each network user takes into account the wider costs of its decisions, and
- protecting security and reliability of supply.

2.5. Challenges for the future include ensuring that network businesses have incentives to invest in a timely and efficient way to protect security of supply and ensuring that renewable electricity generators are able to connect to distribution and transmission networks, adopting innovative techniques where appropriate.

2.6. Ofgem also continues to encourage the development of competition in areas associated with networks where this is an appropriate way to protect customer interests, such as in the provision of new gas and electricity connections.

### **The Next Two Years**

#### *Gas and Electricity Transmission*

2.7. Work will continue on the gas and electricity transmission price control reviews. These controls were last set in 2001 and 2002. In the intervening period, the transmission businesses will have had an opportunity to improve efficiency and earn higher rates of return. The price control reviews provide an opportunity to share these efficiency gains with consumers and take into account new information and developments across these sectors. Particular challenges for the transmission price control reviews include:

- assessing the level of asset replacement required on the electricity transmission system, and
- developing incentives so that transmission companies can respond quickly and flexibly to demands for new capacity to support new gas infrastructure such as storage, LNG terminals and import pipelines and new conventional and renewable electricity generation.

2.8. The intention is to consult further during the first half of 2006 and publish final proposals in autumn 2006. The new controls will take effect from 1 April 2007.

2.9. Alongside this work, there will be important issues to consider in relation to the structure of charges and developing arrangements that allow network users to signal their demand for capacity by making medium and long-term commitments.

2.10. Ofgem is assisting the Department of Trade and Industry (DTI) to develop the regulatory and licensing regime for the underwater cables that will be needed to connect offshore wind generation where the cable connections are developed in a cost effective manner and consumers' interests are protected. The Secretary of State is due to announce the future regulatory regime early in 2006.

#### *Gas Distribution*

2.11. The main priority for the next two years is the gas distribution price control review. This will be the first time that the gas distribution price controls have been set since National Grid (NG) sold four of its British gas distribution businesses. We will be publishing more detailed papers in 2006 and early 2007, ahead of final proposals in autumn 2007. This work will encompass:

- extending the existing price control by one year to 31 March 2008,

- resetting the main control from 1 April 2008, and
- establishing a cost reporting framework to operate from 1 April 2008.

2.12. Other important work will involve reforming the arrangements for interruption on gas distribution networks to ensure that capacity is used efficiently across gas distribution and gas transmission networks, and introducing incentives on gas distribution networks to purchase an efficient level of gas transmission capacity.

#### *Electricity Distribution*

2.13. New price control arrangements came into effect in April 2005. There are two particular priorities for the next two years:

- to encourage the development of robust distribution charging arrangements that are appropriately cost-reflective, and
- the annual collection and review of cost data and regulatory asset value calculations. This should make the price control review process more transparent, predictable and effective. Over time this should encourage companies to be more efficient and lead to lower prices for consumers.

2.14. Ofgem will also

- continue to develop indicators and incentives for quality of service (recognising that failures on electricity distribution networks cause most supply interruptions),
- consult on the development of competition in connections and options to increase its effectiveness, and
- review progress with the new initiatives introduced in the last price review to promote innovation.

#### **A Five Year View**

2.15. Looking ahead, it is likely that significant network investment will continue to be needed, to ensure that the networks are robust and can accommodate changes in supply and demand patterns, such as that arising from the increase in renewable generation and gas imports, as well as any further market changes. We will also seek to extend and develop incentives to improve the quality of service to network customers and we will continue to monitor and, where appropriate, promote the development of technology.

2.16. On completion of the electricity distribution price control review in 2005, we undertook an assessment of the review process which identified a number of areas in which lessons could be learned for the future. These will be taken into account in the current transmission and gas distribution reviews, following which we will conduct further assessments of our approach. The conclusions of these will feed into our next cycle of price control reviews, commencing with electricity distribution in 2008 and 2009. Our intention is to develop a clear and predictable approach to the conduct of price control reviews in order to reduce uncertainty and provide a stable framework for long-term decisions by network companies.

### 3. Helping protect the security of Britain's energy supplies

3.1. We will make sure that any barriers that prevent the market delivering security of supply are removed. We will regulate to promote timely and economic investment in networks and help consumers, particularly large users, understand the role they can play in maintaining reliable and secure supplies.

#### Questions

- 1. Does this theme remain valid?
- 2. Have we identified all the relevant issues within the theme?
- 3. Is Ofgem's approach to the challenges ahead the right one?

#### Introduction

3.2. Ofgem has important statutory duties relating to security of supply reflecting the value that consumers place on reliable energy supplies. Although some large business consumers have contracts with suppliers that allow for interruption, the majority of consumers expect uninterrupted supplies of gas and electricity.

3.3. Competitive wholesale markets will best protect security of supply. If supplies become scarce relative to demand, prices should rise, encouraging investment to provide more energy supplies and, if necessary, short term reductions in demand.

3.4. In addition to competition in wholesale markets, security of supply requires effective network regulation to maintain and improve reliability of the transmission and distribution networks that transport gas and electricity to homes and businesses.

3.5. All major policies are assessed to see what impact they will have on security of supply.

#### The Next Two Years

3.6. The faster than expected decline in gas production from the North Sea is likely to lead to tighter gas supplies this winter and next. The gas supply situation will ease as significant investment is being made to deliver new sources of gas supply through new pipelines and LNG terminals. There are also plans to double Britain's available gas storage capacity. During the next two years, before these supplies become available, security of supply will be a major area of work for Ofgem.

3.7. Ofgem will continue to make sure that the market and customers are well-informed of the situation and of the options for customers to manage the difficulties created by higher prices. Ofgem will also continue to work with the European Commission and other regulators to make sure that arrangements in continental Europe do not restrict supplies of LNG and/or piped gas to the UK during this difficult two year period.

### *System Balancing*

3.8. Transmission system operators have responsibility for co-ordinating the actions of wholesale market participants such that, on a day-to-day basis, the supply and demand for gas and electricity remains in balance. It is essential that these arrangements complement a competitive energy market and that any market participants that cause imbalances across the system are exposed to any resulting costs. This should create incentives on participants to ensure that they have secure supplies and encourage flexibility and efficiency from consumers.

