

## Corporate Strategy and Plan 2009-2014

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### **Overview:**

This document sets out Ofgem's strategy for 2009-2014.

In November 2008 Parliament legislated to amend our statutory duties. Revised statutory guidance on social and environmental matters will follow shortly.

Our strategy reflects and anticipates these developments by setting out a wide range of activities to meet the interests of current and future energy consumers and contribute to achieving a sustainable energy sector.

This strategy is presented in a year like no other in terms of the magnitude and nature of the challenges faced by the energy sector and stakeholders.

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## Context

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

## Associated Documents

- Proposed Corporate Strategy and Plan 2009-2014 and covering consultation letter, January 2009, and the responses to that consultation  
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=329&refer=About%20us/CorpPlan>
- Corporate Strategy and Plan 2009-14 initial consultation letter, August 2008 and the responses to the consultation letter, September 2008  
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=316&refer=About%20us/CorpPlan>
- Corporate Strategy and Plan 2008-13  
<http://www.ofgem.gov.uk/About%20us/CorpPlan/Documents1/CORPORATE%20STRATEGY%20AND%20PLAN%2028%20MARCH%202008.pdf>

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## Foreword

We are entering a year like no other in terms of the magnitude and nature of the challenges faced by the energy sector and its stakeholders. The worldwide financial crisis has few precedents in living memory. At the same time the need to tackle climate change brings major reductions in carbon emissions - demands matched only by expectations of secure supplies and affordable prices.

Ofgem is committed to taking action to protect the interests of energy consumers, including vulnerable consumers. We have announced new measures to address the unjustified pricing identified by our probe into the energy retail sector, along with a wide-ranging package of remedies to improve the transparency of the market and thereby enable consumers to engage effectively in the competitive market. In the current economic situation we will maintain our strategy to scrutinise suppliers' approaches to debt and disconnection to ensure vulnerable customers are protected.

We have also embarked upon a series of major projects that address the longer term interests of consumers and will contribute to achieving a sustainable energy sector. *Project Discovery* is analysing the energy market's ability to deliver secure energy supplies in the next decade and beyond. Its focus is on the impact of the credit crisis coupled with the planned closure, under European environmental legislation, of many of Britain's coal- and oil-fired power stations. We are making good progress with our *RPI-X@20* review of how we regulate the pipes and wires businesses and we have also published a report on long-term electricity network scenarios (LENS) that highlights the major challenges in developing renewable generation out to 2050.

Our work on the arrangements for connecting renewable generation to the national grid and on the new regulatory regime for offshore electricity transmission give us a great opportunity to begin the transformation of our energy infrastructure to meet the very different needs of the future. Meanwhile, we are undertaking an overhaul of the industry governance rules to cut red tape and accelerate vital reforms.

The EU is expected to adopt the 'Third Package' of energy legislation in the spring. This will be a significant development that could have profound implications for British energy consumers in the future. We are considering how we can shape and contribute to the European energy scene after the legislation is agreed.

Parliament has enacted changes to our duties to increase the focus on sustainability and future consumers. We believe that the programme of work set out in our strategy demonstrates that Ofgem is working hard to protect existing and future consumers and to contribute to the achievement of a sustainable energy sector.

Ofgem is being asked to do more, including taking on greater responsibilities to administer the Government's environmental programme. We are coming to the end of our self-imposed five-year cap on expenditure and it is already clear that we will need greater financial support to enable us to fulfil our increased responsibilities.

**The Lord Mogg, KCMG**  
**Chairman, Gas and Electricity Markets Authority**

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

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## Introduction

In August 2008, Ofgem published an open letter seeking views on the key challenges and priorities for the next five years. In January 2009, we consulted on a Proposed Corporate Strategy and Plan. The responses to both rounds of consultation are available on our website. This document sets out our strategy for 2009-2014, which we have developed in the light of the responses.

Ofgem's principal objective in carrying out its functions is to protect the interests of consumers, existing and future, wherever appropriate by promoting effective competition. We promote competitive solutions wherever appropriate, but direct regulation of network monopolies is essential to protect the interests of consumers.

Ofgem must carry out its functions in the manner best calculated to further the principal objective, having regard to the need to secure that all reasonable demands for electricity and gas are met, the need to secure that licensees can finance their authorised activities and the need to contribute to achieving sustainable development. In performing that duty, Ofgem must have regard to the needs of vulnerable customers.

Ofgem has other important duties. These include securing diverse and long term supplies and having regard to the principles of best regulatory practice. In addition, we must have regard to guidance issued by the Secretary of State for Energy and Climate Change on social and environmental matters. Revised guidance is expected to be published shortly. Appendix 5 gives more detail about our duties and powers.

The strategy is based around the following seven themes:

1. Creating and sustaining competition
2. Regulating networks effectively
3. Helping to achieve sustainable development
4. Helping to protect the security of Britain's energy supplies
5. A leading voice in Europe
6. Helping to tackle fuel poverty
7. Better regulation

Respondents to both rounds of consultation generally endorsed these themes. Work under the themes is discussed in the chapters that follow.

Responses to our proposed strategy are summarised in appendix 1. Appendix 2 sets out our deliverables and performance indicators for 2009-10. Appendix 3 sets out our budget for the period 2009-14. Appendix 4 contains our Simplification Plan, which sets out the work that we intend to undertake in 2009-10 under the better regulation agenda and in particular our duty in respect of regulatory burdens under the Regulatory Enforcement and Sanctions Act 2008.

Appendix 6 is a glossary of technical terms used in this document. Appendix 7 provides details of how to give feedback to us about the way we have carried out this consultation, should you wish to do so.

## 1. Creating and sustaining competition

### Chapter Summary

Our energy supply probe identified a number of areas where the transition to fully effective competition needs to be accelerated. We are seeking agreement with suppliers on the proposed reforms. If they do not agree, we can refer the matter to the Competition Commission. We will continue to monitor the energy markets to make sure that they are operating in the interests of all energy consumers. We will periodically publish information and analysis to inform the debate on issues such as wholesale market transparency, liquidity and the role of large customers in the market. We will continue to seek to reduce barriers to smart metering and microgeneration.

### Introduction

#### Retail markets

1.1. In February 2008 Ofgem launched its study of the state of the British energy supply markets (the probe). The probe was undertaken during a period of unprecedented increases in world fuel prices, which flowed through into record increases in wholesale and retail gas and electricity prices in Great Britain.

1.2. A typical household's energy bills have more than doubled since early 2004 and many households are now struggling to pay their energy bills. The number of consumers in debt to their energy suppliers, average debt levels and disconnection rates are all rising. These energy price rises have come at a time when household budgets are under pressure from the rising cost of food, petrol, mortgages and other essentials. Vulnerable consumers and those in fuel poverty are particularly affected. As fuel prices, wholesale energy costs and the costs of environmental compliance rise, it becomes even more vital that energy retail markets function properly because the potential adverse impact on energy consumers of any inefficiency is greater.

1.3. In October 2008 we published the findings of our probe. Ten years after British energy markets were opened to full retail competition, and six years after the domestic supply price controls were removed, we concluded that the fundamental structures of a competitive market were in place and that the transition to effective competition was well advanced and continuing. The market shares of the 'Big 6' suppliers in their former monopoly markets continue to fall year-on-year, though these markets remain highly concentrated. There are greater levels of consumer switching than almost every other energy market in the world and most other service markets in the United Kingdom (UK).

1.4. Suppliers compete actively for those consumers who seek out the best deal in the market. Dual fuel, direct debit tariffs offer the lowest prices, especially for online consumers. Around 8.5 million consumers benefit from these deals, which

represents 38 per cent of all consumers with both gas and electricity supplies. Suppliers have also considerably widened the range of tariffs available. They offer fixed, capped or variable prices, green energy deals, social tariffs, energy service packages, and other incentive and reward deals.

1.5. Concerns were expressed that the Big 6 operate as a cartel. We examined very carefully whether this was the case and are satisfied that the suppliers' key pricing decisions are made independently and without unlawful agreements or information exchange between them. Suppliers do consider the pricing policies of their competitors and possible reactions to price changes but this is a normal feature of a competitive market that we would expect to see.

1.6. We did, however, find a number of areas where the transition to competition needs to be accelerated. Many consumers are not yet benefiting fully from the competitive market. Vulnerable consumer groups are disproportionately affected. We therefore consulted on a package of measures designed to tackle these issues. We remain convinced that consumers benefit most from a vibrant competitive market and our proposals are intended to improve the functioning of the market for all consumers.

### **Wholesale markets**

1.7. As part of the probe, we examined the manner in which wholesale price changes have been passed through to consumers by the Big 6 suppliers. There is clear evidence of a lag between changes in wholesale and retail prices. This is largely the result of suppliers hedging their wholesale market exposures. We have found no evidence that this lag is greater when prices are falling than when they are rising.

1.8. There is evidence that the Big 6 benchmark their hedging strategies against each other in order to minimise the risk of their wholesale costs diverging materially. We are therefore concerned that hedging might not be adequately driven by the risk preferences of consumers. We will monitor price changes over the coming months, during which wholesale prices are likely to remain volatile, and have committed to publish quarterly reports on the relationship between wholesale and retail prices.

1.9. During the probe, small suppliers and potential new entrants highlighted price volatility and a lack of liquidity in the wholesale electricity market as potential barriers to entering the retail market. They also raised concerns about the operation of the wholesale market itself. We are as a matter of urgency undertaking work to identify both the underlying causes of low market liquidity and any actions that would improve liquidity. We are also exploring the issues raised by the Business and Enterprise Select Committee in its report in summer 2008 on energy prices. We need to be certain that the vertically integrated industry structure does not exacerbate liquidity problems or distort long-term investment decisions in wholesale businesses.



## The next two years

### Retail markets

1.10. Since the probe began the premiums paid by some customer groups, including PPM users, have been reduced significantly. Some suppliers have also made further reductions applying to the more than four million households off the gas grid and others we identified as missing out on the best deals. These developments are welcome but there is scope for further improvements by suppliers to achieve greater cost-reflectivity between different tariffs and to end undue discrimination between customer groups.

1.11. As stated above, the level of consumer participation in British energy supply markets is amongst the highest of any retail energy market in the world. We are pursuing measures to help more consumers engage actively with the market and to make well informed switching decisions. The proposed retail remedies package includes obligations on suppliers to provide:

- a standard annual statement covering, among other things, the tariff name, the customer's consumption and a reminder of the customer's right to switch;
- simplified information on tariffs to make comparison easier including an at-a-glance price score card to help consumers in switching;
- written quotations following doorstep sales and, for prepayment meter (PPM) customers, proof that the offer made on the doorstep is better than the customer's existing deal;
- new protections for small businesses including clear and transparent contract terms and conditions, and an end to automatic roll-over when fixed-term contracts expire; and
- greater financial transparency to give consumers confidence that the market is competitive and fair.

1.12. Encouraging more consumers to participate actively in the market and improving the quality of switching decisions should intensify competitive rivalry among suppliers and erode any undue price differentials between groups of consumers. However, we consider that in order to protect consumers in the short-term it is also necessary to introduce a new licence requirement on suppliers not to discriminate unduly when setting charges, including for different payment types.

1.13. Even after unjustified differentials are removed, PPM tariffs will remain amongst the most costly. It will be essential to ensure that PPM customers are aware of this price premium and that they can switch to a lower cost option as easily as possible. Improving the direct selling experience for all consumers should benefit PPM customers in particular.

1.14. The probe identified several concerns that particularly affect vulnerable groups. For example, low income groups are more likely to use PPMs and may also be prevented from switching by their existing suppliers if they are in debt. We are

reviewing the right of suppliers to prevent switching by indebted customers and will review the assistance that suppliers provide to vulnerable customers, including considering whether supplier obligations on debt and disconnection remain appropriate.

1.15. Ofgem expects that suppliers will deal fairly with their customers and facilitate their effective engagement with the competitive market. In order to encourage this, Ofgem has proposed a set of overarching standards of conduct for suppliers. The standards will complement the new licence conditions that will deliver the proposed retail remedies package and will remind suppliers of what customers are entitled to expect of them in all instances.

1.16. Ofgem will, in April 2009, publish a consultation on the drafting of the non-discrimination licence condition and related guidance. In April 2009 we will also publish a consultation on the detail of the package of retail market remedies. Subject to responses, we intend to decide on the final package by July 2009 so that the measures can be implemented before the winter of 2009.

1.17. Following concerns raised at the end of last year, Ofgem reviewed suppliers' direct debit arrangements. We found no evidence of deliberate attempts by suppliers to increase cash flow through unjustified increases in direct debits, nor of systematic errors. However, it is clear that, at a time of volatile prices, supplier processes for setting direct debits can result in large variations in payment levels. A lack of transparency and poor communication by suppliers is at the heart of the problem. We have consulted on proposals, including licence changes if necessary, to ensure that suppliers improve their customer service in this important area.

1.18. In October 2008 the Government introduced new arrangements for domestic and small business consumer representation in the energy sector. At the same time Ofgem introduced stringent new complaints-handling standards for energy suppliers. The new arrangements strengthen the incentives on suppliers to establish effective internal procedures for dealing with consumer complaints. We are auditing suppliers' practices and it is open to us to impose financial penalties on suppliers that fail to comply with the standards.

1.19. We will continue to liaise closely with Consumer Direct, Consumer Focus and the Energy Ombudsman as necessary to ensure that the arrangements operate in the interests of consumers. In 2009 we will carry out a review of how the new statutory ombudsman arrangements are working after a year of their operation and will follow up on the findings from our complaint-handling standards audit.

1.20. Theft of electricity and gas increases the cost of energy to honest customers. It can also endanger lives and property. In 2009-10 Ofgem will develop and consult on proposals to strengthen the incentives on industry participants proactively to detect and minimise theft. There are also linkages to existing price control incentives on electricity and gas distribution companies to reduce losses. We will aim to publish final proposals in late 2009 to align with the timetable for DPCR5.

1.21. Our retail market probe also found that there is no significant 'competitive fringe' - companies of a markedly different scale and business model offering a material threat to the Big 6. Consistent with our better regulation duties, we are reviewing existing regulatory obligations to gauge whether they deter new entry and growth and, if they do, whether they might be removed or made less onerous.

### **Wholesale markets**

1.22. Wholesale energy price increases have been by far the most significant driver of the price increases faced by domestic consumers. Around 65 per cent of retail prices are accounted for by wholesale electricity and gas costs. The vast majority of these costs (more than 50 per cent of the final bill) arise from international energy commodity markets in coal, oil, gas and carbon. These are drivers over which Ofgem has limited influence. Higher wholesale gas prices in part reflect the decline in supplies from the North Sea and the higher costs of importing gas over longer distances. Several major new gas storage and import infrastructure projects will be completed in the next few years and this is likely to affect the wholesale price.

1.23. Liquidity in the wholesale electricity market is low compared to other traded energy markets, including the British gas wholesale market. As a result, many small suppliers cannot always trade the products they need to hedge the requirements in both the short and longer-term. A closely related issue is the degree of vertical integration in electricity markets. Integrated companies use their generation plant as a hedge for their retail businesses. Non-integrated suppliers should be able to emulate that through trading in accessible and liquid wholesale markets. However, if liquidity is insufficient, the use of generation capacity to hedge retail profitability by integrated players is likely to exacerbate the hedging difficulties faced by non-integrated suppliers.

1.24. Ofgem intends to focus on improving wholesale market liquidity directly. In 2009 we will develop and consult on proposals to improve wholesale market liquidity. In addition, we will continue to monitor the wholesale electricity market to make sure that there is no evidence of anti-competitive behaviour. We have also just launched a consultation on the need for new powers to tackle potential abuses in wholesale energy markets.

