

# Electricity and Gas Supply Market Report

## Report

**Reference:** 176/11**Publication date:** 19 December 2011**Response deadline:** 31 January 2012**Contact:** Tim Collins, Regulatory Economist**Team:** GB Markets**Tel:** 020 7901 7212**Email:** tim.collins@ofgem.gov.uk

### Overview:

Our snapshot estimate of the net margin on supplying a typical, standard tariff, dual fuel customer is approximately £105 per customer for the year from December 2011. This represents a £20 reduction from our previous report. The net margin is an indicator of how profitable a typical dual fuel customer would be for a supplier assuming no other factors change over the next 12 months. Ofgem expects this margin to fall further over the next six months to around £85, although there are many uncertainties, not least wholesale prices, which could affect this figure.

We indicated in our October report that we expected net margins to begin declining due to the persistence of high wholesale energy costs. Trends in forward wholesale energy markets since October have meant that the upward trend in hedged wholesale costs since October has been gentler than expected. However, rises in other costs mean that net margin is £20 below October's level overall.

None of the Big 6 suppliers have announced retail price changes since our October report, so the average bill for a standard tariff dual fuel customer remains at £1345.

In order to increase transparency further, Ofgem intends to move towards publishing weekly updates of our key supply market charts in the New Year, and to include a 12 month rolling average net margin indicator.

## Associated Documents

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- Electricity and Gas Supply Market Report. December 2010. Reference number 146/10  
<http://www.ofgem.gov.uk/Markets/RetMkts/ensupro/Documents1/Electricity%20and%20Gas%20Supply%20Market%20Report%20December%202010.pdf>
- Electricity and Gas Supply Market Report. March 2011. Reference number 36/11  
[http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Supply\\_Market\\_Report\\_March2011.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Supply_Market_Report_March2011.pdf)
- Electricity and Gas Supply Market Report. June 2011. Reference number 81/11  
<http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/SMR%20June%202011.pdf>
- Electricity and Gas Supply Market Report. October 2011. Reference number 133/11  
[http://www.ofgem.gov.uk/MARKETS/RETMKTS/RMR/Documents1/SMR\\_Oct\\_2011.pdf](http://www.ofgem.gov.uk/MARKETS/RETMKTS/RMR/Documents1/SMR_Oct_2011.pdf)
- Publication of 2010 segmental generation and supply statements by energy companies  
<http://www.ofgem.gov.uk/Markets/RetMkts/ensupro/Documents1/Publication%20of%202010%20statements.pdf>
- Why are energy prices rising? Factsheet - Reference number 108  
<http://www.ofgem.gov.uk/Markets/RetMkts/ensupro/Documents1/Publication%20of%202010%20statements.pdf>

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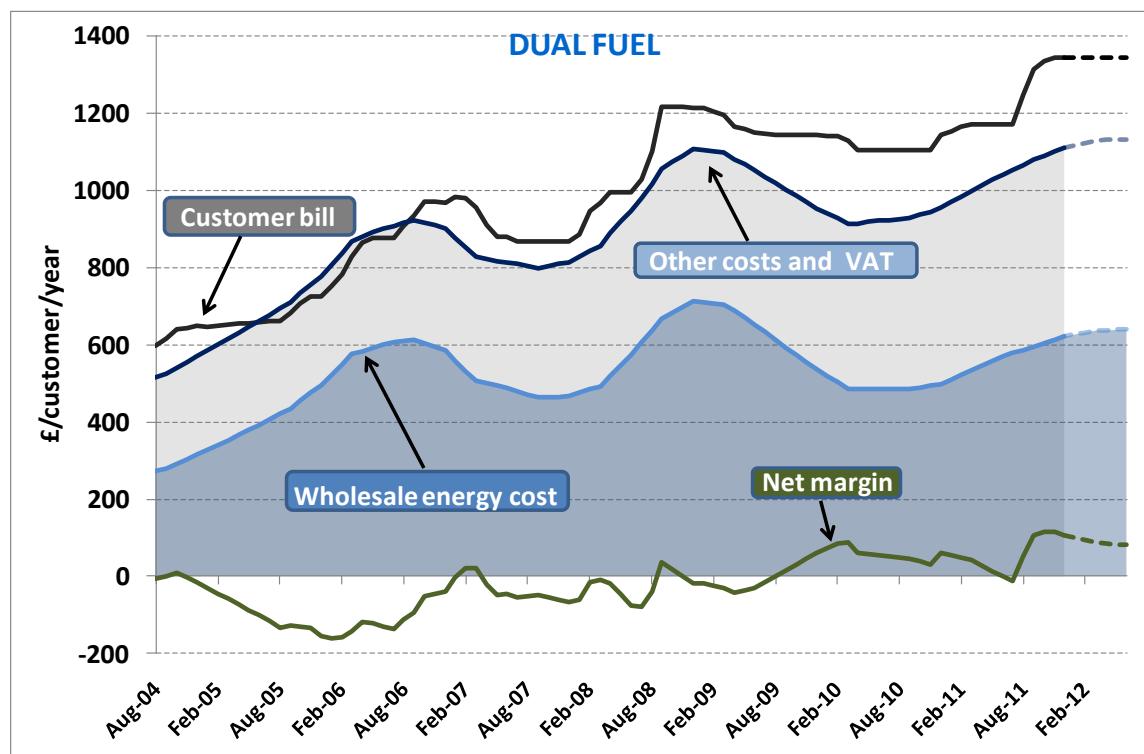
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# Executive Summary

Our indicator of the net margin on supplying a standard tariff, dual fuel customer is £105 for the year from December 2011. This represents a £20 reduction in net margin compared to our October report. The £105 figure takes account of new information on network charges and environmental costs. These costs will not be effective until April 2012, but they still affect our analysis, because we look at the expected costs of supplying a typical domestic customer over the next 12 months.

