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Department of Energy and
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Social and Environmental Guidance to the Gas and Electricity Markets Authority

As an organisation we are continually working to deliver our principal objective. This is to protect the interests of existing and future gas and electricity consumers. We must also have regard to the social and environmental guidance¹ in carrying out our roles. This letter will demonstrate how we have helped the government make progress towards the goals of the guidance. We have done this through our actions as an independent economic regulator and as an administrator of government environmental programmes.

Environmental issues

Improving networks

Our RIIO price control framework² contributes significantly to GB's renewable and greenhouse gas targets. The settlements for gas distribution and electricity and gas transmission networks came into force in April 2013 and will continue until 2021.

- We give network companies an incentive to meet environmental targets by working more **efficiently** and **innovatively**, and by focussing on operating costs as well as capital costs. Under a sharing incentive, savings are split between the companies and their customers. Network operators are driven to find cheaper alternatives to reinforcement, which encourages demand management solutions.
- We have received applications from Scottish Hydro Electric Transmission for three major new projects (called "**Strategic Wider Works**") to reduce bottlenecks on the Scottish transmission network. We have recently endorsed the needs case for the Caithness-Moray project which is the largest single reinforcement. The project will significantly increase the capacity of the transmission network in northeast Scotland by 2018 to cope with around 1.2GW of new renewable generation.
- When the network companies are installing new equipment, they must consider the environmental impact, including the **visual impact**. In RIIO, there is flexibility to fund technology or equipment to address unacceptable impacts, where needed to get planning and development consents. We have voluntary schemes to address the visual impacts of existing infrastructure in areas designated for natural beauty.

¹ See section 3B of the Electricity Act 1989 and section 4AB of the Gas Act 1986.
<http://www.ofgem.gov.uk/About%20Us/Documents1/file37517.pdf>

² RIIO stands for: Revenue = Incentives + Innovation + Outputs

- The **Environmental Discretionary Reward** gives electricity transmission companies and the system operator access to a share of £32 million of reward funding over the price control period. To gain a share of the funding – and the reputational benefits that come with it – they have to provide evidence that they are helping the transition to a low carbon energy system and achieving high standards in environmental management.
- Gas distribution networks are expected to **cut gas transport losses**, which make up 95% of their carbon emissions, by 15-20% by 2021.
- To ensure better **integration of low carbon technologies**, we analysed and approved changes to the way **transmission charges** are calculated. This now reflects the costs of different types of generators connecting to the transmission network, particularly intermittent generators like windfarms. We are also exploring the arrangements for **electricity transmission system planning and asset delivery** that exist onshore, offshore and cross-border. We want to make sure these support the efficient and integrated development of the GB network.
- We have granted **offshore transmission owner licences** for three projects that we competitively tendered. These let the winners own and operate transmission links with offshore windfarms. We also launched a third round of tenders. This included changes to make the process more efficient and to reduce costs for bidders. As well as lowering the cost of offshore wind by attracting new sources of investment through competitive tendering, the regime has brought considerable savings for consumers. Savings from the first tender round alone are estimated at £200-400 million.
- We have embedded **adaptation** and **resilience** to climate change within our 8-year RIIO price control framework. We are working with other regulators to identify how we can work together on sector specific reporting and by working with various committees and bodies concerned with UK infrastructure resilience.

Energy efficiency and demand reduction

Energy efficiency benefits consumers, such as through lower energy bills, and can also reduce greenhouse gas emissions. We encourage energy efficiency both for the organisations we regulate and for GB consumers.

- Through **RIIO**, network companies must have a strategy to reduce losses. In addition, two of the **Low Carbon Network Fund** projects we funded this year will investigate the role domestic energy efficiency can play in managing networks.
- The rollout of **smart meters** will give consumers more information about their consumption. This will help them use energy more efficiently. We are ensuring that suppliers take all reasonable steps to meet their licence obligation to install smart meters in homes and small businesses by 2020.
- We have approved services that National Grid may procure to balance the system. They can now offer businesses an additional opportunity to provide **demand-side response** during times of high demand in return for a payment.
- We helped the Council of European Energy Regulators produce a major consultation on market and regulatory arrangements for **demand-side flexibility**. This led to a set of regulatory principles which will help integrate intermittent renewable generation across Europe in a cost-effective way.
- We've examined how current market arrangements might constrain efficient, **system-wide demand-side response**. Our work has identified the need for a demand-side response framework that formalises the interactions between different parties in the market. We are working out what steps we will take to establish this framework. We expect to publish our findings in 2015.

