

The Ofgem logo, consisting of the word "ofgem" in white lowercase letters inside an orange rounded rectangle.The "ofgem E-Serve" logo, consisting of the word "ofgem" in white lowercase letters and "E-Serve" in white uppercase letters inside a dark green rounded rectangle.

Promoting choice and value
for all gas and electricity customers

A collection of translucent, reflective spheres in shades of orange and light green, scattered across the top half of the page against a light blue background.

Overview of Ofgem Annual Report 2010-11

This document is a summary of Ofgem's Annual Report 2010-11. The full document, together with our resource accounts, can be downloaded from www.ofgem.gov.uk





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Introduction

April 2010 to March 2011 was a remarkable year of delivery for Ofgem. This was set against a background of challenges and uncertainties - for consumers, for the energy industry and for us.

In Britain we saw:

- rising gas and electricity prices
- a major investment challenge to meet low carbon and energy security goals
- government reviews of Ofgem and Ofgem E-Serve
- separate reviews and audits of Ofgem by the National Audit Office, Deloitte and the Office of Government Commerce
- a self-imposed recruitment freeze at Ofgem to meet the demands of austere times.

Looking wider, we were reminded how global events can influence GB energy markets:

- the devastating natural disaster in Japan, with ensuing concerns over its nuclear plants and potential rerouting of Liquefied Natural Gas (LNG) supplies

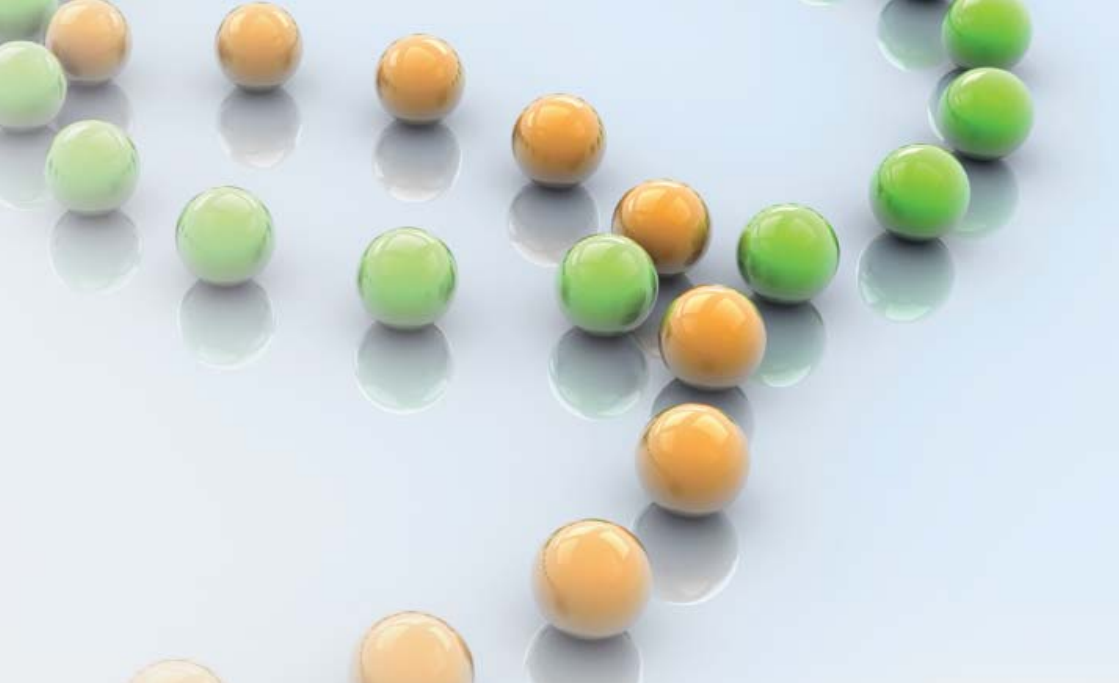
- political upheaval in the Middle East
- uncertainties surrounding gas supplies in continental Europe
- further US development of shale gas.

Present and future consumers, whose interests we protect, are always at the heart of our regulation. So at this time of uncertainty and change, we delivered powerful initiatives to help create an environment of stability and confidence. This will encourage the investment needed to move towards a secure low carbon economy, at value for money for consumers.

We also tackled concerns in the retail market, to rebuild consumer trust in the industry.

Among our main achievements we:

- radically overhauled the 20 year old network regulation regime
- reviewed the retail energy market, proposing radical changes



- fined National Grid £15 million for abuse of dominance
- created new rules so suppliers must give at least 30 days advance notice of price rises
- launched an investigation into misselling in face to face and telephone sales
- advised government on legislation to meet new EU energy reforms
- underspent our budget by £20 million – despite increased workload
- saved £5 million from licence fees, under our cost reduction regime.

Ofgem E-Serve continued to deliver government social and environmental programmes efficiently at value for money. This included:

- the rapid introduction of the new Feed-in Tariff on time and on budget
- successful delivery of the first phase of the government roll-out of smart meters

- a competitive tendering process for the new Offshore Transmission licences.

