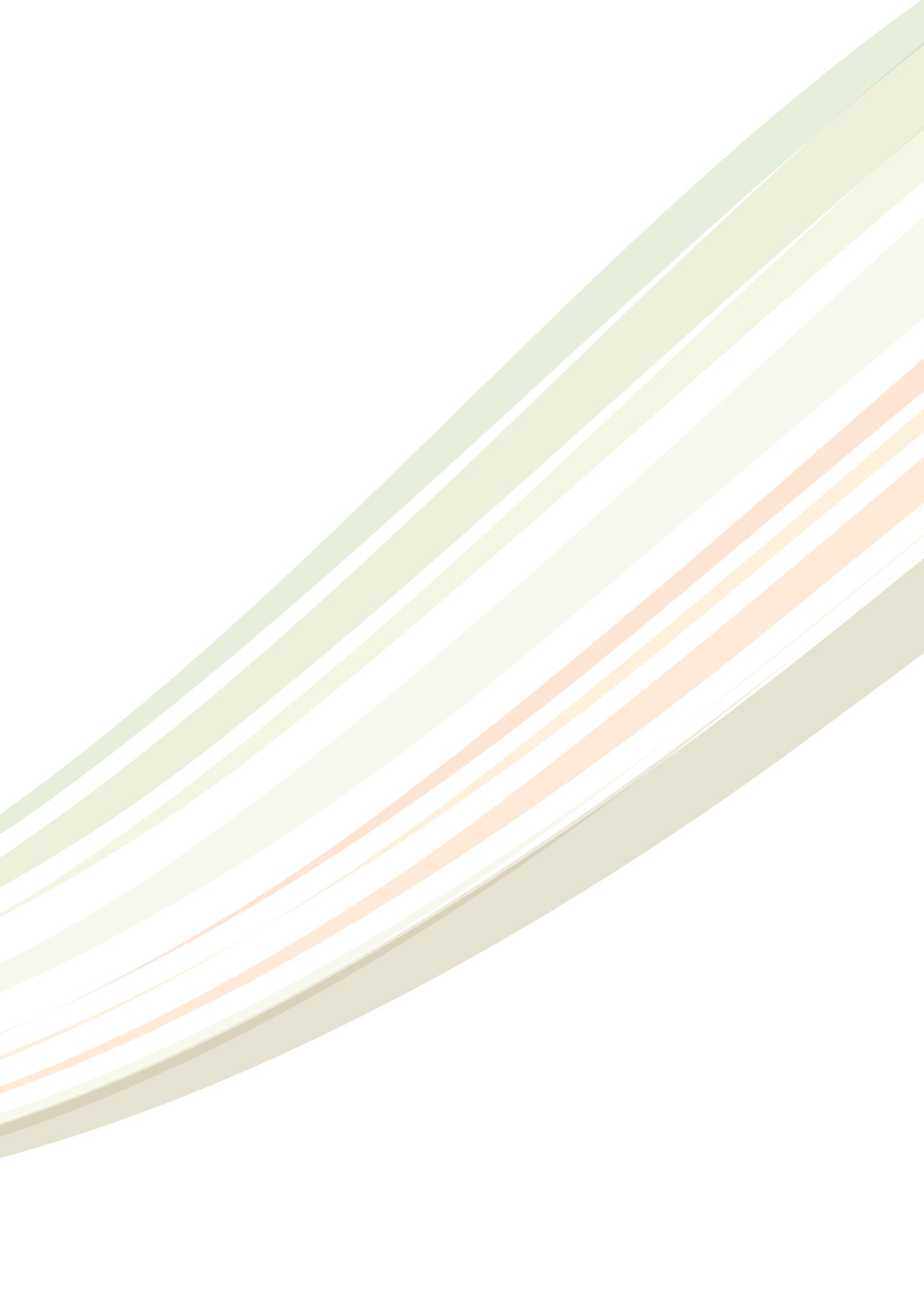


ofgem

ofgem E-Serve

Office of Gas and Electricity Markets (Ofgem)
Annual Report 2009-2010

Change, challenge and the **consumer**





ofgem

ofgem E-Serve

Office of Gas and Electricity Markets (Ofgem) Annual Report 2009-2010

Ofgem is the Office of Gas and Electricity Markets, regulating the gas and electricity industries in Great Britain.

Ofgem operates under the direction and governance of the Gas and Electricity Markets Authority which makes all major decisions and sets policy priorities.

The Authority's powers and duties are provided for under the Gas Act 1986, the Electricity Act 1989, the Competition Act 1998, the Utilities Act 2000 and other statutes.

Report of the Office of Gas and Electricity Markets for the period 1 April 2009 to 31 March 2010 to the Secretary of State for Energy and Climate Change.

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Contents

| | | |
|---------------------|---|-------|
| 1 | Foreword: Tough calls in tough times | 4-5 |
| 2 | The Gas and Electricity Markets Authority | 6-7 |
| 3 | Introduction: Excellence in Energy and Sustainability | 8-9 |
| 4 | New challenges, new responsibilities, new structures | 10-12 |
| 5 | A voyage of discovery | 13-15 |
| 6 | Pricing in the future | 16-18 |
| 7 | Reviews, reforms, renewables | 19-21 |
| 8 | Better, greener, fairer deals | 22-25 |
| 9 | A leading voice in Europe | 26-28 |
| 10 | Energy, efficiency, environment | 29-32 |
| 11 | Delivering value for money | 33-36 |
| Appendix I | Ofgem's performance against 2009-2010 deliverables | 37-41 |
| Appendix II | Performance indicators 2009-2010 | 42-43 |
| Appendix III | Impact Assessments undertaken 2009-2010 | 44-45 |
| Appendix IV | Investigations and enforcement action 2009-2010 | 46-47 |
| Appendix V | Simplification plan 2009-2010 | 48-50 |
| Appendix VI | Financial statements (extracts) 2009-2010 | 51-52 |

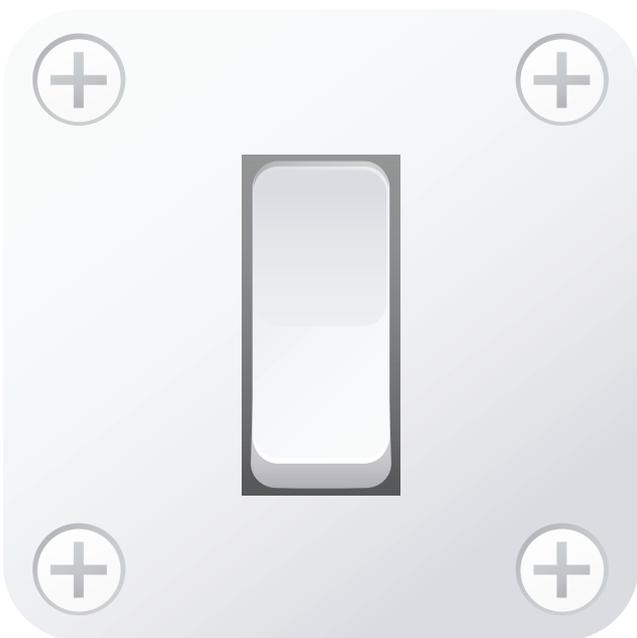
The Ofgem Resource Accounts for 2009-2010 are published separately

1 Foreword: Tough calls in tough times

The past year has been one of the most challenging in Ofgem's history. Essential and radical internal reorganisation has been carried through against the backdrop of an industry confronting a fundamental dilemma: the need for massive investment to secure low carbon energy and market stability, at a time of acute fragility in the global financial system and economic weakness.

Ofgem's internal reform was driven by the organisation's growing role in Britain's plans to develop a low carbon economy. A separate business unit, Ofgem E-Serve, has been created under the Gas and Electricity Markets Authority (the Authority), with the twin tasks of administering many of the Government's environmental programmes and delivering vital projects such as the offshore transmission regime; the roll-out of smart meters; the carbon capture and storage levy and feed-in tariffs.

We have also restructured our regulatory activity - the traditional core of Ofgem's business — to put even greater emphasis on sustainability. A new sustainable development division has been created, bringing together environmental, social and consumer policy. Two separate networks divisions have been set up, designed to ensure that Britain's high voltage transmission networks are more accessible to new sources of renewable generation. They also bolster the role of regional networks in tackling climate change by increasing micro and renewable generation access to local smart grids.



The challenges of reshaping our own organisation have come at a time when the external environment has been characterised by competing pressures. On one hand, the need to reduce carbon emissions and a demand on the industry to make huge investments to replace ageing nuclear and fossil-fueled generation. On the other hand, the need to ensure a stable regulatory framework within which to make those investments.

At the same time the crisis in the financial system meant, and continues to mean, that investors and the boards of many companies are often much more cautious in their approach to risk, especially in relation to the type of long term investment required by the energy industry. Governments around the world, too, are borrowing more as the global economic slowdown, which followed the financial crisis, has adversely affected public finances – with a knock-on increase in competition for funds in the financial markets.

A slow-down in the global economy has brought a reduction in energy demand with a consequent fall in wholesale prices. That has been reflected in a modest, albeit temporary, fall in retail gas and electricity prices in Britain. However, a pickup in global economic growth in the future is likely to see resumption in the upward pressure on global energy prices.

In the face of such external turbulence Ofgem has taken a series of difficult decisions and set in train a number of initiatives. The findings of our earlier in-depth investigation into the workings of the retail energy market, for example, demonstrated that there were a number of areas where action was required to benefit and protect consumers.

The Authority decided that it would use its existing powers to deliver the reforms needed without incurring potentially long delays and uncertainty. Over the last year a number of beneficial changes for customers have been introduced – with others following in the next few months – so that consumers now enjoy better protection and a stronger voice.

Other reforms launched by Ofgem last year included our review of Codes Governance, the industry's rules making process; and RPI-X@20, a root and branch analysis of the regime which has determined the revenues and expenditure of Britain's energy networks for the past 20 years to determine whether it will remain fit for purpose in the future.

A major inquiry, Project Discovery was also completed and is currently in the final stages of consultation. This was a comprehensive analysis of the challenges facing Britain's energy supplies as the country becomes more reliant on imports, and an indication of the scale of the investment that is likely to be required to enable Britain to

secure its energy supplies and meet its climate change targets over the coming decade.

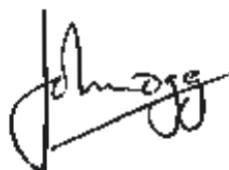
It is increasingly evident that continental Europe exerts a growing influence on Britain's energy policies and energy markets. With the negotiation and the implementation of the European Third Energy Package, the ground is laid for a more competitive European energy market and the establishment of the Agency for the Co-operation of Energy Regulators (ACER). Ofgem welcomes the implementation of the European Third Energy Package as a major milestone in the development of a more open European energy market.

The challenges posed by the need to tackle climate change and deliver secure energy supplies are not, however, confined to one country or one continent but are truly global in scale. The year has seen the establishment of the International Confederation of Energy Regulators (ICER) at the World Energy Forum in Athens. ICER's purpose is to review key energy issues from a global perspective and report to the next World Energy Forum in Quebec in 2012.

