

Our strategy





Chairman's foreword

We are in a period of keen scrutiny of energy markets, energy companies and the way the sector is regulated. The strength of this interest is not surprising. Energy is an essential service. Virtually every household and business in the country depends on energy companies to provide a reliable supply at a reasonable price. The way energy is produced and traded and the price at which it is sold are of intense interest to politicians and the media as well as to consumers. It has never been more important to be clear what energy regulation is for and why it matters.

Our strategic mission is to make a positive difference for energy consumers through independent regulation. We do this in a sector that is inherently complex. Significant, long-term investment is underway to move to low-carbon forms of generation, to make networks more flexible and to provide residential consumers with new tools to manage their energy use through smart meters. Against this background of ongoing change, consumers also face more immediate pressures from rising prices, poor customer service and, too often, serious failures by energy companies.

The health of competition in the retail market remains a top priority for us and we continue to consider how best to encourage new entrants and strengthen competitive pressures on the incumbent businesses. We also look for opportunities to extend the benefits of competition to activities that are currently monopolies.

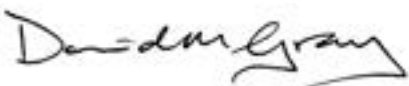
The complex environment in which we work in brings a sharpened focus on our role. In response, we have set out the key elements of the strategy that will guide our work over the next few years. In this strategy, we describe the outcomes we aim to deliver for consumers and the six critical strategic outputs we need to deliver— regulation, competition, standards, partnership, trust and efficiency.

These outputs signal our priorities for the future and make clear our commitment to the development of energy markets that work better for consumers. Our strategy also highlights the importance of independent regulation, working in accordance with statutory duties, and standing apart from the shorter term interests of government.

For independent regulation to be effective, the regulator needs to understand and respond to the experience of consumers, the concerns of the public and the business realities of the energy industry. Our strategy and our Forward Work Programme demonstrate our focus on delivering real benefits in an efficient and cost effective way.

We welcome views on our strategic priorities and on what more we could do to ensure that regulation enables a strong, competitive energy sector that benefits the whole economy.

David Gray



Statutory duties

Ofgem is the Office of Gas and Electricity Markets. We are a non-ministerial government department, an independent economic regulator established in statute, a National Competition Authority, and a National Regulatory Authority under EU directives.

Our statutory duties are established in UK law, mainly in the Gas Act 1986 and Electricity Act 1989. Provisions also appear in other legislation, including the Competition Act 1998, Utilities Act 2000 and Energy Act 2013.

- Ofgem's principal objective is to protect the interests of existing and future consumers, taken as a whole to include the reduction of greenhouse gases, and security of supply, and their interests in the fulfilment of the objectives set out in the EU energy directives
- Ofgem must carry out its functions in the manner which it considers is best calculated to further this principal objective, wherever appropriate by promoting effective competition; and by considering whether there is any other manner of carrying out functions (whether or not it would promote competition) that would better protect the interests of consumers
- When it carries out its functions it must have regard to:
 - the need to secure that all reasonable demand for gas and electricity is met where economical to do so
 - the need to secure that companies are able to finance their activities
 - the need to contribute to the achievement of sustainable development
- In carrying out its primary duties Ofgem must have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes or live in rural areas
- Ofgem shall, subject to primary duties, carry out functions in the manner best calculated to:
 - promote efficiency and economy
 - protect the public from dangers
 - secure a long term energy supply
 - having regard to effect on the environment
- In carrying out its functions Ofgem must have regard to the need for best regulatory practice. Regulatory activities should be transparent, accountable, proportionate, consistent, and targeted only at cases in which action is needed
- Ofgem must have regard to the strategic priorities set out in the strategy and policy statement designated by the Secretary of State.



We interpret our duties as:

Our priority is to protect and make a positive difference for all energy consumers. We work to promote value for money, security of supply and sustainability for present and future generations. We do this through the supervision and development of markets, regulation and the delivery of government schemes. We work effectively with, but independently of, government, the energy industry and other stakeholders. We do so within a legal framework determined by the UK government and the European Union.