3.9. The cash-out arrangements provide the incentives on companies to balance the amount of energy they supply to their customers with the amount of energy they put onto the transmission system. Ofgem has established a cash-out working group that comprises industry experts in order to discuss and provide analysis on the way in which cash-out prices are determined. The intention is that this group will be able to take a holistic view of developments across both the gas and electricity markets. Nevertheless, it will continue to be for individual market participants to propose changes to the cash-out rules. The analysis provided by the cash-out working group will help Ofgem, the industry and customers to decide whether changes to the cash out requirements are required.

### *Monitoring Security of Supply*

3.10. The Government and Ofgem have a role to monitor and inform the market about key developments with respect to security of supply. Ofgem is a member of the Joint Energy Security of Supply (JESS) group, which was established to monitor developments across the gas and electricity markets and in particular to provide information to market participants to help them plan investment decisions. JESS publishes annual reports on security of supply. Following the requirements of the Energy Act 2004, Ofgem will work with the DTI to enable the Secretary of State to publish annual reports to Parliament on security of supplies. In addition, the UK is required to monitor and report on security of supplies under the European Union (EU) Directives. Ofgem and the DTI seek to ensure that all these reports are as useful as practicable to market participants.

### *The Regulation of Infrastructure for Gas Imports*

3.11. As gas production from the North Sea declines, a number of major projects have been commissioned, or are currently under development, that will substantially increase Britain's capacity for the import and storage of gas. Ofgem has developed, and will continue to apply, a light-touch regulatory regime in order to encourage such investment where this approach continues to promote competition and customers' interests.

### *Demand-side Working Group*

3.12. A feature of British energy markets is that gas and electricity energy demand is much higher in winter than in summer and that electricity demand is much higher at certain periods during the day than at night. Companies can either invest in supplies

to meet the higher demand or take measures to encourage demand to be reduced. These actions can help protect security of supply and contribute to lower wholesale prices. NG's assessment for winter 2005-2006 is that a significant demand-side response will be needed if the weather is severe. To try to ensure that there are no barriers to the demand-side responding, Ofgem has established a demand-side working group. Various changes have also been made to improve transparency ahead of this winter so that customers and suppliers can anticipate when supply conditions might be tight and large business customers may have to provide demand-side response. We expect these arrangements to continue and develop throughout 2006.

#### *Gas Quality*

3.13. For reasons of safety and efficiency, gas quality specifications are applied to gas supplies and historically these standards have been geared towards North Sea supplies. As more gas is imported, these standards will need to evolve. Ofgem is working with the DTI, Health and Safety Executive, the Department for Environment, Food and Rural Affairs (Defra) and the European Commission to develop new gas quality standards that are non-discriminatory and cost effective. In the shorter term, Ofgem is also working with the industry to identify whether small changes to gas quality specifications could allow more gas to be delivered through existing infrastructure over the next two years without reducing safety.

#### *Network Investment*

3.14. Efficient and timely investment in transmission and distribution systems is needed to ensure sufficient network capacity and reliability, so that available supplies of gas and electricity can be transported to consumers. Ofgem continues to monitor the reliability of networks and seeks to use the price control reviews to develop and improve the incentives on network companies to invest in a timely and efficient way.

#### *Emergency arrangements*

3.15. Market arrangements are underpinned by contingency planning designed to ensure that the energy industry is prepared in the event of an emergency. These issues are not unique to energy markets and the Government attaches high importance to emergency preparedness at a national and local level. In response to the requirements to provide a high-level link between government and industry, the Energy Emergencies Executive has been established to oversee the structures and practices of energy emergency planning. It is chaired by DTI and includes Ofgem and NG. The Energy Emergencies Executive will continue to oversee the development of effective emergency arrangements during 2006.

### **A Five Year View**

3.16. We will continue to monitor the evolution of competitive markets and key indicators of security of supply to ensure that any difficulties are dealt with in a timely way. As gas production from the North Sea declines and market participants commission more infrastructure projects to allow the import of gas, the majority of GB's gas supplies will eventually be imported. The development of new gas



infrastructure – including storage facilities, LNG terminals and new pipelines linking GB with Norway and the EU – are very encouraging developments that should ensure that GB has adequate gas supplies over the next five years.

3.17. These developments will further increase the interactions with European and global gas markets (as LNG is traded globally) and impact on prices. There are also important interactions between gas and electricity markets as around 30 per cent of gas is used to generate electricity. Ofgem will need to monitor these market developments and ensure that competition continues to evolve and security of supply is maintained.

3.18. There has been substantial investment in new gas-fired electricity generation since privatisation as well as the closure of old, less efficient stations. In electricity the margin of generating capacity over demand is about 20 per cent – consistent with the planning margins used before the industry was privatised. As coal and nuclear power stations come to the end of their operating lives it will be important that significant new investment is made in the electricity generation sector in both conventional and renewable generation. A number of energy companies have announced plans to invest in new conventional and renewable generation. Investors will expect a stable political and regulatory environment before making investment in new capacity and Ofgem will continue to work with and advise the Government to provide stability and certainty in the long term regulatory and policy framework to facilitate this investment.

## 4. A leading voice in Europe

4.1. We will continue to promote the development of an effective EU-wide energy market and to influence the development of EU regulatory and competition policy.

### Questions

- 1. Does this theme remain valid?
- 2. Have we identified all the relevant issues within the theme?
- 3. Is Ofgem's approach to the challenges ahead the right one?

### Introduction

4.2. European energy markets and EU regulatory/competition policy have a major influence on Britain's energy markets and consumers. In particular:

- British wholesale gas and electricity prices are heavily influenced by wholesale gas prices in Europe,
- around 30 per cent of gas in Britain is used in power stations and so wholesale gas prices in Europe can have an indirect impact on electricity prices,
- as Britain becomes a net importer of gas through the development and expansion of interconnectors, European gas will be increasingly important for security of supply, and
- European Directives and Regulations have the potential to have a direct impact on competition and regulatory policy in Britain.

4.3. In the light of this, Ofgem will continue to work with the Government, European Commission, other national regulators and competition authorities to promote the development of an effective, competitive European energy market and ensure that EU regulations and policy are consistent with the principles of better regulation.

4.4. EU environmental regulation is also increasingly important to the operation of the gas and electricity industries in Britain. These matters are discussed further in the section on helping to protect the environment.