Amid the many changes, both internal and external, one factor has remained constant: Ofgem's determination to meet its responsibilities to existing and future consumers promptly and efficiently while keeping its costs under tight control. Over each of the last five years Ofgem has met our self-imposed and demanding target of keeping cost increases to three percentage points below the rate of inflation – saving consumers some £11.9 million to date.

Ofgem's ability to deliver its responsibilities as industry regulator and as a leading player in the Government's plans to build a low carbon economy has earned respect – although not without challenge. We shall continue to make every effort to do better although the burden of criticism should perhaps be seen as a fact of life for any regulator. Indeed, there will always be some who will say we should do more – and others who would be happier if we did a little less.

I began by saying that last year was one of Ofgem's most challenging. The current year shows every sign that more "hard pounding" is to be expected. With our able and expert staff, to whom all on the Authority pay particular credit and extend their heartfelt thanks, the organisation seems well equipped to meet every challenge.



Lord Mogg
Chairman

2 The Gas and Electricity Markets Authority

Ofgem is governed by the Gas and Electricity Markets Authority which determines strategy and decides on major policy issues. The Authority is made up of executive and independent non-executive members.

Membership



Lord Mogg
Chairman



Alistair Buchanan CBE
Chief Executive



Professor David Fisk CB
Non-executive



Miriam Greenwood OBE DL
Non-executive



David Harker OBE
Non-executive



Sarah Harrison
Executive

The Authority is supported by a Senior Management Team and committees that have clear terms of reference. There are three main committees: the Audit Committee, the Remuneration Committee and the Enforcement Committee. They create a strong framework of internal control throughout the organisation.



John Howard
Non-executive



Jim Keohane
Non-executive



Jayne Scott
Non-executive



Steve Smith
Executive



Andrew Wright
Executive



John Wybrew OBE
Non-executive

3 Introduction: Excellence in Energy and Sustainability

In 2009/10 both the regulatory policy and regulatory delivery functions have been characterised by major set piece projects. The common themes in these projects have been significant commitment to sustainability, intellectual rigour and punctual delivery. The common binding across all of what we do is serving and representing consumers' interests.

Regulatory policy has been dominated by three set-piece projects in 2009/10:

- Project Discovery was a review of GB's security of supply born from the Authority's concerns about 'the unholy trinity of events' impacting the sector: the credit crisis, the crisis in carbon pricing, and the vagaries of global gas markets. On behalf of consumers we used our Utilities Act duties to prepare a report which inputted directly into the Government's Energy Market Assessment, announced in March 2010. The £200 billion investment by 2020, identified by Project Discovery, has been broadly accepted across all parties as the benchmark of what will be required.
- The fifth Electricity Distribution Price Control Review (DPCR5), our five yearly setting of the regulated prices, was a ground breaking review. Under our new sustainability duty we significantly 'greened' the process, including the provision of £500 million for low carbon network innovations.
- The RPI-X@20 project will deliver its conclusions in the Summer 2010, but most of the detailed work was done in 2009/10. This is the moment when we say good-bye to the way we have been doing regulatory network reviews since 1990.

These projects are the 'tip of the iceberg' and our work has straddled a range of issues – at times complex, at times relating to very basic needs of vulnerable consumers. We rely heavily on our staff to deliver under demanding conditions, and their efforts enable Ofgem to be seen as a very attractive place to work. The level of enquiry and application for posts at Ofgem, from graduate positions to Group Finance Director was extraordinarily high in the last year.



By serendipity the regulatory delivery work has also been dominated by three set piece work streams:

- In June 2009 we delivered the new offshore transmission regime to 'go active' status, and we spent the rest of the year delivering Round 1 of the tender process. I am pleased to report that Ofgem has delivered this on time to enable an announcement of 'go live' status by the Department of Energy and Climate Change (DECC). This should give a welcome boost to both the renewables and offshore wind businesses.
- Throughout 2009/10 Ofgem has been working on the initial phase of the smart meter roll-out campaign. The Prospectus should be signed off by our Gas and Electricity Markets Authority and DECC, on schedule, this summer.
- The Feed-in Tariff (FIT) programme came into existence on 1 April 2010, as one of the many environmental based schemes run and operated by Ofgem E-Serve. This was an excellent example of our delivery team (including our IT department) meeting stringent timescales laid down by our client, DECC.

All of these projects have reflected well on the way that Ofgem E-Serve has developed as a business in 2009/10 – the first year in creation. The service and commercial culture has progressed across all the activities. The new senior management team is now in place, attracted from both the private and public sector.

The Energy Acts of 2008 and 2010 have further empowered Ofgem in our work to promote sustainable energy and take account of the interests of future as well as existing consumers. Across our work we can point to decisions that are impacted by these new statutory duties, and lay to rest the idea that an economic regulator cannot handle matters such as sustainability. In our networks businesses, our rulings on interim connect and manage (to get early renewable projects plugged into the system) or the high rate of return provided to the cable providers to the Scottish islands or in the coastal waters between Scotland and England reflected our new approach. More directly for consumers, we continued to roll out our 2008 Energy Supply Market Probe remedies to provide greater confidence about the behaviour of their power companies. We also worked at building consumers' confidence in green energy supply with a new green tariff logo. Even closer to home Ofgem set up a division with specific responsibilities for sustainable development, led by a senior partner.

Ofgem's roles straddle facilitation, advisory and regulatory policy leadership. However, we never forget that our job as a policeman is vital. In a number of instances this entails 'throwing the charge book' at the companies and seeking redress against them. In the last year we were pleased to report that the Competition Appeals Tribunal upheld our case against National Grid, and we fined EDF Energy Networks £2 million for failing to make timely connection offers to customers. Further, we sought and obtained greater powers in the 2010 Energy Act to tackle market abuse and strengthen penalties to put Ofgem in the strongest position to act, where necessary, in consumers' interests. On a more regular basis we continued to deliver the quarterly

review of prices, which we believe has significantly enhanced the debate over supply margins and prices in general.

With such national focus on value for money, I am very pleased to report that Ofgem's delivery under our self imposed RPI-3 per cent cost control regime has comfortably beaten our five year target. This takes our own savings for consumers in the five year control period, which finished on 31 March 2010, to £11.9 million. Our audit committee's recommendation that we live under the same stringent annual cost controls until 2015, has been accepted by HM Treasury. Away from beating our financial targets, Ofgem improved strongly in its own sustainability targets, notably on electricity usage (down 9.1 per cent), our travel choices (rail travel to Brussels and Glasgow office are strongly up against air travel), and our building rating. We also signed up to the 10:10 corporate challenge.

A particular focus for the organisation, now administering £4 billion of consumers' money, has been risk management. The audit committee and the Authority continue to set very high standards in this area and our new Group Finance Director has a distinguished record in this field, having once been global risk manager for Diageo plc. External and internal auditors continue to give both risk management and our major projects in Ofgem E-Serve considerable attention. The smart meter project so far in 2010 has had audit reviews from various external bodies including the Office Government Commerce, National Audit Office and HM Treasury. We welcome this level of review, and helpful advice.

Finally, as a national regulator we take our GB-wide role and responsibilities very seriously. In the last year we set up a directorate responsible for Scotland, Wales and the Regions based in our Glasgow office. This appointment coincided with the opening of our new office in Glasgow by Jim Mather (Scottish Minister for Enterprise, Energy and Tourism). As well as being cost effective, this initiative has been well received and seen as symbolic of our commitment to Scotland. In particular, regulatory network policy is very high on the agendas in Holyrood and Cardiff and we seek to listen and respond to these views. We have Board meetings in both countries and we have just appointed our first Ofgem staff member based full time in Cardiff.

I continue to be hugely impressed by the enthusiasm and dedication of the staff at Ofgem. We need to ensure that we convert this 'excellence in energy and sustainability' into direct positive action for consumers but as importantly to work for consumers through other bodies. As well as working through our own Consumer First campaign, we also collaborate with other regulators with whom we share powers, such as the Office of Fair Trading, and with other organisations such as Citizens Advice and Consumer Focus to safeguard consumers' interests. Our relationship with Government is one that protects our independence but supports the DECC and HM Treasury in maintaining their momentum on critical public policy agendas in energy and climate change.



Alistair Buchanan
Chief Executive

4 New challenges, new responsibilities, new structures

Highlights

- Key organisational changes in 2009/10
- Creation of new business unit, Ofgem E-Serve
- Two separate network divisions
- Increased focus on sustainability
- Separate European directorate
- Expanding presence in Scotland, Wales and the Regions



Introduction

Ofgem's principal role is the protection of present and future electricity and gas consumers – a duty which includes helping to maintain sustainable and affordable energy supplies. Alongside that central responsibility, the Government has also asked Ofgem to take a leading role in the drive to create a low carbon economy, a strategy through which Britain aims to cut carbon emissions by 34 per cent by 2020.

Over the past year Ofgem has undertaken a radical reform of our own structures, including the creation of a new business unit, Ofgem E-Serve. This allows us to address the challenge of our increased responsibilities and to help drive through the major changes in the energy industry needed to deliver a low carbon economy.

Ofgem E-Serve

Through a series of incentives and requirements, the Government is encouraging the market to embrace measures which will help build a low carbon economy. Ofgem E-Serve has been created to help efficiently deliver that low carbon future for UK consumers. Ofgem had already taken responsibility for almost £4 billion a year of Government environmental programmes and the £15 billion offshore transmission tendering regime. These responsibilities have been placed within Ofgem E-Serve which is also taking a leading role in other key areas, including:

- Feed-in tariffs to encourage local generation
- The development of the renewable heat incentive
- Responsibility for collecting the carbon capture and storage levy
- Preparations for the introduction by suppliers of smart meters in Britain's 26 million homes

Networks Divisions

Networks have a vital role in fulfilling Britain's ambitions for a low carbon economy. In recognition of that role Ofgem has set up two separate network divisions:

Transmission and governance division – responsible for the high voltage national electricity grid and the high pressure gas network, as well as issues around easier access for the UK's growing renewable electricity generation;

Local Grids and RPI-X@20 division – responsible for bringing forward reforms to the 20 year old approach to network regulation. It is also supporting measures to ensure more renewable and micro-generation can be connected to local smart grids, notably through the fifth distribution price control review (2010-2015).

Sustainable development

A new sustainable development division has been formed. It brings together environmental, social and consumer policy which together with enforcement, provides a stronger voice in helping Ofgem carry out our duties to promote sustainability and the interests of existing and future consumers in the energy market.

Markets Division

The Markets division is continuing to monitor and analyse the security of Britain's energy supplies, as its reliance on imported energy continues to grow. It also performs a role in actively policing the retail and wholesale, electricity and gas markets to ensure they work fairly for consumers.

Europe

In response to the introduction of the European Third Energy Package and the important influence of events in Europe on UK energy markets and supplies, Ofgem has set up a separate European directorate.

Scotland Wales and the Regions

Building on our existing presence in Scotland a new role of director for Scotland, Wales and the Regions has been created to ensure the interests of stakeholders are fully understood. This allows us to enhance our engagement with the Scottish Parliament and the Welsh Assembly.