Who we are and what we do

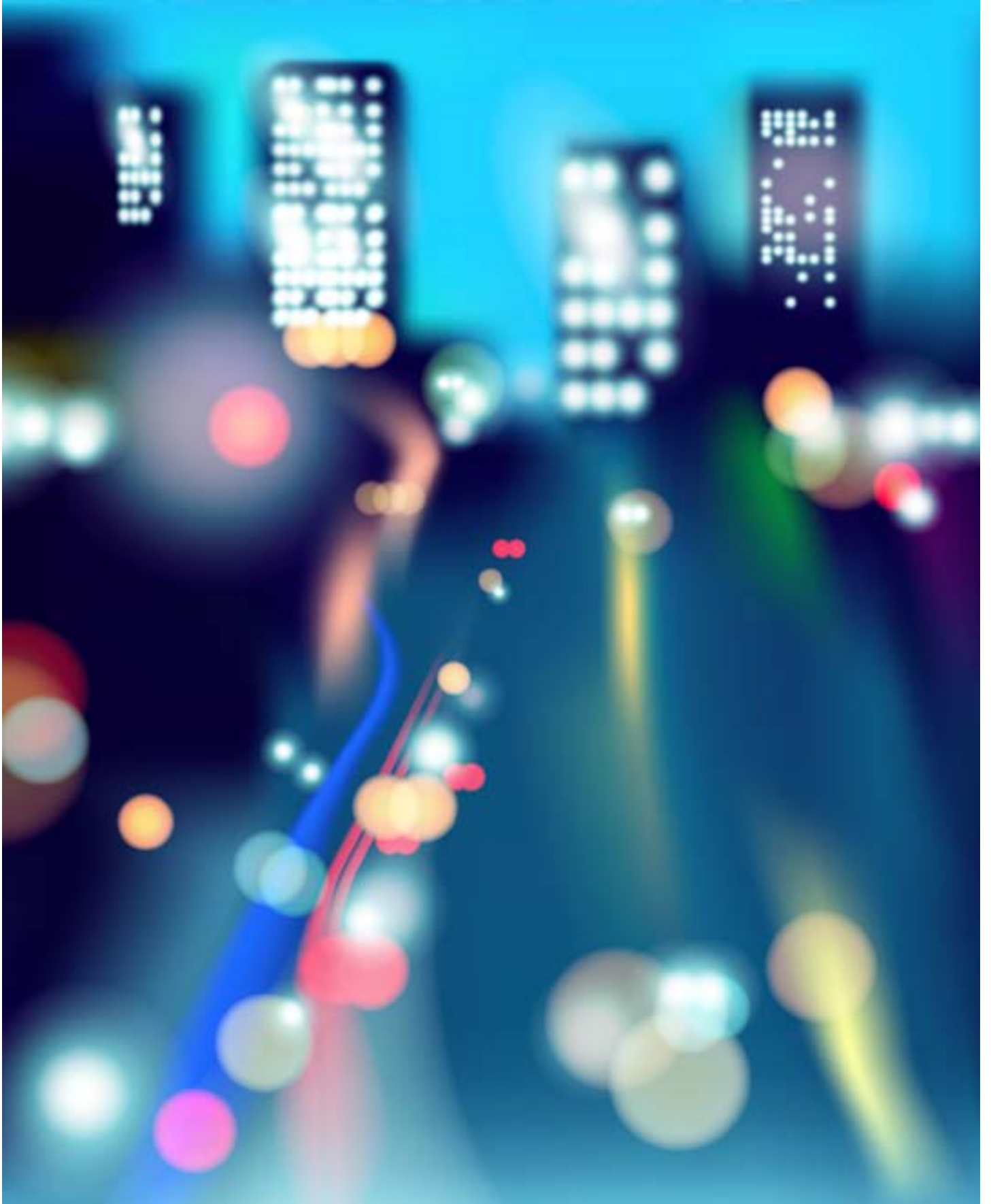
Ofgem is the Office of Gas and Electricity Markets. We are the independent regulator of the electricity and gas system in Great Britain. We exist to make a positive difference for all energy consumers.¹

To be able to do this well, we need to make the most of our resources and our powers. That is why we have created this strategy. In this document, we will set out what our purpose is, what we will achieve and how we will do it. We will review this strategy every year, with a more fundamental review every five years or so. This will make sure it is flexible enough to adapt to changes in the world around us.

Energy is likely to remain high on the agenda for the foreseeable future. Our powers and duties have changed over the years and could change again as they are set by Parliament. Whatever happens, we will continue to make sure that independent regulation works for all energy consumers, both now and in the future.