1.25. The wholesale market rules determining imbalance ('cash-out') prices can have a significant impact on wholesale market liquidity and prices. In October 2008 we approved a modification to the Balancing and Settlement Code on the basis that it represented an improvement to those rules. However, that modification did not address all the defects of the current arrangements. While we recognise that some market participants would like a period of stability in the cash-out arrangements, we consider that there remains scope for further improvement. Specifically, we believe that issues such as the targeting of reserve costs, the cash-out price spread, the timing of gate closure and contract notifications would warrant consideration in any future modification proposals. In 2009 we will take forward work to reform these arrangements with a view to reducing their complexity and improving the economic signals on market participants to balance their energy positions efficiently.

1.26. Ofgem has for several years expressed concerns about the operation of continental European gas markets and the impact on British wholesale gas prices. The third package of energy market reforms described in chapter 5 will drive significant pro-competitive changes across the European Union (EU). We are working to accelerate implementation of the key reforms, such as improving the transparency of cross-border flows.

1.27. Given the increasing level of interconnection between Britain and continental gas markets, we have stepped up our monitoring of EU (and global) gas markets. Such monitoring is especially important when prices are high and consumers want reassurance that their bills reflect market fundamentals and are not being artificially inflated either in Britain or by companies operating abroad.

1.28. The industry has for some time been considering how to improve the cash-out arrangements in the event of a gas supply emergency. We are considering whether there is a need to strengthen price signals during an emergency and whether any other changes can be made to reduce the likelihood of an emergency occurring.

### **Metering**

1.29. The Energy Act 2008 contains a power for the Secretary of State to mandate a roll-out of smart meters across Britain by 2020. We welcome this development. Ofgem believes smart metering has the potential to bring great benefits to energy consumers. Smart meters could put an end to estimated bills and on-site meter reading. They could also provide consumers with the information that they need to become more energy efficient. This could deliver reduced bills and reduced carbon emissions, thereby helping to tackle climate change and fuel poverty simultaneously.

1.30. The Government has still to define exactly how smart meters will be delivered to all homes. We will advise DECC with a view to ensuring that smart meters are introduced in a cost-effective manner that maximises the benefits to consumers. We will also continue to work with DECC and industry on a range of issues that need resolving in order to minimise longer-term disruption to customers, such as agreeing minimum standards for smart meters and on general interoperability issues.

1.31. On behalf of the Government and industry, Ofgem is managing a three year Energy Demand Research Project to trial better billing and a range of smart meter technologies. The project is assessing customers' long term response to better information on their energy use and the effectiveness of different interventions in delivering energy savings. The trial involves around 50,000 households across Great Britain, including specific customer segments such as the fuel poor.

1.32. The Government will use the results of this trial to inform its policy on the roll-out of smart metering. As has already been recognised, the introduction of smart metering has implications for consumer protection (for example by enabling remote disconnection). Ofgem will take forward work, with DECC, on any changes that may be needed to ensure that consumers are appropriately protected.

## **Distributed energy**

1.33. Distributed energy can make a large contribution towards reducing carbon emissions from the energy sector. Local electricity generation cuts losses of electricity as it is transmitted over long distances from large power stations. In 2008 we introduced proposals to remove barriers to distributed energy within the existing marketing and licensing arrangements. This will make it easier for community electricity generators to supply customers while protecting consumer rights to switch supplier. We will monitor the impact of the changes closely.

1.34. As set out in chapter 2, we have sought to promote changes to the structure of electricity distribution charges that would, inter alia, encourage the growth of distributed energy. We will seek to make further progress in 2009. We will also advise the Government in relation to any proposals that it brings forward for the introduction of feed-in tariffs for small-scale generation using its new powers under the Energy Act 2008. We may in due course have a role in administering feed-in tariffs as part of our growing role of administering Government sustainable development programmes (see chapter 3 for details).

## **A five year view**

1.35. It is not appropriate for Ofgem to try to predict the evolution of a competitive market. Capital market competition and corporate transactions can drive efficiencies but must not be allowed to diminish the competitive pressures on energy companies. We will continue to examine the implications of energy sector mergers and will advise the relevant competition authorities of any concerns that we might have.

1.36. We expect that competition will continue to develop in the provision of bulk supplies of gas, electricity generation, wholesale markets and retail energy markets. We will monitor these markets actively to ensure that participants are acting consistently with competition and sectoral legislation. We will make sure that the resources we devote to this work remain appropriate as the markets evolve.

1.37. We will continue to promote retail market competition as the best means of protecting the interests of consumers and will continue to take full account of our other duties, including those relating to sustainable development, vulnerable consumers and security of supply. We will continue to advise the Government on how to manage the transition to a low carbon energy sector in the most cost-effective way. As part of this, we will work closely with DECC on the efficient introduction of smart metering.

1.38. Looking further ahead, the retail market might change quite radically with a growing focus on energy efficiency and reducing demand. We will consider how the regulatory framework might develop in order to facilitate the emergence of energy service companies.

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## 2. Regulating networks effectively

### Chapter Summary

Ofgem considers that incentive-based regulation is the best framework for regulating the energy network companies. However, the *RPI-X at 20* review will objectively evaluate the strengths and weaknesses of our approach to network price controls. The team will report in 2010 on whether that approach remains the best means of incentivising the companies to invest in their networks, maintain security of our energy supplies and tackle climate change. Ofgem will work with the industry to facilitate the connection of new, lower carbon generation to the transmission and distribution networks. We will develop price controls that encourage the electricity distribution companies to play their full part in tackling climate change. We will promote cost-reflective network charges and take decisions consistent across sectors wherever appropriate.

### Introduction

2.1. In general it is not efficient to have competition in most aspects of transmission and distribution activities because duplication of networks would substantially increase consumers' bills. Regulation of network monopolies is therefore necessary to protect the interests of consumers.

2.2. Regulation of networks encompasses revenue controls on network businesses; the structure and level of network charges paid by network users; incentives on quality of service; and ring-fencing the licensed network businesses so that they have adequate resources to meet the networks needs and are shielded from any financial difficulties that may be experienced by a parent company. It also means developing policies to help the network companies play their part in making the energy sector more sustainable.

2.3. Incentive-based regulation encourages network companies to deliver a variety of outputs, such as efficiency, reliability and quality of service, that are in the interests of consumers. If network businesses outperform their statutory and licence targets and obligations, they should earn higher returns. If they do not, they should earn lower returns and run the risk of incurring financial penalties. This approach encourages reliable networks, good customer service and cost efficiency and over the longer term ensures that prices to consumers are no higher than necessary.

2.4. Our approach is evolving so that the regulatory framework is flexible enough to accommodate changing patterns of supply such as renewable and other low carbon generation and new gas import terminals. We have introduced incentives such as the Innovation Funding Incentive to encourage the network companies to innovate where this will result in better outcomes for customers. We apply simple solutions where they are likely to be effective and, where appropriate, adopt policies that are consistent across the networks.

2.5. We continue to support the development of cost-reflective charging methodologies for use of the networks. This is the best means of promoting more sustainable, efficient investment in networks over the longer term and of reducing the carbon and wider environmental footprint of the energy networks.

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

## **The next two years**

### **All networks**

#### *Network of last resort arrangements*

2.7. The implications of a network company experiencing financial distress and struggling to maintain and develop its network could be serious for consumers in terms of reduced security and/or quality of supply. Therefore, over several years we have developed arrangements to protect consumers from the financial failure of a network company. These arrangements include:

- procedures for collecting and monitoring network data;
- financial ring-fencing conditions which place constraints on the operation of network companies;
- provisions for reopening or disapplying price controls; and
- provisions to place a 'protected energy company' into special administration.

2.8. While we consider that the existing arrangements are sound, they have never been tested. No gas or electricity network company in Britain has been put into administration. We consider it is important to test the robustness of our existing arrangements to ensure that consumers do not face any undue risks associated with financial failure.

2.9. In the interests of transparency, we have also developed a procedural manual setting out in detail the arrangements we have in place to respond to deteriorating financial health of a network company. We have carried out a simulation exercise to test the arrangements and will shortly publish the draft manual for consultation. We intend to publish the final manual later in the spring. We will also continue to monitor the network companies on an ongoing basis.

2.10. This work is not driven by concerns about any specific network company. Nor is it our aim to prevent the financial failure of inefficient network companies. Rather, we aim through these arrangements to ensure that the risks to and impact of deteriorating financial health on consumers are minimised. It remains at all times the responsibility of the network companies' management to ensure that they run businesses that are financially sound.

*RPI-X at 20*

2.11. In March 2008, we unveiled our *RPI-X at 20 review*. This is a two-year project examining whether the current approach to regulating Britain's energy networks will continue to deliver customers reliable, well-run networks with a good quality of service and at reasonable prices despite the growing investment challenges faced by the energy networks. These challenges include facilitating the move to a low carbon economy and ensuring continued security of supply. Ofgem is committed to ensuring that the regulatory regime is up to the task.

2.12. Ensuring effective stakeholder engagement is vital to the success of this review. We want to engage the full range of stakeholders during the review through a variety of channels. We have held a number of successful workshops, launched our web forum and we published our first consultation document in February. The review will be in two phases. The first is a 'visionary' phase, thinking strategically and exploring new and emerging concepts. The second phase will involve the development and detailed assessment of policy options. We intend to present a report with recommendations to the Authority in the summer of 2010 and subsequently to consult on the recommendations.

*Long-term electricity network scenarios (LENS)*

2.13. In November 2008 we published the LENS report from our academic partners at the University of Strathclyde and King's College, London. This report and the ongoing LENS initiative will play an important role in helping to inform and shape the development of the regulatory framework to deliver future energy networks that meet climate change and renewables targets. We hope that the report will allow Ofgem, Government, the energy industry and other stakeholders to understand better the issues that climate change and our renewables targets raise for the future development of our energy networks. It is important that Ofgem and other policy makers do not inadvertently 'close off' options for developing the networks.

2.14. In March 2009 we published an update on the LENS project, setting out our current views on the implications of the LENS scenarios for networks and regulatory policy. We remain committed to continuing the LENS initiative over the coming months and years and intend to update the report at regular intervals. We think it is important that we have joined-up thinking in all areas of Ofgem. We have established cross-project working internally to ensure that this happens effectively, and so that the LENS findings continue to be factored into our ongoing policy work across different areas. Our work to consider further the implications of the LENS scenarios for the regulation of networks will be initially taken forward through our *RPI-X at 20* review.

**Transmission networks**

2.15. We have worked closely with DECC to develop the regulatory and licensing regime for offshore electricity transmission networks. Offshore networks are important because they will transmit electricity from marine renewable generation



plant to the onshore network and therefore can help increase security of supply and decrease carbon emissions. The regulatory regime for offshore electricity transmission is designed to ensure costs are economic and efficient yet provide certainty about network delivery and operation to offshore generators. We have set up a dedicated team to manage the tenders for offshore electricity transmission licences efficiently so as to keep costs reasonable for participants. We expect to launch the first competitive tender process in the summer of 2009.

2.16. Access to the onshore electricity transmission network is currently governed by rules that were devised to connect large conventional gas, coal and nuclear power stations. These rules are poorly suited for the rapid connection of a large volume of smaller renewable generators or a significant volume of new, lower carbon conventional plant. Reform of the access rules is critical if Britain is to achieve its 2020 renewable targets and to maintain security of supply as we seek to lower carbon emissions from the electricity sector.

2.17. In the summer of 2008 Ofgem and DECC published proposals to speed up the connection of new generation projects while protecting consumers from inefficient expenditure. In the meantime, Ofgem and DECC have introduced measures to speed up the connection of renewables. This could hasten the connection of more than 1GW of extra renewables capacity over the next 18 months. Chapter 3 gives more details. More enduring access reform and new investment incentives on transmission companies should allow much faster access in future and make sure that new transmission capacity is built where and when it is needed and see the end to the significant queue of generators waiting to connect.

2.18. We also will continue to work with DECC on new regulatory arrangements that may be necessary to extend the electricity transmission network to the Scottish Islands.

2.19. We will continue to carry out annual performance monitoring and reporting on the electricity and gas transmission companies' costs and performance; reports will be published early in the succeeding calendar year. We have reviewed proposals from the transmission companies for improved output measures. We will take this work forward with a view to introducing new output measures that will enhance our ability to assess whether the companies have invested enough to sustain network performance and how much they need to invest in future.

2.20. The transmission system operators (SOs) are responsible for balancing supply and demand on the network in real time and for managing short-term network capacity constraints. We set commercial incentives to encourage the SOs to balance the system and manage constraints in an economic and efficient manner. System balancing costs have increased in recent years and we will be considering how the longer-term incentives on the SOs could be improved. We will also consider the interaction of SO incentives with the incentives placed on the transmission owners.

**Distribution networks**

2.21. In 2009 we will develop proposals for the next electricity distribution price control (DPCR5) that will come into effect on 1 April 2010. As outlined in the policy document that we published in December, we will be seeking to strengthen the incentive on the distribution network operators (DNOs) to play a full role in tackling climate change for instance connecting renewables and microgeneration and reducing losses on their networks.

2.22. We are committed to maintaining the undergrounding scheme in Areas of Outstanding Natural Beauty and National Parks and will be seeking views on how it might be improved. We are looking for ways to encourage DNOs to address the worst served customers in their areas and are developing a broad measure of customer satisfaction against which to assess the performance of the companies. We will also strengthen and widen the scope of output measures to encourage the DNOs to consider the impact of their decisions on levels of network risk and quality of service to consumers. This will make it clear what customers should expect to receive in return for paying distribution charges.

2.23. As part of DPCR5 we will set out a framework to encourage the DNOs to assess how the networks should evolve to anticipate changes in network use which might come about as a result of more distributed generation, smart meters, zero carbon homes or electric vehicles for example. As part of the RPI-X@20 project we are considering how the DNOs' role might develop into the medium-term in order to tackle climate change and ensure secure energy supplies.

2.24. Regulatory reporting in electricity distribution has enabled us to make better comparisons between companies. With the introduction of regulatory reporting for GDNs as well as DNOs, we will look for ways to streamline our requirements and reduce the burden on companies. We will continue to publish cost, revenue and quality of service data for DNOs and GDNs. We are looking to produce reports that, over time, allow a holistic assessment of each company's performance. We are also exploring how to widen the range of data that we publish. For example, we have already published data on the companies' return on regulatory equity and are considering publishing more information on the different components of network company pension costs.

2.25. Charging models play an important role in delivering efficient and sustainable network development. In 2008 we began a project on the structure of electricity distribution charges with a view to encouraging efficient network development and helping to tackle climate change by rewarding distributed energy and demand-side management where these bring network benefits. The project seeks to achieve a common, cost-reflective charging methodology with open governance arrangements across all 14 DNOs by April 2010. Following consultation in December 2008, the Authority has decided to propose new licence conditions that will ensure implementation of a common methodology and governance at lower voltage levels for April 2010. The Authority has also decided that at the highest voltage levels the DNOs may choose between two charging models and we will be seeking to place new special licence conditions on the DNOs to facilitate this. We will use the next price

control period to assess the impact the methodologies have on capital expenditure efficiency and will take steps to ensure that customers do not carry the cost of expenditure that could have been avoided through more cost reflective charging.

2.26. Gas distribution network businesses (GDNs) must also ensure that their charging methodologies remain appropriate and consider the merit of proposals that parties might bring to them. We will seek to refine the regulatory framework in response to potential new uses for the gas networks, such as biogas entry into the network. We will continue to work with the GDNs to ensure that the networks extensions scheme is successful in delivering cheaper connections to fuel poor households and communities. We are encouraging the GDNs to partner with other agencies so that network extensions are available to those communities and households eligible for grants for central heating and gas appliances. We will also consider reviewing the gas distribution licences.