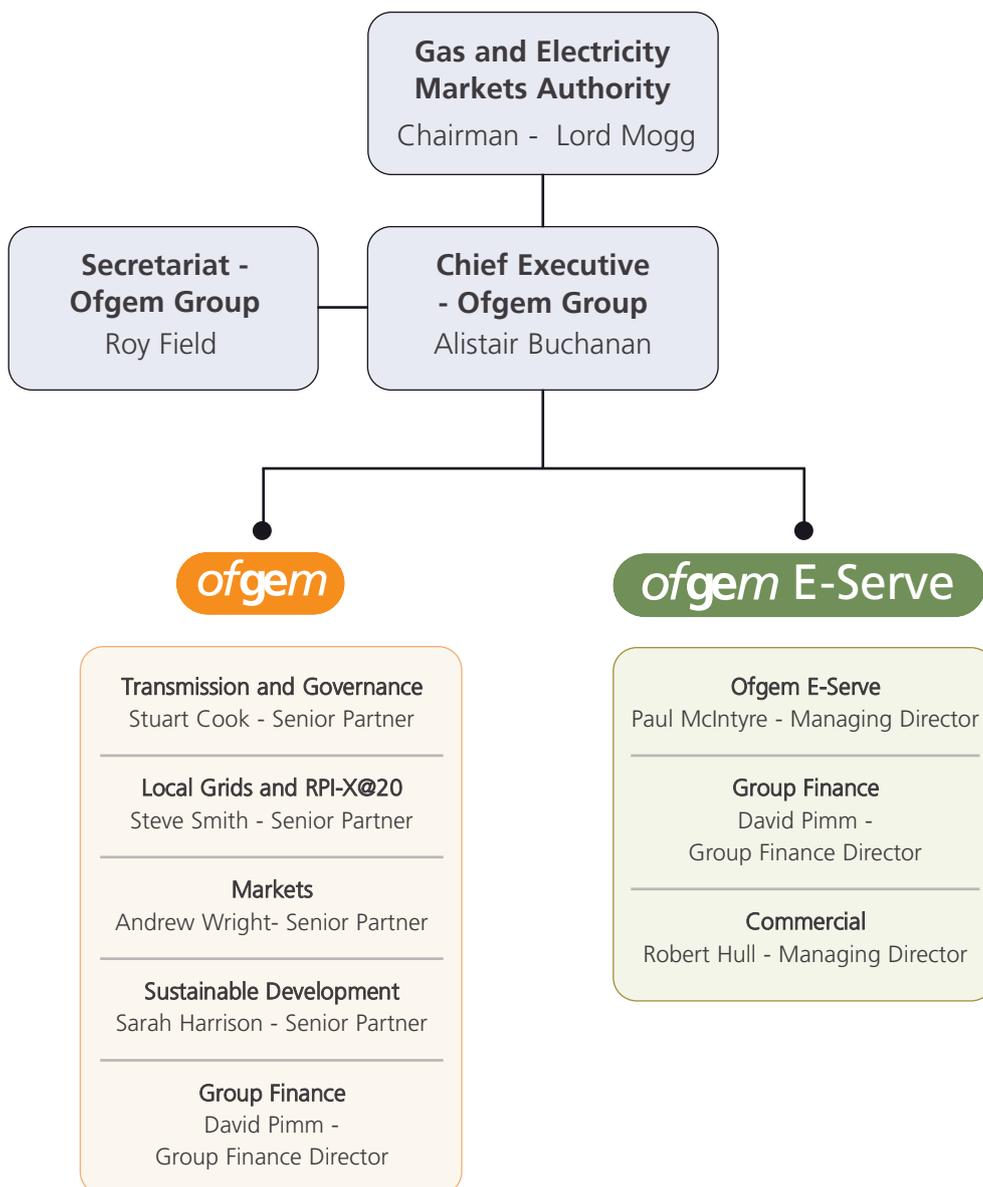
Key themes going forward

Underpinning the organisational changes that were introduced in response to our external challenges and new responsibilities, Ofgem is now focusing on four key themes:

1. Contributing to the achievement of a low carbon energy sector

2. Helping to maintain the security of Britain's energy supplies
3. Promoting consumer choice and value and protecting vulnerable customers
4. Ensuring the timely and efficient delivery of Government programmes for a sustainable energy sector (through Ofgem E-Serve).

The increasing responsibilities, particularly the implementation of Government policies designed to foster a low carbon economy, mark a step change in the functions Ofgem is being asked to undertake. While this has meant a need to increase the resources available to the organisation, Ofgem will continue to maintain its policy of efficient delivery against a background of tight cost control. (See operational report).



5 A voyage of discovery

Highlights

- Project Discovery - the £200 billion investment challenge
- Energy Supply Market Probe implemented
- Enhancing liquidity in the electricity market



Introduction

The need to secure sustainable energy supplies in the coming years presents an unprecedented challenge. Britain is becoming more dependent on imports of gas as the output from the North Sea declines. Many of Britain's ageing fossil-fuel fired and nuclear power stations will have to close. Heavy investment will be needed in new, renewable and low carbon generation, and in the transmission infrastructure needed to connect that generation to the national grid.

Project Discovery

In October 2009 Ofgem published an in-depth scenario analysis, Project Discovery, setting out what we saw as the risks and challenges facing both gas and electricity industries over the next 10 to 15 years. That was coupled with an assessment as to whether the current market-based industry framework would be able address them.

Project Discovery concluded that Britain could need up to £200 billion of investment in energy infrastructure by 2020 – at a time when other countries would also be seeking large scale energy investment and credit, while equity markets were likely to remain cautious in the wake of the recent crisis in the financial markets.

In February, after widespread consultation, Ofgem put forward a series of options – from specifically targeted reforms to the creation of a single entity responsible for ensuring Britain had sufficient energy supplies - which could be used to tackle the looming energy crunch. Ofgem warned that current energy market arrangements could not be left untouched. Rather, significant action would have to be taken and whilst the threat to security of supply is not immediate, it is important that some measures are introduced as soon as possible.

Project Discovery also looked at the potential need for new gas storage – an area where Britain lags behind countries such as France and Germany; new combined cycle gas turbines to replace ageing power stations; the need for low carbon electricity generation including nuclear new build and carbon capture and storage; and finally the need to at least double the amount of electricity generated by wind farms.

It acknowledged, however, that investment was required at a time of increased risk and uncertainty, including worries that the future price of carbon might not be high enough to tempt investors to back low carbon technologies.

Project Discovery also warned that the cost of financing the investment programme would be likely to push energy bills higher. That in turn could

affect Britain's economic competitiveness and could make it harder for an increasing number of consumers to afford the gas and electricity they need. Discovery did not specifically address the issue of affordability but Ofgem continues to assess the impact of higher prices on specific groups of consumers.

Energy Supply Probe: the reforms

In February 2008 Ofgem launched an investigation into Britain's energy supply markets through which domestic consumers and small businesses buy their gas and electricity. The probe concluded that while, in general, the markets were working well, there were several areas where competition was not fully effective so that not all consumers were receiving the full benefits of competition.

Over the last year, and after detailed consultations, Ofgem has been introducing a series of measures designed to address the problems highlighted by the probe.

In September Ofgem introduced two new licence conditions to tackle unjustified price differentials. The first said the prices charged by companies to consumers using different payment methods – for example those using pre-payment meters – had to reflect the cost of providing those different payment methods. The second prohibited companies from using undue discrimination in their terms and conditions – for example offering unjustifiably better prices to one group of customers than were available to another.

Since October a second package of reforms aimed at improving competition and giving consumers more information is being progressively rolled out. The package said companies must:

- Improve the information provided with customers' bills as well as an annual statement which provides all the information a consumer needs in order to switch suppliers in a single document

- Provide help to vulnerable and indebted customers who were unable to switch suppliers because of their outstanding debts
- Improve the conduct of their sales and marketing activities to prevent mis-selling
- Supply small business customers with better information in relation to their supply contracts
- Improve the transparency of their supply and generation operations by providing more information on their costs and revenues.

Opening the electricity market

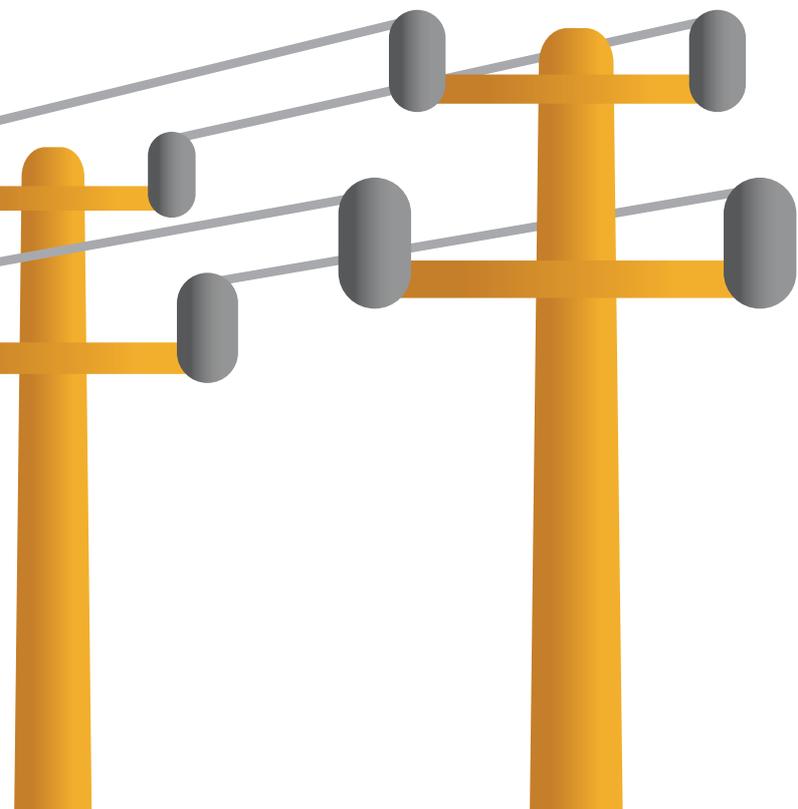
One result of the Energy Supply Market Probe was to highlight a lack of liquidity in the wholesale market for electricity. That lack of liquidity has made it difficult for small firms that want to enter the supply market to buy a sufficient variety of small scale contracts which would allow them to manage their risks and recruit customers in a manageable manner. Enabling more firms to enter the market would increase competition, benefitting consumers.

It is hoped that new market-led measures will help improve liquidity and give small, new, independent suppliers the boost they need. However, Ofgem is prepared to take action if that does not happen and has launched a consultation on measures which could be introduced if the market-led mechanisms fail to deliver.

6 Pricing in the future

Highlights

- Price control review opens way for £7.2 billion network investment
- Work continuing on review of 20-year-old price control regime
- New guidance on regulatory response to network financial distress
- Network merger rules updated



Introduction

The fifth electricity distribution price control review set the allowed revenues for companies to deliver £7.2 billion of network investment, with particular focus on sustainable development. Building from this, the aim of the biggest review to network regulation in 20 years, RPI-X@20, is to encourage companies to be more flexible and innovative and to plan with a longer term view to meet the demands of their customers.