None of the Big 6 suppliers have announced retail price changes since our October report, so the average bill for a standard tariff dual fuel customer remains at £1345.

## Typical dual fuel customer bill, costs and net margin



In our October report, we noted that wholesale energy prices were showing some signs of easing, after a period of sustained increase. Whilst wholesale prices remain relatively high, there have been falls in both gas and electricity forward prices since October, reflecting the subdued economic situation and, thus far, modest demand due to the mild weather in the past three months.

Energy suppliers buy much of their energy over a period of time (hedging), so changes in wholesale energy costs modelled in our report will lag behind changes observed in forward wholesale energy prices over the October to December period. Nonetheless, if current wholesale market trends continue, hedged wholesale costs for both gas and electricity should begin to ease.

Looking further forward, our analysis suggests that the dual fuel net margin may begin to stabilise at around £85 over the course of the next 6 months – although in practice, there are many uncertainties, particularly around wholesale costs, which could affect this figure.

In the interests of increasing transparency further, Ofgem intends to move towards publishing weekly updates of our key supply market charts in the New Year. At the moment, we produce a supply market report every three to four months. Next year we intend to replace this roughly quarterly publication with a publication on our website of the dual fuel, gas and electricity cost, price and net margin charts (figures 1.1 to 1.3 in this report). These charts would be updated on a weekly basis.

Ofgem originally produced its report on the relationship between wholesale and retail prices to provide consumers with four snapshots a year on energy prices and margins. By moving to a more frequent weekly publication cycle, we will be better able to reflect the workings of a market where costs change frequently, and provide more regular snapshots on energy prices and margins for consumers.

At the same time, we intend to expand our analysis to include an indicator on each chart, showing the 12 month rolling average net margin. We consider that this will help consumers understand more about the trends in modelled net margins, given that our snapshot indicators are affected by the volatility in costs and prices.

We welcome comments from stakeholders on the changes we intend to make.

# 1. Customer Bills, Wholesale Energy Costs and Net Margin

## Chapter Summary

The estimated net margin on supplying a standard tariff, dual fuel customer is £105 for the year from December 2011. The £105 net margin figure represents a £20 reduction since our October report. The reduction has mainly been caused by rises in network and environmental costs.

None of the Big 6 suppliers have announced retail price changes since our October report, so the average bill for a standard tariff dual fuel customer remains at £1345.

In order to increase transparency further, Ofgem intends to move towards publishing weekly updates of our key supply market charts in the New Year, and to include a 12 month rolling average net margin indicator.

1.1. This report examines the relationship between wholesale energy costs and standard tariff energy bills for a typical customer. It provides an indicator of the margin a supplier might expect to earn on a typical standard tariff customer over the next 12 months, assuming no other factors change.

1.2. In the interests of increasing transparency further, Ofgem intends to move towards publishing weekly updates of our key supply market charts in the New Year. At the moment, we produce a supply market report every three to four months. Next year we intend to replace this roughly quarterly publication with a publication on our website of the dual fuel, gas and electricity cost, price and net margin charts (figures 1.1 to 1.3 in this report). These charts would be updated on a weekly basis.

1.3. Ofgem originally produced its report on the relationship between wholesale and retail prices to provide consumers with four snapshots a year on energy prices and margins. By moving to a more frequent weekly publication cycle, we will be better able to reflect the workings of a market where costs change frequently, and provide more regular snapshots on energy prices and margins for consumers.

1.4. At the same time, we intend to expand our analysis to include an indicator on each chart, showing the 12 month rolling average net margin. We consider that this will help consumers understand more about the trends in modelled net margins, given that our snapshot indicators are affected by the volatility in costs and prices.

1.5. We welcome comments from stakeholders on the changes we intend to make.

1.6. Net margin is not an estimate of individual energy supply company profits. It is calculated by Ofgem based on information from publicly available sources, data which Ofgem purchases (e.g. price data) and information gathered as part of the

Energy Supply Probe and Retail Market Review. Individual suppliers' costs may vary (e.g. they may use different hedging strategies and have different operating costs) so actual margins may differ from our indicator.

1.7. We have included the latest gas network charges applicable from April 2012 in this report, as our analysis seeks to model suppliers' costs over the next 12 months. We have also incorporated the expected costs to suppliers of a higher Renewables Obligation from April 2012 and suppliers' expenditure under the Warm Homes Discount scheme (a Government rebate scheme for priority customers which is replacing social tariffs).

1.8. As with our previous reports, we welcome feedback on our methodology as well as our findings. Please see Appendix 3 for more details about our assumptions, including figure 3.2 for a summary of any changes made since the previous report.

