

Secretary of State  
Department for Business, Energy and Industrial  
Strategy  
1 Victoria Street  
London  
SW1H 0ET

15 December 2016  
Our ref: dg/mp/rp

Dear Secretary of State,

### **Social and Environmental Guidance to the Gas and Electricity Markets Authority**

Our principal objective is to protect the interests of existing and future gas and electricity consumers.<sup>1</sup> We are also required to have regard to the Social and Environmental Guidance from government in carrying out our role.<sup>2</sup> The Guidance sets out that the government's key social and environmental energy goals are to increase the levels of renewable electricity, reduce greenhouse gas (GHG) emissions in line with carbon budgets, eliminate fuel poverty as far as reasonably practical and reduce energy consumption.

This letter provides a summary of the key activities that demonstrate how we have helped the government make progress towards these goals since our last letter in December 2015. We have conducted these in our role as an independent economic regulator and as an administrator of government social and environmental programmes.

### **Our corporate strategy**

Consumers are at the heart of everything we do. This is recognised explicitly in our Corporate Strategy<sup>3</sup> which outlines the key consumer outcomes we are aiming to achieve. These outcomes are:

- 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 bills.

These five consumer outcomes relate to the government's key social and environmental energy goals.

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<sup>1</sup> See point 1.4. of the Powers and duties of GEMA: <https://www.ofgem.gov.uk/publications-and-updates/powers-and-duties-gema>

<sup>2</sup> See section 3B of the Electricity Act 1989 and section 4AB of the Gas Act 1986:  
<https://www.ofgem.gov.uk/ofgem-publications/74203/file37517.pdf>

<sup>3</sup> See Ofgem corporate strategy here: <https://www.ofgem.gov.uk/publications-and-updates/corporate-strategy>

Our work which is of most relevance to the government's social and environmental goals to 'increase the levels of renewable electricity, reduce greenhouse gas (GHG) emissions & reduce energy consumption' and to work to 'eliminate fuel poverty as far as reasonably practical' is summarised below. More detail on this work can be found in our Annual Report and Accounts.<sup>4</sup>

## **Increase the levels of renewable electricity, reduce greenhouse gas (GHG) emissions & reduce energy consumption.**

### *Networks and the RIIO price control*

Our RIIO (Revenue = Incentives + Innovation + Outputs) price control system for regulating networks for electricity and gas transmission and gas distribution runs from 2013 to 2021. For electricity distribution, the eight-year price control started in April 2015.

Within RIIO's environment output for gas and electricity distribution, there are various incentives and reporting requirements for networks to monitor their emissions and encourage reduction in greenhouse gas emissions. These include the Business Carbon Footprint (a reputational league table of transport and operational related carbon emissions) and the Environment Report (for electricity distribution).

The RIIO framework incentivises companies to reduce their own business carbon footprint (narrow environmental objectives) and to contribute to meeting GB carbon reduction targets (broad environmental objectives). There are two primary outputs for protection of the environment: to provide bio-methane connections information and to meet shrinkage (leakage) commitments. These are monitored and reported annually via our Annual Reports.

For the gas distribution price control, we run a three-yearly Gas Discretionary Reward Scheme (DRS). The first RIIO-GD1 Gas DRS panel assessment took place in 2015. The aim of the DRS is to encourage gas distribution network operators (GDNs) to undertake activities to help address a range of social or environmental issues. It has a maximum reward of £12m for the 8 year price control shared amongst the four GDNs (£4m reward per competition, every three years).

The panel assessed performance in the first two years of RIIO-GD1 (2013-14 and 2014-15). Under the environment category of the reward, £1.05m was awarded to GDNs, out of the possible £4m. These rewards were given primarily for progress of GDNs (using various initiatives) in connecting biomethane to their networks. Under the social outputs category, a total of £750,000 was awarded to the GDNs, recognising initiatives that helped the GDN's most vulnerable. Although the reward is every three years, the companies need to demonstrate how these initiatives are on-going, which are then monitored through annual reports.

Each year as part of the price control we run innovation competitions to help Britain's energy networks become smarter and more cost-efficient. In November this year, we awarded £44.6m of funding for six projects through our Gas and Electricity Network Innovation Competitions. These projects help the electricity and gas networks meet the demands of the low carbon energy sector and, if successful, deliver cost savings to consumers.

This year, we also awarded £4m under the Environmental Discretionary Reward scheme to Scottish Power Transmission. This scheme is designed to encourage and recognise good environmental performance from electricity transmission network owners. This represents positive progress given no company was rewarded in the first year of the scheme, and National Grid Electricity Transmission was awarded £2m last year.