### The Next Two Years

4.5. Ofgem is a member of the group of energy regulators (ERGEG) and of the Council of European Energy Regulators (CEER) that advise the European Commission on the development of regulatory and competition policy. Ofgem's Chairman, Sir John Mogg, has recently been elected the Chairman of ERGEG and President of CEER. These groups will certainly play an active role in developing and implementing the roadmaps for the gas and electricity sectors that will set out the key policy steps necessary to establish effective energy markets in Europe.

4.6. Ofgem has three members of staff seconded to the DG Competition (the Directorate of the European Commission that has responsibility for competition issues) in order to help with its sectoral inquiry into competition in the gas and electricity industries across Europe. Given the Directorate's initial conclusions that

there were 'serious malfunctions' in the market, there will be a continuing strong focus on this over the coming year. The Commission has signalled that it will develop remedies and take action under European competition law to tackle these concerns. The Commission's interim report is expected on 16 February 2006.

4.7. In parallel, DG Transport and Energy (the directorate that has responsibility for the gas and electricity industries) is investigating compliance with existing EU directives and regulations to liberalise European energy markets. These reports should help to address the remaining obstacles to liberalisation and effective competition across Europe.

4.8. Responding to comments made in the responses to consultation, we will explore how best to ensure that industry is aware of emerging European issues and has an opportunity to engage in the debate.

### **A Five Year View**

4.9. We will continue to work with ERGEG/CEER, DG Competition and DG Transport and Energy to ensure that competition and regulatory policy in Europe benefits British consumers. Particular challenges will include:

- supporting an approach to competition policy that deals in a timely and effective way with any abuse of market power,
- encouraging DG Transport and Energy to enforce existing obligations and if necessary develop new legislation to underpin key components of liberalisation that are presently applied unevenly across Europe (including powers of regulators, separation of transmission activities, restraints on market power),
- refining parts of the present regulatory framework through the comitology process including congestion management on transmission networks, and
- filling in the gaps in the present framework, such as the regulation of access to gas storage.

## 5. Helping to protect the environment

5.1. We take account of the environmental impacts in all our decisions. We will continue to administer various environmental schemes on behalf of the Government.

### Questions

- 1. Does this theme remain valid?
- 2. Have we identified all the relevant issues within the theme?
- 3. Is Ofgem's approach to the challenges ahead the right one?

### Introduction

5.2. Electricity generation and the use of gas by consumers contribute around 50 per cent of CO<sub>2</sub> emissions. In addition to its Kyoto targets, the Government has set a target to reduce CO<sub>2</sub> emissions by 20 per cent by 2010 and has an aspiration for a 60 per cent reduction by 2050.

5.3. While Ofgem's principal statutory objective is to protect the interests of consumers, we have important secondary duties relating to the environment and sustainable development, and the Secretary of State has provided statutory guidance on social and environmental matters.

5.4. A framework has been established to ensure that policies which have a significant environmental dimension are consistent with our statutory objectives and duties. This includes valuing CO<sub>2</sub> emissions to take account of the environmental damage that they cause. In a number of key policy areas, such as in relation to renewable energy and energy efficiency, the Government (or EU) has already established arrangements that provide substantial funding to schemes that have environmental benefits. In these circumstances, consumers are already funding reductions in CO<sub>2</sub> emissions. Nevertheless, we will continue to look at other areas of policy that could have an impact on the environment. These include the obligations on suppliers to promote energy efficiency and the incentives on network businesses to reduce energy losses. While all these initiatives are important, they are unlikely to deliver significant reductions in CO<sub>2</sub> emissions. This would require further action by the Government or EU.

5.5. Ofgem has a role in advising the Government and EU on approaches to meeting environmental targets which have the lowest overall costs for consumers, where possible using market-based instruments and solutions that do not distort competition in energy markets.

5.6. We also administer a number of environmental programmes for the Government, including the Renewables Obligation and the Energy Efficiency Commitment.

### **The Next Two Years**

5.7. Each year, Ofgem produces a report on our Environmental Action Plan and takes advice from a panel of industry specialists and experts (the Environmental Advisory Group) on environmental matters. The Environmental Action Plan summarises Ofgem's environmental policy programme.

5.8. Areas of policy that may have significant implications for the environment over the next two years include:

- price control reviews, which will provide an opportunity to consider the treatment of losses and shrinkage, electricity network investment for renewable generation and the impact of electricity network investment on visual amenity (in particular in national parks and areas of outstanding natural beauty),
- advising the DTI on offshore electricity transmission regulation – as decisions on these arrangements will have implications for renewable generation,
- the review of supply licence conditions could provide an opportunity to refine the obligations on suppliers which have implications for energy efficiency,
- work on innovative metering also has the potential to encourage energy efficiency, and
- the conclusions of a review of the regulatory and market issues affecting the development of microgeneration.

5.9. Ofgem has been carrying out an assessment of the policy options in respect of metering innovation and intends to take this work forward throughout 2006. We will publish a consultation paper by the end of January, which will pull together the key strands of our work and invite views from stakeholders on the most appropriate way forward. Ofgem considers that metering innovation is a particularly important strand of work, especially given the context of the Government's Climate Change Programme Review and the implementation of the EU Energy Services Directive. We will ensure that our future work in this area takes these developments fully into account.

5.10. In terms of influencing the debate on wider environmental policy Ofgem will be:

- organising a seminar on, and assessing the impact of, the EU Emissions Trading Scheme (EU ETS) on the electricity generation sector and consumers,
- inputting in to the process for establishing the EU ETS National Allocation Plan and advising Defra and the DTI on these matters,
- contributing to the European Commission's review of the EU ETS Directive;
- running the CEER work programme on environmental matters,
- advising on the European Commission Energy Efficiency Action Plan, including research on the scope for quantifying energy saving measures and possibly the trading of credits, and research on the effectiveness of energy efficiency measures, and
- contributing to the Government's Joint Working Group on Energy and the Environment and its Sustainable Energy Policy Network.

### **Government policy reviews**

5.11. The Government's review of its Climate Change Programme is due to report shortly. This review may have important implications for gas and electricity consumers and Ofgem will consider carefully the conclusions of this review and, if necessary, work with Government and advise on how best environmental targets can be met in a cost-effective manner.