- By administering government schemes such as the **Energy Companies Obligation (ECO)**, we help consumers reduce their energy consumption. ECO went live in January 2013 and saw suppliers install energy efficiency measures in over 600,000 households by 31 March 2014.

Distributed and renewable energy

There may be opportunities to move towards the government's low-carbon goals through distributed energy and heat technologies. We are identifying and removing unnecessary regulatory and market barriers to the economic deployment of these technologies.

- We are engaging with the **community energy** sector to make sure we are aware of any barriers they encounter, so that we can address them if appropriate. This has involved an outreach workshop in September 2013 and chairing a working group about connecting community energy groups to the distribution network.
- We actively engaged with the industry and stakeholders interested in a licensing approach often called 'Licence Lite'. This was introduced to help distributed generators enter the supply market while still protecting consumers. We expect to process the first application before 2015 and will be consulting on updated guidance later this year.
- We issued over 62 million **Renewables Obligation** Certificates, up from 42 million in the previous year. This has been the government's main support mechanism for incentivising renewable electricity.
- We reviewed the **green tariffs market** and proposed changes. By improving trust in this area, demand for renewable energy may increase.
- In 2013-14 we registered over 90,000 installations for **Feed-in Tariffs**. This creates incentives to use small-scale renewable and low-carbon technologies.
- We continue to work with the Department of Energy & Climate Change (DECC) to simplify the **Non-Domestic Renewable Heat Incentive** in line with feedback from applicants. This encourages companies and organisations to install renewable heat generation systems in place of fossil fuel ones.
- We launched the **Domestic Renewable Heat Incentive** in April 2014, to encourage domestic consumers to install renewable heating. When developing the scheme we worked closely with DECC to simplify the customer experience, including by user testing the application form and guidance.

Innovation and technology

Through our price controls, we encourage network companies to invest in innovative technologies and approaches. We are also working on potential future changes in the energy system, such as smart grids and an increase in demand-side response.

- We are working with DECC on the **Smart Grids Forum**. The forum is looking at commercial and regulatory arrangements, and has delivered an interim report on ways that distribution network operators may be able to implement demand-side response. A full report is due in 2015.
- We awarded £59.4 million of funding for ten innovation projects through our **Low Carbon Networks Fund** and **Network Innovation Competitions**. These competitions stimulate innovation to help network companies meet the challenges of moving to a low carbon economy in a cost-effective way.
- We have established the **Smarter Markets Programme** to make retail energy markets work better for consumers. We want to make sure our regulations let consumers engage with markets. We're changing some of our regulations, including

the process for changing supplier and the settlement arrangements for allocating energy.

- We are working with the DECC on the **Future Trading Arrangements** Forum. We are committed to ensuring that the electricity market evolves to meet these new challenges and delivers secure, low-carbon, affordable electricity.

Social issues

In July 2013 we launched our Consumer Vulnerability Strategy. The overarching aims of the strategy are to protect and empower customers in vulnerable situations and ensure they have equal access to market benefits – so people are not disadvantaged because of their situation. The main drivers of fuel poverty are energy-inefficient homes, energy prices and incomes. Through protecting the interests of consumers in these areas we are helping the government achieve its fuel poverty targets.

Helping customers access the cheapest deals

Our **retail market reforms**³ have made it easier for all customers to compare offers and find the best deal for them. We recognise that some customers need support or can face additional barriers.