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<sup>4</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-s-annual-report-and-accounts-2015-16>

## *Connections*

We assessed the service provided to larger and complex connection customers (including generation customers) under the RII0-ED1 Incentive on Connections Engagement (ICE). The ICE drives network companies to identify an engagement strategy, work plan of activities and set of performance outputs to meet the needs of their connection stakeholders. If a Distribution Network Operator (DNO) fails to demonstrate that it has engaged with stakeholders or delivered its work plan or performance outputs, we can apply a penalty. This year was the first year of the incentive. Overall we were pleased with the quality of the ICE submissions and the majority of stakeholders considered that the DNOs' engagement was leading to improvements in their connection services. We therefore determined that all DNOs met the minimum criteria and did not apply any penalties to any DNOs. Nevertheless, there are still areas that require further work and we published a letter highlighting the areas that we considered required additional focus. In particular we expect next year's ICE submissions to demonstrate the steps taken by DNOs to address the needs of stakeholders in areas with limited network capacity available.

We have continued our work developing quicker, more efficient grid connections. Earlier this year we published an update letter<sup>5</sup> summarising the progress made by the industry to use existing grid capacity more effectively and identify new ways of connecting customers (including renewable connection customers) to the network. This includes considering how network companies can enable further anticipatory investment in advance of customers requesting a connection. We intend to publish a further update for stakeholders in January 2017.

We continued to jointly chair the Smart Grid Forum with BEIS, bringing stakeholders together to consider the challenges and opportunities for the electricity distribution networks in a low carbon world. We are implementing the recommendations from last year's Workstream six report for us to remove the commercial, regulatory and technical barriers to realising an efficient smart grid in GB, which will allow for more efficient use of renewable electricity.

We have recently published a joint call for evidence with BEIS, seeking views on how we move towards a smart, flexible energy system. A smarter and more flexible energy system can help to ensure that GB has a secure, affordable and clean energy system now and in the future. In particular, it can help make more efficient use of variable output sources of renewable and distributed energy.

## *Offshore Transmission and Interconnection*

Our competition in offshore transmission regime has delivered 15 offshore transmission owners (OFTOs) and connected over 4.3 GW of offshore wind farms to the onshore grid. In addition to this, tenders are currently underway on 6 more OFTO projects which would see a further 2.6 GW connected to the onshore grid.

Electricity interconnectors can help to transition to a low carbon world by enabling electricity trading with countries with significant renewable electricity sources, increasing the flexibility of the electricity system, and better enabling regional specialisation in renewables development. The UK has only 4 GW of electricity interconnection, and in order to encourage new investment in interconnection we created the cap and floor regulatory regime. To date we have granted six projects a cap and floor which could add around 7 GW of electricity interconnection. If all projects become operational, this will mean we will have

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<sup>5</sup> See update letter here:

[https://www.ofgem.gov.uk/system/files/docs/2016/01/quicker\\_and\\_more\\_efficient\\_connections\\_jan\\_2016\\_-\\_final\\_29.01.2016\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/01/quicker_and_more_efficient_connections_jan_2016_-_final_29.01.2016_0.pdf)

circa 11 GW of electricity interconnection with European countries (France, Ireland, Belgium, the Netherlands, Norway and Denmark) by the early 2020s.

We have also closed our second application window with three further projects (to Norway, France and Germany). We will assess the needs case for these projects and consult on our proposals in 2017. Interconnector projects can also apply for an exemption route and we have granted an exemption to one interconnector with a further application expected in 2017. These combined projects have the potential to deliver a further 7 GW of interconnection.

### *Adapting to Climate Change*

We finalised our second round Climate Change Adaptation Report to Defra in September 2016.<sup>6</sup> In preparing our report we considered the evidence of climate impacts facing the network companies, and met with industry stakeholders to discuss their plans.

It is clear that the energy sector is undergoing a major transitional period as generation is increasingly decarbonised, and new scales of delivery (eg distributed energy) and demand trends (flexible, smart systems) start to emerge. This means that the long term resilience of the sector needs to take into account risks to both current and new types of infrastructure, as well as consider future uncertainties and the interdependencies between sectors. Overall, our findings suggest that the majority of electricity transmission and distribution companies are effectively identifying and assessing climate risks, and taking proportionate actions to build resilience.

We consider that we have robust regulatory policies and approaches in place to ensure that the regulated energy system delivers a secure and reliable supply to customers; and that the network companies are responding to the challenge of adapting to climate change.

### *Competition and Markets Authority (CMA) remedies*

In June 2016, the CMA produced its final report into the energy industry. The report contains 48 remedies to address the 10 adverse effects on competition identified. The remedies are a mix of specific projects, such as the reallocation of gas tariff codes to address a lack of tariffs for prepayment customers and longer-term changes to structural elements of the market, such as the licensing of code bodies. These remedies should remove inefficiencies from the market, with ultimate effects of reducing costs and improving outcomes for consumers via greater competition.