1.9. Each point on the charts in this section represents the expected cost, revenue or margin for the following year, for a typical standard tariff customer, on a £/year basis. The average customer bill is represented by the black line. Wholesale energy costs are estimated using our 18 month hedging strategy and are represented by the blue shaded area. Other costs, such as network charges, social and environmental supplier obligations<sup>1</sup> and VAT, are represented by the grey shaded area.

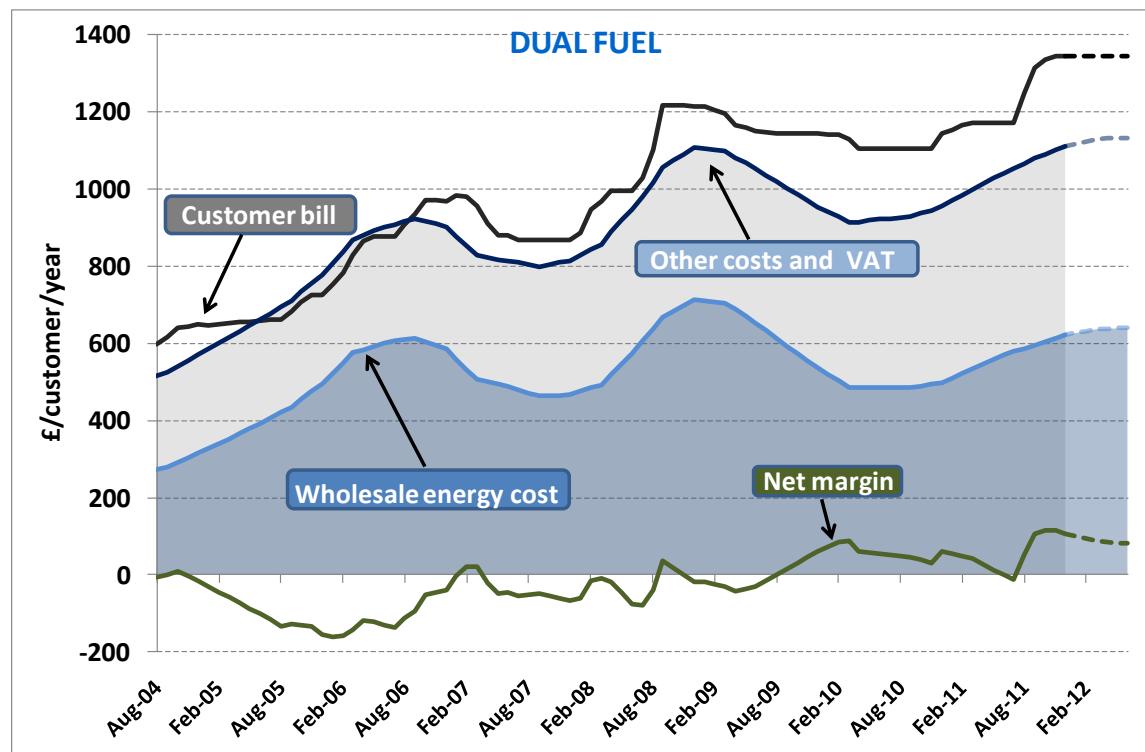
1.10. The area between the customer bill and the combined wholesale and other costs lines represents gross margin. Subtracting operating costs from the gross margin gives the net margin, represented by the green line. Operating costs include: staff costs, IT costs and overheads. They also include discretionary elements (such as sales and marketing costs) and bad debt costs. These costs were updated as part of our Retail Market Review work.

1.11. Figure 1.1 shows that the estimated net margin for supplying a typical standard tariff, dual fuel customer has fallen to £105 for the year from December 2011. This compares to £125 in our October report. The fall in net margin is mainly a result of increases in gas network charges from April 2012, a higher Renewables Obligation from April 2012 and suppliers' expenditure under the Warm Homes Discount scheme. Our estimate of hedged wholesale energy costs for the year from December has also risen compared to October's wholesale costs, even though spot prices in the forward wholesale energy markets have fallen. This means that the rise in hedged wholesale costs has been gentler than expected in October. Hedged wholesale cost changes lag behind day to day wholesale market price changes.

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<sup>1</sup> Please see Appendix 3 for an explanation of our methodology, including our treatment of social and environmental costs.