Fifth distribution price control review

All seven owners of Britain's electricity distribution networks accepted Ofgem's proposals for the 2010-2015 price control. The seven companies between them own the 14 regional networks which transport electricity from the national grid to homes and businesses. The settlement will allow the companies to invest in improving their networks at a fair price to consumers who will get better service.

In total, over the next five years, the companies will be able to invest up to £7.2 billion in upgrading their networks. This includes a £500 million low carbon network fund allowing them to undertake large-scale trials of smart grids and other technology and commercial arrangements required in a low carbon economy. The impact on household electricity bills will be an increase of £4.30 per year on average across the country. The new price control began at the beginning of April 2010 and will run until 31 March 2015.

Ofgem's focus on sustainable development was a key part of the price control package and was welcomed by the Sustainable Development Commission (SDC). The SDC said the price control provided a practical example of how existing policy frameworks could be adjusted better to deliver the transition to a low carbon economy in the short-term, pending the conclusions of Ofgem's more fundamental, ongoing review of the approach to network regulation under the RPI-X@20 project.

The SDC noted that following its 2007 report on Ofgem, progress has been made in all the areas it identified to give the energy sector more incentives to reduce greenhouse gas emissions.

RPI-X@20

Ofgem is undertaking the biggest review in 20 years of the price control regime which governs Britain's energy networks - the pipes and wires which bring gas and electricity to homes and businesses.

The networks are natural monopolies which are subject to price control regulation by Ofgem. Network charges account for between 17 and 18 per cent of household energy bills.

For more than 20 years Ofgem has set network prices based on an inflation linked formula RPI-X. The system has worked well, delivering big efficiency savings which in turn have helped to keep down customer bills. However, Ofgem has looked hard at the RPI-X approach in light of the need to replace ageing infrastructure, connect new, renewable generation and build new infrastructure for the gas imports on which Britain is becoming increasingly reliant. Its analysis shows that, while the current price control arrangements are not broken they do not represent the best method of meeting the challenges and uncertainties of building a low carbon economy.

Ofgem believes networks need a simple, effective, regulatory regime which encourages the companies which run them to be flexible, innovative and prepared to make long term investments to meet the demands of their customers. The emphasis has changed from a regime designed to squeeze out efficiencies for the benefit of consumers to one which will deliver vital, large scale, investment. It is estimated that some £40 billion will need to be invested in the gas and electricity networks to secure Britain's energy supplies and meet its climate change target – almost a quarter of the total figure Ofgem believes needs to be invested across the energy industry.

Ofgem has produced a series of consultation documents outlining its thinking on a new price control regime and seeking the views of stakeholders. More detailed proposals will be published in summer 2010 and will then be incorporated in Ofgem's network price controls. The Transmission and Gas Distribution Price Control Reviews in 2013 will be the first time the new regime will be implemented.

Networks Financial Health Check

New guidelines were published dealing with the way Ofgem would respond if one of the networks ran into financial difficulties. The move was not prompted by concerns about any particular network. It followed a stress test of existing arrangements for dealing with financial distress as part of Ofgem's commitment to best practice and forward planning in the interest of consumers, particularly at a time of tight credit markets. The new guidelines cover Ofgem's responses to network companies experiencing different degrees of financial difficulty up to and including energy administration. However primary responsibility for a network company's financial integrity lies with that company's management and its shareholders.

Ofgem believes the new regime is robust and will carry out periodic reviews to ensure it remains up to date and effective.

Merger policy reviewed

In February 2010 Ofgem suspended its policy for mergers between network companies, following consultation, and initiated a policy review. Since the end of the year in question a new merger policy is in place and applies to all network sectors: electricity distribution, gas distribution and transmission.

7 Reviews, reforms, renewables

Highlights

- Final proposals on code governance published
- £4 billion package for critical investment
- Connect and manage access arrangements introduced
- Securing timely access to transmission
- Facilitating carbon capture and storage



Introduction

Ofgem has carried out a two year review of the code governance in line with its better regulation principles. The review looked at ways in which the rule-making process could be modernised to cut red tape, speed up industry reform and allow consumers and small generators and suppliers the opportunity to engage more actively in industry reform. At the same time Ofgem is working with industry in funding proposals to allow £4 billion of critical investment needed to help meet the Government's 2020 environmental targets.

Code governance reform

At the end of March Ofgem published its final proposals for the reform of the code governance – the rule book which governs Britain's gas and electricity industry. The review concluded that the code governance arrangements needed strengthening in a number of areas. As they stood, the arrangements slowed the pace of necessary change and, in the longer term, threatened the industry's ability to deliver reforms needed to meet environmental challenges and security of supply issues.

The changes put forward have been designed to make existing arrangements more flexible, transparent and accessible to smaller players in the industry and to consumers, allowing them greater understanding of what is happening and therefore increasing their ability to formulate and express their views.

Other measures included ways of speeding up the implementation of wide ranging and complex changes as well as moves to give the industry a greater degree of self governance by reducing the regulator's role in areas where there would be little or no impact on consumers.

Funding critical investment

In January final proposals were put forward for a £1 billion package, which is the first tranche of the £4 billion additional expenditure identified by the working group, led by Ofgem and the industry, that is needed to put Britain on the right track to meet its 2020 carbon reduction and renewable targets.

The funding proposals will enable vital new generation, much of it renewable, to be connected to the grid. Ofgem has been working with industry to overcome delays to critical investments and the funding proposals mark a significant step towards facilitating the Government's 2020 carbon emission reductions target.

The £1 billion package is in addition to the £3.8 billion investment Ofgem approved for the three electricity transmission companies to spend on network upgrades in their current price control review (2008-2012).

Interim connect and manage

As part of the ongoing effort to make it quicker and easier to allow new generation capacity to be connected to the grid, Ofgem introduced interim measures to allow new sources of generation, much of it renewable, to be connected to the grid. This avoids the need to wait until the transmission grid has been reinforced so it can handle the additional output from these new generators.

Transmission access review

If Britain is to meet the Government's climate change and renewable energy targets, it is critical that renewable and other low carbon generators secure timely access to the national grid. To achieve this, we need access rules which encourage the best use of the existing transmission capacity and which support the timely delivery of new capacity. We are supporting the work of DECC who are leading a project to reform these rules.

Other developments

The year also saw the introduction of enduring arrangements for exit capacity and the introduction of entry capacity substitution onto the high pressure gas grid. The former completes a programme of work which commenced with the sale of a number of gas distribution entities by National Grid. The latter allows grid capacity to be transferred from points on the system where it is no longer needed, to points where there is a demand for additional capacity, which is expected to help reduce consumers' bills by reducing the level of unnecessary investment.

At the request of National Grid, Ofgem also looked at the possibility of using part of the network to transport carbon dioxide from a coal-fired power station in Scotland to allow it to be buried in an exhausted gas field in the North Sea. The potential use of depleted North Sea fields to store carbon dioxide, using existing gas infrastructure fits in with DECC's programme to encourage the commercial development of carbon capture and storage (CCS). Ofgem is due to report in full in summer 2010.

8 Better, greener, fairer deals

Highlights

- Certifying green tariffs
- Tighter guidelines to protect vulnerable customers
- Monitoring suppliers' social spending
- Working with consumers for consumers



Introduction

The Sustainable Development division was set up during the year as part of a reorganisation at Ofgem as it geared up to support the Government's programme to deliver ambitious carbon reduction targets as well as for changes in the market environment. The division encompasses consumer and environmental policy and the social action strategy. At a time of dramatic changes and challenges in the energy industry the division aims to ensure consumers have a powerful voice.

Green tariffs

In February this year Ofgem supported the launch of a new certification scheme for green electricity tariffs, the 'Green Energy Certified' label, led by suppliers. The new scheme should give confidence to customers that when they choose a certified green energy deal they will be supporting suppliers who are going the extra mile to reduce carbon emissions.

The certification scheme seeks to ensure consistency with Ofgem's Green Supply Guidelines, published last year. To be eligible for certification, suppliers will have to demonstrate to an independent panel of experts among other things that their tariffs result in a reduction of carbon dioxide emissions over and above a minimum threshold.

Crucially, suppliers must show that the activity associated with the green tariff is in addition to what they already have to do to meet existing Government targets for sourcing more renewable electricity and reducing household carbon emissions. The certification scheme is administered by an independent panel made up of leading environmental and sustainability experts.

To date, ten tariffs have been given the 'Green Energy Certified' label across all seven participants in the scheme.

Protecting vulnerable customers

Ofgem has continued to press energy suppliers to help customers who are struggling to pay their bills, with particular emphasis on the protection of vulnerable consumers. In partnership with Consumer Focus, Ofgem conducted a review of the issue of disconnections of vulnerable consumers during the year. The review found that while there was much good practice across energy suppliers to protect vulnerable customers from disconnection, there was still room for improvement.

As a result of the review Ofgem has tightened licence obligations on suppliers and the representative body, the Energy Retail Association (ERA) has strengthened its guidelines to ensure elderly and other potentially vulnerable customers are better protected.

Overall in 2009 the total number of disconnections of domestic energy customers fell to 4,230 compared with 5,890 during 2008, 8,384 in 2007 and around 30,000 a year a decade ago.

Ofgem is continuing to press suppliers to help customers who are struggling to pay their bills or who have fallen into debt. A major innovation in the year has been Ofgem's debt review, conducted jointly with Consumer Focus. This review has focused on suppliers' approaches to customers who could fall or have fallen into debt.

Ofgem has set new principles of best practice which it expects suppliers to take into account in meeting their licence obligations. These have been backed by industry and are in line with the best practice standards set by Citizens Advice which worked with Ofgem in promoting them.

Suppliers' social spending

In the 2008 budget the Chancellor announced suppliers had agreed to increase their voluntary social spending by at least £150 million a year by 2011. Government asked Ofgem to assess suppliers' performance in meeting the targets laid down. The result has been a sharp increase in the number of customers receiving help, more than doubling to one million in the year to March 2009 the number of customer accounts receiving a social tariff. Ofgem will continue to monitor the performance of suppliers and is working with Government to develop and administer the new social price support mechanism which will replace the current arrangements for social support.

Ofgem has a strong commitment to the promotion of equality and diversity. During 2009 we published Equality Schemes for race, gender and disabilities. These schemes outline what

Ofgem has done so far, and what we propose to do, to ensure that we embrace best practice in the way we consider equality and diversity issues in our policy work as well as in our employment and operational policies. To help us develop and monitor our Disabilities Equalities Scheme we established a Disabilities Advisory Forum comprising a range of organisations representing the interests of people with physical and mental disabilities. The Forum meets with Ofgem on a regular basis and provides advice on key policy issues affecting energy customers with disabilities such as the design of smart meters and suppliers' debt collection practices.

Energy Supply Market Probe

Ofgem introduced a series of reforms designed to tackle problems for the consumer highlighted by Ofgem's 2008 Energy Supply Market Probe into retail energy markets, including a ban on unjustified pricing differentials, more detailed bills and improved arrangements for customer switching including those in debt.

