

**David Gray**  
Chairman



Making a positive difference  
**for energy consumers**

The Rt Hon Greg Clark MP  
Secretary of State  
Department for Business,  
Energy and Industrial Strategy  
1 Victoria Street  
London  
SW1H 0ET

22 February 2018  
Our ref: dg/mp/ar

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 2016. 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; and
- Benefits for society as a whole including support for those struggling to pay bills.

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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>

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

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 emissions & reduce energy consumption.**

#### *Networks and the RIIO price control*

Our RIIO (Revenue = Incentives + Innovation + Outputs) price control framework 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, 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). These are monitored and reported on annually in our RIIO annual reports.

In July 2017, we launched the preparation for RIIO-2, the next generation of price controls, which will start in April 2021 for transmission and gas distribution and in April 2023 for electricity distribution. We are currently reviewing the RIIO framework to consider what improvements can be made based on lessons learnt from RIIO-1 as well as recognising the challenges that companies will face in future. The details of the specific outputs and incentives relating to this area will be reviewed and developed at the sector specific strategy stage, which is expected to commence later this year

As part of the price control, each year, we run innovation competitions to help Britain's energy networks become smarter and more cost-efficient. In November 2017, we awarded £57.6m of funding for seven projects through our Gas and Electricity Network Innovation Competitions. These projects help the electricity and gas networks address the challenges they face in facilitating the transition to a low carbon energy sector. If successful, they will deliver cost savings to consumers. In December 2017 we also awarded £4m under the Environmental Discretionary Reward scheme to Scottish Power Transmission (SPT). This scheme is designed to encourage and recognise good environmental performance from electricity transmission network owners. This is the second successive reward of £4m to SPT and brings the total funding awarded under the existing price control to £10m.

#### *Connections*

Under the RIIO-ED1 Incentive on Connections Engagement (ICE), we assessed the service provided to larger and complex connection customers (including generation customers). The ICE drives Distribution Network Operators (DNOs) to identify an engagement strategy, work

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<sup>4</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-annual-report-and-accounts-2016-17>

plan of activities and set of performance outputs to meet the needs of their connection stakeholders. If a 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, overall, we were satisfied with the quality of the ICE submissions and we were pleased that the majority of stakeholders considered that the DNOs' engagement was leading to improvements in their connection services. After consulting stakeholders, we determined that all the DNOs met the minimum criteria and therefore, did not apply any penalties. Nevertheless, there are still areas that require further work and we sent letters to two DNOs, highlighting the areas of their engagement that we considered required additional focus. More generally, we expect next year's ICE submissions to demonstrate the steps taken by DNOs to address concerns raised through this year's assessment process and put in place plans to ensure they are meeting the needs of all their connections customers – this includes steps to facilitate connections in constrained network areas and engaging with newer customer types (such as storage providers) to understand their requirements better.

### *Offshore Transmission and Interconnection*

Our competition in offshore transmission regime has delivered 15 offshore transmission owners (OFTOs) and connected over 4.3GW 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 2.6GW connected to the onshore grid. We expect further projects to qualify for a tender process during 2018. 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 4GW 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 nine projects a cap and floor, which could add around 11GW of electricity interconnection. If all projects become operational, this will mean we will have circa 15GW of electricity interconnection with European countries (France, Ireland, Belgium, the Netherlands, Norway and Denmark) by the early 2020s. A further project has requested an exemption, which we have yet to approve but is currently with the Agency for the Cooperation of Energy Regulators (ACER) for review. We don't currently plan to open any further application windows for the cap and floor regime until we have concluded a strategic review of the framework.

### *Adapting to Climate Change and facilitating a flexible energy system*

The energy sector is undergoing a major transitional period as generation is increasingly decarbonised, and new scales of delivery (e.g. distributed energy) and demand trends (flexible, smart systems) start to emerge. Accordingly, we recognise that the regulatory and market arrangements need to evolve to support and encourage change, in a way that protects and advances consumers interests and enables them to benefit from innovation and new services. As part of joint work with the government, we have been working to remove barriers to new ways of providing flexibility in either demand or supply, enable smart homes and businesses, and make markets work for flexibility. We jointly published the Smart Systems and Flexibility Plan with government in July 2017.<sup>5</sup> This sets out 29 action points that include upgrades to the regulatory environment to provide a level playing field for

<sup>5</sup> <https://www.gov.uk/government/publications/upgrading-our-energy-system-smart-systems-and-flexibility-plan>

storage and other sources of flexibility, which can help to integrate low carbon generation and to manage system operation. Other changes will help providers of flexible solutions to maximise their access to existing markets, access new markets or revenue streams and stack value across them.