5.12. We will also contribute as appropriate to the Government's recently announced Energy Review which will be dealing with many of these issues and to the Stern Review, on the economics of climate change, by providing analysis and support on those aspects of the review that affect energy markets.

### **Administering Government schemes**

5.13. Ofgem also administers a number of the schemes and arrangements that have been established by Government as part of its Climate Change Programme. The main schemes include the Renewables Obligation - which creates obligations for electricity suppliers - and the Energy Efficiency Commitment (EEC) - which creates obligations for both gas and electricity suppliers. We also administer the Renewable Energy Guarantees of Origin arrangements, exemptions from the Climate Change Levy for renewables and CHP, and the CHP database. In respect of all these schemes we will continue to provide advice to the Government on how they are functioning and ways in which they might be made more effective.

### **'Greening' Ofgem**

5.14. Ofgem has taken a number of steps to reduce its own energy usage. In 2003, for example, it installed a CHP unit that has meant reduced carbon emissions totalling 750 tonnes of CO<sub>2</sub>. In addition, the replacement of four boilers has led to a 35 per cent increase in our energy efficiency. Ofgem was the first Government Department to achieve certification to the international standard on Environmental Management Systems (ISO14001) and continues to seek ways of reducing its impact on the external environment. We are currently introducing area-specific utility meters, which will further enhance our ability to measure accurately the effectiveness of any new energy saving steps that we take.

### **A Five Year View**

5.15. We will continue to develop environmental policy in a manner consistent with our statutory remit. In particular:

- ensuring a robust framework is in place, allowing policy to be developed in a way that is consistent with our statutory objectives and duties, taking full account of any environmental dimensions. This will include keeping under review the valuation of the damage caused by CO<sub>2</sub> emissions,
- encouraging the Government and EU to carry out cost benefit analysis in developing policy and to look for cost-effective solutions and market orientated policy instruments to meet environmental targets,

- seeking to influence the implementation of environmental policy in a way that achieves maximum carbon emissions reductions at least cost to consumers while recognising that the setting of targets is something for Government and the EU, and
- contributing to policy debates on the best way for the Government and EU to meet CO2 targets by providing analysis and advice.

## 6. Helping to tackle fuel poverty

6.1. We will promote a holistic and targeted approach to fuel poverty. We will take account of the particular needs of vulnerable customers in all our decisions.

### Questions

- 1. Does this theme remain valid?
- 2. Have we identified all the relevant issues within the theme?
- 3. Is Ofgem's approach to the challenges ahead the right one?

### Introduction

6.2. The Government has a target that by 2010 no vulnerable household should be in fuel poverty. This target has become increasingly difficult to meet over the last few years as energy prices have started to increase in real terms.

6.3. Although the broad issues of poverty and social exclusion are for Government, there is a role for Ofgem in protecting consumers, by promoting competitive energy markets and regulating monopoly companies, such that prices are as low as practicable. Consistent with our statutory duties to have regard to sustainable development, the needs of the sick, elderly, those on low incomes and those living in rural areas, Ofgem seeks to integrate social issues and considerations throughout our work.

6.4. Ofgem has published a Social Action Strategy describing how we will take forward this work under four broad themes:

- developing the regulatory framework and ensuring all suppliers comply with the regulatory obligations designed to protect vulnerable consumers,
- encouraging best practice among energy suppliers,
- influencing the debate about measures to help tackle fuel poverty, and
- considering how best to inform consumers about ways to lower energy bills.

### The Next Two Years

6.5. Over the next two years, with prices likely to remain high relative to historic levels, the issue of fuel poverty will continue to be a priority. A holistic approach that brings together help on energy efficiency, social security benefits and money advice, is likely to be the most effective way to combat fuel poverty. Improved working between Government, industry and consumer agencies is therefore important to identify and target help to where it is most needed.

6.6. Examples of initiatives that Ofgem will be taking forward under the Social Action Strategy include:

- the review of supply licence conditions where in particular we will look at how best to provide protection for vulnerable customers,



- exploring the barriers to further expansion of the gas network as a part of the gas distribution price control review,
- encouraging network operators to develop best practice in respect of vulnerable consumers, going beyond the formal requirements of their licences, through initiatives such as the electricity distribution discretionary reward scheme,
- putting in place a new reporting system for social obligations to enable stakeholders to track progress in the spread of best practice among suppliers,
- continuing mystery shopping exercises and benchmarking surveys to track performance and help identify best practice, for example in relation to debt and disconnection and provision of front line advice to vulnerable customers,
- following up on the corporate social responsibility audit conducted in 2004-2005,
- working with Government and other stakeholders on the next phase of the EEC and issues concerned with its integration with other Government schemes such as Warm Front,
- helping to get the message across to consumers about the options for reducing bills, through the Energysmart campaign and the new fuel poverty helpline launched by the major suppliers to provide a one-stop shop for consumers on measures to address fuel poverty.

### **A Five Year View**

6.7. Looking ahead, the Government's 2010 target to eliminate fuel poverty in vulnerable households looks extremely challenging. Tackling climate change through reducing carbon dioxide emissions is likely to continue to put upward pressure on energy prices even as gas supplies ease. Meeting the fuel poverty target is therefore likely to require significant additional resources and we will work with Government, industry and consumer groups to ensure that any new schemes that are developed are targeted and effective and are consistent with the operation of competitive retail markets.

6.8. Issues around the protection of vulnerable consumers are likely to remain even as competition in the supply market matures. Nevertheless, if suppliers continue to take a proactive role there is the potential for self-regulation to be increasingly important.

## 7. Better regulation

7.1. We are committed to better regulation and are continually seeking to improve our efficiency and effectiveness. We keep our costs under tight control.

### Questions

- 1. Does this theme remain valid?
- 2. Have we identified all the relevant issues within the theme?
- 3. Is Ofgem's approach to the challenges ahead the right one?
- 4. Are there any licence conditions or other obligations that impose an unnecessary administrative burden?

### Introduction

7.2. Ofgem is committed to the principles of better regulation and to running our operations as efficiently and effectively as we can. Across the range of our activities Ofgem seeks to adhere to the principles of good regulation as developed by the Better Regulation Task Force. These are:

- proportionality – regulators should only intervene when necessary, remedies should be appropriate to the risk posed, and costs identified and minimised,
- accountability – regulators must be able to justify decisions, and be subject to public scrutiny,
- consistency – government rules and standards must be joined up and implemented fairly,
- transparency – regulators should be open, and keep regulations simple and user friendly, and
- targeted – regulation should be focused on the problem, and minimise side effects.