This strategy, and your comments, will influence our business planning. Our business planning and management will reflect our strategic objectives, our immediate priorities and our ambition to do more for consumers, using fewer resources. We want to know what you think and we will engage with stakeholders about this strategy, particularly our priorities for the immediate future.

¹ Regulation of the electricity and gas system in Northern Ireland is the responsibility of the Northern Ireland Authority for Utility Regulation, usually known as the Utility Regulator. Ofgem works with the Utility Regulator on matters of shared interest.



Why energy matters

Energy matters because it is an essential service. Virtually all of the 26 million households and businesses in GB are electricity customers and the vast majority are also supplied from mains gas. The physical system that is required to deliver gas and electricity whenever you want it is an extensive and critically important part of our national and international infrastructure. Much of it is in constant operation, but also needs renewing and updating, and this in turn needs investment.

Gas and electricity systems are essential for consumers but are owned by private companies. Consumers must be able to rely on these systems to power and heat their homes and businesses because there is no easy alternative. This means that the companies which own these systems have to be accountable to consumers.

It has become apparent in recent years that consumers are not happy. There have been big rises in energy bills at a time when household budgets are squeezed and businesses are struggling. Many consumers do not understand why prices have increased, and do not believe the explanations offered by energy companies. When consumers have to deal with energy companies, too often they find that service standards are poor. Complaint numbers are still at record highs. This all serves to reinforce consumers' mistrust of the market.

The energy market works better for some consumers than others. Those who shop around tend to pay less and get a better service. Others who have used the same supplier, payment method and tariff for years usually pay more. These consumers who are not engaged with the market tend to be poorer and more vulnerable – for example, they might not have internet access to compare tariffs online. These variations in outcomes lead many to view the energy market as unfair.

Electricity and gas markets are on the verge of a technological revolution. By 2020, it is planned that every home and business should have a smart meter installed, which will allow real time communication with your energy supplier and other service providers. As well as reducing costs and putting an end to estimated bills, smart meters have the potential of putting consumers in total control of their energy use and their bills.



Energy is also important to environmental concerns. The largest source of greenhouse gases is the use of fossil fuels in the energy sector. The government is addressing climate change by moving to low-carbon generation. This pushes up bills in the short term, but the reasons behind these costs are not widely understood by consumers, which adds to mistrust over prices. As well as helping to facilitate the shift to a low carbon energy system, we want to help consumers understand the changing landscape and its effect on bills, and create conditions that help consumers to control costs by making more efficient use of energy. To do this, we need to understand better how consumers actually interact with the energy market and the products it offers.

Energy is delivered to our homes and businesses through extensive networks of wires and pipes, which are predominantly monopoly activities separate from the energy supply companies. We make sure the network companies deliver value for money, including in the significant investments that are needed to renew their assets, connect new generation, and keep the system safe and reliable.

Older, more polluting power stations are being closed. In response, the government has introduced its Electricity Market Reform – to deliver reliable, low-carbon electricity supplies. This will create more sustainable energy and address concerns about capacity, while lowering costs for consumers in the long term. We have an important role in bringing this about.

Looking internationally, there are major opportunities presented by better connection and coordination between GB and the European energy markets. We are working closely with our European equivalents to put in place new approaches to ensuring energy can be traded between countries. These changes will improve the security of our energy supplies in future and make it cheaper and easier to reduce carbon emissions across Europe.

The key challenge of maintaining capacity and ensuring reliable energy supplies is fundamental to households, businesses and the wider economy in the transition to a low carbon energy system. Our regulation helps to ensure that this transition is managed at good value to consumers and that consumers have the tools they need to achieve control over their energy costs.

Our mission

Our mission is to make a positive difference for all energy consumers, both now and in the future.

We do this through the independent regulation of the electricity and gas system in Great Britain.

Making a difference for consumers

The purpose of this strategy is to help us focus more sharply on the difference we can make for consumers. By 'consumers' we mean both households and businesses, as many businesses often face similar energy problems to domestic customers.

Through our regulation, we aim to deliver these five outcomes for consumers:

- **Lower bills** than would otherwise have been the case.
- **Reduced environmental damage** both now and in the future.
- **Improved reliability and safety.**
- **Better quality of service**, appropriate for an essential service.
- **Benefits for society as a whole** including support for those struggling to pay their bills.