2.27. We will keep under review the market and regulatory structure for independent gas transporters (IGTs) and independent electricity distribution network operators (IDNOs). Our objective is to ensure that the rise in activity in both sectors is delivering real benefits to customers in the form of lower prices or better service and to make sure that the regulatory arrangements do not stand in the way of the development of competition. We will continue our work on monitoring competition in connections and making sure that where competition does not develop, customers are adequately protected through regulation. We are considering as part of DPCR5 whether further measures are needed to improve connections services.

### **A five year view**

2.28. The EU 2020 greenhouse gases and renewables targets will continue to play an important part in shaping our activities. We remain committed to incentive-based regulation as the best means of ensuring that the networks can deal effectively with changing circumstances, whether caused by new UK or European legislation or changing supply or demand patterns. Our policies will be designed to facilitate efficient investment so that customers are protected from the risk of having to pay for network assets that are built but not used. Regulating networks transparently and consistently will further strengthen confidence in the regulatory regime.

2.29. We will continue to develop a clear, predictable and transparent approach to conducting price control reviews as this will reduce uncertainty and provide a stable framework for long term decisions by network companies and investors. Our *RPI-X at 20* review will set the regulatory framework for the network companies to meet the challenges ahead. We will of course consult fully on any changes that might be recommended by the review. Any changes that result from this comprehensive process will be implemented in the new price control reviews that we will be commencing in the next five years. We intend to commence the next electricity and gas transmission price control reviews in 2010, the next gas distribution price control review in 2011 and the next electricity distribution price review in 2013.

## 3. Helping to achieve sustainable development

### Chapter summary

Ofgem will play a full part in facilitating the transition to a low carbon energy sector. We will take full account of environmental impacts and use an appropriate cost of carbon across the range of our decision-making. We will strengthen the incentives on the network businesses to connect renewable and other plant, including low carbon generation. We will also continue to contribute to the debate on how to reduce carbon emissions from the energy sector in the most cost-effective manner, which is especially important in a period of persistently high energy prices.

We will continue to administer Government environmental programmes efficiently and effectively. This work forms a major part of our contribution to the achievement of sustainable development. It is also increasing in scale. As well as administering the existing environmental schemes, we will be running tenders for offshore transmission licences. We might also in the future have an administrative role in relation to heat, feed-in tariffs and smart meters. We will advise the Government on the development of these schemes based on our practical experience.

Chapter 6 sets out all the activities that we are undertaking to contribute to the social dimension of sustainable development.

### Introduction

3.1. The Energy Act 2008 has changed our statutory duties in two important ways. First, it has amended our principal objective to make it clearer that we must protect the interests of future as well as existing consumers. Second, it has promoted sustainable development within the hierarchy of duties so that in seeking to further our principal objective, we must now have regard to the need to contribute to achieving sustainable development. The Government is also revising the statutory guidance on social and environmental matters to which we must have regard.

3.2. Parliament has also legislated to require the UK by 2050 to reduce its carbon emissions by 80 per cent from 1990 levels. We regard these changes as a clear signal that sustainable development must continue to be an increasingly important factor in all of our policy and decision-making. As the independent regulator of the energy sector, which is responsible for the majority of our greenhouse gas emissions, it is clear that we have an important role to play.

3.3. Recognising the increasing weight of scientific evidence on climate change, changing attitudes in society, and the potential costs of inaction highlighted by the Stem Report, we have done much to take forward the sustainability agenda within the context of our existing statutory duties. Given our statutory duties, we are keen to ensure, as far as we can, that emissions reductions are made cost-effectively to minimise the burden on consumers, especially those in fuel poverty.

3.4. During 2008 we demonstrated our continued commitment to putting environmental considerations at the heart of our work. For example, we:

- incorporated the shadow price of carbon in our impact assessments and brought environmental considerations firmly into the network code modification process;
- published proposals to reform the arrangements governing access to the electricity transmission system to enable faster connection of lower carbon and renewable generation (see paragraphs 3.13-3.17 for more detail);
- published proposals to remove unnecessary regulatory and market barriers to the economic deployment of distributed electricity technologies, while protecting consumers' rights to switch energy supplier;
- published our latest thinking on DPCR5, which sets out our intention to increase sharply the incentives on electricity distribution business for 'green' investment;
- introduced new incentives for the gas distribution networks to cut greenhouse gas emissions from their networks;
- continued to engage with industry and the Government on smart metering, including running the smart metering trials and developing technical standards that will speed up the roll out of smart meters nationwide;
- continued to develop new guidelines for green tariffs, focusing on environmental benefits and greater clarity for consumers;
- advised the Government in relation to the EU Renewables Directive and the development of the UK Renewable Energy Strategy; and
- published our third report on sustainable development, which highlights the actions that we will take and notes actions needed elsewhere.

3.5. Sustainable development is at the heart of our policy and decision-making processes. The Authority's sustainable development sub-committee, which is chaired by Robin Bidwell, meets regularly to discuss policy proposals. We also organise the high level industry Environmental Advisory Group, which discusses environmental issues and their impact on the energy sector. We participate actively in a range of industry committees and initiatives that concentrate on sustainability issues.

3.6. An important role for Ofgem and the Government is to remove barriers to innovation and to provide regulatory and policy frameworks that support long term investment. This will encourage companies to invest in new, innovative and effective ways of delivering a more sustainable energy system. In recent years we have introduced incentives for the network businesses to invest in innovative technologies. We will seek opportunities to strengthen these incentives.

3.7. Where matters are not under our direct control we nonetheless see it as our responsibility to facilitate change. We do this by engaging in the debate, trying to persuade the relevant parties to make the changes that would ease the transition to a low carbon energy sector in a cost-effective way, contributing information and expertise where we can.

## The next two years

### Sustainable energy markets

3.8. Ofgem expects suppliers to offer their customers products that enable them to manage their energy use and energy costs effectively. Suppliers' quality of service can include the quality and accuracy of billing, as well as the availability of energy service products or other services that allow consumers actively to manage their own energy consumption.

3.9. In November 2008 we began work to analyse the performance of the retail market in stimulating sustained behavioural change and the uptake of energy efficiency measures. We are examining the impact of different tariff structures and products, including rising block tariffs and energy service packages, on the uptake of energy efficient measures. We are also looking at their implications for consumers, including those in fuel poverty. We will also consider the role that can be played by active demand management and so-called 'smart homes'. We will use this work to inform our advice to the Government on energy saving and heat, the Carbon Emissions Reduction Target and the UK Renewable Energy Strategy.

3.10. We have been working closely with industry and interested stakeholders on developing revised guidelines for 'green' supply. We are seeking an increased emphasis on transparency to ensure that green claims are verifiable and to make the environmental benefit of any tariff a central part of the guidelines. Once we have finalised the green supply guidelines we will work with industry to establish a certification scheme, based on the requirements set out in the guidelines, that suppliers sign up to and in so doing give customers greater clarity and ensure that green tariffs deliver environmental benefits. We expect this to occur in 2009.

3.11. As stated in chapter 1, Parliament has given the Secretary of State a power in the Energy Act 2008 to introduce feed-in tariffs for small-scale generation. We will work with DECC on the design of any proposals to implement feed-in tariffs. We will also continue to encourage DNOs to develop charging methodologies that facilitate the connection of microgenerators and will, as part of DPCR5, seek to introduce new measures to encourage DNOs to connect renewable and other low carbon distributed generation. We have worked with the Energy Savings Trust (EST) to ensure that domestic customers can easily compare the export and generation rewards available from suppliers. Export and generation tariff prices will soon be available from the Green Homes advisory service and on the EST website with guidance for customers on how to choose the best tariff for their circumstances.

### Sustainable energy networks

3.12. Ofgem will facilitate the development of sustainable energy networks. Significantly increasing the amount of renewable and other low carbon generation is a key part of this. In recent years Ofgem has approved unprecedented investment in

the electricity networks to enable the connection of low carbon generation. We have also sought radical reform of electricity transmission access arrangements.

#### *Electricity transmission access*

3.13. It is important that access to the transmission network is fair. Renewable generators need to compete on a level playing field with existing generators that already have access to network capacity. When demand for network capacity exceeds supply, as is currently the case, National Grid's 'first come, first served' approach to connections favours existing generators over new generators - which are often renewable or lower carbon than existing generators. Existing generators are given preference even though they have made no long term financial or contractual commitment to pay for network access and have the option to stop paying any charges at one year's notice.

3.14. The ultimate solution to the generation queue is to increase the capacity of the transmission network. Given the long lead time to get planning permission and then to build the upgrades, Ofgem and DECC believe that further measures are needed. We have asked the transmission companies to develop detailed investment plans that would deliver the transmission capacity required to hit the 2020 targets. We will publish this report shortly.

3.15. Ofgem is also working with the transmission companies to develop a new financial incentive framework for transmission investment. Under this framework, transmission companies will be able to anticipate demand and build new capacity before securing contractual commitments from generators to fund the links. The risk in doing this is that the companies may not correctly forecast the level or location of new demand and may invest substantial sums of money in unneeded capacity. Ofgem is proposing to allow the companies to earn higher returns than allowed under typical network price controls in return for the companies taking on some of this stranding risk. This mechanism will protect customers from the financial and environmental costs of new transmission lines that are built but not used. We are also looking to advance funding for 'pre-construction' costs such as planning surveys and applications so that this investment can be delivered as quickly as possible.

3.16. Working with the industry, National Grid is developing a range of proposals that could result in radical reform to the access arrangements. These proposals could end the first come, first served approach and deliver quicker and fairer access to the transmission system. They could also allow for much more effective use of existing transmission capacity through sharing, which will be increasingly important given the intermittency of wind generation. National Grid submitted the proposals to us in December and we aim to reach our decision in the summer of 2009. If introduced, the new arrangements would go live progressively in the period up to 1 April 2010.

3.17. As it is likely to take over a year to deliver the full set of new arrangements (and might take longer if there is a legal challenge) we are pursuing measures to accelerate renewable connections during this period. As an interim measure, Ofgem has implemented an approach known as 'connect and manage'. This will allow

renewable generators that can connect faster to make an application to National Grid to connect sooner. An extra 1GW of renewables could be connected sooner through this approach, which would represent an increase of around a third in the amount of UK renewable generation. Parliament has given the Government a power in the Energy Act 2008 to drive through reforms if the industry makes insufficient progress.

#### *Other networks issues*

3.18. Offshore renewables can make an important contribution to the UK's share of the EU renewables target. Offshore transmission networks will be required to transfer marine electricity to our onshore networks. Ofgem will carry out competitive tenders for the provision of these networks. The competitive offshore regulatory regime is designed to ensure efficient investment, allow scope for innovation, and to be flexible enough to meet the needs of future offshore generators. We believe the design of the regime will improve the economics of offshore wind by securing lower cost transmission infrastructure and encourage innovation as new players enter this exciting new market. Tenders are due to be launched in the summer of 2009.

3.19. Making sure that electricity generators located far from energy consumers face the full costs of the networks they use helps to promote microgeneration and other technologies that can bring generation closer to demand, and smaller, local energy networks. Locational charging has a key role to play in encouraging more decentralised generation, including microgeneration, and smaller networks.

3.20. The gas and electricity industries also affect the environment through the emission of pollutants and through their visual impact on our countryside and communities. We remain committed to working with all stakeholders to ensure that we take those wider considerations into account in all of our decisions.

#### **Advising the Government on environmental policies**

3.21. Ofgem will continue to advise the Government on environmental policies where they are likely to affect existing and future energy consumers. The EU has recently passed Directives on renewable energy and the EU ETS. The Commission has now determined that 15 per cent of the UK's energy should come from renewable sources by 2020. We will advise the Government on how the UK can achieve this target at the lowest cost to consumers, including mitigating the effects on fuel poverty. We advised the Commission on the long term future of the EU ETS and will monitor the development of the allowance market and its effects on British energy markets.

3.22. The Energy Act 2008 gives the Government a power to introduce a renewable heat incentive. We recognise that the supply of heat by third parties is likely to become a more established part of the competitive market as a result of government policy to encourage combined heat and power (CHP) plant, district heating schemes and heat markets more generally. We will help assess different approaches for providing safeguards for domestic customers connected to district heating schemes. We support the Government's consideration in its Renewable Energy Strategy of



additional measures for distributed energy and community energy, including CHP. We will contribute to policy development on renewable and low carbon heat.

3.23. Energy conservation and improved energy efficiency are critical elements in any sustainable development strategy. We recognise the huge range of benefits - environmental, social and economic - that energy saving can bring. We will play our part to encourage energy consumers to be more energy efficient. We will also work with agencies across Government to support initiatives to reduce the energy intensity of the economy, ensuring as far as possible that the market rewards investment in energy saving on an equivalent basis to energy consumption.

3.24. As stated in chapter 1, we welcome the Government's decision to take powers in the Energy Act 2008 to mandate a roll-out of smart meters across Britain by 2020. We hope that the Government will introduce smart meters in a cost-effective manner that maximises the benefits to consumers. We believe that this will best be achieved by preserving the benefits of competition and allowing suppliers to offer consumers the products that they want, taking account of the fact that consumers respond in different ways to information given to them.

### **Sustainable Development Reports**

3.25. We published our third annual report on sustainable development in December 2008. The report sets out the progress that we have made in facilitating a more sustainable energy industry and the actions we will take in 2009-10. It also looks at the challenges that the industry and government will face in meeting Britain's climate change and sustainability targets.

3.26. We will continue to use this report as a basis for engaging in the wider debate on climate change and for pointing out where Government and other organisations can take action to promote a more sustainable energy system. We will publish our fourth annual Sustainable Development Report in late 2009. This will again report on progress made on key indicators and give our latest views on the way forward.

### **'Greening' Ofgem**

3.27. In 2002 Ofgem became the first Government Department to achieve certification to the international standard for Environmental Management Systems (ISO14001). We have retained this certification ever since. This reflects a sustained drive to reduce our own energy usage and carbon footprint.

3.28. In 2003, for example, we installed a combined heat and power unit that has since saved well over a thousand tonnes of carbon dioxide and, since April 2007, all of our electricity has been procured from renewable sources. In 2007 our energy saving achievements were recognised by accreditation to the Energy Efficiency Accreditation Scheme (EEAS). The EEAS is an independent award scheme managed by the National Energy Foundation on behalf of the Carbon Trust. In 2008 Ofgem established an internal Environmental Champions Team, which organises awareness-

raising campaigns to drive down our use of resources such as energy, water and stationary. We will continue to seek ways of reducing our impact on the external environment. More detail on the measures we have adopted so far can be found in our Sustainable Development Action Plan.

### **A five year view**

3.29. All Ofgem policies will fully reflect our duties towards future consumers and the need to contribute to the achievement of sustainable development.

3.30. Climate change is one of the most significant challenges facing the world today. In response, the EU has proposed that 15 per cent of the UK's energy should come from renewable sources by 2020. Parliament has introduced statutory targets to reduce UK carbon dioxide emissions by at least 26 per cent below 1990 levels by 2020 and at least 80 per cent below 1990 levels by 2050.

3.31. Meeting these targets may require a transformation of the energy networks and generation technologies used to meet demand. We will continue to work with all stakeholders to identify barriers hindering the shift to a low carbon energy system. We will examine ways to enhance energy efficiency focussing for example on network losses, metering and innovative tariffs. We will seek to reduce barriers to distributed generation, renewable generation and the use of heat. We will also keep under review actions that might be required to reduce the sector's emissions of non-carbon greenhouse gas, such as methane and sulphur hexafluoride.