The remedies included 26 recommendations to Ofgem. We have issued our approach to implementing these recommendations in our Implementation Strategy<sup>7</sup> and given more details of specific milestones in our Implementation Plan.<sup>8</sup> The remedies include measures to target fuel poverty, including the introduction of a temporary price cap for customers on pre-payment meters and the extension of tariffs to restricted meter customers. These remedies will be implemented as part of our vulnerability strategy. The implementation of all remedies will be in line with our statutory duties and will take account of social and environmental goals.

### *Future of Retail Market Regulation*

As part of our work on the Future of Retail Regulation, we see a role for principles as well as prescriptive rules in the domestic supply licence. This would create incentives for suppliers to innovate and put responsibility firmly on suppliers for achieving good consumer outcomes. We published a working paper in August 2016 outlining plans to introduce a

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<sup>6</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/566125/climate-adrep-ofgem.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/566125/climate-adrep-ofgem.pdf)

<sup>7</sup> <https://www.ofgem.gov.uk/publications-and-updates/cma-remedies-implementation-strategy>

<sup>8</sup> <https://www.ofgem.gov.uk/publications-and-updates/cma-remedies-implementation-plan>

broad vulnerability principle. This principle would set out our expectation that suppliers must consider the needs and circumstances of customers in vulnerable situations. This would ensure that our regulatory framework enables these customers to engage effectively and benefit from market developments now and in the future.

Alongside BEIS, we play a substantial role in ensuring that the smart meter roll-out is effective and timely, that the benefits are captured for consumers, and that there is effective consumer protection in place. This includes engagement through observer roles on the Smart Energy GB board and Smart Metering Installation Code of Practice governance board, and oversight of company roll-out plans.

We also play a key part in delivering Electricity Market Reform. We manage changes to the capacity market rules, ensuring changes are aligned with our principal objective and the objectives of the capacity market. We also oversee National Grid Electricity Transmission's delivery of Electricity Market Reform.

#### *Other relevant activities and outputs this year*

Ofgem runs the Confidence Code, our voluntary code of practice for domestic energy price comparison services. One of the obligations accredited price comparison websites need to comply with is providing energy efficiency information whereby a price comparison website must, on the homepage or during the consumer journey, provide signposting to independent sources of advice on energy efficiency matters that will be of benefit to all energy consumers. This signposting should be prominent, clear and intelligible, so that consumers are aware what information is available within these sources. A service provider must, during the consumer journey, alert relevant consumers to the possibility that if they move to certain suppliers, they could lose support from government energy support schemes such as the Warm Home Discount benefit. This messaging may include signposting to relevant websites.

Our "Licence Lite"<sup>9</sup> aims to help new suppliers enter the electricity supply market. It lets a new supplier partner with an existing larger one, to take care of some of the more costly and technically challenging parts of a supply licence. We updated the guidance in 2015, recognising that interest in it has diversified beyond the original objective to encourage distributed energy (some of which is renewable). The Greater London Authority is the first party to apply for an electricity supply licence and direction to operate under the Licence Lite arrangement; at the time of preparing this report we are in the final stages of assessing the GLA's arrangements.

### **Eliminate fuel poverty as far as reasonably practical**

#### *The Fuel Poor Network Extension Scheme*

The Fuel Poor Network Extension Scheme for gas distribution network companies (GDNs) enables eligible households to switch to natural gas, where gas is the right solution for such consumers. GDNs are required to identify suitable eligible customers and provide the gas connections to these households. Since 2008, GDNs have connected over 70,000 households.

We reviewed the Scheme in 2015. This was done to ensure that the Scheme aligns with wider government energy and fuel poverty strategies. Under our review we increased the companies' targets to over 90,000 households connected by 2021 (the end of the price control). This is an increase from the 77,000 originally set at the start of RII0-GD1. We also updated the eligibility criteria to ensure that households that benefit from the Scheme

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<sup>9</sup> See Licence Lite project page here: <https://www.ofgem.gov.uk/licences-codes-and-standards/licences/licence-lite>

are equally likely to benefit from other forms of assistance (eg Home Heating Cost Reduction Obligation for England, Wales and Scotland).

### *Consumer Vulnerability Strategy*

Our strategy aims to protect and empower consumers in vulnerable situations – to reduce the likelihood and impact of vulnerability and also ensure all consumers have access to market benefits. We monitor how well suppliers comply with the rules over debt and disconnection, network incentives to support vulnerability and affordability, and redress to benefit fuel poor customers.