We are also driving distribution and transmission network companies and the System Operator (SO) to evolve and deliver the changes that are needed over the next few years. This includes them better signalling their needs and opening up the delivery of network solutions to the market, and improving coordination so that whole system network requirements can be identified and acted upon efficiently. We will be making regulatory clarifications and have put the onus on network companies to respond accordingly. Alongside this, we have set out reforms to separate the SO into a distinct, ring-fenced company within National Grid Group. We have published a series of documents relating to the future arrangements for the Electricity System Operator over 2017, and propose to separate the functions by April 2019.

In order to secure potential savings for customers from a more flexible system while accommodating new low carbon technologies efficiently, there also needs to be appropriate and effective signals to network users about how they can alter their behaviour to reduce the costs or increase the benefits they confer on the system. We are therefore reviewing the signals for electricity network usage: the access and charging arrangements. We published a working paper on the reform of electricity network access and forward-looking charges in November 2017.<sup>6</sup> We also launched a Targeted Charging Review Significant Code Review in August 2017<sup>7</sup> to consider reform of residual charging for transmission and distribution. We have set up and chair a Charging Futures Forum to help steer the various existing industry-led charging reviews and related work groups as we take these work programmes forward.

### *Supply market regulation*

Our regulation needs to stay ahead of market developments and in a way that does not distort them. It must enable diverse approaches so we can foster more competition and innovation and support new market participants, while offering effective protection to all consumers. At the time of privatisation, the market was designed with suppliers as the primary interface between energy consumers and the energy system. The role of suppliers as the 'hub' of the market has been entrenched in legal frameworks, licensing arrangements and industry rules. We are now seeing significant opportunities for innovation across the energy system and are now examining the role that traditional suppliers play in the market, and the opportunities for consumers to access and manage their supply in new ways. In this context, we issued a call for evidence<sup>8</sup> exploring whether the supplier hub model is still fit for purpose or whether we should consider changes as the energy system evolves. We sought evidence on barriers to innovation, default supply arrangements for consumers that do not engage in the market, and protection for all consumers regardless of how they access their energy supply.

Within our existing supply licences, we remain committed to relying more on enforceable principles instead of detailed prescriptive rules. We expect this to create incentives for suppliers to innovate and put responsibility firmly on suppliers for achieving good consumer

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<sup>6</sup> <https://www.ofgem.gov.uk/publications-and-updates/reform-electricity-network-access-and-forward-looking-charges-working-paper>

<sup>7</sup> <https://www.ofgem.gov.uk/publications-and-updates/targeted-charging-review-significant-code-review-launch>

<sup>8</sup> <https://www.ofgem.gov.uk/publications-and-updates/future-supply-market-arrangements-call-evidence>

outcomes. As part of our work on Future Retail Regulation<sup>9</sup> we introduced changes to strengthen our principle requiring suppliers to treat customers fairly, including a new vulnerability principle to protect vulnerable consumers better. We also introduced five new principles relating to marketing and sales activities, and removed associated prescription from the rulebook. We summarised the complete supply licence in a series of accessible published guides, focused on the outcomes we expect suppliers to deliver for consumers. In addition, we progressed work to reform rules relating to supplier-customer communications – changes to these rules in 2018 should ensure suppliers are giving consumers the right information, in the right format and at the right time.

The smart meter rollout is underway and has the potential to bring significant benefits to consumers. Ofgem provides regulatory oversight for the rollout and, working with the government, we aim to ensure the rollout results in the best possible outcomes for consumers. Our key roles are to oversee suppliers' compliance with their smart metering obligations, and regulation of the Data Communications Company. In June 2017, following a design and implementation process, which we had led with industry and consumer stakeholders, cost-effective arrangements for elective half-hourly settlement came into effect. Building on the rollout of smart meters, that will enable customers' actual electricity usage to be recorded every half hour, we launched, in July 2017, a Significant Code Review for Settlement Reform.<sup>10</sup> Our aim is a design for market-wide half hourly settlement reform that exposes suppliers to the true cost of their customers' usage and incentivises them to take steps to help their customers move their consumption to times of the day when electricity is cheaper to generate and transport e.g. by offering smart tariffs and other innovative products. We expect settlement reform to help lower customers' bills, reduce carbon emissions and enhance security of supply by increasing the flexibility of the energy system.