The main ways in which we will do this are by:

- Making rules that allow competition to be introduced into the electricity and gas systems where appropriate and ensure that competition works in the interests of consumers over time.
- Using regulation or the enforcement of competition law to make sure that competition in these markets is effective and works in the consumers interest

- Setting the price caps and incentives to ensure the monopoly networks deliver a quality service at economically as possible
- Setting standards of service and of fair treatment that companies have to adhere to
- Listening to consumers and ensuring we understand how they actually experience the energy market
- Making sure energy companies abide by our rules and enforcing against companies if they do not
- Being a trusted and authoritative source of advice and information, so that consumers and investors trust the market.

We will maintain sector knowledge and organisational capability to assess risks to delivery of these outcomes and to mitigate those risks where we are able to do so. These risks include, for example, the potential for disruption caused by extreme weather events that lead to widespread outages. We will monitor for risks to energy systems and ensure that our response to incidents is focused on energy companies acting swiftly in the best interests of consumers.

Balanced decision making

- Our work must balance the five consumer outcomes. Sometimes, our decisions will involve trade-offs between one objective and another, while at other times it may be possible to realise several objectives together, for example through energy efficiency.

- Similarly, as our duty is to all energy consumers, both now and in the future, we will often have to balance today's costs against tomorrow's benefits. This can be challenging, in view of the inevitable uncertainty surrounding long term projections in the energy sector. The need to decarbonise and reduce reliance on fossil fuels requires long-term investment in new technology and new ways to strengthen energy efficiency and manage demand.

- It is also important for our decision making to recognise that continuing investment is required to ensure that our energy systems are resilient. Energy systems will face a range of risks – extreme weather, long-term supply shortages and price shocks from unpredictable global events all have to be taken into account.

- We need to work closely with government and other parties to decide how to make these trade-offs. We should also be guided by the views of consumers and their representatives, and align our goals with the wider goals and policies of government. Parliament has enacted legislation requiring the government to set out its strategic priorities for energy policy through a Strategy and Policy Statement (SPS). We will have to ensure that our work has regard to these priorities and is consistent with any changed arrangements in relation to the devolved administrations.

- In doing this, we acknowledge that when we are considering how best to deliver our consumer outcomes in the context of the SPS, we do not believe it is for us as an independent regulator to initiate or pursue a policy to achieve social or environmental outcomes which has the purpose of levying significant costs, or seeking significant redistribution of costs among consumers. We believe it is important to provide clarity on where legitimacy and responsibility properly sit for any significant redistribution arising from interventions.

- Energy regulation cannot solve wider problems such as the difficulty many people have paying their bills, but we can promote ways for consumers to engage with markets and make sure that those who don't engage are not disproportionately worse off because of that. Helping to meet the needs of consumers who are poor, old, chronically sick, or disabled, and those in rural areas is central to our strategy. We must make sure their circumstances do not stop them from being able to get the same benefits of the market as all other consumers.

All these factors govern our decision making.

How we will regulate

There are six things we focus on to deliver our main objectives. These are not priorities, nor are they performance indicators. They are a way to explain what we will do, and how we will do it.

1 Regulation

We design strong, stable systems for regulating monopoly activities and the way markets operate.

How we do this

- ✓ Setting and monitoring monopoly network price controls through the RIIO regime².
- ✓ Creating incentive schemes for the Transmission System Operator and scrutiny of the Data and Communications Company's (DCC's) costs and revenues.
- ✓ Establishing a predictable framework for efficient investment in infrastructure.
- ✓ Setting rules for competitive markets.
- ✓ Monitoring and assessing energy markets to check that they serve consumer interests.

2 Competition

We promote effective competition where this can benefit consumers by driving down costs and improving service quality.

How we do this

- ✓ Making it easier for new suppliers and generators to enter the market.
- ✓ Giving consumers information that helps them switch supplier, and making the process faster and less hassle.
- ✓ Bringing competition to network services, where appropriate.
- ✓ Supporting innovation in products and services.

²RIIO stands for Revenue = Incentives+Innovation+Outputs

3 Standards

We ensure company behaviour and protection for consumers meet the high standards expected of an essential service.