- The **Energy Best Deal** is a programme designed to support the most vulnerable consumers. We work with Citizens Advice so customers have access to face-to-face advice on switching, debt, financial management and energy efficiency.
- We are looking at how we can support **third-party intermediaries** that help people switch supplier. This includes collective switching schemes.
- Our improvements to the **Confidence Code** will make switching sites better meet the needs of vulnerable customers, including prepayment meter customers.
- Our **Be An Energy Shopper Campaign** aims to increase consumers' awareness of their ability to get a better deal on their energy bills.

Reducing energy bills

- We administer part of the **Warm Home Discount** scheme, and monitor whether energy suppliers are meeting all of their obligations to help customers who are in, or at risk of, fuel poverty. We estimate that in 2012-13 more than 2.7 million customers received assistance through the Warm Home Discount.
- We are working with DECC to develop the policy and operational requirements of the proposed **Government Electricity Rebate** scheme. Suppliers will have to give their domestic electricity customers a rebate of £12 in both 2014 and 2015.

Supporting competition

We continue to monitor the operation of the market, including the pricing and charging strategies of suppliers. We have referred the energy market to the Competition and Markets Authority to ensure there are no barriers to effective competition. We introduced a new licence condition in March 2013 to improve liquidity in the wholesale market.

Tackling energy-inefficient homes

One of the main obligations under the **Energy Companies Obligation** aims to reduce the cost that customers on certain benefits pay to heat their homes. By 31 March 2014 suppliers had delivered around £3.7 billion of lifetime savings to vulnerable customers under the Affordable Warmth Group element of ECO.

Helping customers not on the gas grid

Some customers don't have a mains gas supply, which means they often have to rely on more expensive fuels.

³ <https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/retail-market-review>

- We have continued developing the **Fuel Poor Network Extension Scheme**, as part of our work on the latest gas distribution price control. This scheme will help them get connected. It will assist up to 80,000 homes by 2021. We are reviewing the scheme to ensure it is aligned with the government's heat strategy and wider work to address fuel poverty.
- Under the electricity distribution price control, we are incentivising electricity network operators to help vulnerable customers. They will be expected to play a role in targeting advice and linking with third parties to help customers who are not on the gas grid. Their actions will be incentivised through an annual award.

Enforcement

We are rolling out the changes decided upon in our **Enforcement Review**, to increase impact and efficiency in our enforcement work. We have consulted on revised Enforcement Guidelines and new policies for penalties and consumer redress. **Consumer redress** powers granted under the Energy Act 2013 will enable us to require suppliers to compensate affected consumers, pay redress to specific groups of consumers, or pay into a consumer fund. In 2013-14, we secured payments of £24.5 million back to consumers through our enforcement action.

Ensuring fairness for vulnerable consumers

- We introduced new **standards of conduct** licence conditions to ensure domestic customers are treated fairly. Fairness may require treating customers differently according to their circumstances. This means that if a consumer is in a vulnerable situation, suppliers will need to take this into account.
- We are consulting on ways to make sure consumers are not disadvantaged because of their circumstances. Our proposals will improve peace of mind of customers who may need additional support to stay or feel safe in their homes, particularly when their supply is interrupted. They will also improve the sharing of consumer information between utility companies and other departments, using **vulnerability indicators** agreed between them.
- We have reviewed differences in costs for customers using **different payment methods**. Prepayment meters are currently used by 15% of consumers, who are disproportionately on low incomes. While we concluded that these differences reflected suppliers' costs, we recognise that this may still be an issue for vulnerable consumers. We will be inviting DECC to a roundtable in autumn to discuss this.
- We also reviewed charging for customers who choose **paper bills** over online accounts. We found that the current price differences did reflect costs, but we'll keep this under review.
- We are taking steps to remove more **barriers to switching** for prepayment meter customers. This includes improvements to the **Debt Assignment Protocol** that allows customers with debt of up to £500 to switch supplier.
- We continue to monitor suppliers' social obligations performance on consumers' levels of **debt, disconnection rates and help for vulnerable consumers**. We use this information to identify best practice and areas for improvements from suppliers. For example, we've made it clear to suppliers that in principle consumers in vulnerable situations shouldn't have to pay a standing charge if they aren't using gas, or have to pay to have their meter removed.