Ofgem is also committed to encouraging and enabling more consumer engagement in order to increase competition and erode the two-tier market; maintain an element of competition during the price cap and help ensure we have the conditions to lift it; and create a more open environment - better placed to facilitate the energy transition. In the last year we have developed and trialled a number of different interventions focused on engaging customers on default tariffs and the results of these trials are encouraging. We will continue to trial new and additional ways to prompt consumers, aiming to develop a suite of interventions that tackle a broader range of behavioural barriers.

#### *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.

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<sup>9</sup> <https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/future-retail-market-regulation>

<sup>10</sup> <https://www.ofgem.gov.uk/publications-and-updates/electricity-settlement-reform-significant-code-review-launch-statement-revised-timetable-and-request-applications-membership-target-operating-model-design-working-group>

Our “Licence Lite”<sup>11</sup> policy aims to ease potential barriers to entry and help new suppliers enter the market. It involves granting a derogation that lets a new supplier partner with an existing supplier (a Third Party Licensed Supplier), to take care of some of the more costly and technically challenging parts of the supply licence. We updated the guidance in 2015, recognising that interest in Licence Lite has diversified beyond the original objective to encourage distributed energy (some of which is renewable). This year we have already granted derogations to three suppliers to allow them to enter the market and operate with the Licence Lite. These are EVenergi UK Ltd,<sup>12</sup> PX Supply Ltd<sup>13</sup> and the Greater London Authority.<sup>14</sup> We are currently considering further cases. This policy should enable greater choice and price benefits to consumers.

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

### *Retail price protection and vulnerable consumers*

Ofgem shares the government’s concern that the energy market is not working for all consumers and is determined to reduce the detriment suffered by all those overpaying for their energy, particularly those who are vulnerable.

In particular, prepayment customers can find it difficult to get a better deal in the market and are more likely to be vulnerable. Last April we introduced the safeguard tariff for over four million households on prepayment meters following the Competition and Market Authority’s (CMA) investigation into the energy market. The safeguard tariff stops suppliers from charging customers too much because they have to ensure that their prices are below the level of the safeguard tariff cap. It also ensures any price increase is justified by rises in underlying costs. From April 2018 eligible customers will make annualised savings of around £66 on average. On the 2 February 2018, Ofgem extended the prepayment safeguard tariff to around 1 million more vulnerable households. This means that around 5 million households now benefit from price protection.

In the coming year, Ofgem will work with the government so that all those on standard variable and other default tariffs receive price protection as soon as possible once legislation has been passed. The government’s current draft bill states that its price protection to cap default deals is temporary and will end no later than 2023. This will allow time for reforms designed to improve engagement to be put in place and for the roll-out of smart meters to be completed. Ofgem will also work on extending price protection to at least a further 2 million vulnerable households for winter next year if the government’s price cap is not in place.

Even if our reforms to improve engagement in the market are successful, there will always be some vulnerable consumers who risk being left behind. That is why our work goes beyond the introduction of retail price protection. Ofgem’s consumer vulnerability strategy<sup>15</sup> sets out the framework for protecting and empowering vulnerable consumers to reduce the likelihood

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<sup>11</sup> <https://www.ofgem.gov.uk/licences-codes-and-standards/licences/licence-lite>

<sup>12</sup> [https://www.ofgem.gov.uk/system/files/docs/2017/08/licence\\_lite\\_derogation\\_decision\\_-\\_evenergi\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/08/licence_lite_derogation_decision_-_evenergi_0.pdf)

<sup>13</sup> [https://www.ofgem.gov.uk/system/files/docs/2017/09/licence\\_lite\\_derogation\\_decision\\_-\\_px\\_supply\\_ltd\\_18\\_09\\_2017.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/09/licence_lite_derogation_decision_-_px_supply_ltd_18_09_2017.pdf)

