

Rt Hon Edward Davey MP
Secretary of State
Department of Energy and Climate Change
3 Whitehall Place
London SW1A 2AW

Date: 18 July 2013

Dear Secretary of State

Social and Environmental Guidance to the Gas and Electricity Markets Authority

The Gas and Electricity Markets Authority (GEMA) must have regard to the Social and Environmental Guidance ("the Guidance") issued by the Secretary of State¹. It sets out an expectation that each year GEMA will demonstrate how it has helped the government make progress towards the aims and targets it contains. I suggest that your officials might be invited to provide you with some targeted briefing for Parliamentary use to underline the extensive contribution Ofgem makes to the Government's policy and the close collaboration and shared objectives the two have.

The Guidance² is clear that the government's key social and environmental energy goals are to increase renewable energy levels, to reduce greenhouse gas (GHG) emissions and energy consumption, and to eliminate fuel poverty as far as is reasonably practicable. Through our actions as an independent economic regulator and as an administrator of government environmental programmes we have continued to make a significant contribution to achieving these goals in 2012-13. In particular, I draw your attention to the following actions.

Increasing renewable energy levels and decreasing GHG emissions

The most significant way in which we contribute to the UK's renewable and GHG targets is through the RIIO (Revenue = Incentives + Innovation + Outputs) price control settlements, which incentivise network companies to meet environmental targets by working efficiently and innovatively. These settlements for gas distribution and electricity and gas transmission networks came into force in April 2013 and have earmarked up to £31.2 billion to deliver new and upgraded infrastructure for Britain's gas and electricity networks. We have also published our strategy decision for assessment of proposals for the electricity distribution RIIO price control settlements which are due to come into force in 2015.

Some key environmental benefits of the RIIO framework are set out below.

- Gas distribution networks are expected to cut gas transport losses, which make up 95 per cent of their carbon footprint, by 15-20 per cent by 2021.

¹ See section 3B of the Electricity Act 1989 and section 4AB of the Gas Act 1986.

² See: <http://www.ofgem.gov.uk/About%20us/Documents1/file37517.pdf>

- Electricity transmission owners and the system operator will have access to a share of £32 million reward funding over the period of the price control (2013 to 2021) if they help the industry move towards a low carbon energy system and achieve high standards in environmental management.
- Electricity distribution network operators will be incentivised to be flexible and smart so that low-carbon technologies such as heat pumps, solar panels and other small-scale renewable generation can be connected at the least long-term cost to consumers.

In addition to our work on the RIIO price controls, I also draw your attention to other 2012-13 activities including:

- The award of £45.5 million of funding for five innovation projects through our Low Carbon Networks (LCN) Fund. The LCN Fund stimulates innovation in the electricity distribution networks and helps network companies to meet the challenges of transitioning to a low carbon economy. We are also applying similar approaches to funding innovation in the gas distribution and electricity and gas transmission sectors by establishing the Innovation Stimulus as part of the RIIO framework.
- A consultation on proposed changes to the method of calculating transmission charges in order to better reflect the costs imposed by different types of generators on the electricity transmission network, particularly intermittent, renewable generators like windfarms.
- Our Integrated Transmission Planning and Regulation project is an exploration of the issues and options to ensure that the electricity transmission system planning and delivery arrangements that exist onshore, offshore and cross-border can facilitate the efficient and integrated development of the GB network. This project arises from the evolution of electricity transmission networks to support integration of newer forms and sources of generation (including renewables). Our initial work has now been followed up with a public consultation on our emerging thinking (issued in June 2013).
- Contributing to lowering the costs of offshore wind by using competitive tendering to grant two new Offshore Transmission Owner licences to own and operate high-voltage transmission links with GB offshore windfarms. Once all licences are granted we estimate the first two tender rounds will have secured around £2.5 billion of investment, connecting 3.9GW of offshore wind.
- Consulting on and developing policy to support the coordination of offshore electricity networks and implementation of the enduring regime for offshore transmission. We expect the first enduring tender round, Tender Round Three, to commence later in 2013.
- Continuing to work with the Department of Energy & Climate Change (DECC) on the Smart Grids Forum. We have focussed on a workstream which has created a bespoke model to examine the costs and benefits of smart approaches to developing low carbon technology, and another which has examined commercial and regulatory barriers to actions like demand-side response (changes in energy use by end-use customers in response to a signal) which can exploit the full environmental benefits of smart grids.
- As part of our Smarter Markets Programme, examining how current market arrangements might constrain the efficient, system-wide use of demand-side response, which can enhance security of supply and contribute to sustainable development.
- Engaging with the Agency for the Cooperation of Energy Regulators (ACER) and the Council of European Energy Regulators (CEER). You will be aware that I chair ACER's