**Figure 1.1: Typical dual fuel customer bill, costs and net margin**



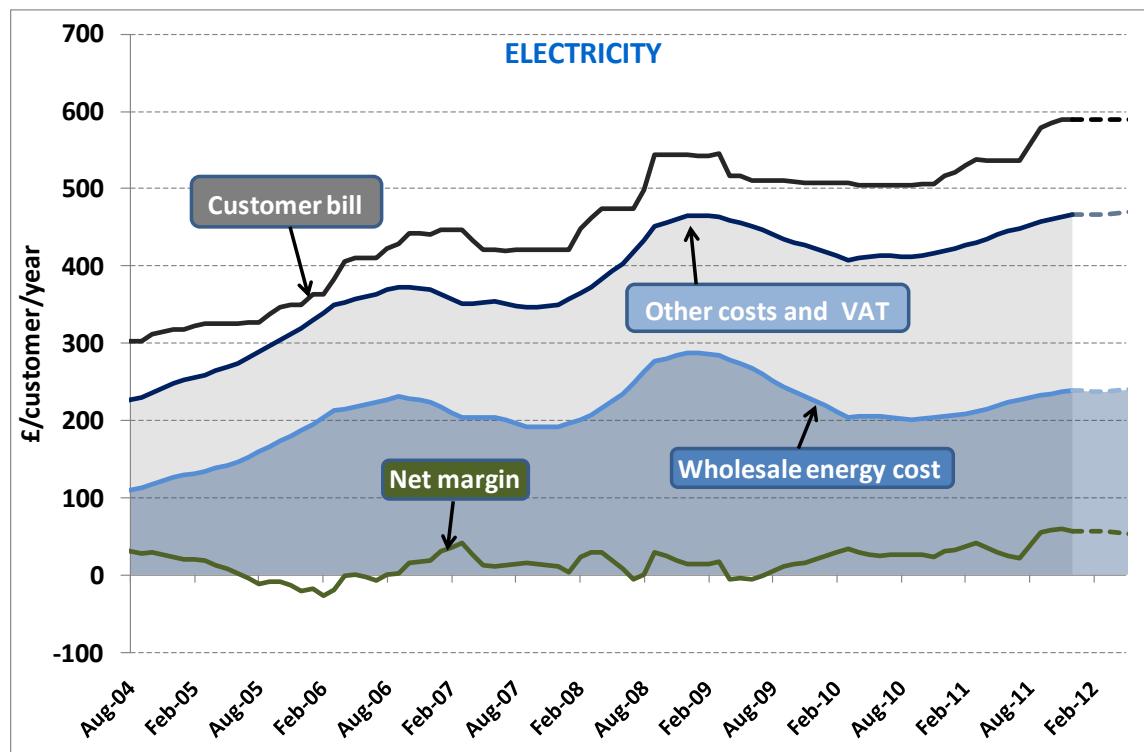
1.12. None of the Big 6 suppliers have announced retail price changes since our October report, so the average bill for a standard tariff dual fuel customer remains at £1345.

1.13. Wholesale energy costs are estimated using our 18 month hedging strategy. These costs now stand at £620 for the year from December, compared to £605 for the year from October. Although this represents an increase since October, the size of the increase has been moderated by falling spot prices in the forward wholesale energy markets since October. The falls reflect the subdued economic situation and, thus far, modest demand due to the mild weather in the past three months.

1.14. Looking further forward, our analysis suggests dual fuel net margin might begin to stabilise at around £85 over the course of the next 6 months – although in practice, there are many uncertainties, particularly around wholesale costs, which could affect this figure.

1.15. Figure 1.2 replicates figure 1.1 for a typical, stand-alone electricity customer account. The figure shows that our estimated net margin for the year from December has fallen to £55, from £65 in October.

**Figure 1.2: Typical electricity customer bill, costs and net margin**



1.16. The main reasons for the fall in electricity net margin are the higher Renewables Obligation from April 2012 and a slight rise in our estimate of hedged wholesale electricity costs. As is the case with our dual fuel analysis, the size of the increase in hedged wholesale electricity costs since October has been moderated by falling spot prices in the forward wholesale electricity markets between October and December.

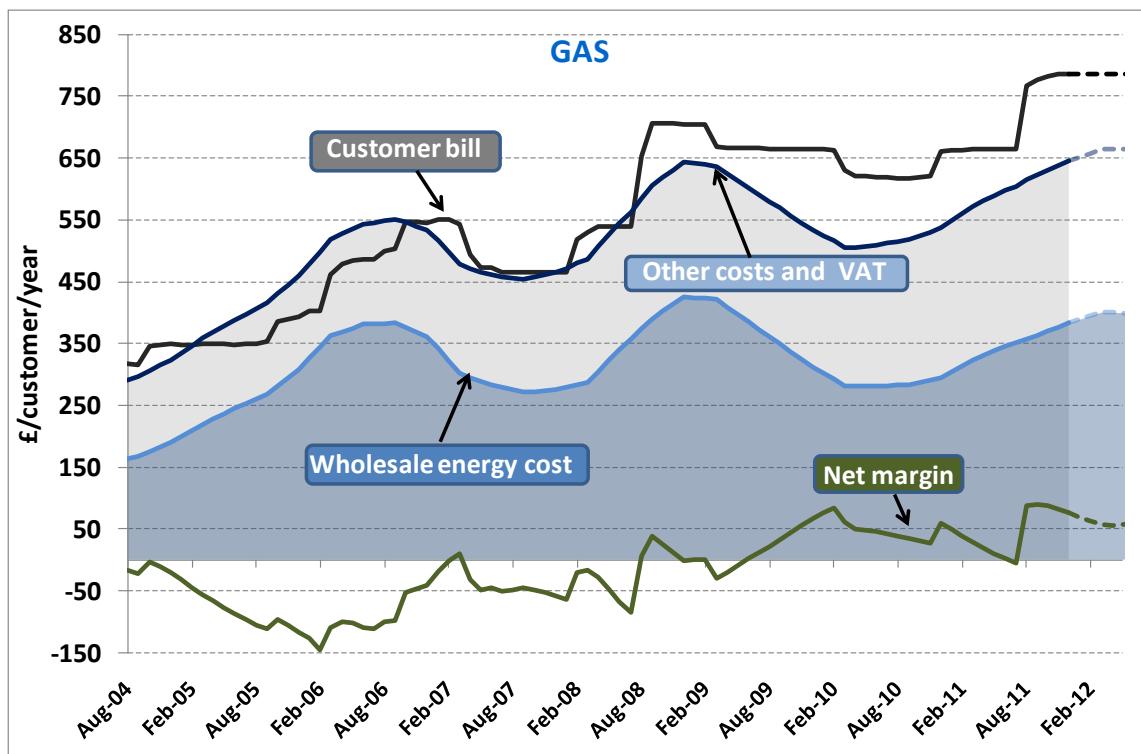
1.17. Looking forward, our modelling suggests that net margin on electricity will remain fairly stable over the coming months. As noted in previous reports, this depends on other factors, particularly wholesale costs, remaining stable, so it is important to recognise the uncertainty around this figure.