Pre-Payment Meter (PPM) customers are more likely to be in vulnerable circumstances and as such are included as a focus area in our Consumer Vulnerability Strategy. We recently closed our consultation on final proposals to protect customers who have prepayment meters installed under warrant. We don't want any consumers to face disproportionate costs or actions throughout the debt recovery process, and believe that consumers in vulnerable situations should not face costs that result from their vulnerability or exacerbate it. Our proposals include a cap of £100 or £150 on warrant costs and a prohibition on suppliers from charging the most vulnerable consumers warrant costs, and in some cases from installing PPMs. We are currently considering responses to the consultation.

New Guaranteed Standards of Performance for suppliers took effect on 1 January 2016. These give suppliers specific requirements when interacting with their customers, for example on making and keeping appointments, and fixing meters promptly when a customer reports a fault. Suppliers must pay customers £30 if they fail to meet one of these standards, and must pay a further £30 if they fail to make the payment within 10 working days. We are working with suppliers to improve the transparency with which suppliers publicise their own performance against the standards.

### **Investigations, redress and enforcement**

This year we have worked with two suppliers in relation to historic breaches of the performance standards that were in force until the end of 2015. One of the companies, E.ON, agreed a voluntary redress package involving payments of £1.2m to affected customers and £1.9m to charity to help consumers in need. This includes helping service personnel through National Energy Action's 'Help for Heroes' scheme. We expect shortly to announce details of the voluntary redress package to be paid by the other supplier.

We have also continued to deliver on our commitment to shine a light on supplier complaint handling. We published the latest report of our biannual survey of complaints handling for the largest nine suppliers. This survey was conducted within the context of falling complaint numbers but showed wide disparity in performance across the suppliers surveyed. Following the survey we wrote to all the chief executives of the suppliers surveyed to make clear that their results are unacceptable and to ask them to respond publically setting how they have made, and intend to make, improvements. In addition we asked two of the suppliers to arrange for an independent audit of their complaint handling procedures and to publish the results.

So far this year Ofgem has closed two formal investigations resulting in redress funds being allocated to charities for use in England, Wales and Scotland. £1.4m has been distributed to National Energy Action (NEA) for the Big Energy Saving Network, jointly funded by BEIS and NEA. A further £3m was awarded to NEA and Energy Action Scotland, both working in partnership with Macmillan Cancer Support, to provide energy advice and energy efficiency installations to vulnerable consumers' homes. £1.5m has also been allocated to Age UK to provide energy and warmth advice to older people.

In June this year Ofgem announced that one of its annual enforcement priorities is:  
*"Taking action where industry behaviour fails to meet obligations for consumers in vulnerable circumstances."*

Ofgem has subsequently opened four investigations into energy suppliers' conduct in relation to this enforcement priority.

### **Delivering government social and environmental schemes**

E-Serve is Ofgem's specialist delivery and operational arm which administers a number of renewable energy schemes and environmental and social programmes for government. Established in 2009, E-Serve has since administered schemes worth more than £6 billion a year and provided value for consumers by delivering them for less than 0.5% of their total value. E-Serve's role is to provide support to government through effective scheme administration, and ensuring compliance, fraud prevention and overall value for money.

E-Serve continues to administer the Domestic and Non-Domestic Renewable Heat Incentives, the Renewables Obligation, the Feed-in Tariff, the Energy Company Obligation and the Warm Home Discount. We do this in partnership with BEIS but we also work with a broad range of stakeholders, from scheme participants to suppliers and vulnerable consumers.

### **Better Regulation**

In autumn 2017, we will publish our first State of the Market Report, which will assess how energy markets are operating. This follows a recommendation in the CMA's market investigation. The flagship report will include analysis of the evolution of energy prices and bills, the profitability of energy firms, and the interplay between decarbonisation, security of supply and affordability.

For the first time, some of Ofgem's decisions, along with those of other regulators, will be incorporated within the Business Impact Target during this Parliament. We are working with the Better Regulation Executive and the Regulatory Policy Committee to develop our analysis of the impacts of our work on businesses, including through impact assessments. We continue to look for opportunities to reduce business costs, including those of new entrants to the industry, where doing so is consistent with our principal duty to protect consumer interests. For instance, we expect our work on the Future of Retail Regulation to reduce the number of prescriptive rules that suppliers are expected to follow.

We are active participants in the UK Regulators Network, which is designed to improve how regulators work together across sectors. Our chief executive, Dermot Nolan, is the Network's current chair. We have contributed to several of its 2016-17 projects, including data sharing on customer vulnerability, a peer review of the Northern Ireland regulator's cost of capital decision, a joint project with Which? on consumer challenge and engagement and a report on price comparison websites.

This document has outlined some of the ways in which our actions to protect consumer interests are in line with the government's Social and Environmental Guidance. We would of course be happy to provide further details on any of the actions we describe, and look forward to continuing engagement with your officials on these important issues in the future.

### **David Gray**

Chair, Gas and Electricity Markets Authority