3.32. We will make a positive contribution to the debate about the role of the gas and electricity markets in tackling environmental issues by providing the Government with constructive and creative advice on designing and developing policy instruments for the energy sector. As part of this, we will continue to engage with policy makers so as to ensure that they recognise and consider any trade-offs that are inherent in their policy proposals. We will also encourage the Government and the EU to carry out robust cost-benefit analysis in developing policy and to look for cost-effective solutions and, wherever possible, market-based policy instruments to meet environmental targets.

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## Sustainable development programmes

Ofgem increasingly has two main 'businesses'. One of these is the core function of an economic regulator to regulate the gas and electricity markets. The other is to administer a range of Government programmes that in various ways contribute to the achievement of sustainable development. Ofgem is well placed to administer these schemes given our knowledge of the industry and its governance.

The number and scope of these programmes is increasing. Already we administer schemes relating to renewables and energy efficiency. From 2009 we will manage tenders for offshore transmission licences. In the course of the next five years we might be asked to take on an administrative role in relation to smart meters. In addition, the Energy Act 2008 leaves open the possibility that we might be asked to administer the Renewable Heat Incentive and the feed-in tariff scheme. Our aim in all cases will be to administer the programmes as efficiently as possible so as to minimise both the burdens on companies and costs to consumers.

The main environmental schemes that we administer are the Renewables Obligation (RO), which creates obligations for electricity suppliers, and the Carbon Emissions Reduction Target (CERT) which replaced the Energy Efficiency Commitment (EEC) in creating obligations for both gas and electricity suppliers. We also administer the Renewable Energy Guarantees of Origin arrangements and exemptions from the Climate Change Levy for renewables and CHP generators. In 2008 we published a review of the EEC 2005-08 and we will shortly publish our annual report on the RO.

We have extensive knowledge of the environmental programmes based on our experience of their administration. We advised the Government and the Devolved Administrations on their reforms of the RO, including the introduction of banding, which will be implemented in April 2009. We will advise the Government on any further reforms of the RO and will seek to use our expertise to secure efficient outcomes for British energy consumers. We will also be closely involved in the development of the Government's £1 billion Home Energy Savings Programme. We will ensure that resources are well targeted and that measures interact effectively with fuel poverty programmes such as Warm Front.

In April 2008 we introduced a new IT system to administer the renewables and CHP programmes. We believe that the new system has reduced burdens on the industry. We will continue to seek further efficiencies and to ensure that the schemes are administered in a customer-focused way.

From 2009 Ofgem will manage the competitive tenders for offshore electricity transmission licences. We anticipate that the cost of administering tenders in 2009-10 will be around £4.8 million. The cost of administering the other environmental programmes is projected to be £2.9 million in 2009-10, including overheads and support costs. (For a more detailed breakdown see appendix 3.) There is continuing upward pressure on these costs because of the increase in scale and complexity of the schemes since we started administering them. This work requires different skills to those needed for the economic regulation of the energy markets. Beyond advising the Government on the design of the schemes we have little discretion over the scope and nature of what we do in this part of our business.

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

### Chapter summary

A combination of competitive markets and effectively regulated networks has to date delivered secure energy supplies for Britain. Looking ahead, a number of factors, such as the credit crisis and new environmental targets (including new requirements that may be imposed by the forthcoming Industrial Emissions Directive) mean the framework for delivering security of supply will be tested more severely than it has been in recent years. We will continue to assess all policies in terms of their impact on security of supply.

### Introduction

4.1. Ofgem has important statutory duties that relate to security of supply. In protecting the interests of current and future consumers we must have regard to the need to secure that all reasonable demand for gas and electricity is met, the need to secure that licensees can finance the services that they are obliged to provide and also the need to contribute to the achievement of sustainable development. We are also required to secure a diverse and viable long-term energy supply. Therefore we assess all policies for their impact on short- and long-term security of supply.

4.2. Competitive markets provide strong commercial incentives for companies to contract for and build sources of energy supply to meet customers' demand. Competing suppliers will also seek diverse sources of supply to manage their commercial risks.

4.3. If supplies become scarce relative to demand, prices will rise and this will encourage investment to provide additional energy supplies. Prices may also go up for short periods in response to short-term shocks or sudden, unexpected disruptions to supply. Some customers will respond to short-term price shocks by temporarily reducing their energy use helping to balance supply and demand.

4.4. Since privatisation over £14 billion has been invested in around 30 GW of new electricity generation. This is more than 40 per cent of total generation capacity in Britain. Generators have invested £800 million in Flue Gas Desulphurisation to reduce emissions and prolong the life of 8.3 GW of coal-fired plant that would otherwise be unable to operate under EU laws limiting sulphur dioxide emissions from power stations.

4.5. There is at present 20 per cent more generation capacity than required to meet peak demand. This provides a satisfactory cushion in times of need and is consistent with the planning margins used before the industry was privatised. Looking forward, the closure of some coal plant on environmental grounds and the ageing of our nuclear fleet mean that the generating margin is likely to erode progressively in the absence of significant new investment.

4.6. A number of recent developments require us to scrutinise the outlook for security of supply, and the mechanisms for delivering it, even more carefully than in recent years. The credit crisis has diminished the appetite for investment in general and we need to understand fully its impact on the energy sector. In addition, there is now greater uncertainty in global energy demand and supply which impacts Britain through our links to international markets, particularly in gas. The disruption of Russian gas supplies to Europe resulting from the dispute between Russia and Ukraine emphasised the risks associated with relying heavily on limited sources of supply. Looking ahead, new and tougher environmental targets will increase the share of generation from wind onto the system, which is subject to intermittency. Ofgem needs to be confident that energy supply will be delivered reliably and efficiently under these conditions.

4.7. Britain is moving from self-sufficiency to being more reliant on gas imports. In response, the market is and has been investing significantly in gas import and storage facilities. Last year saw the expansion of the LNG gas import facility at the Isle of Grain by 9bcm and the two facilities at Milford Haven in Wales are expected to start commercial operations later this year, adding 16.5bcm to import capacity. Further investment in gas storage and import capacity will play an important role going forward as UK indigenous supply continues to decline. Under National Grid's base case forecast, the UK will be able to store about 10 per cent of its expected annual demand by 2020-21.

4.8. The value of carbon dioxide emission allocations under the European Union Emissions Trading Scheme (EU ETS) will be a powerful influence on future investment in generation. Higher carbon prices will feed through into wholesale electricity prices which will encourage greater energy efficiency by domestic and business customers. Greater certainty is needed about the arrangements for future phases of the EU ETS to encourage investment in low and zero carbon technologies. We support the full auctioning of carbon permits for electricity generators. It is also important that, whatever the allocation method, the carbon costs are passed through to customers to encourage greater energy efficiency. As we have suggested previously, revenues raised through auctioning could be used to tackle fuel poverty.

4.9. As the sources of electricity generation and gas production change, so the energy networks must evolve to meet the new demands. We facilitate the investment necessary in transmission and distribution systems when it is required. This ensures sufficient network capacity and maintains and improves reliability, so that energy supplies can be transported to consumers. We monitor network reliability and seek to improve the incentives on network companies to invest efficiently where and when the market wants network enhancements.

4.10. During the last 20 years, over £30 billion has been invested in the gas and electricity networks. Between 1991 and 2005, £6 billion was invested in the high-voltage transmission network and over £15 billion was invested in the local electricity networks. In 2005 Ofgem authorised a further £7.4 billion of investment in the local electricity networks for the period 2005-10. We also authorised more than £5 billion of investment in the gas and electricity transmission networks from 2007-12. A further £1 billion of investment might be needed to enable the transmission

companies to respond to requests for connection to their networks by developers of both conventional and renewable generation.

### **The next two years**

4.11. Ofgem has launched an urgent and substantial programme of work (*Project Discovery*) to fully understand the impact of the current economic climate and environmental targets on the outlook for security of supply, and the mechanism for delivering it. This work will inform and draw on our ongoing work on security of supply, including the Energy Market Outlook and the summer and winter outlook consultations discussed below.

4.12. The implications of a network company experiencing financial distress and struggling to maintain and develop its network could be serious for consumers in terms of reduced security and/or quality of supply. As noted in chapter 2, we are testing the robustness of the existing arrangements to ensure that consumers do not face any undue risks associated with financial failure.

4.13. We will continue to seek to remove barriers preventing the market from delivering security of supply that lie within our remit and powers. We will work with Government to remove others, such as planning, and will advise the Government in relation to its forthcoming National Policy Statement for major energy infrastructure projects.

4.14. We will continue to work with customers and industry stakeholders, for example by holding seminars, to ensure that market participants are aware of the options that they have to manage the difficulties created by high and volatile prices during periods of tighter supplies. As part of this we will continue to try to facilitate improvements in demand-side management and response.

4.15. National Grid publishes winter and summer outlook reports looking at the prospects for short-term security of supply in Britain. Given the increasing interdependence of British, European and even global energy markets, we will be working with National Grid to increase the international dimension of these reports. We play a key role in a number of regulatory initiatives being taken forward with other European regulators (see chapter 5 for more details) and we will use these processes to continue to work towards greater transparency and liberalisation of the European energy markets. We will also contribute to the debate over the proposed new EU Directive on gas security of supply.

4.16. We will work with DECC as necessary to refine the arrangements for analysing longer term security of supply issues. At the end of 2009 we will jointly publish our *Energy Markets Outlook*. This document outlines the prospects for medium- and long-term security of supply to help the industry and consumers make the decisions needed to maintain security of supply. The 2009 document will be the first report to be prepared in the light of the EU Renewables Directive and UK Renewable Strategy.

4.17. Working with the industry and the Energy Emergencies Executive, we will maintain and improve the effectiveness of the contingency arrangements that underpin the gas and electricity markets in the event of an emergency. Following the floods that took place in Yorkshire and Gloucestershire in 2007, Ofgem has been considering the issue of flood protection for electricity substations. The DNOs are working with Ofgem, DECC, and the Environment Agency to establish levels of flood risk, determine appropriate solutions and prioritise work. We will take this forward as an important part of DPCR5.

4.18. Ofgem, the DNOs and DECC have been considering the resilience of the distribution networks to high impact/low probability events affecting network infrastructure in key central business districts. This has involved assessing the cost of increasing the level of redundancy of the network to mitigate the impact of such events and the potential economic losses in these areas should power be lost for a significant period of time. We will continue to keep under review the resilience of networks to future climate impacts and will pursue such measures as may be necessary to ensure that security of supply is maintained.

4.19. We will continue working with the European Commission, and other European regulators and stakeholders to ensure that arrangements in continental Europe do not restrict supplies of liquefied natural gas and/or piped gas to the UK. We will continue to apply a light touch regulatory regime for new gas import infrastructure where this will promote competition and protect customers' interests. However, we will impose regulated third party access to these facilities in the absence of effective 'use-it-or-lose it' arrangements.

4.20. Ofgem will continue to work with DECC, the Health and Safety Executive and the European Commission to develop new gas quality standards. The aim will be to introduce new standards that allow greater trading with and transportation of gas to and from continental Europe, who currently have different gas quality standards to the UK, but do not lead to customers facing very high costs to convert gas appliances to meet the new standards.

## **A five year view**

4.21. We will continue to monitor the evolution of competitive markets and key indicators of security of supply and highlight any emerging issues to the market and to customers. We will for example examine the incentives for investment in new electricity generation plant and will monitor the impact of increasing amounts of intermittent generation on the balancing market.

4.22. The development of new gas infrastructure should ensure that Britain has secure gas supplies from a diverse range of sources over the next five years and beyond. We will facilitate this by maintaining our light-touch approach to the regulation of new infrastructure providers where our analysis shows that the new infrastructure will enhance competition in the gas market and benefit consumers.

4.23. These developments will increase the interaction of the British market with European and global gas markets. Over 30 per cent of electricity is generated from gas-fired power stations, so there will be important interactions with the electricity market as well. Ofgem will monitor these developments and ensure that competition continues to evolve and security of supply is maintained.

4.24. Incentive-based regulation will be the best means of ensuring that the network regulatory regime remains fit for purpose and flexible enough to cope with changing circumstances. Our policies will be designed to facilitate new investment in a timely and efficient way. As stated in chapter 2, we will continue to develop a clear and predictable approach to network regulation in order to reduce uncertainty and provide a stable framework for long term decisions by network companies. We 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.



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## 5. A leading voice in Europe

### Chapter summary

We will continue to support the European Commission in its drive to achieve competitive and sustainable energy markets that operate in the interests of British energy consumers. We will work with fellow EU energy regulators and the UK Government on the detailed implementation of the new energy legislation and on the gas and electricity regional market initiatives.

### Introduction

5.1. European energy markets, and EU regulatory and competition policy, have a major and increasing influence on Britain's energy markets and consumers. Gas transported across the continent will be increasingly vital for our security of supply as we become a net importer of gas through new and expanded interconnectors. Continental electricity flows will have an increasing influence on the security of our electricity supply with several new interconnectors under development. British energy prices are already increasingly influenced by market arrangements in continental Europe and this is set to continue.

5.2. The overall objective for our European activities is unchanged. It is to develop truly competitive European electricity and gas markets that benefit British consumers in terms of prices and security of supply. We aim to influence the debate and remove the risk that European markets and regulation roll back the benefits that liberalisation has brought to British consumers.

5.3. We work primarily through the Council of European Energy Regulators (CEER) and the European Regulators' Group for Electricity and Gas (ERGEG). They advise the Commission on energy regulation and competition and are playing an active role in developing the policy framework needed to establish effective energy markets in Europe. Lord Mogg has now been confirmed as Chair until 2010.

5.4. We have built direct relations with EU institutions, in particular the Commission. These links have served us well as the Commission has been developing the third package of legislation to liberalise energy markets. The package, which imposes tougher unbundling requirements, creates a new energy agency and requires the regulators and transmission system operators to draw up legally binding cross-border network codes, is due to be adopted in the spring. We are now advising DECC as it negotiates the detail in European Council meetings and we will work closely with DECC to achieve our common aims for European energy policy.

5.5. We will pursue the development of effective regional energy markets through the Gas and Electricity Regional Initiatives. This is an important practical step towards the eventual goal of a competitive single European energy market.

5.6. Ofgem's efforts through CEER/ERGEG and the regional initiatives have led to significant progress in improving transparency in European electricity and gas markets. Most countries regularly publish detailed data on the availability of generation plant and maintenance plans. This reduces the volatility and risk premia associated with wholesale markets that lack data transparency, to the benefit of consumers. In gas, significant progress in the North West region has been made in publishing data about gas flows and capacity availability. We will be keeping up the pressure to ensure that transmission operators publish a full range of information that the market values.

5.7. The Commission has just published a *Strategic Energy Review*, which proposed several measures to increase security of energy supplies, such as a new Directive addressing in particular gas supply shocks and other emergencies. Following the Russia-Ukraine crisis, legislative proposals relating to security of gas supplies will be made this year. We will use our links with DECC, the European Commission and CEER/ERGEG to encourage measures (such as increased transparency) to enhance security of supply. The Commission has also proposed an action plan for LNG and a blueprint for an offshore North Sea electricity grid. We will actively seek to influence the debate on these matters.

5.8. With higher energy prices and the progressive liberalising of retail markets across Europe, consumer issues are rising up the agenda. We will engage closely in that work to ensure that proposals are workable in the context of the competitive British energy markets and to help develop our thinking on consumer issues generally, such as the impact of smart meters. In October 2008 we hosted the *Citizens Energy Forum* where such issues were discussed. We expect this to be an annual event.