1.18. Figure 1.3 presents our analysis for a typical stand-alone gas customer account. It shows that our estimate of net margin from December 2011 has fallen to around £75, from around £95 in October.

1.19. There are two key factors behind the fall in gas net margin. The first factor is the rise in our estimate of hedged wholesale gas costs since October. As has been the case with electricity, whilst spot prices in wholesale forward gas markets have fallen between October and December, our estimates of hedged wholesale gas costs have continued to rise, although by less than we were expecting in October.

1.20. The second key factor that has caused gas net margins to fall is the increase in gas network costs from April 2012. Our analysis is forward looking over 12 months, so these costs are already being factored into our December margin figure.

**Figure 1.3: Typical gas customer bill, costs and net margin**



1.21. If current wholesale gas market trends persist, hedged wholesale gas costs should begin to level off in the coming months. Our current forecast suggests that margins may stabilise at around £55. However, as is always the case, wholesale markets developments , and therefore our future estimates of net margin, are uncertain.

1.22. To enable comparison of customer bills and suppliers' costs over time, we assume a constant level of consumption. A declining consumption trend impacts on net margin, as a substantial proportion of suppliers' costs are fixed. Holding consumption constant over time means we may have overstated margin in recent years, but understated margin in even earlier periods. The margins over time at constant consumption are presented in the tables below:

**Figure 1.4: Dual fuel summary table (£/customer/year)**

	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11
<b>Customer bill</b>	£865	£1,215	£1,145	£1,145	£1,345
<b>Wholesale costs</b>	£465	£715	£535	£500	£620
<b>VAT and other costs</b>	£350	£390	£415	£455	£490
<b>Gross margin</b>	£50	£110	£190	£190	£235
<b>Operating costs</b>	£120	£125	£130	£130	£130
<b>Implied net margin</b>	-£65	-£20	£60	£60	£105
<b>Notes:</b>	<i>Customer bill is for standard tariffs, weighted by payment method and market share. Average figures assume electricity consumption of 4MWh/yr, gas consumption of 16.9MWh/yr. Figures rounded to nearest £5 and may not sum due to rounding</i>				

**Figure 1.5: Electricity summary table (£/customer/year)**

	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11
<b>Customer bill</b>	£420	£545	£505	£515	£590
<b>Wholesale costs</b>	£190	£290	£225	£205	£240
<b>VAT and other costs</b>	£160	£175	£195	£215	£230
<b>Gross margin</b>	£70	£80	£85	£95	£125
<b>Operating costs</b>	£60	£65	£65	£65	£65
<b>Implied net margin</b>	£10	£15	£20	£30	£55
<b>Notes:</b>	<i>Customer bill is for standard tariffs, weighted by payment method and market share. Average figures assume electricity consumption of 4MWh/yr. Figures rounded to nearest £5 and may not sum due to rounding</i>				

**Figure 1.6: Gas summary table (£/customer/year)**

	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11
<b>Customer bill</b>	£465	£705	£665	£660	£785
<b>Wholesale costs</b>	£275	£425	£310	£295	£385
<b>VAT and other costs</b>	£190	£215	£220	£245	£260
<b>Gross margin</b>	£0	£60	£130	£125	£140
<b>Operating costs</b>	£60	£65	£65	£65	£65
<b>Implied net margin</b>	-£60	£0	£70	£60	£75
<b>Notes:</b>	<i>Customer bill is for standard tariffs, weighted by payment method and market share. Average figures assume gas consumption of 16.9MWh/yr. Figures rounded to nearest £5 and may not sum due to rounding</i>				

# Appendices

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## Appendix 1 - Feedback and Questions

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1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. Feedback and questions related to this report should be received by 31 January 2012 and sent to:

Tim Collins  
GB Markets  
9 Millbank  
London  
SW1P 3GE  
020 7901 7212  
[tim.collins@ofgem.gov.uk](mailto:tim.collins@ofgem.gov.uk)