Direct debit

In late 2008 Ofgem received complaints from almost 1,000 customers in relation to significant increases in direct debit payments. Ofgem investigated suppliers' direct debit arrangements and in March 2009 published the results. Though it found no evidence of deliberate attempts by suppliers to increase cash flow through unjustified increases in direct debits, nor of systematic errors, the review showed suppliers' processes for setting direct debits could result in large variations in payment levels. A lack of transparency and poor communication by suppliers was at the heart of the problem. While suppliers made moves to improve communications, Ofgem decided new licence obligations were needed to secure better customer service. These came into effect in January this year.

Complaints

Ofgem warned companies to improve complaint handling as consumer research found less than one in four customers were satisfied with the way complaints were dealt with. An independent audit commissioned by Ofgem showed suppliers had made the significant systems investments and sought to update their processes in preparation for new complaint handling standards introduced last year, but customers remained dissatisfied.

The research found that consumers were particularly unhappy with the number of times they had to contact the supplier, suppliers who promised to call back but did not, failure to record

details of customers' complaints, the attitude of some staff and the fact that suppliers often viewed the problem as resolved when in the customer's eyes it was not.

Ofgem has warned the companies it will look again at complaints handling in the current year and that it expects to see a significant improvement.

Energy Best Deal

Ofgem and Citizens Advice has continued to operate the Energy Best Deal scheme, designed to identify those consumers who need guidance and advice to get the best deal from the competitive energy market. The scheme, launched in England and Wales last year, is funded by the suppliers EDF, E.ON, Scottish Power and npower. An independent evaluation of the scheme carried out by the Centre for Sustainable Energy found that of the ordinary consumers who attended Energy Best Deal sessions:

- Fifteen per cent did not know they could switch their energy supplier. Of those who did know they could switch, nearly a third said they did not know how to do this prior to the session
- Forty-five per cent went on to look into getting a better deal on their energy. Of these, over two thirds said they found it easy or fairly easy to get information about different tariffs and almost half went on to switch supplier successfully
- Eight per cent said they would apply for a home improvement grant, fifteen per cent said they would check out their entitlement to benefits and tax credits while twelve per cent said they would get advice on paying off their debts
- Ofgem is now looking to extend the Energy Best Deal to cover Scotland in a new partnership between Ofgem and Consumer Focus Scotland

Consumer First

Ofgem has continued to use its Consumer First programme which draws on consumers' insight from its householder panel and researches. This research is used to inform key policy decisions and disseminate genuine insight across the organisation, making Ofgem's consultations more consumer-focused and friendly.

The Consumer First Panel consists of 100 domestic customers recruited from a series of locations across Great Britain. The Panel continued to meet regularly to discuss key consumer issues in relation

to the energy market. In June the Panel looked at price controls and tariffs. It later considered sustainable development and reflected views that every household should play its part. At the same time the panel said fuel poverty remained an important issue.

As part of the Consumer First programme to ensure consumers' interests were taken into account in the 2010-2015 Electricity Distribution Price Control Review, Ofgem set up a Challenge Group. The Group of six consumer experts acted as Ofgem's 'critical friend' and brought additional expertise above and beyond consumer research. The challenge group model is now being developed for the next transmission and gas distribution price control reviews.

9 A leading voice in Europe

Highlights

- European Third Energy Package unveiled
- New climate change measures introduced
- Encouraging the development of cross border integration
- Gas market guidelines drawn up under Ofgem lead



Introduction

Britain's growing reliance on imported energy has meant the regulation and operation of energy markets in the rest of Europe has become increasingly important to Britain's energy industry and consumers.

European Energy Third Package

In June last year the European Union unveiled its European Third Energy Package designed to further liberalise Europe's energy markets.

The package grew out of the European Commission's energy sector enquiry, which identified a number of areas where the Commission believed reform was necessary to improve the workings of the single market in terms of gas and electricity.

Among the measures put forward were reforms "unbundling" transmission networks and electricity generators – effectively creating an operational (but not ownership) separation between the transmission networks and suppliers and generators; restrictions on the ownership of EU transmission system companies by companies from countries outside the EU; and greater powers to national energy regulators. Many European regulators do not currently have the same enforcement powers or the same level of independence as currently has Ofgem.

The measures included in the package are now being introduced into national law and will be brought into effect from next year. They include the establishment of a new agency, the Agency for the Cooperation of Energy Regulators (ACER). ACER will complement and coordinate the work of national regulators at EU-level. Its roles will include participation in the creation of European network rules; taking binding individual decisions on terms and conditions for access and operational security for cross border infrastructure if national regulators cannot agree; giving advice on various energy-related issues to the European institutions; and monitoring and reporting to the European Parliament and the Council.

Since the end of the year under review, Ofgem's chairman, Lord Mogg has been elected chairman of the ACER board of regulators. Lord Mogg is already chairman of the Council of European Energy Regulators (CEER) and the European Regulators' Group for Electricity and Gas.

New climate change measures

The EU agreed a comprehensive package of climate change measures after long running negotiations with member states. The agreement established the 20-20-20 targets (a 20 per cent cut in greenhouse gas emissions by 2020, a 20 per cent cut in energy consumption, with renewables providing a 20 per cent share in energy supply.)

During the year Ofgem played a key role in the development of a number of initiatives designed to encourage the development of cross border energy links:

- It contributed to discussions on electricity target models for cross-border trade and began working with BritNed, the electricity interconnector joint venture, owned by National Grid and TenneT and linking Britain and the Netherlands, on their access rules and market coupling. BritNed is due to come into service next year
- It drafted a consultation on integration of wind generation into EU electricity markets, presented at the Bucharest and Florence Forums on renewables and energy efficiency issues and generally continued to lead sustainable development issues

Gas market guidelines

As part of a wider regional initiative Ofgem completed the project to create more transparency in the gas market. Increasing information on transmission capacity and gas flows is crucial to the development of a more open and competitive European energy market. Subsequently the commission has introduced legally binding rules building on Ofgem's work on transparency. The requirements are designed to ensure effective access to natural gas transmission systems and a minimum guarantee of equal market access conditions. Gas transparency requirements would also apply to gas storage and liquefied natural gas (LNG), not just infrastructure.

- Ofgem has also contributed to the European regulators' work on gas capacity allocation and congestion management and is leading work on gas balancing.

- Through the France-UK-Ireland regional initiative, we have seen implementation of a new capacity allocation and congestion management system on the IFA (England-France interconnector) and earlier introduction of new balancing arrangements.
- Ofgem also hosted the second annual meeting of the European Commission's Citizens' Energy Forum, giving an up to date account of its own retail market probe and as well as the progress made on work with other European energy regulators relating to retail market issues.

10 Energy, efficiency, environment

Highlights

- Creation of E-Serve as a separate business unit
- Offshore transmission tender process underway
- Preparations for the introduction of smart meters
- Expansion of environmental programmes administered by Ofgem E-Serve
- Introduction of the Community Energy Saving Programme (CESP)
- Development and introduction of the Feed -in Tariffs regime



Introduction

The Government has set an ambitious target for the deployment of renewable energy over the next decade. By 2020, the Government expects that 15 per cent of the UK's energy needs will be met from renewable sources. This means that around 30 per cent of our electricity may come from renewables.

To achieve these challenging targets for green energy, the Government has established a policy framework to support investment in renewable generation, deploying a combination of incentives and regulation.

Creation of Ofgem E-Serve

To address its rapidly expanding role in the promotion of a low carbon economy Ofgem has set up a separate business unit – Ofgem E-Serve. The new business unit is responsible for Ofgem's support and delivery functions and its creation is part of a broader Ofgem reorganisation.

In 2009/10 Ofgem administered environmental programmes and services worth some £3.9 billion – more than 25 times greater than in 2001, and the value of environmental schemes and projects is expected to double over the next decade. To date these programmes have been delivered at a cost of less than one percent of scheme values.

The restructuring has been designed to ensure there is no dilution of the organisation's regulatory role and to allow the necessarily different operating styles between delivery and regulatory activities to develop. The new regime will enable Ofgem E-Serve to have access to the expertise and experience of the energy industry within the regulatory arm and to maximise efficiencies by allowing the two arms of Ofgem to share systems and back office facilities.

Offshore transmission

Within the overall policy framework, offshore wind is recognised as being an important source of renewable energy. For this type of power to reach homes and businesses in Great Britain, fit for purpose electricity networks must be developed. Offshore network investment could be up to £15 billion.

Ofgem has been given a central role in developing a competitive offshore transmission regulatory regime and running the tender process for licences to own and maintain new offshore transmission assets. The new regime came into effect in June last year and four weeks later Ofgem began the first set of tenders to appoint new offshore grid

companies (Offshore Transmission Owners – OFTOs).

The auction for the first nine projects in the first round – covering £1 billion worth of transmission links- has attracted stiff competition. Plans for the second auction are underway.

Smart meters

In October 2008 the then Government announced its intention to mandate a roll out of electricity and gas smart meters to all homes in Great Britain, with the aim of completing the roll out by the end 2020.

After consultation a decision was reached on a preferred delivery model for the smart metering roll out. This included a central communications model, under which energy suppliers will be responsible for purchasing and installing meters, and communications will be organised centrally. High-level smart capabilities for domestic electricity and gas meters were set and a central Smart Metering Implementation Programme was established.

The Implementation Programme's work is building on the Government response, and is preparing the way for the start of the mass roll out of smart meters. The first phase is concerned with defining the scope and key principles of the smart metering solution. These principles will form design parameters which will guide the preparation of detailed specifications as well as commercial and regulatory arrangements. This work includes a Prospectus, decided upon by Government and the Authority, taking into account the views of stakeholders.

Ofgem's detailed knowledge of the energy market, its strong relationships with industry players and consumer bodies and its regulatory role, mean it is ideally placed to help design the arrangements for introducing smart metering

effectively into the complex structure of the energy industry.

The implementation programme touches all parts of the energy industry, and careful design and planning will be needed to deliver the maximum benefits to consumers and industry, at the same time as driving down the costs of installing and operating the new smart meters.

Environmental programmes

The Renewables Obligation (RO) and the Renewables Obligation (Scotland), require electricity suppliers to buy part of their electricity from renewable generation. Ofgem administers the Renewables Obligation in England, Scotland and Northern Ireland (the latter on behalf of the Northern Ireland Authority Utility Regulation), accrediting stations, issuing Renewable Obligation Certificates (ROCs) and ensuring suppliers comply with their obligations.

Early in the reporting period Ofgem successfully implemented major changes to the Renewables Obligation. Banding and grandfathering, which required different stations to be issued different numbers of ROCs per MWh depending on their technology, capacity and commissioning date, were introduced with effect for generation from 1 April 2009. Implementation ran very smoothly with generators experiencing very few banding issues since that date.

The number of stations accredited for the RO increased dramatically year on year, largely due to a rush of microgeneration applications prior to the introduction of the Feed-in Tariff scheme. We saw a large increase in the number of stations accredited from 750 in the year to 31 March 2009 to 2,200 in the year to 31 March 2010.

Over 20.5 million ROCs were issued during 2009/10, across the three schemes for England and Wales, Scotland and Northern Ireland (via an agency services agreement), compared with just over 19 million in 2008/09.

In 2009/10 the use of renewable generation supported through the renewable obligations regime reduced CO₂ emissions by an estimated 8 million tonnes – the equivalent of taking almost 2.8 million cars off the road or sufficient to fill Wembley Stadium more than 1,000 times.