How we do this

- ✓ Ensuring electricity and gas companies provide high-quality service.
- ✓ Ensuring vulnerable customers receive the right protection.
- ✓ Ensure suppliers meet their obligations under government schemes.
- ✓ Deliver government schemes in ways that promote consumer welfare.

4 Partnership

We engage with the government and others to make sure consumers get the greatest benefit from independent regulation.

How we do this

- ✓ Listening and talking to the government, consumers and other important stakeholders to understand what matters to them.
- ✓ Using our expertise and knowledge to advise the government on policy development, influence European Union bodies and work with the industry.
- ✓ Building strong relationships with consumer bodies and learning from their experience so that we understand how consumers interact with the energy system.
- ✓ Coordinating with other regulators to improve performance.

5 Confidence

We foster trust and confidence across the energy market through transparency, accountability and good regulatory processes.

How we do this

- ✓ Using our expertise and understanding to provide impartial and authoritative information.
- ✓ Building trust with a stable and predictable framework for investors, to allow innovative and efficient investment and promote consumer confidence.
- ✓ Encouraging trust and striving to improve our performance by supporting our staff.

6 Efficiency

We minimise the direct and indirect costs we impose on consumers and the industry.

How we do this

- ✓ Targeting resources where they will have most effect to achieve positive outcomes for consumers.
- ✓ Setting ourselves challenging budgetary targets and making measurable commitments to reducing expenditure.
- ✓ Delivering government schemes on time and to budget.
- ✓ Minimising regulatory burdens.
- ✓ Reducing the time it takes us to make decisions.

Our priorities

We will use our strategy to focus on the activities that are likely to make the biggest positive difference for consumers. Here are our top priorities for the immediate future.

Regulation

- We will regulate to make sure consumers can benefit fully from smart meters and other new technology. We'll also strengthen the role of demand management in the energy sector.
- We will work with industry bodies to ensure that the governance of industry codes is fit for purpose, given the scale of reform in market arrangements that will be necessary.
- We will monitor network company performance under RIIO and carefully scrutinise proposals for major investments to ensure they represent good value.

Competition

- We will work with the Competition and Markets Authority to ensure that any remedies suggested by its current market investigation are well designed and implemented in a way that benefits consumers.
- We will focus on further competition where appropriate in network activities, including using competitive tenders for onshore and offshore transmission projects and strategic wider works.

Standards

- We will focus on what suppliers do to treat customers fairly and take action if companies fail their customers.

- We will improve our understanding of fuel poverty and detriment, particularly for consumers in rural areas and in vulnerable situations.

Partnership

- We will build our relationships with consumer bodies and other regulators. This will deepen our understanding of affordability pressures on households and explore where we could take joint action.
- We will work with other European organisations to deliver an integrated energy market across the European Union.