7.3. In terms of cost efficiency, Ofgem has adopted an RPI-3 per cent control for the period 2005-2006 to 2009-2010. This will see sustained real reductions in the costs of regulation for the first time since the privatisation of the gas and electricity industries.

### The Next Two Years

7.4. The Hampton and Arculus reports published last year articulated the challenge of reducing the administrative costs of regulation on businesses as an aspect of better regulation which the Government is now taking forward. Ofgem has been considering carefully how best to take forward within the energy sector the recommendations from these reports, including the concept of setting targets for reduction.

7.5. We would therefore welcome your views, as part of this consultation, on whether there are particular licence conditions or other obligations that impose an undue or unnecessary administrative burden, for instance because the protection provided by them could be better provided through alternative means. Clearly it will be helpful to

Ofgem if you can provide specific information wherever possible, for instance in terms of the nature of the burden and any associated costs.

7.6. In recognition of the growing importance of the better regulation agenda, we will be setting up a small better regulation unit to champion the issues within Ofgem and to co-ordinate our contribution to wider Government initiatives in this area. Also, as part of future annual budget discussions, we will explicitly consider the extent to which our plans are consistent with better regulation.

7.7. Responding to concerns raised as part of last year's Corporate Strategy consultation, we launched Project Paperless aimed at reducing the number and complexity of the consultation documents we produce. One conclusion of the project was to redesign our published documents. The present consultation document is the first to be published in the new format and we hope you will agree that it is more accessible. In the coming year, we will be working to make our documents fully electronic so making them easier to navigate.

7.8. Linked to this, we will be redesigning our website to improve transparency and make it easier for stakeholders to locate information they are looking for, picking up on concerns raised through the discussions we held as part of Project Paperless. We will also be looking to introduce electronic records management across the organisation. This should allow Ofgem to respond more quickly and efficiently to requests for information, including those made under the Freedom of Information Act, again improving transparency.

7.9. Our commitment to better regulation initiatives is reflected in our approach to key policy areas:

- in the Supply Licence Review (see section 1 on creating and sustaining competition) where we are looking to remove licence conditions that are no longer required and to ensure that where conditions remain they are targeted and proportionate,
- in the transmission and gas distribution price control reviews (discussed in section 2 on regulating network monopolies) where we are considering carefully the lessons from previous reviews in terms of the process to be followed and the burdens that our information-gathering exercises can impose. Bringing together the gas and electricity transmission controls will also help in ensuring consistency of approach, and
- in developing further our approach to impact assessments.

7.10. We will also seek to ensure that we get effective consumer input to our policy decisions in the light of DTI's proposals for changes to the structure of consumer bodies.

7.11. The key driver in terms of our efficiency is the adoption of an RPI-3 per cent target for cost reduction for each of the five years between 2005-2006 and 2009-2010. This will result in savings of around £5 million by the end of the five-year period, mainly achieved through:

- continuing to reduce our dependence on external consultants,
- seeking greater efficiencies in the use of office space,

- exploring further the concept of shared services with other government departments,
- increasing the energy efficiency of our offices,
- seeking to achieve greater efficiency in our purchasing through better contract management and negotiation, and
- reducing headcount, in part through more prioritisation and ensuring work flows are better organised.

7.12. It will also be appropriate to keep under review and seek further efficiencies in the work Ofgem carries out for Government on administering environmental programmes.

### **A Five Year View**

7.13. We will continue to review our policy and processes with a view to achieving best practice in relation to better regulation. For instance we will consider the scope for conducting reviews of other licences against the better regulation framework and will continue to improve the approach to setting price controls.

7.14. In 2008-2009 it will be necessary to review the RPI-3 per cent cost target and consider what arrangements would be appropriate for 2010-2011 and beyond. It will be important that further cost reduction does not reduce the quality of Ofgem's work, but a better targeted and simpler approach to regulation may facilitate further cost savings.

## Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. The specific questions to which we would welcome responses are:

**Question 1: Do the themes remain valid?**

**Question 2: Have we identified all the relevant issues within each theme?**

**Question 3: Is Ofgem's approach to the challenges ahead the right one?**

**Question 4: Are there any licence conditions or other obligations that impose an unnecessary administrative burden?**

1.2. The deadline for written responses is 27 February 2006. They should be sent to:

Andrew MacFaul  
Head of Better Regulation and Co-ordination  
Ofgem  
9 Millbank  
London  
SW1P 3GE

Email [andrew.macfaul@ofgem.gov.uk](mailto:andrew.macfaul@ofgem.gov.uk)  
Tel: 020 7901 7083

1.3. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.4. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.5. Any questions on this document should, in the first instance, be directed to Andrew MacFaul using the contact details set out above.

## Appendix 2 - Ofgem's Statutory Responsibilities

1.1. Ofgem is the Office of Gas and Electricity Markets, regulating the gas and electricity industries in Great Britain. Ofgem operates under the direction and governance of the Gas and Electricity Markets Authority. The Gas and Electricity Markets Authority has the ultimate responsibility for all that Ofgem does. It determines strategy and decides on major policy issues.

1.2. Ofgem's powers and duties are provided for under the Gas Act 1986, the Electricity Act 1989, as amended principally by the Utilities Act 2000, Competition Act 1998, Enterprise Act 2002 and Energy Act 2004. Ofgem has concurrent powers with the Office of Fair Trading to apply the Competition Act 1998 to the gas and electricity sectors in Great Britain.

1.3. Ofgem's principal objective is to protect the interests of consumers present and future, wherever appropriate by promoting effective competition. 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
- need to ensure that licence holders are able to finance their obligations, and
- interests of those people who are disabled or chronically sick, of pensionable age, living on low incomes, or living in rural areas.

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

- promote efficiency and economy including efficient use of energy,
- protect the public from dangers,
- contribute to the achievement of sustainable development, and
- secure a diverse and viable long term energy supply.

1.5. We shall have regard, in carrying out those functions, to the impact on the environment of the gas and electricity industries.