Smart metering and markets

- In April 2013 we designated the **Smart Metering Installation Code of Practice**. This is used by all domestic and micro-business suppliers installing compliant smart meters. The code sets specific requirements on suppliers when installing smart

meters. It contains particular protections for customers in vulnerable circumstances and prepayment meter customers.

- As part of our **smarter markets** work we are looking at how smart metering can help customers in financial difficulties. This includes how more data and new technology can reduce debt build-up and identify customers who are under-heating their homes. It can also make it easier to help people who are disconnecting themselves.
- We monitored the activity of the **smart metering central delivery body**. Under supply licence conditions, suppliers had to set up the smart metering central delivery body and complete various objectives. These included ensuring that vulnerable, low income and prepayment meter customers could access the benefits of smart metering.

Better Regulation

When we are making decisions, it is important that we protect existing and future consumers. This means balancing the benefits of any action we take against the costs that may be imposed on consumers. This includes considering the effects on the natural environment and long-term sustainability. To help us assess these costs and benefits, we released new guidance on **impact assessment**. This has a greater emphasis on distributional impacts than previous guidance, in line with our approach on consumer vulnerability. The guidance also incorporates our strengthened approach to long-term strategic and sustainability issues. The aim is to consider in more systematic ways how the regulated energy sector can contribute to the UK's carbon reduction and renewable energy targets.

We have been working alongside the **Agency for the Cooperation of Energy Regulators** and the **Council of European Energy Regulators** (CEER), for example by co-chairing CEER's Sustainable Development Task Force.

We are part of the **UK Regulators Network**, which is designed to improve how regulators work together across sectors. The work programme for 2014/15 includes projects to help develop cross-sector infrastructure solutions, to understand the risks around interlinked and interdependent networks, and to identify affordability pressures on different customer groups. Working with other regulators on these areas helps us deliver our social and environmental targets with increased awareness of impacts on other regulated sectors.

We continue to work with DECC on developing the **Strategy and Policy Statement** established under the Energy Act 2013 to outline roles and responsibilities. This includes helping to enable a sustainable and competitive energy market for consumers.

Accounting for our actions

We engage with **government stakeholders** in Westminster, Cardiff and Edinburgh on our work. Senior executives attend Select Committees such as the Energy and Climate Change Committee and the Public Accounts Committee. In May 2014, Dermot Nolan was called to a session on an 'Ofgem Review of Policy'. Dermot described his vision for Ofgem and said that vulnerable consumers are a key priority. He said Ofgem are keen to obtain a better understanding of what specifically is preventing vulnerable consumers from engaging in the market and how we can rebuild trust with this group of customers.

We continue to engage with **stakeholders** on our work. This includes representatives of consumers, environmental groups, the media, the industry and those with an interest in issues such as fuel poverty and climate change. We also do this through two of our advisory groups.

- The **Sustainable Development Advisory Group** includes policy experts from the industry, academia, devolved and national government, and interest groups. It

helps guide us on environmental and consumer issues when projects are at a formative stage.

- The **Consumer Challenge Group** comprises consumer experts who help ensure that consumers' concerns are heard when developing the RIIO arrangements.

We publish **indicators**⁴ showing the progress of the energy sector towards our social and environmental objectives. These are based around five themes:

- Managing the transition to a low carbon economy
- Eradicating fuel poverty and protecting vulnerable consumers
- Promoting energy saving
- Ensuring a secure and reliable gas and electricity supply
- Supporting improvement in all aspects of the environment.

More detail on our activities can be found on our website⁵. Our annual report⁶ outlines the rest of our work.

We look forward to engaging with your officials on these issues in future, particularly through the development of the Strategy and Policy Statement.

David Gray

Chair, Gas and Electricity Markets Authority

⁴ <https://www.ofgem.gov.uk/about-us/how-we-work/promoting-sustainability/sustainability-reporting>

⁵ <https://www.ofgem.gov.uk>

⁶ <https://www.ofgem.gov.uk/about-us/corporate-policy-planning-and-reporting/annual-report-and-accounts>