Board of Regulators and CEER. We are working with other European regulators to seek to remove barriers to cross-border trade, to increase the efficiency of the energy system and thereby to reduce GHG emissions.

- Chairing the Council of European Energy Regulators' Sustainable Development Task Force, which produced two influential reports: one on the impacts of non-harmonisation of renewable energy support schemes, and a comparative review of renewable energy capacity and support levels across the European Union's member states.
- A consultation on proposed revisions to our Impact Assessment guidance, including proposals to integrate long-term, hard-to-monetise strategic and sustainability considerations into our impact assessment process. If brought into effect, these changes should help us to assess the potential contribution of our decision-making to the achievement of the UK's carbon reduction and renewable energy targets in a more systematic way, subject to our wider legal duties and objectives.
- Continuing to administer the Feed-in Tariffs scheme, which aims to promote the use of small-scale renewable and low-carbon technologies to generate electricity. In 2012-13 we registered 131,871 installations.
- Continuing to administer the Renewables Obligation scheme, the government's main mechanism for the incentivising generation of electricity from renewable sources. In 2012-13 we accredited over 500 generating stations under the scheme and issued around 42 million Renewables Obligation Certificates, up from 34.7 million in the previous year.
- Continuing to administer the Renewable Heat Incentive, which provides funding to help non-single domestic premises switch from fossil fuel heating systems to renewable ones, and working with DECC to improve the scheme and extend its benefits to domestic customers.

Reducing energy consumption

We recognise that reducing energy consumption results in benefits for consumers, such as lower energy bills, and benefits for the environment due to a reduction in overall energy demand. We are encouraging energy saving in three key areas.

The roll-out of smart metering will give consumers ready access to information on their consumption, helping them to use energy more efficiently and to identify products suited to their needs. We have established the Smarter Markets Programme to use the opportunity that smart metering presents to make retail energy markets work better for consumers. As part of this Programme, we are seeking to ensure that regulation enables consumers to engage effectively in markets with widespread deployment of smart metering.

Until the schemes ended in December 2012 we administered the Carbon Emissions Reduction Target and the Community Energy Saving Programme, both of which aimed to help people make their homes more energy efficient. We published our reports to you on whether the suppliers and generators have met their obligations under both schemes at the end of April 2013. We now administer these schemes' replacement, the Energy Companies Obligation, which places a legal obligation on the major energy suppliers to help make households more energy efficient. Our role includes checking that suppliers' measures are compliant, monitoring the suppliers' progress against their obligations and reporting to you on that progress.

We amended the rules of the LCN Fund to allow distribution network operators to trial measures that shift or reduce electricity demand. Since this change we have received bids from companies to carry out LCN Fund projects which explore the role of energy efficiency in network management.

Tackling fuel poverty

In 2012-13 our flagship approach to improving the energy market for consumers was our Retail Market Review proposals, aimed at making the market simpler, clearer and fairer. Whilst these proposals are intended to reform the retail market for all consumers, the Retail Market Review may help the fuel-poor via the provision to exempt collective switching from our tariff cap. Collective switching enables consumers to club together to negotiate better energy deals, and in particular has shown potential to benefit vulnerable and disengaged consumers. We have also supported DECC's collective purchasing working group, contributing to information leaflets for consumers and organisers of collective switching, and publishing an open letter to help stakeholders understand the legal framework around collective switching.