5.9. The EU has developed a 'green package' to complement its liberalisation agenda. This includes Directives on carbon emissions trading and renewable generation. These Directives are likely to have significant impacts on national energy markets. Ofgem has for some time been actively involved in the debate, not least in our role as Chair of the EU Sustainable Development Taskforce. In 2009 our focus will shift towards the implementation of these Directives.

5.10. We will continue to support the work of the European Technology Platform ('SmartGrids') that has brought together stakeholders from across Europe to develop a vision for the electricity networks of the future, together with a strategic research agenda and deployment plan to make this a reality.

## **The next two years**

5.11. With the Third Package on energy legislation in place the focus will switch to implementation. As part of this, we will contribute to the work of CEER and ERGEG in preparing for the establishment of the new EU energy agency, for instance by helping to draw up the agency's consultation processes and draft its rules of procedure. The agency is an important part of the new institutional framework for

energy regulation in the EU, which also includes strengthened national regulators that are expressly protected from direct political interference.

5.12. We have in recent years argued strongly for full structural unbundling of transmission networks because it would enable British energy suppliers to gain fair access to continental transmission and storage capacity for the first time, which in turn could help secure British energy supplies and reduce pressure on prices. It will now be vital to ensure that transmission unbundling is carried out rigorously across the EU so these benefits can be secured in full. For our part, we will consider, with DECC, how the Directive's unbundling provisions should be implemented in Scotland.

5.13. Ofgem will work proactively with national energy regulators and industry in areas where we think the potential for benefits to British consumers is greatest. In particular, we will prioritise work to improve transparency in the North West regional gas market and seek to ensure that key transmission businesses publish data on gas flows and transmission capacity.

5.14. Ofgem will seek to draw up guidelines for opening up access to European networks including new mechanisms for the non-discriminatory allocation of transmission capacity. We will consider how best to incentivise investment in cross-border interconnection. We will develop proposals to remove barriers to entry from balancing arrangements and explore the potential for new EU-level powers for tackling abusive conduct in the wholesale electricity market.

5.15. We will also step up our involvement as the Commission develops its thinking on security of supply and environmental issues. We will promote policies that are consistent with facilitating genuinely competitive European energy markets that operate in the interest of British energy consumers. Our aim will be to guard against the risk of measures being implemented that adversely affect competition and consumers in British energy markets.

5.16. As noted above, there is growing interest at European level in the consumer agenda and in particular the extent of consumer protection in liberalised energy markets. We will play a central role in the debate, which is focusing on issues such as potential EU-level complaint-handling standards, monitoring the impact of smart meters and monitoring compliance with consumer protection Directives.

5.17. In recent years we have been heavily engaged in policy development for CEER and ERGEG. We expect that this will continue, for example as we tackle issues such as congestion management, gas interoperability and system balancing in the context of developing cross-border industry codes. We will maintain working groups and industry discussion groups to focus on specific reform proposals. We will also continue to encourage the European regulators to consult, via CEER and ERGEG, on all significant regulatory proposals.

## **A five year view**

5.18. Ofgem will work with CEER, ERGEG, the Commission and the new Agency for Co-operation of Energy Regulators (ACER) to ensure that European competition and regulatory policy benefits British energy consumers.

5.19. We will continue to develop effective regional energy markets that benefit consumers and can evolve into a single competitive European market. We expect that our work will lead to regional electricity and gas markets that are substantially more pro-competitive than the existing arrangements.

5.20. Within the next five years ACER will become fully operational and new, binding cross-border network codes will be in effect. These changes are likely to have far-reaching implications. Ofgem will seek to ensure that the changes operate in the interests of British energy consumers.

5.21. We will also aim to ensure that any new Directives contain proposals that are in the interests of British energy consumers and that they are implemented effectively and consistently across the EU.

## 6. Helping to tackle fuel poverty

### Chapter summary

With increasing numbers of households struggling to pay their fuel bills, we will continue to facilitate efforts by the Government and industry to target fuel poverty measures on those most in need. The package of remedies being developed as a result of our probe will help ensure that vulnerable consumers receive more benefit from the competitive market. We will also continue our broader programme of work as part of our Social Action Strategy to protect the interests of vulnerable customers. We will look at suppliers' measures to protect vulnerable customers, including their approach to debt and disconnection in the current economic climate. This work is a major part of our contribution to the achievement of sustainable development.

### Introduction

6.1. The Government defines fuel poverty as existing where a household needs to spend more than 10 per cent of its income on energy to maintain a satisfactorily warm home. Fuel poverty is part of a wider problem of poverty caused by a combination of high energy prices, low incomes and poor housing conditions. A lack of affordable energy can have a significant impact upon the lives of individuals, raising health issues and having implications for general wellbeing and economic prosperity. The Government and the Devolved Administrations have committed to eliminating fuel poverty and have separate targets, the overall aim being that no household in the UK should live in fuel poverty by 2018.

6.2. Official fuel poverty figures for 2006 estimate that 3.5 million households in the UK were in fuel poverty, of which 2.5 million were vulnerable households (which in this context means a household containing children or those who are elderly, sick or disabled). Since 2006 pressure on energy prices has intensified as a result of global demand, oil price rises and the impact of environmental schemes. Substantial increases in retail prices have created difficulties for lower income customers and pushed more consumers into fuel poverty. As a result, the number of households in England experiencing fuel poverty is expected to have increased by another 0.7 million in 2007 and a further 0.5 million in 2008.

6.3. Ofgem must have regard to the needs of vulnerable customers in carrying out our duties. We must also have regard to social and environmental guidance issued by the Secretary of State, which will shortly be revised. In doing this we can make an important contribution towards achieving the Government's fuel poverty targets.

6.4. Ofgem has been very active in contributing to and influencing the debate about measures to help tackle fuel poverty. In particular, Ofgem has highlighted the need to target help to those who need it most and improve the effectiveness of individual measures. In April 2008 we convened a Fuel Poverty summit bringing together Ministers, Government officials, energy suppliers and consumer organisations to agree a programme of practical action to improve the targeting of existing help to

those in fuel poverty and to help more vulnerable consumers participate more effectively in the energy market. The key outcomes from the Summit included:

- legislation to allow the Department of Work and Pensions and energy suppliers to share data so that help could be targeted at vulnerable pensioner customers;
- greater transparency of energy suppliers' social measures to fuel poor customers;
- Defra, eaga and suppliers agreed to establish a pilot programme to check that 3,000 vulnerable customers were on their supplier's best tariff. This has now been completed and plans for a roll out are being explored.

6.5. In 2008 the Government secured an agreement with suppliers to increase their collective expenditure on their social programmes by £225 million for 2008-11. We published a monitoring framework and guidance document in July 2008 and our first report of suppliers spend against this framework in December 2008. This confirmed a baseline annual spend of £57 million. We also made clear that a supplier's social tariff would be eligible only if it was at least equal to the lowest tariff they offered to customers in that area, including online deals, regardless of the payment method. The challenge remains getting the message to those who most need the help and ensuring that once identified they can benefit from the full range of help available - the 'find and fix' approach. This will continue to require a joined up approach from Government, industry and other agencies.

6.6. The costs of investment needed to meet Britain's evolving energy needs and the cost of measures to reduce carbon emissions will continue to place upward pressure on prices for all consumers. Competitive markets are vital to ensure that energy prices are truly competitive and as low as they can be. Ensuring that the market remains competitive and that vulnerable customers can and do access that lower prices available will therefore remain a key part of our work. Environmental measures have increased energy costs and there is a case for recycling some of the funds raised by auctioning carbon allowances to tackle fuel poverty.

6.7. In developing its approach to climate change, it is essential that the Government adopts a truly sustainable approach that takes full account of the social implications of environmental issues. The Government has announced a full review of its fuel poverty strategy, which will include looking again at the role of social tariffs and how best to target the help available. We will contribute fully to these important debates.

## **The next two years**

### **Retail markets**

6.8. One of the key findings of the probe described in chapter 1 was that many consumers were not yet benefiting fully from the competitive market and that vulnerable consumer groups are disproportionately affected. Lack of internet access, poor levels of literacy and numeracy, reliance on cash and tight budgets all create barriers to participation in the market.

6.9. Ofgem will in 2009 seek to implement a range of measures that will assist vulnerable consumers in participating fully in the benefits of a competitive market. This may include changes to the rules governing suppliers' ability to prevent switching by customers who are in debt, improving the information available to consumers about tariffs and switching and strengthening direct selling rules. In monitoring switching by vulnerable customers we will consider how to assess the quality of switching decisions as well as the rate of switching. We are also looking to introduce licence conditions that require cost-reflective tariff differentials for different payment methods and ban undue discrimination.

6.10. There is scope for significant further increases in domestic energy efficiency. Energy demand could be reduced by improving the efficiency of products and processes and through changes in consumers' consumption or behaviour. Increased energy efficiency contributes to the achievement of Government fuel poverty and climate change targets. Ofgem is currently looking at how to promote greater take-up of energy efficiency measures in order to inform our policy advice to Government.

6.11. We will continue to advise the Government on the evolution of the energy efficiency programmes, including the Supplier Obligation, building on our experience of administering the CERT scheme. Our aim will be to try to ensure that resources are well targeted and that the CERT and the new Community Energy Saving Programme announced by the government in September interact effectively with fuel poverty programmes such as Warm Front. We will also use the result of the smart metering trial to inform our view of the potential for smarter metering to help tackle fuel poverty through increased energy efficiency and lower cost PPMs.

6.12. At a time of rising bills and mounting economic uncertainty, Ofgem has pressed suppliers to increase their efforts to help customers manage their bills, resolve debt early and avoid disconnections. It is essential that suppliers do all they can to assist their customers, particularly those who are vulnerable, to manage their energy bills and to prevent the build up of debt. We will keep up the pressure on suppliers by reviewing debt management practices and by promoting best practice. We will not hesitate to take further action, including naming and shaming suppliers, if necessary.

6.13. In 2009 we will continue to monitor suppliers' social spend and continue our work to ensure that the actions from our Fuel Poverty Summit are implemented. Given that there are now around 5 million consumers in fuel poverty, we need to ensure that we understand where assistance is most required so we can advise on targeting support effectively. We will consider this issue further in 2009. We will also work with the Government's Financial Inclusion Taskforce to encourage appropriate take-up of direct debit as a payment method.

6.14. At European level, we will take part in ERGEG's Consumer Working Group and Consumer Empowerment Taskforce as they develop proposals to harmonise arrangements for consumer representation and redress. We also expect to host the 2009 Citizens Energy Forum sponsored jointly by the energy and consumer Directorates of the European Commission. We will seek to ensure that any EU-wide proposals are consistent with the new arrangements for consumer representation and redress that were introduced in Britain in 2008.

## Energy networks

6.15. Last year, as part of the gas distribution price control review, Ofgem introduced new incentives for GDNs to extend the gas network. The incentives could help to reduce energy charges for fuel poor households who currently use other more expensive heating fuels. We also introduced a Discretionary Reward Scheme for GDNs, which includes incentives to cut the upfront charges of network extensions and in-house works that customers in fuel poor communities face if they want to be connected to the gas network. Encouraging network extensions can help to alleviate fuel poverty and can also bring environmental benefits, for example where customers replace fuel oil with mains gas. We will monitor the impact of these incentives on the extent to which the GDNs do connect fuel poor communities to the gas networks.

6.16. The new arrangements for handling consumers' complaints apply to network-related complaints as well as complaints about suppliers. We will work with *Consumer Focus* to ensure that any emerging trends are monitored so that action can be taken if necessary. We will continue to work with the companies to promote best practice in dealing with vulnerable customers when supplies are interrupted.

## A five year view

6.17. The costs of future investment to meet energy needs and measures to reduce carbon emissions are likely to continue to put upward pressure on energy prices. Consumer and social issues will therefore remain high on the agenda. We will

- monitor the effects of the measures that we implement in 2009 to improve the market for vulnerable consumers and take further action if necessary;
- seek to ensure that vulnerable consumers can engage effectively in the market and make informed switching decisions;
- seek to ensure that competition minimises costs for all consumers;
- keep the companies' regulatory obligations to their most vulnerable customers under review and ensure that the companies comply with them;
- promote best practice across the industry in dealing with the particular issues facing vulnerable consumers;
- play a leading role in developing EU-wide measures on consumer issues; and
- continue to advise the Government on developing fuel poverty programmes.



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## 7. Better regulation

### Chapter summary

We remain committed to policies and processes that are consistent with better regulation principles. We will continue to seek opportunities to remove unnecessary burdens on businesses. We will seek continuous improvement to our operational efficiency and effectiveness and thereby keep our costs under tight control. We will continue to develop our approach to consumer engagement so that consumers' views are properly reflected in our decision-making. We will draw on best practice from Government Departments and regulators as appropriate.

### Introduction

7.1. Ofgem has a long standing commitment to better regulation in all our activities. We apply better regulation principles to the policies that we develop and the way in which we develop them. This approach is consistent with our duty to 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 which appear to us to represent best regulatory practice.

7.2. We will seek alternatives to conventional regulation where we consider that they will better protect the interests of consumers. These alternatives may include self-regulation, especially in the competitive retail markets. Increasingly we are adopting an initiating or facilitating role in which other parties develop policy solutions. We will continue to consider whether any regulations impose burdens on licensees that, in the context of our broader statutory duties, are unnecessary and could be removed. This is consistent with our duty under the Regulatory Enforcement and Sanctions (RES) Act 2008 to keep our functions under review and secure that we do not impose or maintain regulatory burdens that we consider unnecessary.

7.3. Better regulation is not only about policy development. It is also about running our operations as efficiently and effectively as we can. The RPI-3 per cent internal cost control, now entering its last year, gives us an incentive to reduce our costs in real terms. In addition, we seek to administer sustainable development programmes in the most efficient and cost-effective way possible. We will continue to monitor closely any better regulation developments that take place within Government and across regulators and, where appropriate, will draw on best practice as it evolves.

### The next two years

#### The industry codes governance review

7.4. In June 2008, we issued our decision on the scope of the industry codes governance review. The review is one of Ofgem's key better regulation initiatives over the coming year. Whilst the industry codes arrangements have worked well to

deliver incremental reform across a wide range of areas, in setting the scope for the review we have identified a number of concerns with the governance arrangements.

7.5. The arrangements can hinder progress on strategic reforms that could provide significant benefits to consumers. Key reforms are often delayed by piecemeal development of multiple modifications processes as well as by divergences in the interests of commercial players. Two such examples are electricity transmission access reform and electricity cash-out reform.

7.6. The codes arrangements have also become too complex or fragmented and as a result impose unnecessary burdens on market participants, particularly smaller participants and consumers. This is particularly concerning given the changing nature of the market landscape and the entry of smaller suppliers as well as smaller renewable and distributed generation based participants.

7.7. The Authority therefore initiated a major programme of work on codes and charging methodology governance arrangements to ensure that they remain fit for purpose and preserve competition in a changing market landscape. A key focus of this work programme is the introduction of a framework which would enable Ofgem to lead and manage major policy reform programmes under the codes framework.

7.8. In parallel the review is considering proposals that would enable Ofgem to withdraw from making decisions on modifications that have little material consumer or competition impacts. These decisions could be taken by industry. We consider that it is possible that an industry based self-governance process for low consumer impact proposals could produce significant efficiency and better regulation benefits.

7.9. The review is also looking at the scope for simplifying the code modification arrangements. We consider that reduced complexity should benefit all parties, including new entrants, small market participants and consumers in participating in codes processes and influencing policy outcomes. As part of this work we have established an Ofgem-chaired industry working group that is considering improvements to the modification process. We will publish the working group's report shortly.