<sup>14</sup> [https://www.ofgem.gov.uk/system/files/docs/2017/12/licence\\_lite\\_derogation\\_decision\\_-\\_greater\\_london\\_authority\\_20\\_12\\_2017\\_002.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/12/licence_lite_derogation_decision_-_greater_london_authority_20_12_2017_002.pdf)

<sup>15</sup> <https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/protecting-and-empowering-consumers-vulnerable-situations/consumer-vulnerability-strategy>

and impact of vulnerability and ensure all consumers have access to market benefits. In the last year, we have taken a number of steps to help strengthen protections for vulnerable consumers. This includes enabling data sharing between networks and suppliers to enable more consumers to benefit from the Priority Services Register, and introducing measures to protect consumers in debt. We continue to monitor carefully how suppliers treat vulnerable consumers – and stand ready to take compliance or enforcement action to protect consumers' interests, if needed.

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

The Fuel Poor Network Extension Scheme for gas distribution network companies (GDNs) helps households that are not connected to the gas grid to switch to natural gas by providing funding towards the cost of the connection. Access to gas, a cost-effective fuel for heating, is a good way to ensure fuel poor households can access affordable energy supplies. Since 2008, GDNs have connected over 95,000 households. In 2017 we updated the criteria for the scheme to ensure it better targets those in fuel poverty.

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

In June 2017 we concluded two investigations into British Gas. They resulted in redress payments of £4.5m to the Carbon Trust and £9.5m to customers directly affected by the breaches and to the Money Advice Trust for its Business Debtline service.

We also concluded an investigation into E (Gas and Electricity) Ltd. concerning sales and marketing practices aimed mainly at prepayment meter customers. The decision was proposed in November 2017 and imposed in January 2018. The resulting redress payment of £260,000 will be the first payment into our new voluntary redress fund that we established this year. We appointed the Energy Saving Trust to manage the allocation of voluntary redress payments that arise from our enforcement and compliance work. The Energy Saving Trust will identify potential charitable recipients and allocate funds, which could include schemes to help fuel poor, and indebted and vulnerable customers. It will also be responsible for monitoring and evaluating the performance of the funds to ensure that they deliver value for consumers.

We closed an investigation into SSE's practices around switching customers to prepayment meters as we were satisfied with the steps SSE took to deal with the concerns, including paying compensation to affected customers and retraining staff on assessing customers' ability to pay. We also opened two investigations in 2017. One relates to information in Annual Statements issued to prepayment meter customers and the other relates to the termination of domestic customer supply contracts. In March 2017 we published the lessons learned from our enforcement and compliance work<sup>16</sup> in sales and marketing. This aims to help suppliers in understanding problems which have occurred when engaging in direct selling, which have sometimes led to negative outcomes for consumers.

#### **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.

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[https://www.ofgem.gov.uk/system/files/docs/2017/03/lessons\\_learned\\_from\\_enforcement\\_and\\_compliance\\_activity\\_-\\_sales\\_and\\_marketing\\_1.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/03/lessons_learned_from_enforcement_and_compliance_activity_-_sales_and_marketing_1.pdf)

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 October 2017, we published our first State of the Market Report,<sup>17</sup> which assessed how energy markets are operating. It brings together analysis published by us and others, and includes new analysis that provides further insights on some of the key issues. The report included sections on competition in the wholesale and retail markets, affordability and vulnerability for domestic consumers, decarbonisation and security of supply. We intend to publish an updated State of the Market Report each autumn.

For the first time, in June 2017, some of Ofgem's decisions, along with those of other regulators, were incorporated within the Business Impact Target report<sup>18</sup> covering the period of the Parliament from May 2015 to June 2017. We have worked 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.

Ofgem continues to play a leading role in the UK Regulators Network. Our CEO Dermot Nolan is the UKRN chair. We are involved in UKRN's projects on the cost of capital, sharing data on vulnerability between sectors, and identifying demographic trends relating to switching. We regularly attend the meetings of ten networks and interest groups arranged by UKRN, including the lawyers working group, strategy network and young professionals network. Since December 2016, we have also taken part in over 40 more informal requests to share knowledge and experience, arranged through UKRN.

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.

Yours sincerely,



**David Gray**

Chair, Gas and Electricity Markets Authority

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<sup>17</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-launches-annual-state-market-report>

<sup>18</sup> <https://www.gov.uk/government/publications/business-impact-target-bit-annual-report-2016-to-2017>