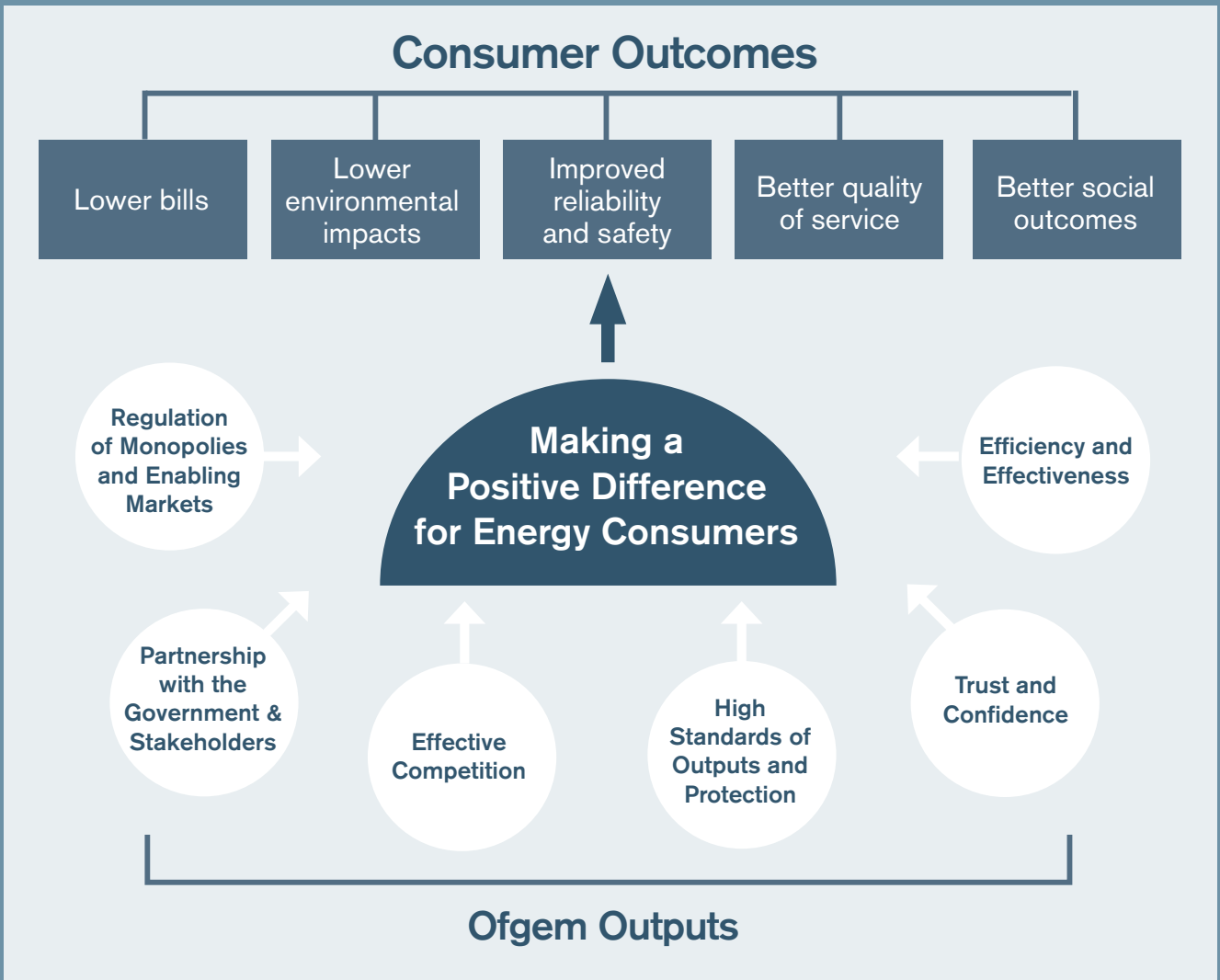
Confidence

- We will provide authoritative, impartial and accurate data and information to consumers and other stakeholders.
- We will monitor the market and use expert analysis to build trust.

Efficiency

- We will manage our resources to deliver more benefit to consumers for less money.

We will do all we can to benefit consumers. However, our energy regulation cannot solve wider problems, such as the difficulty many people have paying their bills. We will promote ways for consumers to engage with markets and make sure that those who don't engage are not disproportionately worse off because of that. But there are limits to what we can do.



This diagram shows how we focus on the activities that are likely to make the biggest difference for consumers.

Principles

Our approach to competition

Competition plays an important role in ensuring that consumers benefit from standards consistent with an essential service. Forcing firms to compete strongly for customers in both price and quality will lead to improved standards and innovation. That's why our general stance will be to use competition wherever it can bring advantages. It's also why we plan to extend competition into some areas currently subject to direct price regulation.

There will always be an important role for regulation, because there is only one electricity system and one gas system in GB. This means regulation is needed to ensure competition can flourish. Even in effective markets, regulatory intervention can help ensure there are good standards of service and conduct. It can also be an important way of ensuring that markets deliver wider social and environmental objectives. Where we need to regulate, we will do this in a way that supports innovation and encourages new business models that could benefit consumers.

We want companies to improve what they offer consumers. Chief among these is the responsibility to treat consumers fairly. We believe in using general standards of conduct to make companies treat consumers fairly. This will make them think hard about their behaviour and whether what they are doing really benefits consumers. Over time we hope to rely more on general standards of conduct rather than detailed rules about what companies can and cannot do.

We want to ensure that vulnerable consumers receive all necessary protections, in accordance with our statutory objectives. We will do this both by ensuring specific measures are put in place for such consumers, and by improving our ability to measure the distributional impacts of general regulatory decisions and explicitly factoring in how vulnerable consumers are affected when we make such decisions.

Support for independent regulation in society

Ofgem is an independent regulator, accountable to Parliament, working in the broader context of the energy sector and mostly funded by consumers. We make our decisions working constructively with the government of the day, always bearing in mind that there are longer-term concerns.