7.10. We are also examining whether the analysis of proposals by the code panels is of sufficient quality, transparency and accessibility to market participants. We are considering measures for improving the performance of the code administrators who manage the process and prepare modification reports. We are also considering whether the codes' objectives should more closely reflect the Authority's statutory duties, relating to sustainable development, and whether market participants should be able to propose modifications to network charging methodologies. We will publish initial proposals in the summer and final proposals by the end of 2009.

**Consumer First initiative**

7.11. Ofgem's principal objective is to protect the interests of existing and future consumers. In order to do this effectively, we need to have a clear understanding of what consumers think about the major policy issues we face so that their views can inform our decisions. To that end we are committed to establishing an effective working relationship with consumer representation organisations such as *Consumer Focus*. However, Ofgem believes it is also important to have a direct relationship with consumers so we can gain the benefit of their insight. This is why we launched our *Consumer First* initiative in January 2007, which has contributed to many of our key policy decisions.

7.12. We have sought to learn more about customers' views on electricity distribution issues, including the extent of their willingness to pay for network improvements. This research is informing our approach to DPCR5. We have also taken a close look at the different issues facing vulnerable customers in order to understand how we might reduce or remove barriers to different groups engaging with the energy market and improve the effectiveness of the advice that they get on switching energy supplier.

7.13. As part of the work for our energy markets probe we carried out behavioural segmentation work to elevate our understanding of how different consumers behave in relation to the energy market and we carried out research with small businesses to explore their views on energy suppliers. In addition, we have improved our understanding of how consumers' attitudes to energy and environmental issues are changing. We have brought this together in a report on *Future Consumers*, which will provide the basis for further work in this area.

7.14. We have established two panels to assist us in our work. The *Consumer First Panel* is a representative sample of 100 energy consumers in five locations across Britain. Through regular meetings where issues can be debated in depth and ad hoc surveys between meetings, this panel will provide us with feedback on key energy topics and regulatory issues. We have also set up a *Consumer Challenge Group* comprising six consumer experts, four domestic and two from business, who have in depth knowledge of the energy sector from the consumers' perspective. This group will help Ofgem in complex, high-level decision-making by discussing issues with the relevant sub-Committee of the Authority. We envisage that the group's input will complement the representations made by the industry and other stakeholders on key policies. We are piloting this approach in DPCR5.

7.15. In our view, the *Consumer First* initiative has positioned us at the leading edge in terms of the way that we engage with the developing priorities of consumers and results in better informed decisions. However, we will look closely at the recent Rating regulators report produced by Consumer Focus to identify where there are examples of best practice from other regulators that we can draw on in the future.

**Retail markets**

7.16. As noted in chapter 1, we are pursuing measures to help more consumers engage actively with the market and to make well informed switching decisions. We have announced our intention to consult on a package of remedies in April 2009.

**Reporting requirements for distribution network businesses**

7.17. Regulatory reporting in electricity distribution has facilitated proper company comparisons and publication has aided transparency. We have spent much time ironing out inconsistencies in interpretation. With the introduction of regulatory reporting for GDNs we will look for ways to streamline the reporting arrangements.

7.18. We remain committed to publishing cost, revenue and quality of service data for DNOs and GDNs. We will explore whether we can widen the range of data that is put in the public domain, exploring for example whether we could publish more on the different components of network company pension costs. We will also seek to publish GDN performance against a balanced score card and DNO performance against new output measures agreed as part of DPCR5. We believe that these measures will enhance transparency and facilitate effective regulation of the networks in the interests of network users and ultimately consumers.

**Improving Ofgem's accessibility and transparency**

7.19. In recent years we have redesigned our consultation and decision documents, simplified our code modification decision documents and redesigned our website. Internally, we have introduced electronic records management across Ofgem. We are currently reviewing our Publication Scheme under the Freedom of Information Act and expect to publish a wider range of operational information as a result.

**Costs and efficiency**

7.20. Internal efficiency savings are primarily driven by the RPI-3 per cent target, which commits us to savings of over £1 million per year from 2005 to 2010. We have beaten this target in each of the first three years of the cost control. As a result we have been able to reduce the licence fees by an additional £2.9 million in 2006-07; £0.6 million in 2007-08; and £0.9 million in 2008-09.

7.21. The RPI-3 cost control regime has led to improved financial discipline, which has enabled us to carry out our corporate programme and achieve high levels of operational performance while beating our cost control targets. We expect this to continue in the final year of the cost control period despite the increasing pressures on our resources and costs. It should be noted that some of our work will be in response to unplanned events and requests, such as those made of us by the Government. By their nature these cannot be fully accounted for in our forward planning and budgeting and they may require us to revise our work.

7.22. Where we are asked to take on the administration of new sustainable development programmes we will always seek to ensure that explicit provision is made for funding as part of these arrangements. The Government has proposed that Ofgem should administer on DECC's behalf new programmes relating to renewable heat, feed-in tariffs and community energy saving. No budgetary provision is currently included for these programmes.

7.23. We are also experiencing upward pressure on our budget in other areas of our work. For example, our probe into the retail markets will lead to additional work to ensure that the industry delivers the full benefits of competition to the entire market and changing market conditions mean that we need to monitor market activity more closely. We intend to maintain a strong cost control discipline and have begun to consider what arrangements would be appropriate in 2010 and beyond.

### **Simplification Plan**

7.24. Appendix 4 contains our latest annual Simplification Plan. It sets out the activities that we intend to undertake in 2009-10 in support of the better regulation agenda. Consistent with our new duty under the RES Act 2008, we have considered whether there are any regulations that impose burdens that could, in the context of our duties generally, be considered unnecessary. The Simplification Plan reflects our current view of the work we should undertake to reduce or remove those burdens. We will set out the progress that we make on these projects in our Annual Report.

### **A five year view**

7.25. We will continue to review our policies and processes with a view to achieving and maintaining best practice in better regulation. We will keep our functions under review to secure that we do not impose or maintain unnecessary burdens on businesses. We will consult on, and publish, annual Simplification Plans and subsequently report progress on removing burdens in our Annual Reports.

7.26. We will seek to ensure that any EU or UK regulation of the competitive generation and supply markets is targeted and proportionate. We will look for further opportunities to withdraw from regulation of competitive markets, but will do so only where it would be in the interests of consumers. We will continue to refine the regulation of the monopoly networks. Our *RPI-X at 20* review will enable us to build on lessons learned from previous price control reviews. We will consider the scope for reviewing electricity generation, electricity transmission and gas transporter licences against better regulation principles. We will continue our work to ensure that we are clear about consumer views to enable us to protect their interests effectively and those of future consumers.

7.27. In 2009-10 we will determine new arrangements for internal cost control in 2010-11 and beyond. Over the next five years we will ensure that the RPI-X cost control regime enables us to strike an appropriate balance between continued cost reductions and maintaining the quality of our work.

## Appendices

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## Appendix 1 - Consultation Questions

1.1. In the consultation on our Proposed Corporate Strategy and Plan 2009-2014 Ofgem specifically sought views on the following questions.

### CHAPTERS 1-7

**Question 1:** Does this theme remain valid?

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

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

### CHAPTER 7 (BETTER REGULATION)

**Question 4:** Are there any areas of regulation that you consider to be an unnecessary burden that should be removed?

**Question 5:** Are there any other activities that we should include in the Simplification Plan that we intend to publish in March?

## List of Respondents

List	Name
1	CE Electric
2	Centrica
3	Consumer Focus
4	EDF Energy
5	Electricity North West
6	E. On
7	Energy Networks Association
8	Energy Retail Association
9	Friends of the Lake District
10	National Grid
11	Northern Gas Networks
12	RWE
13	Scottish Environmental Protection Agency
14	Scottish Fuel Poverty Forum
15	Scottish Power
16	Scottish and Southern
17	Wales and West Utilities
18	Which?

## Summary of Responses

1.2. None of the responses were marked as being confidential. They are all therefore available on Ofgem's website [www.ofgem.gov.uk](http://www.ofgem.gov.uk) and from Ofgem's library.

1.3. The following is a summary of those responses which were received.

### Overview

1.4. Responses highlighted the great challenge of facilitating a low carbon electricity system and new sources of gas supply while maintaining secure energy supplies. Many respondents stated that regulatory stability and predictability was especially important at a time of financial and economic crisis in order to encourage the massive investment that would be needed.

### Creating and sustaining competition

1.5. Responses were divided on the actions that Ofgem should take following the probe. Suppliers stated that it was vital that Ofgem should not intervene in the market in ways that would put at risk the benefits to consumers from competition, such as the freedom of suppliers to innovate on price and product. In general suppliers expressed opposition to new prescriptive regulation, such as a non-discrimination licence condition, but were more receptive to information remedies that could increase transparency for consumers. Consumer groups wanted Ofgem to implement the full range of proposed remedies because they do not believe that competition is working for all consumers. They also looked forward to working with us in relation to debt and disconnection measures and in assessing the effectiveness of the new consumer representation arrangements.

1.6. Several respondents stated that interventions in retail and wholesale markets would increase uncertainty and dampen investment incentives, for example in new generation. It was, however, suggested that Ofgem should review whether the existing electricity wholesale market arrangements were likely to deliver secure supplies in the middle of the next decade. Others stated that a market abuse licence condition was unnecessary.

1.7. Respondents were keen for the roll-out of smart meters to start as soon as possible but some were concerned that the current structure of the metering market would reduce the efficiency of the roll-out. All respondents that commented welcomed our consultation on theft of energy and there was widespread interest in our forthcoming work on the impact of tariff structures on the uptake of energy efficiency measures.



**Regulating networks effectively**

1.8. Many respondents stated that Ofgem should promote regulatory stability and predictability so as to incentivise new investment. Those respondents argued that we should avoid overly complex market-based solutions to issues such as allocating network capacity. Some were critical of our approach to electricity network charges and managing transmission constraints, which they said threatened security of supply.

1.9. Respondents supported our incentive-based approach to network regulation but noted, particularly in relation to electricity distribution, that if the role of the DNO was going to change, Ofgem must lead the process of defining that new role and then make sure that the incentives were adequate. Several respondents welcomed the innovation incentive and hoped it could be developed further. Others said we should do more to encourage transmission investment 'ahead of need'.

1.10. Respondents agreed that the RPI-x@20 project was very important and needed careful consideration, though one party said the timetable was "leisurely". Respondents also welcomed the LENS work but some wanted it to be better integrated with DPCR5. One respondent noted that the LENS conclusions should be tested against the Government's strategies on renewables and heat.

1.11. There was general support for a review of IGTs/IDNOs and also some support for allowing network users to propose changes to charging methodologies. A few respondents advocated extending onshore transmission licence offshore rather than competitive tenders. Some suppliers called for far greater information transparency about network businesses. By contrast, some network companies were concerned about increased reporting requirements under DPCR5 and wanted a reduction of the burden.

**Helping to achieve sustainable development**

1.12. Respondents agreed that tackling climate change was a major challenge but others noted that sustainability also meant focusing on security of supply. Some said that Ofgem should increase its focus on sustainable development and work closely with Government and other regulators.

1.13. One respondent asserted that "Ofgem will have to match the evolving political drive" on renewables and distributed generation, for example by increasing the incentives on networks to connect low carbon generation. Others were concerned that we should continue to advise the Government on how to help meet environmental targets efficiently.

1.14. Many respondents noted that energy efficiency was the best means of increasing the sustainability of the energy system; some felt that we should give this more prominence in our strategy. One respondent noted that Ofgem was right to seek to ensure that the Government funds the SD programmes that we administer.

### **Helping to protect the security of Britain's energy supplies**

1.15. Respondents agreed that maintaining secure supplies was critically important and, while a job primarily for market participants, would require careful policy management by Ofgem. Stable, predictable regulatory policy would be important.

1.16. Some respondents felt that changes to the market structure might be necessary to deliver security of supply from 2014 and stated that Ofgem should review this. As noted above, some respondents asserted that the volatility of network charges was creating sufficient uncertainty as to deter investment and hence threaten medium-term security of supply. Concern was also expressed about our approach to gas quality and blending.

1.17. Others wanted the strategy to say more about the role of gas storage and other new infrastructure in maintaining secure supplies. Those respondents favoured a light-touch regulatory approach and specifically opposed mandated levels of 'strategic' gas storage. They also noted generally that emergency procedures should not undermine the market.

### **A leading voice in Europe**

1.18. The consensus is that this work remains very important, indeed increasingly so. All agreed that Ofgem's voice needs to be heard within European groups to ensure that new EU regulation strengthens competition and is in the interests of British energy consumers. Some commented that we could do better at flagging our forthcoming European work to British stakeholders. Some noted that the new European agency should adopt better regulation principles. Those who commented were divided on transmission unbundling.

### **Helping to tackle fuel poverty**

1.19. Suppliers said that, while they were doing what they could to tackle fuel poverty, responsibility should lie primarily with the Government. Suppliers also noted that the Government's Fuel Poverty Strategy, drawn up in 2001 at a time of cheap energy, needed fundamental reappraisal. Suppliers stated that we should do more to encourage government departments to provide information to suppliers.

1.20. Consumer groups expected our probe remedies to deal effectively with unfair pricing and the other issues faced by vulnerable customers. They wanted a clear timetable for implementation. One supplier, EDF, supported mandated social tariffs.

### **Better regulation**

1.21. Several respondents acknowledged that in general we act in accordance with better regulation principles. Some said that our pursuit of complex solutions on network access and charging was not consistent with better regulation principles.

1.22. One respondent called for standard consultation duration periods and asked us to step up the “mainstreaming” of consumer issues. Concern was also expressed that the internal cost control might prevent us pursuing important projects like enforcement cases.

1.23. Most respondents welcomed the industry codes governance review, especially our proposals for self-governance. Respondents emphasised the importance of proper checks and balances in any major policy review process.

1.24. Respondents also welcomed our proposed Simplification Plan, which sets out the better regulation projects that we intend to pursue in 2009-2010, and our continued commitment to review our functions and remove unnecessary burdens under the Regulatory Enforcement and Sanctions Act 2008. Respondents suggested the following activities to remove “unnecessary” burdens:

- review the gas distribution licence as soon as possible;
- ‘streamline’ network reporting requirements;
- remove guaranteed standards of performance for suppliers; and
- review the gas transportation licence, then electricity transmission and generation.