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

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

1.5. Media enquiries related to this report should be directed to:

Chris Lock, External Communications Officer  
Tel: 020 7901 7225  
Fax: 020 7901 7064  
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Tel: 020 7901 7419  
Fax: 020 7901 7064  
Email: [lydia.fitzpatrick@ofgem.gov.uk](mailto:lydia.fitzpatrick@ofgem.gov.uk)

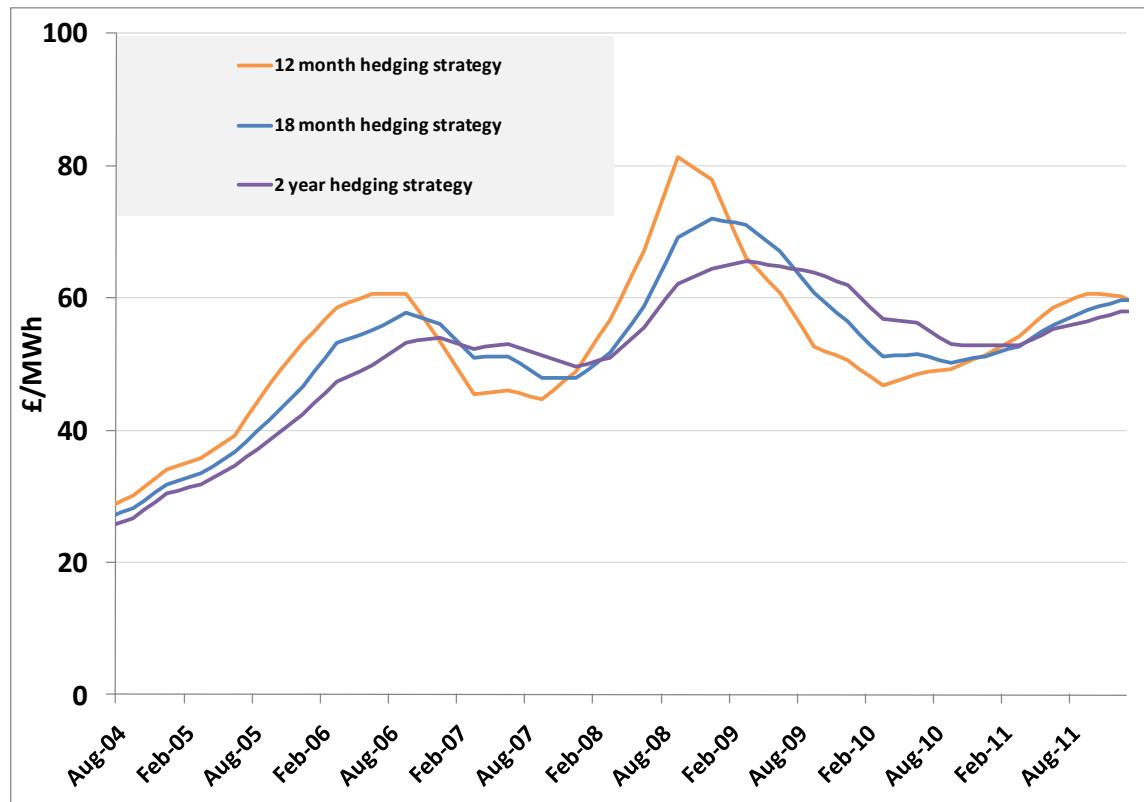
## Appendix 2 – Hedging Strategies

1.1. Suppliers buy much of their energy requirement over a period of time to reduce the effect of large changes in wholesale prices. This practice is known as hedging.

1.2. Hedging helps suppliers to smooth their costs and provides suppliers with more certainty over future costs. Hedging strategies may vary from supplier to supplier according to their business objectives. Suppliers may also change their hedging strategies over time in reaction to market conditions or for other business reasons.

1.3. The charts below depict the costs to suppliers of adopting hedging strategies over 12, 18 and 24 months for both electricity and gas. These hedging strategies were designed based on information collected in the Energy Supply Probe and are intended to represent the industry as a whole rather than any particular firm. Please refer to Appendix 3 for an explanation of the methodology.

**Figure 2.1: Electricity hedging strategies**



1.4. Figure 2.1 shows that wholesale electricity costs are beginning to level off under our 18 and 24 month hedging strategies, and have levelled off under our 12 month hedge. We use the 18 month hedging strategy in our report. There is currently a range of £58 to £60/MWh depending on the hedging strategy used.

**Figure 2.2: Gas hedging strategies**



1.5. Figure 2.2 indicates that wholesale gas costs continue to rise under our 18 and 24 month hedging strategies. However, they have levelled off under our 12 month hedging strategy. We use the 18 month hedging strategy in our report. There is currently a range of 63p to 68p/therm depending on the hedging strategy used.