There are major benefits for consumers if the regulator is independent from both government and industry:

- Decisions are taken on behalf of consumers at a proper distance from government and other interests.
- Clear decision-making and the open and transparent involvement of all stakeholders.
- Independence creates stability and consistency over time. Businesses know what to expect, and that encourages efficient investment, which will result in lower bills.
- We develop a thorough understanding of how the energy sector works, so we can do a better job for consumers.
- There are clear appeals processes established in law. This means we are held accountable for our decisions, and this increases trust in regulation.

Our ability to make a positive difference for consumers stems from the fact we have powers to regulate independently, and we have the support of society and government to use those powers. This wider public support is important, as we cannot rely solely on our regulatory status in law. Our powers and duties have changed frequently since we were founded in the 1980s, and government has taken increased strategic interest in the future of the sector.

Stability is crucial to the value we bring to consumers through our independence, so changes and interventions can undermine this. Among other things, this risks increasing the cost of investment – a point acknowledged by the government in its Principles for Economic Regulation³. Our powers and statutory duties derive from Parliament and it is right that Parliament should ensure they continue to be effective, to meet challenges in the energy sector and in the wider context. Our powers and duties cannot stay fixed at a point in time. However, any change needs to be carefully considered in light of the considerable value of a stable regulatory framework designed for the long-term.

We recognise that we cannot take our status as an independent regulator – and government and public support for our independence – for granted. We must earn support by demonstrating the benefits that independent regulation brings for consumers and wider society. Through this strategy, we aim to demonstrate to government and other stakeholders that independent regulation is the best approach.

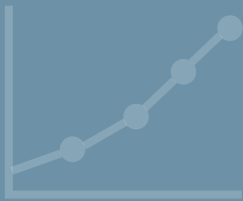
³ Principles for Economic Regulation (published by HM Government April 2011) establishes a set of overarching principles for economic regulation, and explains how government will apply them in practice. <https://www.gov.uk/government/publications/principles-for-economic-regulation>

Becoming **more** effective

Unless we have the resources, expertise and capability to carry out our functions, we cannot deliver for consumers. We want to speed up our actions and decision-making, and we need the ability to achieve this, so there's no delay in consumers benefiting from our actions.

We will work to distinguish Ofgem as an authoritative and trusted source of data, information and impartial advice to consumers and government. To support this, we intend to strengthen our knowledge management, act more promptly and efficiently, and improve our decision-making.

We are acutely aware that most of the costs of independent regulation are recovered from the energy industry and so, indirectly, from consumers. We do not want our regulation to add to bills any more than is necessary. That's why we will prioritise value for money when working out what will bring the greatest benefits for consumers.



Evaluating our work

To track the success of this strategy we will measure, monitor and report on what we do and its likely impact on consumers. We would like to report on the cumulative costs and benefits to consumers of our regulation and how these results change with each intervention. In practice, this is very difficult. Many factors throughout the industry, including the actions of government, influence outcomes, and it can be hard to highlight the particular impact of our contribution. However, we aim to be as transparent and accountable as possible and we will explore what we might be able to provide.



E-Serve and government schemes

We also make a difference for consumers by implementing government environmental schemes through our delivery arm, E-Serve. These schemes provide incentives and obligations to improve energy efficiency, encourage moving to renewable energy sources and developing small-scale, low-carbon generation. They combine renewable electricity, renewable heat, energy efficiency and social programmes.

Running these schemes well will reduce their impact on consumer bills and make Britain's energy supplies more sustainable. As well as meeting government objectives, these programmes support our wider regulatory aims, for example by encouraging innovative energy generation, furthering decarbonisation and encouraging demand-side response. These schemes are an important tool to help manage demand.

We run the schemes through our E-Serve arm. Its objectives focus on preventing fraud, ensuring compliance, improving performance and becoming even more efficient. To support these objectives, we will strengthen the accountability and transparency of E-Serve decision-making, to ensure its continued high performance.

We will introduce new governance arrangements from 1 January 2015. We will establish a committee of the Authority which will act as a new E-Serve board. This board will agree objectives, targets and a risk framework for E-Serve. E-Serve will continue to be part of Ofgem, but its board will have greater control over its own management, resources and accommodation.

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