

ofgem

ofgem E-Serve

Promoting choice and value  
for all gas and electricity customers

# Overview of Ofgem Annual Report 2011-12

This document is a summary of Ofgem's Annual Report 2011-12. The full document, together with our resource accounts, can be downloaded from [www.ofgem.gov.uk](http://www.ofgem.gov.uk)



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# Introduction

**Our main duty is to protect consumers. We do this by promoting competition and regulating the companies that run the gas and electricity networks.**

**Looking back on the year, we can see that progress is being made across a number of key areas.**

## Retail Market Review (RMR)

Whilst there is still significant progress to be made, most of the major supply companies are responding positively to our retail market reform package. Many of the suppliers have now:

- unveiled new proposals on tariffs
- improved customer engagement
- committed to giving more accounting information.

In addition:

- we increased transparency on the potential margins that can be made by suppliers, by weekly publication of the data
- we achieved a landmark outcome from an investigation into marketing activities, when we reached an agreement for money to be given back to consumers
- accountants BDO gave a largely clean bill of health to the industry's accounts, gaining further consumer confidence.

## RIIO (Revenue=Incentives+ Innovation+Outputs)

The scale of investment for GB networks is enormous. Not only do large parts of the network need replacing, but the network needs new build and reconfiguration to manage new energy sources like wind, wave and nuclear.

RIIO is our new price control methodology. The aim is to make sure network companies respond to the needs of their stakeholders and deliver networks for a sustainable low-carbon energy sector, while giving customers a secure supply and value for money.

The RIIO model gives consumers more involvement in network regulation than ever before. For example, under this price control model all transmission and gas-distribution companies have agreed to run an annual customer satisfaction survey, with financial rewards and penalties based on how they perform.

So much progress was made using this model that we awarded two companies (SP Transmission and Scottish Hydro Electric Transmission) 'fast track' status for their transmission businesses. These companies can now waive nine months of red tape and get back to running their businesses.

## Providing value

- This year the Department of Energy and Climate Change (DECC) concluded its formal review of Ofgem. It also completed its delivery landscape review, which included Ofgem E-Serve. DECC gave clearance to both sides of our business.
- We assisted DECC with its electricity market reform package (EMR)
- In Europe we've worked to promote GB consumer interests. We have been very involved through the EU Agency for the Cooperation of Energy Regulators (ACER) as well as the European Commission's Directorate-General for Energy and Transport.

## Providing value for money

- For the seventh year running we achieved savings against budget, despite a big increase in our workload.
- This includes over £4.6 million savings relating to licence-fee-funded regulation, which we will be giving back to licence-fee payers.
- We develop and administer DECC schemes for 0.38 per cent of the programme cost on a not-for-profit basis (a more normal benchmark for similar schemes is two per cent).

The following pages contain more details about our work over the past year.

- **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**

# Theme 1

## Building a low carbon economy

**Great Britain still faces huge challenges in meeting the government's climate change targets. We estimate that meeting these targets could take up to £200 billion of new investment.**

### **Developing the RIIO Price Controls Approach**

Our new price control regime is RIIO (Revenue = Incentives + Innovation + Outputs).

Price controls for the gas and electricity transmission networks (RIIO-T1) and the local gas distribution networks (RIIO-GD1) will run from April 2013 to March 2021.

- This year we assessed the network companies' detailed business plans, which show how they will deliver a more sustainable energy sector, how they will invest to meet the demands of their customers and the revenues they will need as a result.
- We broadly approved and decided to fast-track the plans from SP Transmission and Scottish Hydro Electric Transmission.



In February we launched the price controls for the electricity distribution networks (RIIO-ED1), which will start in 2015.

- A main goal is to make sure they have the right incentives to plug new technologies such as solar and small scale wind into the network quickly and efficiently.

We also extended the Transmission Price Control Review 4 (TPCR4) price controls by one year, up to the time RIIO-T1 starts in 2013.

### Low Carbon Network (LCN) Fund

This is the second year of the LCN Fund, which supports network innovation. It helps Distribution Network Operators (DNOs) try out new technologies or new operating and commercial arrangements that could help the move to a low-carbon energy sector.

- In the first tier of funding money is available for DNOs to fund smaller projects.
- In a second tier, Ofgem runs an annual competition. This year six projects will share £57 million of funding.

### Electricity Transmission: connections and charging

Over the next decade the UK will need to connect a large amount of new generation to the electricity networks.

This year we made good progress on Project TransmiT: our independent and open review looking into whether electricity transmission charges and connection arrangements could be improved.

- We launched a Significant Code Review (SCR), to assess a range of potential changes to the formula for setting transmission charges.
- Our preferred option is to keep location-based charging (where generators pay more the further away they are from demand, to reflect the higher costs they impose on the system). But we would improve the formula to take into account different types of generator and how often they use the network. This will help many low-carbon generators.
- We also asked industry to develop proposals to tackle various issues that generators face when connecting to the networks. We announced our decision in March.