## Appendix 2 - Ofgem's deliverables and performance indicators 2009-10

### Deliverables 2009-10

#### Creating and sustaining competition

Activity	Action	Period
GB Markets - Market monitoring and development	Publish key probe remedies for statutory consultation	Q2
GB Markets - Market monitoring and development	Publish 2009 Energy Markets Outlook report	Q3
GB Markets - Market monitoring and development	Publish final Winter Outlook Report	Q3
GB Markets - Market monitoring and development	Publish proposals for System Operator incentives to apply from 1 April 2010	Q4

#### Regulating networks effectively

Activity	Action	Period
Regulatory Services	Publish financial distress process manual	Q1
Distribution	DPCR5 - methodology and initial cost assessment update	Q1
Distribution	DPCR5 - publish initial proposals	Q2
Transmission	Implement longer-term enhanced Transmission Operator (TO) incentives	Q2
Distribution	DPCR5 - publish final proposals	Q3
Distribution	Publish Connections industry Review	Q3
Transmission	Publish Regulatory Reporting Pack for the Transmission Operators	Q3
Transmission	Make decisions for Connection and Use of System Code modifications relating to the Transmission Access Review	Q3
Transmission	Implement short-term enhanced TO incentives	Q3
Distribution	Publish DNO costs and outputs report	Q4
Distribution	Publish GDN costs and outputs report	Q4
Transmission	Approve gas entry substitution arrangements	Q4

#### Helping to achieve sustainable development

Activity	Action	Period
Environmental Policy	Publish report on incentives for energy saving	Q1
Environmental Policy	Publish Sustainable Development report 2009	Q3

*Sustainable development programmes*

Ofgem administers several environmental programmes on behalf of the Government. The deliverables associated with this work for 2009-10 are as follows:

<b>Activity</b>	<b>Action</b>	<b>Period</b>
Energy Efficiency	Publish a review of the Energy Efficiency Commitment 2005-08	Q2
Community Energy Savings Programme (CESP)	Following the Government's consultation, publish the procedures for the administration of the CESP scheme	Q3
Renewables & Combined Heat and Power	Publish annual report on Renewables Obligation	Q4

**A leading voice in Europe**

<b>Activity</b>	<b>Action</b>	<b>Period</b>
European Strategy	Agree plans for phase 2 of gas transparency in the North West Gas Regional Initiative	Q1
European Strategy	Submit National Report to European Commission	Q2

**Helping tackle fuel poverty**

<b>Activity</b>	<b>Action</b>	<b>Period</b>
Social & Consumer Affairs	Update on Social Action Strategy	Q1
Social & Consumer Affairs	Review of suppliers' debt practices	Q2
Social & Consumer Affairs	Publish a review of the new ombudsman arrangements	Q4
Social & Consumer Affairs	Update on vulnerable customer engagement with the market	Q4

**Better regulation**

<b>Activity</b>	<b>Action</b>	<b>Period</b>
Industry Codes & Licensing	Industry Codes Governance Review - publish initial proposals relating to major policy reviews/self-governance and the role of industry code administrators	Q2
Finance - Fossil Fuel Levy	Set the Fossil Fuel Levy Rate for 2008-09	Q3
Industry Codes & Licensing	Industry Codes Governance Review - publish final proposals relating to major policy reviews/self-governance and the role of industry code administrators	Q4

## Performance Indicators 2009-10

Activity	Measure	Target	Timing
GB Markets	Consult on applications made for exemption from Regulated Third Party Access by prospective storage and pipeline operators	100%	
	Submit decisions to the European Commission within the prescribed timescales if adequate information has been provided	100%	
	Assess and make decisions in relation to any Income Adjusting Event within three months of it being raised if adequate information is provided	100%	
Industry Codes & Licensing	Publish decision letters for industry code modification proposals within 25 working days	70%	Annual
	Grant competitive licence applications within 8 weeks of receipt	90%	Annual
Social & Consumer Affairs	Respond to complaints on enforcement matters confirming whether we will investigate	90%	4 weeks
	Respond substantively to customer contacts	93%	10 working days
Finance - Accounting Operations	Pay authorised invoices within 8 working days of receipt	98%	8 working days

## Sustainable development programmes

Activity	Measure	Target	Timing
Energy efficiency	Respond to suppliers that have submitted schemes	100%	Within 10 days of submission deadline
Renewables & CHP	Follow up with generators outstanding issues in their applications for accreditation	100%	Within 10 days of submission deadline
	Complete reconciliation of CHP LECs	100%	Within 20 working days after receipt of accurate data from Defra
	Recycle the RO buy-out funds	100%	Within one month

## Appendix 3 - Ofgem's budget 2009-14

<b>BUDGET TABLE</b>	<b>RPI-3 per cent five-year cost control period</b>									
<b>£m</b>	<b>2005-06</b>	<b>2006-07</b>	<b>2007-08</b>	<b>2008-09</b>	<b>2008-09</b>	<b>2009-10</b>	<b>2010-11</b>	<b>2011-12</b>	<b>2012-13</b>	<b>2013-14</b>
<b>Costs by theme</b>	<b>Out-turn</b>	<b>Out-turn</b>	<b>Out-turn</b>	<b>Planned</b>	<b>Provisional Outturn (1)</b>	<b>Planned</b>	<b>Planned</b>	<b>Planned</b>	<b>Planned</b>	<b>Planned</b>
<b>Creating &amp; sustaining competition</b>	<b>5.2</b>	<b>5.6</b>	<b>5.5</b>	<b>4.5</b>	<b>6.1</b>	<b>5.6</b>	<b>6.0</b>	<b>6.0</b>	<b>6.1</b>	<b>6.3</b>
GB Markets monitoring/development	2.9	3.2	2.8	2.4	3.6	3.2	3.6	3.8	3.8	4.0
Connections	0.3	0.4	0.3	0.3	0.4	0.3	0.3	0.3	0.4	0.4
Industry Codes and Licensing (2)	1.0	1.1	1.4	0.9	0.9	0.9	0.9	0.7	0.7	0.7
Enforcement & Consumer Affairs (2)	1.0	0.9	1.0	0.9	1.2	1.2	1.2	1.2	1.2	1.2
<b>Regulating network monopolies</b>	<b>9.4</b>	<b>10.7</b>	<b>8.7</b>	<b>9.6</b>	<b>10.1</b>	<b>8.1</b>	<b>8.0</b>	<b>7.7</b>	<b>7.6</b>	<b>7.8</b>
Transmission	5.2	4.0	2.5	2.5	2.7	3.0	4.0	3.5	3.3	2.7
Distribution (3)	3.3	5.8	3.9	4.4	4.4	3.6	2.5	3.3	3.4	4.1
RPI-X at 20 and regulatory finance	0.0	0.0	0.0	0.6	0.7	1.5	1.5	0.9	0.9	1.0
Technical (4)	0.9	0.9	2.3	2.1	1.0	0.0	0.0	0.0	0.0	0.0
Offshore Tender Team	0.0	0.0	0.0	0.5	1.8	4.8	5.2	4.3	4.4	4.5
Offshore Tender Team Recharge	0.0	0.0	0.0	(0.5)	(0.5)	(4.8)	(5.2)	(4.3)	(4.4)	(4.5)
<b>Helping to achieve SD</b>	<b>1.8</b>	<b>2.5</b>	<b>2.4</b>	<b>2.6</b>	<b>2.6</b>	<b>2.6</b>	<b>2.7</b>	<b>2.8</b>	<b>2.9</b>	<b>2.9</b>
Environmental Programmes (5)	1.4	2.0	2.0	2.1	2.1	1.9	2.0	2.0	2.1	2.1
Environmental Policy	0.4	0.5	0.4	0.5	0.5	0.7	0.7	0.8	0.8	0.8
<b>Security of energy supplies</b>	<b>1.2</b>	<b>1.3</b>	<b>1.3</b>	<b>1.2</b>	<b>1.3</b>	<b>1.4</b>	<b>1.6</b>	<b>1.6</b>	<b>1.6</b>	<b>1.7</b>
Security of Supply (6)	1.2	1.3	1.3	1.2	1.3	1.4	1.6	1.6	1.6	1.7
<b>A leading voice in Europe</b>	<b>1.2</b>	<b>1.5</b>	<b>1.0</b>	<b>1.0</b>	<b>1.1</b>	<b>1.3</b>	<b>1.5</b>	<b>1.5</b>	<b>1.6</b>	<b>1.7</b>
Europe	1.2	1.5	1.0	1.0	1.1	1.3	1.5	1.5	1.6	1.7
<b>Helping to tackle fuel poverty</b>	<b>0.3</b>	<b>0.3</b>	<b>0.4</b>	<b>0.4</b>	<b>0.6</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>
Social & Consumer Affairs (7)	0.3	0.3	0.4	0.4	0.6	0.7	0.7	0.7	0.7	0.7
<b>Better regulation</b>	<b>0.3</b>	<b>0.5</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>
Better Regulation	0.3	0.5	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3
<b>Sub Total</b>	<b>19.4</b>	<b>22.4</b>	<b>19.5</b>	<b>19.5</b>	<b>22.0</b>	<b>19.9</b>	<b>20.8</b>	<b>20.6</b>	<b>20.8</b>	<b>21.4</b>

£m	RPI-3 per cent five-year cost control period						2010-11	2011-12	2012-13	2013-14
	2005-06	2006-07	2007-08	2008-09	2008-09	2009-10				
Other Costs	Out-turn	Out-turn	Out-turn	Planned	Provisional Outturn (1)	Planned	Planned	Planned	Planned	Planned
<b>Executive/Support/Overheads</b>	<b>7.9</b>	<b>7.9</b>	<b>9.8</b>	<b>8.8</b>	<b>9.9</b>	<b>9.5</b>	<b>10.1</b>	<b>10.1</b>	<b>10.4</b>	<b>10.6</b>
Strategy and Direction	1.3	1.0	1.0	1.1	1.2	1.3	1.4	1.4	1.5	1.6
Corporate Comms & Scottish office	1.2	1.3	1.5	1.6	1.6	1.6	1.7	1.7	1.8	1.8
Finance	0.7	0.8	0.8	0.9	0.9	0.9	1.0	1.1	1.2	1.2
Human Resources	2.0	1.0	2.0	1.2	2.1	1.2	1.4	1.4	1.4	1.5
HR Graduate Scheme	0.0	0.0	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5
Corporate Services	2.7	2.8	2.8	3.0	3.6	3.5	4.1	4.0	4.0	4.0
Restructuring	0.0	1.0	1.3	0.6	0.1	0.6	0.0	0.0	0.0	0.0
<b>Accommodation</b>	<b>4.5</b>	<b>4.6</b>	<b>5.2</b>	<b>5.1</b>	<b>5.0</b>	<b>4.6</b>	<b>5.3</b>	<b>5.3</b>	<b>5.5</b>	<b>5.6</b>
Gross	8.4	8.3	8.7	8.7	8.6	8.5	9.0	8.9	9.5	9.8
Recharge	(3.9)	(3.7)	(3.5)	(3.6)	(3.6)	(3.9)	(3.7)	(3.6)	(4.0)	(4.2)
<b>Other</b>	<b>0.1</b>	<b>(0.2)</b>	<b>0.2</b>	<b>2.1</b>	<b>0.1</b>	<b>2.1</b>	<b>3.1</b>	<b>3.6</b>	<b>3.6</b>	<b>3.6</b>
Depreciation	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Anticipated developments	0.0	0.0	0.5	2.0	0.0	2.0	3.0	3.5	3.5	3.5
Other Income	(0.8)	(1.1)	(1.2)	(0.8)	(0.8)	(0.8)	(0.8)	(0.8)	(0.8)	(0.8)
<b>Sub Total</b>	<b>12.5</b>	<b>12.3</b>	<b>15.2</b>	<b>16.0</b>	<b>15.0</b>	<b>16.2</b>	<b>18.5</b>	<b>19.0</b>	<b>19.5</b>	<b>19.8</b>
<b>TOTAL COSTS</b>	<b>31.9</b>	<b>34.7</b>	<b>34.7</b>	<b>35.5</b>	<b>37.0</b>	<b>36.1</b>	<b>39.3</b>	<b>39.6</b>	<b>40.3</b>	<b>41.2</b>

Notes: (1) See 2008-09 provisional spend analysis below. (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) Gas distribution and electricity distribution have been merged. (4) This item relates to our statutory obligations in relation to gas and electricity metering and gas quality. The metering work is carried out by the National Weights and Measures Laboratory (NWML) and a full transfer of statutory and financial responsibility to NWML under the Energy Act 2008 is due to occur on 1 April 2009. (5) On behalf of the Government Ofgem administers several environmental programmes. (6) 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 applies to other cross-cutting workstrands. (7) Work that contributes to the theme 'helping to tackle fuel poverty' is also undertaken across other work strands.



## 2008-09 provisional spend analysis

1.1. Provisional expenditure for 2008-9 shows that Ofgem is forecast to spend £1.5 million above our planned budget. This has been funded by a reserve drawn down in accordance with the RPI-3 per cent cost control regime. The reserve drawn down along with the full utilisation of anticipated development has funded the main areas of overspend detailed below:

- GB Markets - additional expenditure was incurred on the Probe project;
- Enforcement & Consumer Affairs - the *Consumer First* project established two new panels, the Consumer First Panel and the Consumer Challenge Group;
- Offshore tender team - the later than planned enactment of the Energy Act 2008, led to higher unrecoverable set-up costs; and
- Support costs – with the additional projects and increased activity, including environmental programmes, associated recruitment costs and IT system development increased.

## Budget commentary

1.2. 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 (2005-06 to 2009-10) and for a further four years (from 2010-11 to 2013-14). As with the last four budgets, we have extracted central and overhead costs for transparency to enable comparisons to be made.

1.3. Much of our work is reactive with constantly changing priorities. To provide for this a contingency for future developments has been included in the budget. In 2008-09 we expect to utilise all the £2.0 million contingency. We have also obtained approval from HM Treasury to use £1.5 million of our £3 million reserves to fund additional activities, such as offshore transmission and the retail market probe.

1.4. In 2009-10 Ofgem proposes to set the contingency for future developments at £2.0 million. In later years, the contingency for future developments is set to rise to reflect increased uncertainties. However, we anticipate that these will reduce as budgets are finalised.

## Offshore electricity transmission

1.5. Under the Energy Act 2008, the Government has set out that Ofgem will be responsible for administering on behalf of DECC the tender process for the award of transmission licences to offshore transmission owners. Costs associated with the offshore tender administration are shown in the above budget table. It is planned that costs relating to the tender process will be recovered through fees associated with the tender rather than by Ofgem's normal licence fee payers.

## Environmental programmes

1.6. As set out in chapter 3, Ofgem administers a range of environmental programmes on behalf of other Government departments. Our projected costs of administering these programmes in 2009-10 are shown in the table below.

Renewable Obligation	£1.0m
Energy Efficiency Commitment	£0.4m
Non-Fossil Fuel Obligation	£0.1m
Climate Change Levy Exemption for Renewables & CHP	£0.3m
Renewable Energy Guarantees of Origin	<u>£0.1m</u>
Sub-total	£1.9m
Overhead & support costs	<u>£1.0m</u>
<b>Total</b>	<b>£2.9m</b>

1.7. Government plans currently propose that Ofgem may be responsible for administering on behalf of DECC additional programmes, such as a renewable heat incentive, feed-in tariffs and a community energy saving programme. No budgetary provision is currently included for these programmes.

## Capital Expenditure

1.8. During 2009-14 Ofgem will continue to invest in computer hardware in order to ensure that our IT capability is maintained. Capital expenditure will be required on our Millbank Headquarters to ensure that we adhere to the terms of our lease.

## RPI-3 per cent cost control programme

1.9. RPI was determined as 3.5 per cent for 2005-06, as 2.2 per cent for 2006-07, as 4.4 per cent for 2007-08, as 4.0 per cent for 2008-09 and as 0.9 per cent for 2009-10. 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>33.9</b>	<b>34.3</b>	<b>34.7</b>	<b>33.1*</b>

\* The budget ceiling has been reduced by £0.8 million as a result of the transfer of metrology responsibilities to the NWML in 2009-10.

1.10. 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. The table indicates that Ofgem is maintaining costs within the RPI-3 per cent cost control regime.

1.11. The budget ceilings give rise to anticipated savings of approximately £1.0 million per year and approximately £5.3 million over the period of the RPI-3 per cent regime. For 2005-06, 2006-07 and 2007-08, the planned savings of £1.1 million were achieved. In addition, extra savings of £2.9 million, £0.6 million and £0.9 million were achieved and returned to licence fee payers in 2006-07, 2007-08 and 2008-09 respectively.