1.6. In carrying out our functions, we must also have regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed; and any other principles that appear to us to represent the best regulatory practice.

1.7. Furthermore, we must have regard to social and environmental guidance issued by Ministers. Ofgem also has a duty to consult and take into account any advice given by the Health and Safety Executive about all gas and electricity safety issues that may be relevant to our functions under the Gas Act and the Electricity Act.

## Appendix 3 – Deliverables and Performance Indicators 2006-2007

### Deliverables 2006-2007

#### Creating & Sustaining Competition

Activity	Action	Period
Retail Competition	Publish findings on whether a full review of non-domestic supply markets is required	Q1
	Publish a consultation document setting proposals for new electricity and gas supply licences	Q2
	Publish initial proposals on development of metering competition and metering price controls	Q2
	Publish final proposals on metering price controls	Q3
	Implement, through collective licence modification processes, new electricity and gas supply licences	Q4
Wholesale Markets	Implement SO incentives for National Grid Electricity Transmission in its role as GB SO in the electricity market for one year from April 2006	Q1
	Publish the Energy Act report on Security of Supply in conjunction with the DTI	Q1
	Publish initial consultation document for the enduring SO incentives schemes for National Grid Gas and National Grid Electricity Transmission in their roles as GB gas and electricity market GB System Operators	Q2
	Publish Final Proposals for the enduring SO incentives schemes for National Grid Gas and National Grid Electricity Transmission	Q3
	Implement licence modifications for the enduring SO incentives schemes for National Grid Gas and National Grid Electricity Transmission	Q4
Connections	Consult on review of progress in competition in connections	Q2

### Regulating Network Monopolies

Activity	Action	Period
Modifications	Implement the Distribution Connection and Use of System Agreement (DCUSA)	Q2
Costs & Outputs	Publish Initial Transmission Price Control Review (TCPR) Proposals	Q1
	Publish Final TPCR Proposals	Q3
	Publish proposals for cost reporting by transmission companies	Q4
Policy Development & Special Projects	Publish proposals for offshore regulation	Q4
Quality of Service	Award rewards under discretionary reward scheme	Q2
	Publish electricity distribution quality of service report	Q3
Finance & Regulatory Reporting	Publish summary cost information for electricity distribution companies for 2005-2006	Q4
Gas Distribution Policy & Price Control Review	Publish initial proposals on Distribution Network interruption reform	Q2
	Publish extension review Initial Proposals	Q2
	Publish extension review Final Proposals	Q3
	Publish gas distribution quality of service report	Q3
	Final proposals for DN interruption reform	Q4



**A Leading Voice in Europe**

Activity	Action	Period
Europe	Obtain approval from ERGEG for Gas Balancing Good Practice Guidelines	Q1
	Ensure ERGEG consults on Guidelines for Good Practice on Information Management and Transparency in EU electricity markets	Q2
	Obtain a commitment from the other regulators to the regional gas initiatives work under the gas roadmap	Q3
	Ensure that monitoring of the Gas Balancing guidelines is carried out	Q4
	Work to ensure compensation mechanism between European Transmission System Operators is agreed and enters into force in 2007	Q4
	Ensure that the regional initiatives on gas hubs incorporate hubs relevant to the GB market	Q4
	Assist DG Competition in coming forward with effective proposals from the sectoral review	Q4

**Helping to Protect the Environment**

Activity	Action	Period
Energy Efficiency	Publish a review of the first year of the Energy Efficiency Commitment 2005-2008	Q2
Renewables & CHP	Publish guidance for generators on fuel measurement and sampling requirements under the Renewables Obligation	Q1
	Publish updated guidance on the administration of the Renewables Obligation to reflect changes resulting from the RO Review	Q1
	Publish annual report on Renewables Obligation	Q4
Fossil Fuel Levy	Set the Fossil Fuel Levy Rate for 2007-2008	Q3
Environmental Policy	Publish Environmental Action Plan Annual Report	Q1

**Helping to Tackle Fuel Poverty**

Activity	Action	Period
Social Action Plan	Proposals on new licence framework for protecting vulnerable customers as part of supply licence review	Q1
	Benchmarking work on the front line customer experience for vulnerable customers	Q2
	Publish follow-up on Corporate Social Responsibility Audit	Q4

**Better Regulation**

Activity	Action	Period
Better Regulation	Apply 'Project Paperless' principles to industry code modification and derogation decisions	Q2
	Implement proposals to improve transparency and access to information on Ofgem's work	Q3
	Conduct audit of stakeholders' views on Ofgem communications, including impact of Project Paperless	Q4

### Performance Indicators 2006-2007

Activity	Measure	Target	Timeframe
Wholesale Markets	Investigate and take appropriate enforcement action (which may include referring the case to the FSA) when there is evidence of licence or competition law infringements within the prescribed timescales	100%	
	Consult upon and carry out consultations regarding any applications made from Regulated Third Party Access (RTPA) by prospective storage facility and pipeline operators	100%	
	Submit decisions to the European Commission within the prescribed timescales if adequate information has been provided	100%	
	Assess and make decision in relation to any IAE within three months of it being raised if adequate information is provided	100%	
Connections	Completion of electricity/gas determinations	95%	16 Weeks
Modifications	Follow published procedures for all modifications		
	Decisions relating to modifications to industry codes, agreements and charging arrangements to be issued	70%	5 Weeks
Licensing	Competitive market licence applications to be processed	90%	10 Weeks
Enforcement	Investigate possible non-compliance with sectoral legislation and the Competition Act, in accordance with statutory timescales in all cases		
Technical Policy	Completion of Meter Asset Manager approvals and authorisations	95%	5 Working Days
Quality of Service	Resolve standards of performance determinations	95%	16 Weeks
Energy Efficiency	Respond to suppliers who have submitted schemes for approval	100%	10 Working Days of submission deadline

Renewables & CHP	Carry out reconciliation of CHP LECs	100%	20 Working Days after receipt of accurate data from Defra
	Follow up with generators any outstanding issues in their applications for accreditation	95%	5 Working Days
	Circulate the buy-out funds	100%	1 Month
	No complaints are raised under Ofgem's complaints procedure about its administration of the Renewables and CHP schemes		
Better Regulation	Respond to Freedom of Information Act queries	100%	20 Calendar Days
	Pay undisputed bills	98%	30 Calendar Days