The following pages contain more details about our work over the past year. We have broadly split this work into four themes:

- **Theme 1** - Building a low carbon economy

- **Theme 2** – Helping to maintain security of supply

- **Theme 3** – Promoting quality and value for consumers

- **Theme 4** – Timely and efficient delivery of government programmes

The overriding theme in all our work remains to protect Great Britain's energy consumers.



Theme 1

Building a low carbon economy

Great Britain faces an unprecedented challenge, as it prepares to meet government's climate change targets. We estimate that over £200 billion of investment is needed over the decade (Ofgem's Project Discovery, 2009). This includes over £30 billion of investment in energy networks alone.

Over the year we delivered some key initiatives which will encourage this investment, bringing us closer to a low carbon future, at best value for consumers.

Low Carbon Network Fund (LCNF)

We instigated the £500 million LCNF to kick start our low carbon economy. It will help local electricity network companies understand how they need to adapt and change to become the smart grids of the future.

In this first year of the competition, with an independent panel of experts we awarded a total of £64 million to four winning, innovative projects, chosen for their real potential to tackle the challenges faced by networks. For example:

- how to connect more charging points for electric cars

- how new technology such as smart fridges and smart meters can help customers control their energy use
- how networks can cope with intermittent renewable generation, such as wind.

Knowledge from the projects will be shared amongst all network companies, bringing long-reaching benefits for consumers.

New price control regime – RIIO (Revenue=Incentives+Innovation+Outputs)

In November we published our plans for a new price control regime. Breaking away from the previous regime of RPI-X was a radical departure, but while this system had served the networks well for two decades, it was no longer fit for purpose.

RIIO will drive the transition to a low carbon energy sector, while providing best



value for money for consumers. Network companies that perform well will earn greater returns; those that perform less well will be penalised through reduced revenue.

In March we set out the framework for the new price controls for electricity and gas transmission (RIIO-T1) and gas distribution (RIIO-GD1), from 2013 to 2021. Key aspects include:

- a Network Innovation Competition (NIC) will work like the LCNF, providing £240 million of innovation funding for electricity transmission and £160 million for gas transmission and distribution
- gas distribution companies will be incentivised to resolve consumer complaints effectively, with penalties for poor performers
- gas distribution companies will also have to address fuel poverty, connect fuel-poor off-grid customers, and tackle the risks of carbon monoxide poisoning.

Project TransmiT

We also launched an independent and open review of the transmission charging regime. Again, the current arrangements have served consumers well, but we now need to ensure that they are not a barrier to the development of new generation.

Having the right arrangements in place as we move to our low carbon future, will mean continued safe, secure network services at value for money for consumers.

Consumer engagement

Last year we continued to encourage consumers to look at adapting the ways and times they use energy. This is known as 'demand side response' and can help the networks run more efficiently, with significant financial and environmental benefits for all parties.

We assessed regulatory and consumer protection issues raised by new technology and initiatives such as smart meters, or tariffs that reward customers for using energy at times of low demand.

We also engaged with other bodies, including non-governmental organisations and sustainability groups, to develop our sustainable policies. More details of these can be found in the year's Sustainable Development review, which we published in November.

Theme 2

Helping to maintain security of supply

Depleting UK continental shelf supplies mean that Britain has had to rely increasingly on gas imports. This inevitably makes Britain more susceptible to global energy market fluctuations and increases the need to keep reserves under close scrutiny.

Monitoring winter energy supplies

As in previous years, we asked National Grid to provide an assessment of energy supply over the coming winter. We also wrote to all gas shippers asking for information about their sources of supply and anticipated demand levels.

An unusually early prolonged cold spell provided a substantial challenge for the system. But all gas demands were met, with comfortable margins in electricity generation. We continued to monitor supplies throughout the winter, including global supply and demand.

EU Rules

We have taken a lead in Europe in developing many areas of energy policy. Our chairman, Lord Mogg, is the first chair of the new European central regulatory body – the Agency for the Cooperation of Energy Regulators (ACER). We have also taken the chair of the regulators' group exploring a North Sea supergrid. We played a leading role in devising a new EU model for gas market integration and transparency, as well as developing guidelines for the development of a single EU energy market.

In February we approved new rules governing access to BritNed, an electricity interconnector which links the Thames Estuary with the Netherlands.



Over the year, we worked closely with other European regulators to develop arrangements for more potential electricity interconnectors.

The Third Package is a set of EU reforms designed to further liberalise Europe's energy market. We advised government as it prepared the legislation needed for full UK implementation of the new rules.

Code Governance Review (CGR)

Industry Codes set out rules for companies who want to participate in the GB energy markets. Last year we completed our two year review of the parts of the rules which govern how they can be changed in the future. We wanted to ensure the rules can adapt to Great Britain's changing needs.

Following this we launched a review considering whether changes are needed to the financial arrangements to balance supply and demand in the gas market, to enhance security of supply.



Theme 3

Promoting quality and value for consumers

Our main priority is to protect consumers. This includes Ofgem's role in the special protections needed for vulnerable and fuel-poor customers. When we see concerns with the market, we act on behalf of all consumers, and take enforcement action where appropriate.

Retail Market Review

Following our ongoing concerns that suppliers were not playing it straight with consumers, in November we launched a review into the retail energy market.