<b>BUDGET/RPI-3 PER CENT COST CONTROL RECONCILIATION</b>					
<b>(£ million)</b>	<b>2005-06 Outturn</b>	<b>2006-07 Outturn</b>	<b>2007-08 Outturn</b>	<b>2008-09 Provisional</b>	<b>2009-10 Planned</b>
<b>Total costs</b>	<b>31.9</b>	<b>34.7</b>	<b>34.7</b>	<b>37.0</b>	<b>36.1</b>
<b>Costs excluded (funded by licensees)</b>					
Administering Environmental Programmes (net)	(0.4)	(1.3)	(1.2)	(0.8)	(1.1)
Depreciation	(1.2)	(0.9)	(0.9)	(0.9)	(0.9)
Reserve drawn down				(1.5)	(1.5)
<b>Costs excluded (funded by non- licensees)</b>					
Offshore tender process - gross costs	0.0	0.0	0.0	0.5	4.8
Offshore tender process - recharge income	0.0	0.0	0.0	(0.5)	(4.8)
<b>Costs included (funded by HMT)</b>					
<b>Capital</b>	1.0	0.8	0.8	0.8	0.8
<b>Total adjusted costs</b>	<b>31.3</b>	<b>33.3</b>	<b>33.4</b>	<b>34.7</b>	<b>33.1</b>
<b>RPI-3 per cent budget ceiling</b>	<b>34.2</b>	<b>33.9</b>	<b>34.3</b>	<b>34.7</b>	<b>33.1</b>
<b>Variance</b>	<b>(2.9)</b>	<b>(0.6)</b>	<b>(0.9)</b>	<b>0.0</b>	<b>0.0</b>

## Appendix 4 - Ofgem's Simplification Plan 2009-10

1.1. Ofgem is committed to the principles of better regulation and we are continually seeking to improve our efficiency and effectiveness. As a part of this, and in response to the Government's drive to reduce regulatory burdens while ensuring consumer protection, we published our first Simplification Plan in March 2006.

1.2. We set out below our Simplification Plan that outlines the work that we intend to undertake in 2009-10 in support of our better regulation agenda. Consistent with our duty under the RES Act 2008, we have considered whether there are any regulations that impose burdens that could, in the context of our duties generally, be considered unnecessary.

1.3. In consulting on the strategy we sought views on whether the activities that we have identified were appropriate and would be likely to reduce or remove unnecessary burdens. Respondents generally welcomed the Simplification Plan while suggesting several other projects that we could undertake. We have carefully considered these suggestions. The Simplification Plan reflects our view of the work we should undertake to reduce or remove those burdens pursuant to the new duty. We will set out the progress that make on these projects in our Annual Report.

### Process initiatives

Initiative	Outcome	Current status
Ofgem RPI-3 per cent cost control for 2005-10.  Commits Ofgem to save at least £5 million in 5 years.	The internal cost control has stimulated greater internal efficiency.  Licensees have benefited from reduced fees.	We are approaching the final year of the existing cost control period.  In each of the first three years of the control we beat our cost reduction target. We returned an extra £4.4 million of savings to licence fee payers in 2006-08.  In the light of increasing cost and other resource pressures we are considering how best to incentivise internal efficiencies after 2010.

<b>Initiative</b>	<b>Outcome</b>	<b>Current status</b>
<p>Industry codes governance review.</p> <p>The review is considering whether existing code and can be improved, for example by introducing:</p> <ul style="list-style-type: none"> <li>▪ a framework enabling Ofgem to lead and manage major policy reform via the codes; and</li> <li>▪ self-governance where proposals have little impact on consumers or competition.</li> </ul> <p>We are also aiming to make the modification process more transparent and accessible, for example to smaller code participants.</p>	<p>The reformed governance regime should:</p> <ul style="list-style-type: none"> <li>▪ deliver change in a manner that results in a proportionate regulatory burden;</li> <li>▪ promote inclusive, accessible and effective consultation;</li> <li>▪ are transparent and easily understood;</li> <li>▪ are administrated in an independent and objective fashion;</li> <li>▪ provide rigorous and high quality analysis of proposed changes;</li> <li>▪ are cost-effective; and</li> <li>▪ are sufficiently flexible that they will always allow for efficient change management.</li> </ul>	<p>We set out the scope of the review in June 2008.</p> <p>For the following work strands we will publish initial proposals in Q2 of 2009 and final proposals in Q4 of 2009:</p> <ul style="list-style-type: none"> <li>▪ Major Policy Reviews and Self-Governance</li> <li>▪ Role of Code Administrators and Small Participant Initiatives.</li> </ul> <p>We will publish further consultations on code objectives in April 2009 and on charging Methodologies in April or May 2009.</p>
<p><i>Consumer First</i> project to improve our understanding of the priorities of domestic consumers, for example on sustainability issues</p>	<p>Improved decision-making that takes proper account of consumers' views. We will publish research and other data to facilitate debate.</p>	<p>Ongoing. We have focused on vulnerable customers and attitudes to the environment. We have also established new consumer panels (see chapter 7 above).</p>
<p>Project Paperless:</p> <p>Establishment of an Editorial Board to with remit to include:</p> <ul style="list-style-type: none"> <li>▪ a review of the quality and quantity of print and electronic publications; and</li> <li>▪ a review of the success of Paperless; and</li> <li>▪ to consider options for a second phase to the project</li> </ul>	<p>Benefits all stakeholders who will need to spend less time and effort working through Ofgem documents</p>	<p>Implemented from December 2007.</p> <p>The Editorial Board will produce revised internal guidance to Ofgem staff on writing 'plain English' documents in 2009.</p>

**Policy initiatives**

<b>Initiative</b>	<b>Outcome</b>	<b>Current status</b>
Probe follow-up work: Increased transparency (eg separate accounts, more accessible bills)	Better informed switching decisions by consumers	We have announced our intention to consult in April 2009 on a package of measures
Removing barriers to distributed energy (DE) within the existing marketing and licensing arrangements.	Reduced administrative burden for DE providers.  The changes will make it easier for DE providers to supply customers while at the same time protecting consumer rights to switch supplier.	We introduced proposals to remove regulatory barriers that took effect in late 2008. DE companies can contract with larger suppliers to manage the administrative requirements of industry codes. We will monitor the impact of the changes closely in 2009.
Streamlined approach to the 2010-15 electricity distribution price control	Reduced administrative burden for electricity distribution businesses	We will develop and consult on detailed proposals throughout 2009
<i>RPI-X at 20</i> review.  This is examining whether the current RPI-X approach to network regulation will continue to deliver reliable, well-run networks with good quality service at reasonable prices despite growing investment challenges.	The review team will report to the Authority in the summer of 2010. We will subsequently consult on the recommendations.  The eventual conclusions will inform our approach to new price control reviews after 2010.	Following a series of workshops with industry, investors, customers and academics, we published a consultation document in February 2009 seeking views on whether we are looking at the right issues during the 'visionary' phase of the project.
New, simplified reporting regime for distribution companies  We remain committed to publishing cost, revenue and quality of service data for GDNs.	Reduced administrative burden for distribution businesses and greater data transparency for network users.	We are looking for ways to simplify the reporting requirements. We will explore whether we can widen the range of data that is put in the public domain. We will also seek to publish GDN performance against a balanced score card and DNO performance against new output measures agreed as part of DPCR5

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Distribution licence reviews	<p>Ensure that the licences remain fit for purpose and that they do not impose unnecessary burdens on licensees.</p> <p>Simplify the text to make them more accessible to those using them.</p>	<p>We completed the electricity distribution licence review and published revised licences in May 2008. The changes improved the style, format and ease of use of the licences.</p> <p>Noting stakeholders' views about the desirability of doing so promptly, we will consider taking forward a review of gas distribution licences in the next year or two.</p>
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## Appendix 5 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority ('the Authority'), the regulator of the gas and electricity industries in Great Britain. This appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in UK statute (such as the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Acts of 2004 and 2008) as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this appendix are to Part 1 of each of those Acts<sup>1</sup>. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This appendix must be read accordingly.<sup>2</sup>

1.3. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of consumers, existing and future, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.4. The Authority must when carrying out those functions have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them<sup>3</sup>;
- the need to contribute to the achievement of sustainable development<sup>4</sup>; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.<sup>5</sup>

1.5. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

1 Entitled "Gas Supply" and "Electricity Supply" respectively.

2 However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

3 Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

<sup>4</sup> This obligation was introduced by the Energy Act 2008 with effect from 26 January 2009. See below for more details.

<sup>5</sup> The Authority may have regard to other descriptions of consumers.



- promote efficiency and economy on the part of those licensed<sup>6</sup> under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply.

1.6. In carrying out these functions, the Authority must also have regard to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- 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 it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.7. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Britain. The Authority is a designated National Competition Authority under the EC Modernisation Regulation<sup>7</sup> and is therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

### **The Energy Act 2008**

1.8. The Energy Act 2008 has modified the general duties of the Authority in carrying out its functions under the Gas Act and the Electricity Act.

1.9. When carrying out its functions in the manner which it considers is best calculated to further its principal objective, the Authority must now do so by having regard to the need to contribute to the achievement of sustainable development equally with the need to have regard to the need to secure that all reasonable demands for electricity and gas are met and that licensees are able to finance their regulated activities. It has also been highlighted within the text of the principal objective that the Authority's consideration of the interests of consumers includes both future as well as existing consumers.

1.10. The Authority already takes account of sustainable development in its decisions but the changes mean that increased weight is attached to such considerations.

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<sup>6</sup> Or persons authorised by exemptions to carry on any activity.

<sup>7</sup> Council Regulation (EC) 1/2003.

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## Appendix 6 - Glossary

### A

#### Area of Outstanding Natural Beauty

An Area of Outstanding Natural Beauty (AONB) is an area of countryside with significant landscape value that has been designated by the Countryside Agency. The purpose of the designation is to conserve and enhance the natural beauty of the landscape. AONBs rely on planning controls and practical countryside management.

### C

#### Community Energy Savings Programme

The Government in late 2008 announced its intention to establish a new programme, the Community Energy Savings Programme, to achieve CO<sub>2</sub> savings and reduce fuel bills in targeted dwellings. DECC is consulting on the details of the programme.

#### Climate Change Levy

The climate change levy is a tax on the use of energy in industry, commerce and the public sector, with offsetting cuts in employers' National Insurance Contributions and additional support for energy efficiency schemes and renewable sources of energy. The aim of the levy is to encourage users to improve energy efficiency and reduce emissions of greenhouse gases.

#### Combined Heat and Power

The simultaneous generation of useful heat and power in a single process.

#### Council of European Energy Regulators

The Council of European Energy Regulators (CEER) comprises the independent national energy regulators from EU Member States and the European Economic Area. CEER acts as a focal point for contacts between national energy regulators and is their main interface at European level. Its aim is to facilitate the creation of a single, competitive and sustainable internal European market for gas and electricity.

### D

#### Distribution Network Operators

Distribution network operators (DNOs) are the ex-Public Electricity Suppliers who came into existence on 1 October 2001. There are 14 DNOs each covering a discrete geographical region of Great Britain. They take electricity from the high voltage transmission system and distribute this over low voltage networks to industrial complexes, offices and homes. DNOs must hold a licence and comply with licence conditions for the networks they own and operate in their distribution services area.

**E****EU Emissions Trading Scheme**

A cap and trade scheme in which EU Member State Governments are required to set emissions limits for all installations in their country covered by the scheme. It is an administrative approach used to reduce the cost of pollution control by providing economic incentives for achieving reductions in the emissions of greenhouse gases.

**F****Feed-in tariff**

A fixed price paid for electricity produced from renewable energy sources, usually with different (above market) price levels set for different technologies.

**Fossil Fuel Levy**

The Fossil Fuel Levy is a tax charged on domestic and industrial bills. The levy effectively funds the difference between the contract prices payable to the renewable generators and the market price of electricity.

**Fuel Mix Disclosure**

On 18 March 2005 a new standard licence condition was introduced into electricity supply licences by The Electricity (Fuel Mix Disclosure) Regulations 2005 (SI No. 391). The condition obliges electricity suppliers to provide customers with details of the mix of fuels used to produce the electricity supplied to them along with certain environmental information on or with their bills.

**G****Gas Distribution Networks**

Gas is piped from the gas transmission network into each of the eight regional gas distribution networks, which in turn distribute gas to customers. The eight gas distribution networks are owned by four companies - National Grid Gas, Northern Gas Networks, Scotia Gas Networks, and Wales and West Utilities.

**I****Impact Assessments**

Impact assessments are studies of the potential effects of policies on economic, social and/or environmental conditions. Ofgem has a statutory duty to carry out and publish impact assessments for major policy proposals. Ofgem has published guidance on its approach to carrying out impact assessments.

## ISO 14001

ISO 14001 is an internationally recognised standard for Environmental Management Systems. An Environmental Management System provides a framework for managing environmental responsibilities so they become more efficient and more integrated into overall business operations.

## L

### Large Combustion Plant Directive

The Large Combustion Plant Directive aims to reduce acidification, ground level ozone and particles throughout Europe by controlling emissions of sulphur dioxide, nitrogen oxides and dust particulate matter from large combustion plants. These include plants in power stations, petroleum refineries, steelworks and other industrial processes running on solid, liquid or gaseous fuel.

### Liquefied Natural Gas

Liquefied natural gas (LNG) is natural gas that has been condensed into a liquid at atmospheric pressure by cooling it to approximately -163 degrees Celsius. LNG is transported by specifically designed vessels and stored in specially designed tanks. LNG is about 1/600th the volume of natural gas, making it much more cost-efficient to transport over long distances where pipelines do not exist.

## M

### Microgeneration

The small-scale generation of heat and/or electricity from a low carbon source, for example solar panels, micro-wind, micro combined heat and power and heat pumps.

## N

### National Grid Electricity Transmission and National Grid Gas

National Grid Electricity Transmission owns and maintains the high-voltage electricity transmission system in England and Wales. It also operates the system across Great Britain, balancing supply with demand on a minute-by-minute basis. National Grid Gas is the licensed gas transporter responsible for the gas transmission system and for four of the regional gas distribution companies.

## P

### Prepayment meters

Meter designed to enable consumers to pay for electricity and gas as they use it. The customer needs to be provided with a network of outlets where tokens can be purchased, or cards or keys can be charged up. This network of outlets needs to be linked to a payment settlement system for suppliers.

**R****Registered Power Zones**

Registered Power Zones (RPZs) are focused specifically on the connection of generation to distribution systems. RPZs are intended to encourage DNOs to develop and demonstrate new, more cost-effective ways of connecting and operating generation that will deliver specific benefits to new distributed generators and broader benefits to consumers generally.

**Renewables Obligation and Renewables Obligation Scotland**

The Renewables Obligation (RO) obliges licensed electricity suppliers in the United Kingdom to source an increasing proportion of electricity from renewable sources. Suppliers meet their obligations by presenting Renewables Obligation Certificates (ROCs) or by payment into the buy-out fund.

**Renewables Obligation Certificate**

A Renewables Obligation Certificate is a transferable certificate received by eligible renewable generators for each MWh of electricity generated. ROCs are traded separately from power and are used by suppliers to fulfil their Renewables Obligations under the Utilities Act 2000.

**S****Self-disconnection**

Self-disconnection occurs where a prepayment customer does not have sufficient credit on their meter which results in their energy supply being discontinued.

**Smart Metering**

Advanced gas and electricity metering technology that offers customers more information about, and control over, their energy use (such as providing information on total energy consumption in terms of value, not only volume). Smart meters can also allow automated and remote measurement.

**Sulphur hexafluoride (SF<sub>6</sub>)**

One of the most potent greenhouse gases and is widely used in transmission and distribution equipment.

**System Operator**

National Grid is the electricity and gas system operator, responsible for managing the operation of the electricity transmission system and the gas transmission network. They balance supply and demand, in gas maintaining satisfactory system pressures and ensuring gas quality standards are met, and for electricity ensuring the stability and security of the power system and the maintenance of satisfactory voltage and frequency.

## Appendix 7 - Feedback questionnaire

1.1. 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. In any case, we would be keen to get your answers to the following questions:

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

1.2. Please send any comments to:

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