## Appendix 4 - Ofgem budget 2006-2010

<b>BUDGET TABLE</b>						
<b>£m</b>	<b>2005-06</b>	<b>2005-06</b>	<b>2006-07</b>	<b>2007-08</b>	<b>2008-09</b>	<b>2009-10</b>
<b>Costs By Theme</b>	<b>Planned</b>	<b>Provisional outturn*</b>	<b>Planned</b>	<b>Planned</b>	<b>Planned</b>	<b>Planned</b>
<b>Creating &amp; Sustaining Competition</b>	<b>5.6</b>	<b>0.0</b>	<b>5.1</b>	<b>5.2</b>	<b>5.4</b>	<b>5.4</b>
Retail Competition (1)	1.7		1.5	1.5	1.5	1.4
Wholesale Markets (1)	1.3		1.2	1.2	1.3	1.3
Connections	0.4		0.4	0.4	0.4	0.4
Industry Codes & Licensing (2)	1.1		1.1	1.2	1.2	1.2
Enforcement & Consumer Affairs (2)	1.1		0.9	0.9	1.0	1.1
<b>Regulating Network Monopolies</b>	<b>8.7</b>	<b>0.0</b>	<b>10.1</b>	<b>8.1</b>	<b>8.4</b>	<b>7.8</b>
Transmission	3.9		3.7	1.8	1.8	1.9
Electricity Distribution	2.0		1.6	2.3	3.3	2.8
Gas Distribution	0.8		2.7	1.8	1.1	0.9
Technical (2)	2.0		2.1	2.2	2.2	2.2
<b>Helping Protect the Security of Britain's Energy Supplies</b>	<b>1.0</b>	<b>0.0</b>	<b>1.1</b>	<b>1.1</b>	<b>1.3</b>	<b>1.3</b>
Security of Supply (3)	1.0		1.1	1.1	1.3	1.3
<b>A Leading Voice in Europe</b>	<b>1.4</b>	<b>0.0</b>	<b>1.5</b>	<b>1.4</b>	<b>1.1</b>	<b>1.1</b>
Europe (4)	1.4		1.5	1.4	1.1	1.1
<b>Helping to Protect the Environment</b>	<b>1.9</b>	<b>0.0</b>	<b>2.4</b>	<b>2.7</b>	<b>2.3</b>	<b>2.6</b>
Environmental Programmes (5)	1.5		1.9	2.2	1.8	2.0
Environmental Policy	0.4		0.5	0.5	0.5	0.6
<b>Helping to Tackle Fuel Poverty</b>	<b>0.4</b>	<b>0.0</b>	<b>0.3</b>	<b>0.3</b>	<b>0.4</b>	<b>0.4</b>
Social Affairs	0.4		0.3	0.3	0.4	0.4
<b>Better Regulation</b>	<b>0.0</b>	<b>0.0</b>	<b>0.5</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>
Better Regulation	0.0		0.5	0.2	0.2	0.2
<b>Sub Total</b>	<b>19.0</b>	<b>0.0</b>	<b>21.0</b>	<b>19.0</b>	<b>19.1</b>	<b>18.8</b>

£m	2005-06	2005-06	2006-07	2007-08	2008-09	2009-10
Other Costs	Planned	Provisional outturn*	Planned	Planned	Planned	Planned
<b>Executive/Support/ Overhead Costs</b>	<b>7.9</b>	<b>0.0</b>	<b>6.9</b>	<b>7.1</b>	<b>7.1</b>	<b>7.2</b>
Board	1.1		1.0	1.1	1.1	1.1
Strategy (6)	0.4		0.0	0.0	0.0	0.0
Corporate Communications (inc. Scotland)	1.4		1.3	1.3	1.3	1.3
Finance	0.9		0.8	0.8	0.8	0.9
Human Resources	1.2		1.0	1.0	1.0	1.0
Office Services	1.0		1.0	1.1	1.1	1.1
Information Management	1.9		1.8	1.8	1.8	1.8
<b>Accommodation</b>	<b>5.0</b>	<b>0.0</b>	<b>5.0</b>	<b>5.4</b>	<b>5.2</b>	<b>5.3</b>
Gross (7)	8.3		8.3	8.9	8.7	8.9
Recharge	(3.3)		(3.3)	(3.5)	(3.5)	(3.6)
<b>Other</b>	<b>2.9</b>	<b>0.0</b>	<b>2.9</b>	<b>3.4</b>	<b>3.9</b>	<b>4.4</b>
Depreciation	1.2		1.2	1.2	1.2	1.2
Contingency	2.5		2.5	3.0	3.5	4.0
Other Income	(0.8)		(0.8)	(0.8)	(0.8)	(0.8)
<b>Sub Total</b>	<b>15.8</b>	<b>0.0</b>	<b>14.8</b>	<b>15.9</b>	<b>16.2</b>	<b>16.9</b>
<b>TOTAL COSTS</b>	<b>34.8</b>	<b>0.0</b>	<b>35.8</b>	<b>34.9</b>	<b>35.3</b>	<b>35.7</b>

1 On average about 50 per cent of Wholesale Markets' time and 20 per cent of Retail Competition's time is spent dealing with modifications to industry codes.

2 Work in these areas cuts across most of the Ofgem themes. They are listed here for transparency. It is not possible to predict how these costs will be apportioned as work in these areas is mainly demand-led.

3 Security of supply costs indicated are directly attributable to work in this area, but many workstrands under other themes contribute to the work in this area. To avoid duplication, costs included in other themes are excluded from those shown under security of supply. This also applies to a number of other cross-cutting workstrands.

4 The reduction in spend in Europe from 2008-2009 is because four members of staff will finish their secondments at the Commission.

5 Costs are projected to increase due to increased volume of activity and a planned new IT System.

6 Strategy work is being reallocated across policy divisions from 2006-2007.

7 2007-08 costs include provision for external renovation and 2008-2009 costs factor in a rent review.

\* This column will be completed in March when provisional outturn figures are known, and will be included in the final version of the Corporate Plan along with an explanation of any major variances between planned and actual expenditure.

### Budget commentary

1.1. The above table provides an estimated breakdown of Ofgem's costs by activity and theme for the years covered by the RPI-3 per cent cost control regime (2005-2006 to 2009-2010).