### Promoting smarter energy markets

DECC is leading the government programme to put smart meters into UK homes over the next decade. Our role is to support and advise DECC as it creates the necessary rules and regulations, and then to enforce them once they are in place.

- Smart meters will give consumers the information they need to manage the energy they use, and help suppliers create new services to cut customers' bills.
- They could also help the industry create more efficient energy markets, and pave the way for smart grids. We consulted on our suggestions for how this could be done and we are now developing more detailed

recommendations. They include what changes we need to make to market arrangements so consumers benefit and are protected.

- As smart meters are rolled out we also need to manage the process of replacing traditional meters. This year we finished our review of the market arrangements for traditional metering. We also consulted on how to make sure this process happens efficiently. We will make our recommendations later in 2012.
- With DECC we established the Smart Grids Forum (SGF). This stakeholder group will lead discussions around the role smart grids can play in a low-carbon future and help shape policy.

## Theme 2

# Helping to maintain security of supply

**Britain is increasingly relying on gas imports, so we are more susceptible to fluctuations in the global energy markets. Also, new EU regulations are changing how the energy markets work.**

### Implementing the EU Third Energy Package

We have been heavily involved in implementing the EU third package of energy reforms, which DECC brought into UK legislation in November.

- Our chairman, Lord Mogg, chairs the European Board of Regulators (ACER).
- We consulted on a new regulatory framework for investment in electricity interconnectors. The consultation focused on project NEMO, the proposed interconnector between Great Britain and Belgium, as a case study.
- We approved access rules on Britned, the interconnector with the Netherlands, which ‘couples’ the British market with the Dutch market for the first time.

- We gave the European Commission our first thoughts on making sure our transmission systems in Great Britain comply with the Third Package unbundling requirements.
- In March we asked for views on what the plans for integrating electricity markets may mean for the GB energy market, and on planning for an integrated electricity transmission system within a single European market.

### Securing the gas supply

In early 2011 we began a Significant Code Review (SCR) into the security of gas supply in Great Britain.

- In November our draft decision and impact assessment suggested significant changes to the gas emergency arrangements.
- It included proposed payments to customers on non-interruptible contracts, if suppliers fail to cover all their demand.

In November, DECC also asked us to look into whether we need to take further action to make sure medium to long-term gas supplies for consumers remain secure. We are working to assess the risks to gas security.



## Securing the electricity supply

From September 2012 we have to give the Secretary of State a yearly assessment of different electricity capacity margins for the next four years and any risks to security of supply. We have asked National Grid to develop the model we need to do this.

This year, following consultation, we also decided that we would launch a Significant Code Review (SCR) into the payments faced by market participants who consume or generate more or less energy than they are contracted for.

- These are known as 'electricity cash-out arrangements' and we see them as a significant incentive for electricity suppliers and generators to meet customer demand, to help keep electricity supplies secure.
- We will now work with stakeholders to decide how detailed this review will be.



## Theme 3

# Promoting quality and value for consumers

**Our main duty is to protect consumers. This year our major initiatives included our Retail Market Review, working with stakeholders, using consumer research to shape policy across Ofgem, taking enforcement action where necessary and protecting vulnerable consumers.**

### Retail Market Review

In November and December we published our updated Retail Market Review (RMR) proposals, ready for consultation. These proposals followed our initial findings, published in March and June 2011. In the interim we carried out and published a large amount of consumer research to make sure our proposed changes will be as effective as possible.

- Our proposals describe in detail the changes we think are needed to increase consumer engagement and effective competition in the retail energy market.

- They include changes in both the non-domestic and domestic sectors of the market.
- They will create a significant change to the regulatory framework of the industry and are designed to make the market more competitive, clearer and simpler for consumers.

In February we also published detailed proposals to make entry to the wholesale power market easier and to strengthen competition. This includes a proposal to make the Big Six sell up to 25 per cent of their generation through an open and transparent auction.

We also began to publish a rolling weekly report on retail and wholesale energy prices. This is a further step to make the energy market more transparent for consumers and market participants.



## Enforcement

This year we continued to take a tough stance on enforcement.

- In March 2012 we announced we had found EDF in breach of its marketing licence conditions. We agreed with EDF measures worth £4.5 million to help vulnerable consumers. This means consumers will benefit directly from our investigation.
- We fined RWE npower £2 million and British Gas £2.5 million in July, following our investigations into complaint handling.
- We fined Northern Gas £900,000 and National Grid £4.3 million for not hitting standards on how quickly and consistently they react to reports of gas leaks.
- We fined British Gas £1 million for misreporting their Renewables Obligation figures.

We also consulted on changes to our enforcement guidelines and started a full review of our enforcement policy, which will finish in 2013.