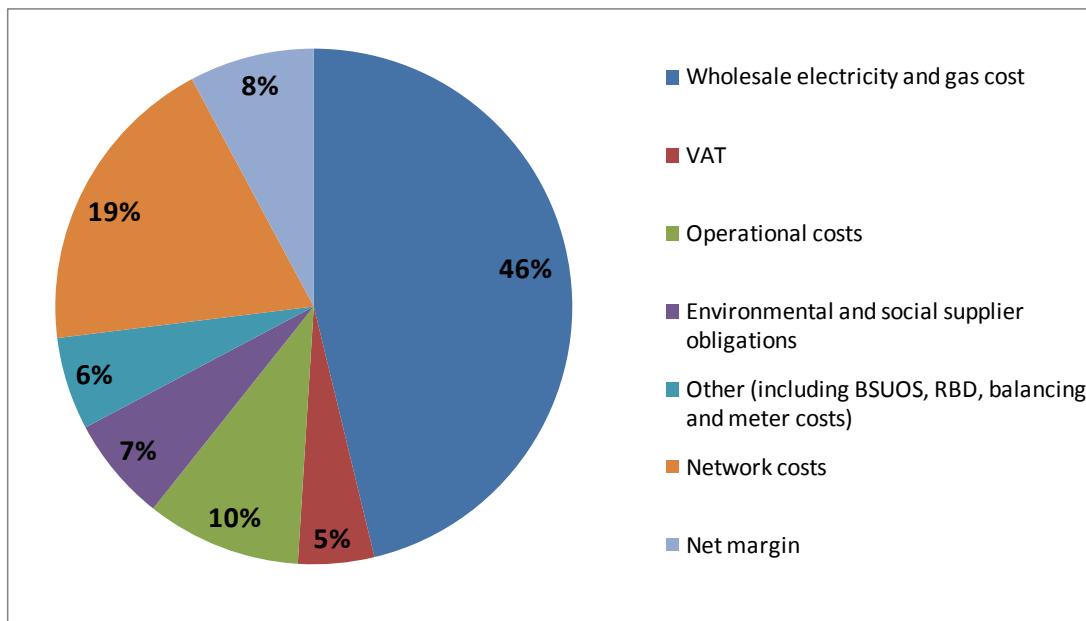
## Appendix 3 – Methodology

1.1. This section provides a detailed description of the methodology behind the following data we have used in this report:

- consumption levels;
- average customer bill;
- wholesale energy costs;
- other supply costs (including network charges, environmental supplier obligations and meter costs);
- gross margin (average customer bill minus wholesale energy costs and other supply costs); and
- net margin.

1.2. Prices and costs are calculated at an average consumption per annum of 4MWh of electricity and 16.9MWh of gas and are held constant over time in the analysis presented in the text to aid comparability. This reflects data from DECC's *Energy Trends*, December 2009 publication. These values differ from the consumption figures we currently use in average bill calculations in other Ofgem publications, and do not represent a change in Ofgem's standard consumption figures (used for example in our 'Energy bills explained' factsheets).

**Figure 3.1: Illustrative breakdown of a typical dual fuel customer bill**



### Average customer bill

1.3. The average customer bill is an estimate of the average cost paid by retail energy customers on standard tariffs in GB. All price increases announced by the Big 6 energy suppliers over the summer, and their effective dates, have been incorporated into this analysis.

1.4. The average customer bill in the report is constructed using monthly prices charged by the Big 6 companies. Each supplier's standard regional tariffs are averaged to give a national average price for each payment method. These national averages are weighted by the proportion of customers on each payment method and by the market share of each company.

1.5. We have not taken into account the impact of discounted and fixed price tariffs as we are carrying out the analysis from the perspective of a typical customer and standard tariffs remain the most popular tariff form. We are not trying to model supply business profits.

### Wholesale energy costs

1.6. The proportion of a customer's final energy bill which is accounted for by wholesale costs varies between suppliers and over time with changing wholesale costs and other costs.

1.7. Wholesale prices can be volatile. Suppliers therefore buy much of their energy requirement over a period of time (hedging) to reduce the effect of large changes in wholesale prices. This helps suppliers to smooth costs and provides them with more certainty over future costs. Wholesale prices on any given day are therefore not a good indicator of suppliers' wholesale costs, nor are short term products such as within-day or day-ahead products. We use wholesale energy price data up to and including 8 December 2011 in this report.

1.8. We estimate the relationship between wholesale prices and suppliers' wholesale energy costs. Our analysis is based on forward looking wholesale costs. It estimates the expected cost of supplying energy to a customer for the next 12 months at each point in time, based on pricing information available at that time. Costs are based on buying seasonal and quarterly products in electricity and gas, respectively.

1.9. We have estimated costs based on a range of different hedging strategies. These strategies draw on information provided to us as part of the Energy Supply Probe. Our model shows what we believe to be generally representative of wholesale costs across the industry. However, it is important to note that hedging strategies may vary between suppliers and suppliers may change their strategies over time in reaction to market conditions.

1.10. Firms operate a range of trading strategies, including purchasing energy internally and on long-term contracts. By using market-based prices to estimate

wholesale costs, we are pricing energy at the price which firms are able to sell the energy at on the wholesale market<sup>2</sup>.

1.11. The actual weighted average cost of electricity and gas could be different from this if companies purchase energy internally from their upstream generation business at a price different from the prevailing market price. Any margin made on energy bought below market prices would mean an equivalently lower margin in the generation business.