1.2. We have extracted central and overhead costs this year for transparency to enable comparisons to be made.

1.3. Much of Ofgem's work is of a reactive nature with constantly changing priorities. This is reflected by an increasing contingency provision over the period of the cost control regime.

1.4. The headline costs to licence payers go up by £1 million from 2005-2006 to 2006-2007 largely because of increased costs associated with environmental programmes which are outside the RPI-3 cost control regime. Ofgem believes that it will be able to offset this increase by additional savings achieved over and above the RPI-3 budget set for 2005-2006. This assumes no major changes to Ofgem's planned workstreams for the rest of the financial year.

### RPI-3 per cent cost control regime

1.5. RPI for 2005-06 was determined as 3.5 per cent. For future years this has been estimated as 2.5 per cent but will be adjusted to the rate prevailing at December of the relevant year. This gives rise to the following cost ceiling:

£m	2005-06	2006-07	2007-08	2008-09	2009-10
<b>RPI-3 per cent Budget Ceiling</b>	<b>34.2</b>	<b>34.0</b>	<b>33.8</b>	<b>33.6</b>	<b>33.5</b>

1.6. The table below sets out the cost control ceiling and, following various adjustments to reflect those costs incurred by Ofgem that do not form part of the cost control regime, the net cost to licence fee payers.

<b>BUDGET/RPI-3 PER CENT COST CONTROL RECONCILIATION</b>					
<b>(£m)</b>	<b>2005-06</b>	<b>2006-07</b>	<b>2007-08</b>	<b>2008-09</b>	<b>2009-10</b>
<b>Total Costs as per Budget Table</b>	<b>34.8</b>	<b>35.8</b>	<b>34.9</b>	<b>35.3</b>	<b>35.7</b>
<b>Costs Excluded from Regime (funded by licence payers)</b>					
Administering Environmental Programmes (net)	(0.4)	(1.4)	(1.5)	(1.1)	(1.2)
Depreciation	(1.2)	(1.2)	(1.2)	(1.2)	(1.2)
<b>Costs Included in Regime (funded by HMT)</b>					
Capital	1.0	0.8	0.8	0.8	0.8
<b>Total Adjusted Costs</b>	<b>34.2</b>	<b>34.0</b>	<b>33.0</b>	<b>33.8</b>	<b>34.1</b>
<b>RPI-3 per cent Budget Ceiling</b>	<b>34.2</b>	<b>34.0</b>	<b>33.8</b>	<b>33.6</b>	<b>33.5</b>
<b>Variance</b>	<b>0</b>	<b>0</b>	<b>0.8</b>	<b>(0.2)</b>	<b>(0.6)</b>

1.7. The table above indicates that Ofgem is maintaining costs within the RPI-3 per cent cost control regime. Indications are that while there is a forecast underspend of £0.8 million in 2007-2008, this will be offset in 2008-2009 and 2009-2010. In addition, Ofgem expects to achieve further savings in 2005-2006 which will reduce the fee payable by licence payers in 2006-2007.



## Appendix 5 - Glossary

### C

#### [Council of European Energy Regulators \(CEER\)](#)

CEER brings together the independent national energy regulators from EU Member States and the European Economic Area (EEA). CEER acts as a focal point for contacts between national energy regulators and is their primary interface at a European level. Its overall aim is to facilitate the creation of a single competitive, efficient and sustainable internal market for gas and electricity in Europe. In December 2005, Sir John Mogg was appointed President of CEER and Chairman of the European Regulators' Group for Electricity and Gas (ERGEG - see below).

#### [Climate Change Programme Review \(CCPR\)](#)

In September 2004, Defra launched a review of the UK Climate Change Programme looking at how existing policies were performing and the range of policies that might be put in place in the future. Defra expects that a revised CCP will be published in early 2006, taking into account the December 2005 Pre-Budget Report.

### E

#### [European Regulators' Group for Gas and Electricity \(ERGEG\)](#)

ERGEG is the means by which European energy regulators provide formal advice to the European Commission, both on the rules that regulators see as necessary for the effective implementation of the legislative framework and reporting on the actual state of implementation of the relevant rules and guidelines and on the level of competition in each of the Member States. Membership of ERGEG is limited to the EU regulators but those from candidate countries and the EEA hold Observer Status.

### L

#### [Liquefied Natural Gas \(LNG\)](#)

LNG consists of mainly methane gas liquified at around -260 degrees Fahrenheit. Cooling and liquifying the gas reduces its volume by 600 times such that a tonne of LNG corresponds to about 1,400 cubic metres of methane in its gaseous state. LNG may be stored or transported by special tanker.

### S

#### ['Smart' metering](#)

The primary function of a basic gas or electricity meter is to accurately ascertain the quantity of energy supplied to a consumer. Beyond ensuring that the meter meets performance requirements, is safe and that a secure display is available, no other functionality is required. Smart metering can therefore be defined as metering that

provides facilities over and above this. Technological innovation in this area is continuing at a rapid pace and there already exists a range of possible advances in metering technology, incorporating both different technologies and functionality. For example, the simplest smart meters would enable consumers to monitor energy consumption in money terms rather than kWh, while others would obviate the need for manual meter reading by communicating energy consumption and/or usage data to the energy supplier.

#### Supercomplaint

Section 11 of the Enterprise Act 2002 enables designated consumer bodies such as energywatch to make a complaint to the Office of Fair Trading or a relevant economic regulator that any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers. These complaints are called 'Supercomplaints'.

#### V

#### Vertical integration

An arrangement whereby a company owns more than one element of the supply chain, such as an electricity supplier that also owns generating plant.

## Appendix 6 - Feedback Questionnaire

Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. We would be especially interested in your views on the following questions:

1. Do you have any comments about the overall process adopted for this consultation?
2. Do you have any comments about the overall tone and content of the document?
3. Was the document easy to read and understand or could it have been better written?
4. To what extent did the document provide a balanced view?
5. To what extent did the document make reasoned recommendations for improvement?

Please feel free to add any further comments.

Please send your comments to:

Mick Fews  
Head of Licensing  
Ofgem  
9 Millbank  
London  
SW1P 3GE  
[michael.fews@ofgem.gov.uk](mailto:michael.fews@ofgem.gov.uk)