## Reducing debt and disconnection, social tariffs and the Warm Home Discount

Our view is that suppliers need to be responsive to customers when recovering debt, and use disconnection only as a last resort. This year we continued to

meet regularly with the large suppliers to highlight areas of concern and promote best practice.

- The amount of disconnections is now down from more than 8,000 in 2007 to about 1,300 in 2011.
- During the year our investigation into British Gas' compliance with debt payment licence obligations resulted in important clarification for all energy suppliers on their approach to taking account of individual customers' circumstances in setting repayment rates.
- This clarification of the high standard required will inform Ofgem's future interpretation of these licence obligations to protect vulnerable consumers.
- We worked with suppliers to reduce the disparity between the weekly debt repayments they ask from prepayment meter customers and the amounts asked from credit customers.

In 2008 the Big Six agreed to increase their collective spending on social programmes to at least £150 million a year by 2011. In the final year of the commitment they spent £178.7 million – almost £29 million above target.

Ofgem E-Serve administers part of the Warm Home Discount scheme for DECC. This replaces the voluntary commitment on social programmes and tariffs and will run until 2015.

## Promoting consumers' interests in energy markets

Our programme of consumer engagement, Consumer First, helps us improve our understanding of how consumers behave, and their experiences and concerns.

As part of this we commission our own research, hold a regular Consumer First panel, and examine external data. This year we worked closely with teams across Ofgem to make sure this research informed all our policies and initiatives.

We put in place a range of measures as part of the 'Spring Package'. These included new protections for customers getting early smart meters.

- We set out our commitment to enforce existing consumer protection legislation in the area of smart data privacy.
- We worked with DECC, industry and consumer groups to develop the Smart Meter Installation Code of Practice.

We also set out final proposals for enforceable licence obligations on gas suppliers to detect and prevent theft.

Energy Best Deal, launched in 2008, is a joint initiative with the Citizen's Advice Bureau to give consumers impartial advice about keeping energy costs down. The programme is GB wide and is expanding further in its fourth year of running.

This year we launched Energy Best Deal online with a series of consumer videos, including a Welsh-language version.

## Consumer insight shaping policy across Ofgem

We commission our own consumer research. This includes large-scale surveys, but also our regular Consumer First panel (made up of 100 people from six locations broadly representing GB consumers). Plus we examine a range of external data.

This year we again made sure that this research informed all our policy work.

For example:

- we developed a consumer segmentation model, which proved very useful for considering how the Retail Market Review (RMR) proposals could have the biggest beneficial impact on as many people as possible
- our research into how consumers might react to better market information has helped shape our RMR proposals to improve tariff visibility and comparability for consumers
- our latest research into customer satisfaction with suppliers' complaints handling shows that while there have been improvements since the last review, there is still a need for further progress from suppliers.

## Theme 4

# Timely and efficient delivery of government programmes

**Through our delivery arm, Ofgem E-Serve, we implement and run regulatory programmes with the Department of Energy and Climate Change (DECC). We also develop and administer government environmental schemes on a not-for-profit basis.**

### Offshore

Offshore wind power is expected to play a big part in Britain's efforts to cut carbon emissions. We run the offshore transmission regime with DECC.

- We successfully ran the competitive tender process for licences for three more Offshore Transmission Owners (OFTOs) to own and operate high-voltage transmission links with UK offshore wind farms.
- These licences are all part of a first round of tenders, which involves £1.1 billion of offshore transmission links to nine wind farms.

- The tender process will drive down costs for consumers, create vital new infrastructure and allow new players to enter the market.
- We launched the Integrated Transmission Planning and Regulation (ITPR) project. It aims to review the UK's system planning process, and identify what needs to be done by the National Electricity Transmission System Operator (NETSO).

### Renewable Heat Incentive (RHI)

In November we launched the Renewable Heat Incentive (RHI), the first scheme of its kind in the world. It provides funding to help businesses switch from oil- and gas-fired heating systems to sustainable ones.

We put together guidelines, set up an enquiry line to answer their queries about how to take part, and designed and built a secure IT system.

### **Feed-in Tariffs**

This was the second year of the Feed-in Tariffs (FITs) scheme. It aims to get more people using small-scale renewable and low-carbon technologies. Licensed electricity suppliers pay tariffs to generators for any electricity they generate and export.

- We maintain the central FIT register (a database of all the registered installations), make sure suppliers comply with regulations, and accredit certain generating stations.
- At the end of the second year there were around 248,000 registered FIT installations, up from about 30,000 at the beginning of the financial year.

### **We also administered the**

- **Warm Home Discount scheme**
- **Carbon Emissions Reduction Target (CERT)**
- **Community Energy Saving Programme (CESP)**

More recently, DECC has asked us if we can work more closely on the new ECO (Energy Company Obligation) programme that starts in 2012.

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