In December 2012 we consulted on measures to improve liquidity in the wholesale market. Liquidity ensures that electricity products are available to trade, and that prices are robust; the consequential increase in competition may benefit consumers via downward pressure on prices. Having developed this work, we published a further consultation in June 2013.

In March 2013 we took over management of the Confidence Code, a code of practice for on-line domestic energy price comparison services. Using a price comparison website can help consumers to lower their energy bills. We will be considering the regulatory framework of the Code over the coming year.

We also launched a consultation on our proposed Consumer Vulnerability Strategy. This consultation helped us develop a more sophisticated understanding of consumer vulnerability, which will affect what action we expect from suppliers and distributors to assist fuel-poor consumers. The associated work plan on consumer vulnerability included two features relevant to the issue of fuel poverty:

- A review of the Priority Services Register, which currently provides services for customers who are of pensionable age, disabled or chronically sick. The purpose of the review is to ensure the Register is providing the right type of support to consumers in vulnerable situations.
- Establishing a Consumer Vulnerability Network with the roles of contributing to developing policy, helping us find new ways to engage consumers and making sure we stay connected to the real experience of the consumers we are trying to help through our Strategy.

This consultation has now been followed up with our finalised Strategy, issued in July 2013. As part of our Enforcement activity we worked with E.ON on a package to compensate customers who had lost out due to E.ON's failure to ensure that customers were not charged higher prices and termination fees if they had signalled their intent to leave on receiving a notice from E.ON informing them of a price increase. In addition to compensating a total of £1.4 million to affected consumers, E.ON also agreed to make an additional payment of £300,000 to a consumer fund run in partnership with Age UK which provides social initiatives and programmes particularly for older people.

In addition to our work on the Retail Market Review, the Confidence Code, our Consumer Vulnerability Strategy and Enforcement work detailed above, I should like to draw your attention to other activities:

- Establishing new arrangements requiring gas suppliers to do more to detect, prevent and investigate gas theft, thus reducing the cost to consumers which industry research estimates may currently be as high as £138 million per year (around £6 per gas customer). We also began to explore whether to apply similar measures for tackling theft to the electricity market within our strategy proposals for the next electricity distribution price control.

- Establishing a requirement on Gas Distribution Networks to connect an additional 77,000 fuel-poor customers to the network during the 2013-2021 price control period.
- Our strategy decision for the next electricity distribution price control under the RIIO framework has a strong emphasis on distribution network operators identifying and providing assistance for consumers in vulnerable situations including fuel-poor customers, through both their own comprehensive stakeholder engagement and working in partnership with a range of specialist organisations.
- Obtaining suppliers' agreement to a package of measures designed to increase the number of prepayment meter customers in debt switching supplier. This includes increasing the threshold for the amount of debt that can be switched between suppliers from £200 to £500, increasing awareness of the ability to switch, and improving the processes through which customers switch.
- Continuing to monitor suppliers' social obligations performance with regard to consumers' levels of debt, disconnection rates and the assistance provided to vulnerable consumers, using this information to identify best practice and areas of suppliers' practices where improvements are needed.
- Continuing to deliver the Energy Best Deal in partnership with Citizens Advice, giving front line workers the training they need to give face-to-face advice to lower income households on their energy rights and how to get the best energy deal.
- Ongoing administration of part of the Warm Home Discount scheme, by monitoring whether energy suppliers are meeting their obligations to help customers who are in, or at risk of, fuel poverty.

Accounting for our actions

A more detailed account of these activities, alongside the rest of our work, can be found in our 2012-13 Annual Report which is annexed to this letter.

We are held to account on social and environmental targets throughout the year by our stakeholders, particularly two of our advisory groups. The Consumer Challenge Group comprises a small number of consumer experts who act as a 'critical friend' to Ofgem during the price controls, helping to make sure consumers' concerns are heard when developing the RIIO arrangements. The Sustainable Development Advisory Group is made up of policy experts from government, industry and interest groups, and helps guide us on environmental and consumer issues when our work is at formative stages.

We shall also look forward to engaging with your officials as the Energy Bill progresses through Parliament and as the new Strategy and Policy Statement is taken forward.

Lord Mogg

Chair, Gas and Electricity Markets Authority