Ofgem E-Serve has also continued to administer the following programmes on behalf of the Government:

- Climate Change Levy (CCL) exemption for renewables in 2009/10 issuing nearly 25 million Renewables Levy Exemption Certificates (LECs), broadly flat with the previous year. Since April 2003, the exemption from CCL for direct supplies of Combined Heat and Power (CHP) generated electricity, from sources designated as good quality, was extended to include indirect supplies - those supplies exported to the grid. We issued just over 22 million CHP LECs in 2009/10 to complying CHP schemes compared with just over 21 million in 2008/09.
- Renewable Energy Guarantees of Origin (REGOs) scheme which was introduced as part of a European Union directive. REGOs are issued by Ofgem E-Serve to generators to prove that their electricity is being produced from renewable sources.
- Carbon Emissions Reduction Target (CERT) which places an obligation on certain gas and electricity suppliers to meet a carbon emissions reduction target from domestic properties. The overall target is set by DECC with at least 40 per cent of the target having to be met from the priority group (those on certain benefits or over 70 years of age).

In 2009 the CERT was amended to increase the target by 20 per cent and to introduce behavioural measures into the scheme. Ofgem E-Serve successfully implemented these changes into its processes to allow the suppliers to use these new measures to demonstrate their compliance with their obligations. Over the course of the year the suppliers installed measures leading to lifetime carbon savings of more than 55 million tonnes CO₂, professionally installing insulation in more than 550,000 cavity walls and 700,000 lofts.

Development

During the reporting period Ofgem E-Serve also set up and launched two significant new environmental schemes against very demanding deadlines:

- The Community Energy Savings Programme (CESP) went live on 1 October 2009, and our compliance activities were launched on 1 December 2009. The CESP is a 3 year, £350 million scheme which requires suppliers and large generators to implement energy efficiency activities targeted at vulnerable consumers

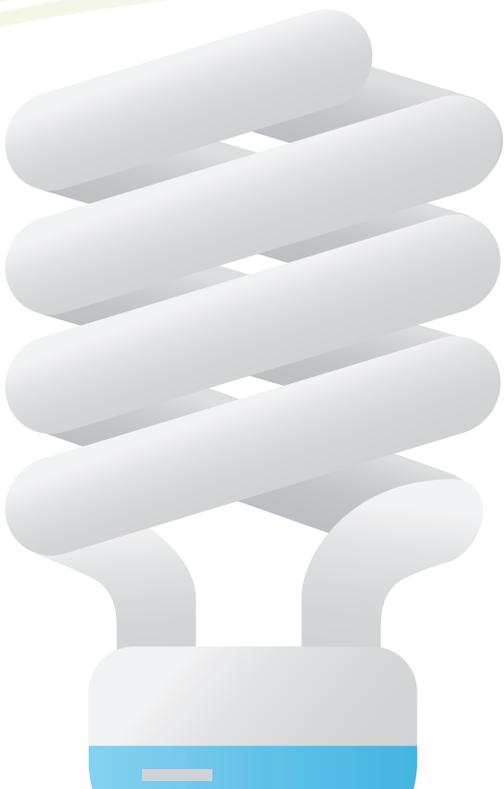
- The Feed-in Tariff Scheme was launched on 1 April 2010. The FIT scheme is an £8 billion scheme which requires electricity suppliers to pay fixed tariffs to small scale renewable electricity generators in order to make this type of installation financially viable. Over 1,000 generators have already registered to receive feed-in tariffs, which is evidence of the smooth running of the scheme since its launch.

We also commissioned independent benchmarking of our FIT administration costs against other comparable government schemes. The benchmarking study, conducted by Grant Thornton, showed that administration costs for similar schemes were typically between 3-12 per cent of the value of the scheme, whereas our administration costs for the FITs is expected to be 1 per cent when the scheme matures. This is evidence that Ofgem is delivering cost-effective, value for money environmental schemes.

11 Delivering value for money

Highlights

- Strong operational performance
- Tough financial savings target exceeded
- Delivering value for money in management of environmental programmes
- Services to other regulators
- Committed to reducing our impact on the environment



34 Introduction

Operationally Ofgem's year could be characterised as 'business as usual in unusual times'. It has continued to seek to improve the regulatory regime through a series of reviews and reforms alongside the day-to-day regulation of the energy industry for the benefit of consumers.

As a result of the Code Governance review, for example, Ofgem introduced a series of measures designed to enable necessary reforms to the rules governing the industry to be brought in with greater speed and transparency with a bigger voice for all stakeholders. At the same time industry has been given a greater measure of self governance in areas where there is little or no impact on the consumer.

The review of the energy networks price control regime (RPI-X@20), which has been unchanged for two decades, is aiming to build a regulatory framework which is simple and efficient and which encourages companies to be flexible and innovative in their approach.

Delivering performance targets

As well as the Code Governance reforms and the RPI-X@20 review, Ofgem undertook a series of major initiatives including the widely-discussed Project Discovery, the fifth distribution price control review and a number of directly consumer-focused initiatives.

In all Ofgem delivered a total of 27 out of the 31 deliverables to which it was committed to complete within the year to the end of March (see appendix I).

Ofgem has a duty to undertake impact assessments (IAs) for all important policy proposals. It has developed a rigorous approach to IAs in line with best practice, while ensuring that decisions are consistent with its wider statutory duties. Its guidance takes account of best practice as it has developed, for instance in relation to sustainability issues, and sets out Ofgem's approach to cost-benefit analysis.

Whilst impact assessments are not determinative of the final policy decision that we make, they are a vital part of the policy-making process and provide a valuable framework for assessing the impact of important policy proposals. In December 2009 we published revised guidance that reflected the Government's own approach to valuing carbon emissions. A list of the IAs published in 2009/10 can be found in appendix III.

Delivering value for money

Ofgem is primarily funded by a licence fee levied on the energy industry and not by taxpayers. The fines it imposes on the industry for infringement of the rules – some £38 million since 2002, go to HM Treasury and are not used to fund Ofgem.

Once again Ofgem delivered against stiff financial performance targets. It outperformed its own cost control measure of RPI-3 per cent (the equivalent of a three per cent cut in costs in real terms) for the fifth year in a row.

Both operational performance and tight budgetary control were achieved against a background of a radical reshaping of the Ofgem organisational structure, an expanded portfolio of responsibilities and the need to recruit, train and integrate the staff required to ensure Ofgem has the resources to carry out its enhanced work load efficiently and cost effectively.

As an indication of the rapidly expanding scale of Ofgem's work, in 2001/02 Ofgem administered government environmental programmes worth £150 million – with 12 members of staff but is now delivering on £4 billion worth of programmes with a staff of 54 at a cost of £8 million. In 2010/11 government environmental programmes are expected to account for more than half Ofgem's total budget, making it one of the leading organisations delivering the low carbon economy in the UK. The cost of administering environmental programmes is met from a variety of sources but predominantly by DECC.

Ofgem's drive to deliver value for money has been recognised externally. In March Ofgem achieved CIPS Certification and the Standard of Excellence, the recognised global accreditation for achieving procurement excellence through an organisation's procurement and supply chain policies, procedures and strategies. Ofgem was the first UK Regulatory Body to achieve CIPS Certification which independently benchmarks the organisation against "best in class". We now have peer group recognition from our stakeholders and this standard will lay the foundation for further and continuous improvement.

Achieving CIPS Certification will give our stakeholders - DECC, suppliers, auditors, the energy sector and, ultimately, energy consumers - confidence that we know what we are doing in terms of procurement and delivering value for money. It will also give suppliers confidence that we maintain high ethical standards and deploy robust, fair and transparent procurement processes.

The certification process also encouraged the focus on cost savings which led to over £1 million of quantifiable savings being recorded for 2009/10.

Ofgem also helps other regulators to keep down their costs. We provide finance services for Postcomm and administer aspects of the renewable programme for the Northern Ireland Authority for Utility Regulation.

People development

Retaining, recruiting and developing staff to maintain high standards of performance is vital to Ofgem's success.

In 2009/10 average staff numbers were 360. We have a 14 per cent target for turnover. Actual staff turnover during the year was 13 per cent for permanent staff and 16 per cent for all staff (permanent and casual). This is significantly lower than the 20 per cent level of two years ago for all staff and is in line with our target level.

Equal Opportunities

Ofgem's Equal Opportunities Policy aims to ensure that no eligible job applicant or employee receives less favourable treatment on grounds of age, disability, sex, race, ethnic or national origin, sexual orientation, religion or religious affiliation or because the employee works part-time.

At the end of the financial year:

- 0.2 per cent (0.6 per cent in 2008/09) of all staff were known to be disabled

- 44 per cent (44 per cent in 2008/09) of all staff were women
- 39 per cent (41 per cent in 2008/09) of staff in managerial grades were women
- 32 per cent (29 per cent in 2008/09) of senior civil service members in Ofgem were women
- 23 per cent (17 per cent in 2008/09) of staff were known to be of ethnic minority origin
- 15 per cent (11 per cent in 2008/09) of staff known to be of ethnic minority origin were in managerial grades.

The policy statement describing Ofgem's equal opportunity framework is available to provide guidance for all employees.

Days lost due to absence

Ofgem encourages a culture where good attendance is expected and valued. However, we recognise that from time to time absences for medical reasons may be unavoidable. Ofgem aims to treat staff who are ill with sympathy and fairness and where possible to provide them with support which will enable them to recover their health and attend work regularly.

In 2009/10, the percentage of working days lost was 1.4 per cent or 5 days per annum per employee. Recent figures show the average for the public sector is 7 to 8 days and for the private sector 6 days.

Communities

Ofgem seeks to support its employees who commit personal time or funds to help charities, community activities or voluntary public activities. For example, special leave may be granted for acting as a school governor, a magistrate or an employment tribunal panel member.

A number of events, organised by charities, have also taken place at Ofgem.

Sustainability

Ofgem is committed to reducing our impact on the environment and, in addition to those mandated by central government, set 26 of its own targets in 2009.

These targets encompass the areas of climate change and energy efficiency, waste management and recycling, procurement and travel.

Highlights of our performance for the year are:

- CO2 emissions fell by 18 per cent
- Water consumption per person fell by 17 per cent
- Total energy consumption fell for the fifth year in succession with electricity consumption down by 24 per cent
- 97 per cent of business travel between London and Brussels in 2009/10 was by train, compared with 93 per cent in 2008/09
- Total waste produced fell by 27 per cent.

Our performance has been particularly assisted by:

- Voltage optimisation unit (installed in November 2008) – saves 9.1 per cent of electricity consumption
- Increased awareness of carbon footprints leading to greater use of rail over air on business travel and increased use of video conferencing
- Change of waste contractor leading to all waste now being reused, recycled or sent to waste to energy plant.

In addition Ofgem has retained its certification to the ISO14001 Standard for environmental management for the ninth consecutive year.