In March we concluded that a combination of tariff complexity, poor supplier behaviour and lack of transparency was stifling competition. We also found poor supplier response to reforms following our 2008 probe into the market. We warned energy companies that if they frustrate our reforms the issue could be sent to the Competition Commission.

Our proposals include a range of radical measures to tackle the problems we uncovered. We proposed that the Big Six make up to 20 per cent of their generation available through open, transparent auctions and for customers to


be able to compare deals through a single unit price.

We also announced that we are asking independent accountants to look at the Big Six company accounts, to provide consumers with greater clarity on the relationship between wholesale and retail prices.

Enforcement

Over the year we took a range of enforcement actions – evidence that we are determined to use all our regulatory powers to act on behalf of consumers.

- June: we found EDF Energy in breach of complaint handling regulations between October 2008 and March 2009. EDF agreed to contribute £200,000 to consumer advice campaign Energy Best Deal, and the Money Advice Trust.

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- August: the Supreme Court backed our 2009 decision under the Competition Act that National Grid had acted anti-competitively in the gas meter market. Our £15 million fine is still one of the highest UK penalties for abuse of dominance.
 - September: we launched investigations into four suppliers to see if they were complying with obligations to prevent misselling, and set up a consumer hotline.
 - December: we took action against First Utility for failing to put in place sufficient measures to guard against vulnerable customer disconnections in its early roll-out of smart meters.
 - January: we fined National Grid Gas (NGG) £8 million for breach of obligations to provide us with accurate information. We made it clear that the fine would have been higher had NGG not cooperated with us in addressing the issue.
 - February: we fined three local electricity network companies a total of £1 million for missing the required time scales for new customer connections. We also introduced compensation arrangements for missed targets for customer service on connections.

Listening to and protecting customers

In February we launched a consultation into the consumer protections needed

alongside government's planned roll-out of smart meters. We proposed new licence obligations, particularly around remote disconnection issues. We also set up a Consumer Advisory Group to inform our work in this area.

In addition, over the year we:

- reported on suppliers' performance under their Voluntary Agreement to provide support for fuel poor customers
- established principles for suppliers drawing up debt repayment or disconnection plans
- commissioned a review into the Energy Ombudsman, which concluded that it delivers a fair and independent scheme, but identified some important areas for improvement
- carried on investing in our Consumer First programme, through which 100 consumers meet regularly to give us their views on a range of energy issues
- gained valuable insight and advice from our large industrial user group, and small to medium sized business group
- continued to run the Energy Best Deal campaign with Citizens Advice. Independent evaluation showed 98 per cent of consumers who access the campaign find it useful.

Theme 4

Timely and efficient delivery of government programmes

Ofgem E-Serve provides the expertise and resources to run those government programmes which will help deliver a low-carbon future. We do this effectively and efficiently: at a cost of just 0.27 per cent of scheme value.

Offshore Transmission

Ofgem E-Serve runs the competitive tendering process for the innovative Offshore Transmission regime.

The £1.1 billion first tender round alone will deliver around £350 million savings for consumers. In March, together with the Department of Energy and Climate Change (DECC) we awarded the first of nine licences, for a £65 million link from the 180MW Robin Rigg wind farm in the Solway Firth to the onshore grid.

The second round had eight bidders compete for another three projects worth a further £1 billion.

Smart meters

On behalf of DECC we managed the policy design phase of the government's smart meter rollout programme to Britain's 26 million households. DECC will now take forward implementation and our role will be regulatory oversight of the roll-out and operation.

Government schemes.

Government's new Feed-in Tariff (FIT) scheme was a significant challenge for us. We had to develop new IT systems for a Central FIT register database. But we delivered on time and in budget.

More than 40,000 small scale generators successfully registered with us over the year, showing a significant uptake of new small scale renewable generation. We are also supporting government's Warm Home Discount scheme.

We continue to administer existing government schemes including the Renewables Obligation, Carbon Emissions Reduction Target (CERT) and the Community Energy Saving Programme (CESP).



Looking towards the year ahead: 2011-12

After the challenges of last year, we now face the year ahead with knowledge that some of our own uncertainty has been settled. In May 2011 government set out the main conclusions of its Ofgem review. DECC confirmed its commitment to independent regulation and the critical role we play. It said “consumer groups welcomed Ofgem’s more recent proactive approach to consumer protection”.



The National Audit Office has also concluded its review, noting: "Ofgem has a sound system of financial controls and reporting. We found that only Ofgem (amongst economic regulators) was producing self contained impact assessments equivalent to those produced by government departments."

Welcoming this scrutiny, over the next year we will continue to actively look at ways of improving our processes. For example, we will review the way we consult on policy, assess if we have appropriate powers to fulfil our roles, and work hard to improve our communications.

There is no doubt that there is still more uncertainty. We do not know how quickly other EU member states will implement the new Third Package rules. And in Great Britain, we have the ongoing challenge of moving to a low carbon economy, alongside rising global energy prices.

Against this background, we will continue to work hard on behalf of consumers. Next year, we will again report back and tell you how the inevitable energy challenges of the year ahead have been met.



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