1.12. In Appendix 2 we present costs based on our 12, 18 and 24 month hedging strategies. In the report we choose a central hedging strategy where costs are based on firms starting to purchase energy 18 months ahead of time t. Figures 2.1 and 2.2 in Appendix 2 show how wholesale costs vary with alternative hedging strategies. The alternative hedging strategies shown are:

- Firms start to purchase energy 12 months ahead of time t;
- Firms start to purchase energy 18 months ahead of time t; and
- Firms start to purchase energy 24 months ahead of time t.

1.13. Prices are weighted to take account of seasonal consumption trends (by quarter for gas and by season for electricity). For electricity, wholesale costs include both losses and our proxy for shaping costs. Wholesale energy cost is calculated by averaging forward electricity and gas product prices over the buying period, assuming a constant rate of purchase.

1.14. The wholesale cost model calculates wholesale costs on a quarterly basis. We convert these values into a monthly series by taking a straight line average between quarterly points.

### **Other supply costs**

1.15. The components of other supply costs are network charges (transmission and distribution), balancing costs, meter costs, RBD costs, environmental and social supplier obligations (Community Energy Savings Programme -CESP, Carbon Emissions Reduction Target – CERT, Renewables Obligation Certificates – ROCs, Feed in Tariffs – FiTs and the Warm Homes Discount scheme<sup>3</sup>), other direct costs and VAT. Note that electrical losses and shaping costs are included within the wholesale cost of electricity, as is the cost of the EU Emission Trading Scheme (EU ETS), which is borne by electricity generators and will be reflected in the wholesale cost of the electricity generators sell.

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<sup>2</sup> Formally this is known as an opportunity cost methodology.

<sup>3</sup> The Warm Homes Discount scheme is replacing social tariffs as a means of assisting priority customers with their energy bills.

1.16. Other costs are the expected costs over the next 12 months. For example, suppliers' costs for the year from March 2011 capture the additional cost of the extended CERT scheme introduced from April 2011.

### **Gross Margin**

1.17. Gross margin is calculated as the difference between the average customer bill and the sum of wholesale costs and other supply costs.

### **Net margin**

1.18. The net margin is calculated as the difference between gross margin and operating costs. Operating costs include customer service staffing, IT, sales and marketing, billing and bad debt costs.

1.19. Detailed operating cost data was collected from the Big 6 as part of the Energy Supply Probe for the period 2005 to 2007. We have recently updated our operating costs based on information provided to us by the Big 6 in connection with our Retail Market Review. We produce weighted average operating costs for electricity and gas based on the market shares of the Big 6 (on a customer numbers basis) to represent the operating costs of a typical supplier. This is consistent with our method of calculating the average retail bill.

**Figure 3.2: Summary of changes to our calculations since our last report**

<b>Updates</b>	<b>Source</b>
Network charges updated	Joint Office of Gas Transporters
ROC costs updated	DECC
Warm Homes discount / social tariff costs updated	Ofgem

## Appendix 4 – The Authority's Powers and Duties

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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 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, 2008 and 2010) as well as arising from directly effective European Community legislation.

1.3. References to the Gas Act and the Electricity Act in this appendix are to Part 1 of those Acts.<sup>4</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>5</sup>

1.4. The Authority's principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. The interests of such consumers are their interests taken as a whole, including their interests:

- in the reduction of greenhouse gases;
- in the security of the supply of gas and electricity to them; and
- in the fulfilment by the Authority, when carrying out its functions as designated regulatory authority for Great Britain, of the objectives set out in Article 40(a) to (h) of the Gas Directive and Article 36(a) to (h) of the Electricity Directive.

1.5. The Authority is generally required to carry out its functions in the manner it considers is best calculated to further the principal objective, wherever appropriate by promoting effective competition between persons engaged in, or commercial activities connected with,

- the shipping, transportation or supply of gas conveyed through pipes;
- the generation, transmission, distribution or supply of electricity;
- the provision or use of electricity interconnectors.

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<sup>4</sup> Entitled "Gas Supply" and "Electricity Supply" respectively.

<sup>5</sup> 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.

1.6. Before deciding to carry out its functions in a particular manner with a view to promoting competition, the Authority will have to consider the extent to which the interests of consumers would be protected by that manner of carrying out those functions and whether there is any other manner (whether or not it would promote competition) in which the Authority could carry out those functions which would better protect those interests.

1.7. In performing these duties, the Authority must 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>6</sup>; and
- the need to contribute to the achievement of sustainable development.

1.8. In performing these duties, the Authority must have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.<sup>7</sup>

1.9. 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:

- promote efficiency and economy on the part of those licensed<sup>8</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, and shall, in carrying out those functions, have regard to the effect on the environment.

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

- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

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<sup>6</sup> 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 Acts in the case of Electricity Act functions.

<sup>7</sup> The Authority may have regard to other descriptions of consumers.

<sup>8</sup> Or persons authorised by exemptions to carry on any activity.

1.11. The Authority may, in carrying out a function under the Gas Act and the Electricity Act, have regard to any interests of consumers in relation to communications services and electronic communications apparatus or to water or sewerage services (within the meaning of the Water Industry Act 1991), which are affected by the carrying out of that function.

1.12. 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 Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation<sup>9</sup> and 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.

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<sup>9</sup> Council Regulation (EC) 1/2003.

## Appendix 5 - Feedback Questionnaire

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1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was 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, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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