There are many other areas that are not covered by specific targets but to which Ofgem remains committed. These include:

- Recycling of all printer cartridges and batteries and recycling/reusing of mobile phones
- The use of bottled tap water for meetings
- The use of minimum 75 per cent recycled content copier paper and use of recycled paper for all external documents including this report
- Promoting the use of corporate Oyster cards for travel within London
- Freedom of Information: We received 183 questions under the Freedom of Information Act, of which 160 (87.4 per cent) were processed within the prescribed time. A further four had extensions as permitted under the legislation.

Appendices



Appendix I

Ofgem's performance against 2009-2010 deliverables

Ofgem's Corporate Strategy and Plan for 2009-2010 included a number of key deliverables to be achieved in each quarter.

The table below and detail on the following pages show deliverables met.

| | Number in Corporate Plan* | Total Achieved | | | Deferred to 2010/11 | No longer apply |
|--------------------|---------------------------|----------------|------------------|-------------|---------------------|-----------------|
| | | Met in Qtr | Met in later Qtr | Met in year | | |
| Full year | | | | | | |
| Year Total | 31 | 25 | 2 | 27 | 3 | 1 |
| % | - | 81% | 6% | 87% | 10% | 3% |
| 1st Quarter | | | | | | |
| Quarter Total | 6 | 6 | 0 | 6 | 0 | 0 |
| % | - | 100% | N/A | 100% | N/A | 0% |
| 2nd Quarter | | | | | | |
| Quarter Total | 6 | 6 | 0 | 6 | 0 | 0 |
| % | - | 100% | N/A | 100% | N/A | 0% |
| 3rd Quarter | | | | | | |
| Quarter Total | 10 | 7 | 2 | 9 | 0 | 1 |
| % | - | 70% | 20% | 90% | N/A | 10% |
| 4th Quarter | | | | | | |
| Quarter Total | 9 | 6 | 0 | 6 | 3 | 0 |
| % | - | 67% | N/A | 67% | 33% | 0% |

*The original corporate plan listed 30 deliverables, during the year the Q2 deliverable "Review of suppliers' debt practices" was replaced with two new deliverables: "Review of suppliers' disconnection of vulnerable consumers" in Q1 (delivered Q1) and "Review of suppliers' debt management" in Q4 (delivered Q4)

A leading voice in Europe

| Directorate | Action | Period | Achieved | No longer applicable |
|-------------------|---|--------|----------|----------------------|
| European Strategy | Agree plans for phase 2 of gas transparency in the North West Gas Regional Initiative | Q1 | Q1 | - |
| | Submit National Report to European Commission | Q2 | Q1 | - |

Better regulation

| Directorate | Action | Period | Achieved | No longer applicable |
|----------------------------|--|--------|----------|----------------------|
| Industry Codes & Licensing | Industry Codes Governance Review - publish initial proposals relating to major policy reviews/self-governance and the role of industry code administrators | Q2 | Q2 | - |
| | Industry Codes Governance Review - publish final proposals relating to major policy reviews/self-governance and the role of industry code administrators | Q4 | Q4 | - |
| Finance | Set the Fossil Fuel Levy Rate for 2010/11 | Q3 | Q3 | - |

Creating and sustaining competition

| Directorate | Action | Period | Achieved | No longer applicable |
|-------------|---|--------|----------|----------------------|
| GB Markets | Probe – remedies | Q1 | Q1 | - |
| | Publish 2009 Energy Markets Outlook report | Q3 | Q3 | - |
| | Publish final Winter Outlook Report | Q3 | Q3 | - |
| | Publish proposals for System Operator incentives to apply from 1 April 2010 | Q4 | Q4 | - |

Helping tackle fuel poverty

| Directorate | Action | Period | Achieved | No longer applicable |
|---------------------------|--|--------|----------|---------------------------------------|
| Social & Consumer Affairs | Publish report on incentives for saving energy | Q1 | Q1 | - |
| | Review of suppliers disconnection of vulnerable consumers* | Q1 | Q1 | - |
| | Update on Social Action Strategy | Q1 | Q1 | - |
| | Publish Sustainable Development Report | Q3 | Q3 | - |
| | Review of suppliers' debt management* | Q4 | Q4 | - |
| | Publish a review of the new ombudsman arrangements | Q4 | - | Awaiting additional consumer research |
| | Update on vulnerable customer engagement with the market | Q4 | Q4 | - |

*The original corporate plan listed 30 deliverables, during the year the Q2 deliverable "Review of suppliers' debt practices" was replaced with two new deliverables: "Review of suppliers' disconnection of vulnerable consumers" in Q1 (delivered Q1) and "Review of suppliers' debt management" in Q4 (delivered Q4)

Regulating networks effectively

| Directorate | Action | Period | Achieved | No longer applicable |
|---------------------|--|--------|----------|-----------------------------|
| Transmission | Implement longer-term enhanced Transmission Operator (TO) incentives | Q2 | Q2 | - |
| | Publish Regulatory Reporting Pack for the Transmission Operators | Q3 | Q4 | - |
| | Make decisions on Connection and Use of System Code modifications relating to the Transmission Access Review | Q3 | - | Superseded by DECC decision |
| | Implement short-term enhanced TO incentives | Q3 | Q1 | - |
| | Approve gas entry substitution arrangements | Q4 | Q3 | - |
| Distribution | DPCR5 - methodology and initial cost assessment update | Q1 | Q1 | - |
| | DPCR5 - publish initial proposals | Q2 | Q2 | - |
| | DPCR5 - publish final proposals | Q3 | Q3 | - |
| | Publish Connections industry Review | Q3 | Q4 | - |
| | Publish DNO costs and outputs report | Q4 | - | Deferred to 2010/11 |
| | Publish GDN costs and outputs report | Q4 | - | Deferred to 2010/11 |
| Regulatory Services | Publish financial distress process manual | Q2 | Q1 | - |

Sustainable development programmes

| Directorate | Action | Period | Achieved | No longer applicable |
|---|---|--------|----------|----------------------|
| Energy Efficiency | Publish a review of the Energy Efficiency Commitment 2005-08 | Q2 | Q2 | - |
| Community Energy Savings Programme (CESP) | Following the Government's consultation, publish the procedures for the administration of the CESP scheme | Q3 | Q3 | - |
| Renewables & Combined Heat and Power | Publish annual report on Renewables Obligation | Q4 | Q4 | - |

Appendix II

Performance Indicators 2009-2010

Performance indicators - regulatory

| Activity | Measure | Target | Actual | Comments |
|---------------------------------|--|--------|--------|--------------------------------------|
| GB Markets | Consult on applications made for exemption from Regulated Third Party Access by prospective storage and pipeline operators | 100% | 100% | Target delivered |
| | Submit decisions to the European Commission within the prescribed timescales if adequate information has been provided | 100% | 100% | Target delivered |
| | Assess and make decisions in relation to any Income Adjusting Event within three months of it being raised if adequate information is provided | 100% | 100% | Target delivered |
| Industry Codes & Licensing | Publish decision letters for industry code modification proposals within 25 working days | 70% | 92% | Target delivered |
| | Grant competitive licence applications within 8 weeks of receipt | 90% | 84% | Target narrowly missed for 2009-2010 |
| Social & Consumer Affairs | Respond to complaints on enforcement matters confirming whether we will investigate | 90% | 90% | Target delivered |
| | Respond substantively to customer contacts | 93% | 96% | Target delivered |
| Finance – Accounting operations | Pay authorised invoices within 8 working days of receipt | 98% | 98% | Target delivered |

Performance indicators - sustainable development programme

43

| Activity | Measure | Target | Actual | Comments |
|-------------------|---|-----------------|-----------------|--|
| Energy efficiency | Respond to suppliers that have submitted schemes within 10 days of submission deadline. | 100% | 100% | Target delivered |
| Renewables & CHP | Follow up with generators outstanding issues in their applications for accreditation within 10 days of submission deadline. | 100% | 78.1% | Target missed due to substantial increase in the number of stations accredited, from 650 stations in 2008-09 to more than 2,200 in 2009-10 |
| | Complete reconciliation of CHP LECs | 100% in 20 days | 100% in 44 days | Target missed - 33% increase in number of stations to be reconciled Statutory requirement: of 90 days delivered |
| | Recycle the RO buy-out funds within one month | 100% | 100% | Target delivered |

Appendix III

Impact Assessments undertaken 2009-2010

Ofgem published 15 impact assessments (IAs) between 1 April 2009 and 31 March 2010.

Further information on the following documents can be found at www.ofgem.gov.uk and searching using the appropriate reference number.

| Date | Title |
|------------|--|
| 14/04/2009 | Further consultation on CAP148 - Deemed access rights to the GB transmission system for renewable generation (Reference number: 40/09) This document contained a further IA of Connection and Use of System Code (CUSC) Amendment Proposal 148. It sought views on the impact of a change in our duties (in the Energy Act 2008) on our 'minded to' position and on issues that had come to light since our previous IA was published. |
| 15/04/2009 | Addressing undue discrimination IA (Reference number: 43/09) This IA set out our thinking on the likely impacts, costs and benefits of new supply licence conditions that we were minded to introduce in order to address undue discrimination in the domestic energy supply market. |
| 21/05/2009 | CAP 170: Category 5 System to Generator Operational Intertripping Scheme (Reference number: 53/09) This document assessed the impacts of CAP170 - an urgent proposal to amend the CUSC to introduce a new category of System to Generator Intertripping Scheme with administered prices. |
| 26/06/2009 | Addressing Undue Discrimination Final IA (Reference number: 73/09) Building on document 43/09 and responses to it, this IA set out a wide range of impacts, costs and benefits of the proposed supply licence conditions to tackle undue discrimination in the domestic energy supply market. |
| 24/07/2009 | Code Governance Review – major policy reviews and self-governance initial proposals (Reference number: 84/09) This consultation assessed the impact of our initial proposal for major policy reviews and introducing a measure of code self-governance. |
| 24/07/2009 | Code Governance Review – role of code administrators and small participant/consumer initiatives initial proposals (Reference number: 85/09) This consultation assessed the impact of our proposals for improving the operation of the industry code panels and the role of the code administrators and assistance offered to smaller participants and consumer representatives. |
| 26/08/2009 | Code Governance Review – governance of charging methodologies initial proposals (Reference number: 108/09) This consultation assessed the impact of our proposals for reforming the governance of gas and electricity transmission charging methodologies, allowing materially affected parties to propose changes and improving upon existing levels of transparency and accountability. |
| 28/09/2009 | Electricity distribution structure of charges project: DNO proposals for a common methodology at lower voltages (Reference number: 114/09) This document sought views on our 'minded to' decision conditionally to approve the common charging methodology at lower voltages and included an IA of the proposals. |

| Date | Title |
|------------|---|
| 07/10/2009 | <p>Credit Arrangements (UNC 246) IA (Reference number: 120/09) This document set out our IAs for the Uniform Network Code (UNC) modification proposal UNC246 ("Quarterly NTS Entry Capacity User Commitment") and its alternatives.</p> |
| 04/11/2009 | <p>Gas Entry Capacity Substitution Methodology Initial IA (Reference number: 136/09) This document assessed the impact of National Grid Gas' methodology for implementing entry capacity substitution (ie. the process by which unsold entry capacity is permanently moved from one NTS entry point to another).</p> |
| 30/11/2009 | <p>Identification and Apportionment of Costs of Unidentified Gas (Reference number: 143/09) This IA set out our assessment of several UNC modification proposals (UNC194, UNC194A, UNC228, UNC228A and UNC229) seeking to amend the rules for allocating the costs of unidentified gas.</p> |
| 03/12/2009 | <p>GB ECM-18 Locational BSUoS IA (Reference number: 149/09) This IA related to a charging modification proposal (GB ECM-18) seeking to introduce locational Balancing Services and Use of System charges.</p> |
| 26/01/2010 | <p>CAP170 current thinking and further consultation on competition issues (Reference number: 11/10) This document set out our latest thinking on some of the key issues raised by CUSC amendment proposal CAP170. It provided interested parties with a further opportunity to submit their views on the competition issues.</p> |
| 03/03/2010 | <p>Review of the Ring Fence Conditions in Network Operator Licences (Reference number: 30/10) This IA and consultation document set out proposed changes to the regulatory ring fence regime for network companies that were intended to address potential weaknesses.</p> |
| 31/03/2010 | <p>Code Governance Review – final proposals (Reference number: 43/10) This document assessed the impact of our final proposals for reforming industry codes governance arrangements.</p> |

On 6 November 2009 we published a cover letter with a report by Frontier Economics assessing the potential impact on consumers of connect and manage access proposals.

Summary of actions taken to which IAs relate

The following sets out the decisions taken during the 2009-10 financial year in relation to proposals for which an IA was previously carried out.

- On 7 July 2009 we published our decision to require the introduction of common electricity distribution charging methodologies for extra high voltage loads. These new arrangements are intended to apply from 1 April 2011.
- On 7 August 2009 we published decisions in relation to tackling undue discrimination in the domestic gas and electricity supply markets (Reference numbers 100/09, 101/09) and associated guidance on the new undue discrimination licence conditions (102/09).
- On 21 November 2009 we published our decision to approve conditionally a common electricity distribution charging methodology at lower voltages. The new arrangements and charges were introduced from 1 April 2010 except where derogations applied (Reference number 140/09).
- On 7 December 2009 we published our decision to approve National Grid's Gas Entry Capacity Substitution Methodology Statement.
- On 1 March 2010 we published our decision that the GB ECM-18 locational BSUoS modification should not be made.

Appendix IV

Investigations and enforcement action 2009-2010

| Company | Issue | Decision | Date of decision |
|--|---|--|------------------|
| EDF Energy Networks | Investigation into compliance by network companies in the EDF Group with their licence obligation to provide a connection offer within a 3 month period (Standard Condition 4D of their electricity distribution licence). | Breach and £2m penalty. | July 2009 |
| EDF Energy | Investigation into EDF's compliance with complaints handling regulations. | Breach of complaint handling regulations for failure to record complaints adequately. No penalty in light of action taken by EDF, making £200k payment to consumer bodies. | June 2010 |
| National Grid | Investigation into compliance with licence obligation to provide a connection offer within a 3 month period (Standard Condition 12) and into the availability of resources needed to comply with the licence condition (Standard Condition 30). | Ongoing | N/A |
| Central Networks East & West plc | Investigation into compliance with licence obligation to provide a connection offer within a 3 month period (Standard Condition 12) and into the availability of resources needed to comply with the licence condition (Standard Condition 30). | Ongoing | N/A |
| Scottish Hydro-Electric Power Distribution | Investigation into compliance with licence obligation to provide a connection offer within a 3 month period (Standard Condition 12) and into the availability of resources needed to comply with the licence condition (Standard Condition 30). | Ongoing | N/A |

| Company | Issue | Decision | Date of decision |
|--------------------------------|--|----------|------------------|
| Electricity North West Limited | Investigation into ENW under Competition Act 1998 – alleged abuse of dominant position by foreclosing the market to competitors. | Ongoing | N/A |
| National Grid Gas plc | Investigation into reporting by NGG of regulatory information. | Ongoing | June 2010 |
| British Gas plc | Investigation into the approach taken by BG towards customers in debt and the extent to which their ability to pay is considered in setting repayment rates. | Ongoing | N/A |

Appendix V

Simplification plan 2009-2010

Each year, during the corporate planning process, Ofgem considers whether there are any regulations that impose burdens that could, in the context of our duties generally, be considered unnecessary. In March 2010 we published our latest Simplification Plan, which set out the activities that we would undertake to reduce or remove those burdens.

The Regulatory Enforcement and Sanctions Act 2008 requires the Authority to report on the progress we have made in removing burdens that we consider unnecessary. The updated Simplification Plan sets out the progress that we have made on our activities to remove unnecessary burdens since March.

Process initiatives

| Initiative | Outcome | Current status |
|---|---|---|
| The new RPI-3% per cent internal cost control for 2010-15 | The previous cost control increased internal efficiency and licensees benefited from reduced fees. The new cost control will maintain pressure for efficiencies and cost reductions that will be passed on to licensees | The new internal cost control came into effect on 1 April 2010 and commits Ofgem to save at least £12.5 million in 5 years |
| The Consumer First project aims to improve our understanding of the priorities of domestic consumers | The project has led to improved decision-making that takes proper account of consumers' views. We have published research and other data to facilitate debate. | We have continued to focus on vulnerable consumers and attitudes to the environment. The Consumer Panel has contributed views on several issues affecting the energy market (such as complaints-handling) and will do so on forthcoming network price controls |
| The codes governance review is seeking to improve governance for example by enabling Ofgem to examine the case for significant code changes, introducing a measure of code self-governance, and making the code modification process more accessible for smaller market participants. | The reformed governance regime is intended to deliver change resulting in a proportionate regulatory burden; promote accessible and effective consultation; be transparent and easily understood; be administered in an independent and objective fashion; provide rigorous and high quality analysis of proposed changes; be cost-effective; and be sufficiently flexible that it will always allow for efficient change management. | We published final proposals on 31 March 2010. After considering responses, we published statutory 28-day consultations on licence modifications in June 2010. We have proposed that the modifications take effect on from 31 December 2010. Relevant licensees have until 1 July 2010 to decide whether to accept our proposals. |

Ofgem Policy initiatives

| Initiative | Outcome | Current status |
|--|---|--|
| <p>Our Probe follow-up work included proposals to increase transparency, for example on billing and in a new annual statement</p> | <p>Our remedies are intended to enable better informed switching decisions by consumers. If, at any time, we feel that the remedies are insufficient to protect consumers, we will consider further action.</p> | <p>These changes come into effect in July 2010 and we will monitor their impact closely.</p> |
| <p>The RPI-X@20 review is examining whether the current approach to energy network regulation will continue to deliver reliable, well-run networks with good quality service at reasonable prices despite growing investment challenges.</p> | <p>The aim is as far as possible to develop a framework that is transparent, streamlined, and accessible to stakeholders. The review team will report to the Authority in the summer of 2010. We will consult on the recommendations. The eventual conclusions will inform our future approach to network price controls. The transmission and gas distribution price controls will be the first time the new regime is used.</p> | <p>Following the Emerging Thinking consultations, the review team is developing recommendations to the Authority. We intend to consult in July and take final decisions on the regulatory framework for energy networks in September 2010.</p> |
| <p>Carrying out a review of the gas transmission licence</p> | <p>Consider the scope for simplifying the licence held by National Grid Gas</p> | <p>We are likely to take this work forward as part of revising the transmission licence for the price control roll over and TPCR5</p> |
| <p>Carrying out a review of gas distribution licences (focusing on the elements of the licence relating to Gas Distribution Networks)</p> | <p>We aim to improve the ease of use and clarity of the Standard and Special Standard Conditions without making substantive changes to underlying policies and obligations. We propose to concentrate on restructuring and consolidation, including removal of redundant conditions and simplifying and redrafting to improve clarity and certainty.</p> | <p>In May 2010 we published a letter on the scope and proposed process for the licence review. We will lead an industry working group that will help drive forward the review. We intend to consult on potential licence changes in spring 2011 and, subject to responses, issue a formal licence modification proposal for statutory consultation in summer 2011.</p> |

Ofgem E-Serve initiatives

| Initiative | Outcome | Current status |
|--|---|--|
| <p>Modifying existing environmental programmes including the Renewables Obligation and the Carbon Emissions Reduction Target</p> | <p>More effective application and efficient administration. Effective use of business process design techniques and compliance powers</p> | <p>Process reviews have been carried out with improvements identified. Action logs are being pulled together</p> |
| <p>Introducing new Government environmental programmes including Feed-in Tariffs (FITs), Renewable Heat Incentive (RHI) and Carbon Capture and Storage (CCS)</p> | <p>We intend to administer these schemes cost effectively and efficiently, drawing on our experience, facilities and teams from existing environmental programmes. We will use business process design techniques and compliance powers effectively</p> | <p>Ofgem E-Serve has worked extensively on the Government's FITs scheme, which went live on 1 April 2010. We have published guidance on how we will administer FITs. We are now advising DECC in relation to RHI and CCS</p> |
| <p>We are making good progress with Phase 1 of the work to design the regulatory regime for smart meters</p> | <p>We will use our energy sector expertise to help design the arrangements for introducing smart metering effectively into the complex structure of the energy industry</p> | <p>We expect, jointly with DECC, to publish the smart metering programme prospectus for consultation in July 2010</p> |
| <p>Developing the offshore transmission regulatory regime</p> | <p>Less onerous regulatory burden at start and during life of projects</p> | <p>The auction for the first nine projects in the first round – covering £1bn worth of transmission links - has attracted stiff competition. We expect to begin the second auction in the summer.</p> |

Appendix VI

Ofgem's financial statements (extracts) 2009-2010

More detailed information on costs can be found in our Resource Accounts
published 16 July 2010 (HC26)

Statement of financial position as at 31 March 2010

| | 31 March 2010 £000 | 31 March 2009 £000 |
|--|-----------------------|-----------------------|
| Non-current assets | | |
| Property, plant and equipment | 3,784 | 3,865 |
| Total non-current assets | 3,784 | 3,865 |
| Current assets | | |
| Trade and other receivables | 12,802 | 4,604 |
| Cash and cash equivalents | 3,235 | 133 |
| Total current assets | 16,037 | 4,737 |
| Total assets | 19,821 | 8,602 |
| Current liabilities | | |
| Trade and other payables | (12,082) | (6,923) |
| Total current liabilities | (12,082) | (6,923) |
| Non-current assets plus/less net current assets/liabilities | 7,739 | 1,679 |
| Provisions | (1,772) | (1,778) |
| Other payables | (1,973) | (2,290) |
| Total non-current liabilities | (3,745) | (4,068) |
| Assets less liabilities | 3,994 | (2,389) |
| Taxpayers' equity | | |
| General fund | 3,994 | (2,389) |
| Total taxpayers' equity | 3,994 | (2,389) |

Operating cost statement
for the year ended 31 March 2010

| | 2009–2010 £000 | 2008–2009 £000 |
|-----------------------------|-------------------|-------------------|
| Administration costs | | |
| Staff costs | 26,199 | 20,625 |
| Other administration costs | 24,862 | 21,394 |
| Operating income | (50,578) | (41,324) |
| Net operating cost | 483 | 695 |

All income and expenditure are derived from continuing operations.

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