07

08

Ofgem Annual Report 2007-2008

Protecting

energy consumer interests

Ofgem London
9 Millbank, London SW1P 3GE
Tel: 020 7901 7000

Ofgem Scotland
Regent Court, 70 West Regent Street,
Glasgow G2 2QZ
Tel: 0141 331 6000

www.ofgem.gov.uk

2007-2008 Ofgem Annual Report

Report of the Gas and Electricity Markets Authority for the period 1 April 2007 to 31 March 2008 to the Secretary of State for Business, Enterprise and Regulatory Reform.

The document comprises a report made under section 5(1) of the Utilities Act 2000. It also sets out information on Impact Assessments as required by section 5A(9) of the Utilities Act 2000, as introduced by section 6 of the Sustainable Energy Act 2003.

Office of Gas and Electricity Markets

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

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

Our 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.

Ordered by the House of Commons to be printed 21 July 2008

London: The Stationery Office £13.90

HC 856

ISBN:978 010295605 4

Contents

The Ofgem Resource Accounts for 2007-2008 are published separately

1

Foreword by the Chairman

This has been a particularly difficult year for energy consumers given the anxiety about the cost of energy that has pervaded the period. Given our principal duty to protect consumers we have been acutely aware of the impact rising prices have had on Britain's households and businesses. In response we have focused our efforts to ease the impact of rising global commodity prices. That focus has been particularly sharp given that the rising cost of energy sector measures to tackle climate change is also adding to Britain's energy bills. Meanwhile we hold our course on the environmental challenges and social issues at the heart of sustainable development.

Foreword by the Chairman

The importance of sustainable development is displayed graphically in the way low incomes, poor housing stock and rising energy prices have added to the growth in fuel poverty. Incomes and housing policy are the remit of government but in April I chaired a fuel poverty summit of ministers, industry, consumer groups and other key stakeholders to consider the hardship faced by people struggling to pay their energy bills. The summit produced a fuel poverty action plan – a raft of commitments to practical measures to help the fuel poor principally through better targeting of existing resources.

Ofgem's growing role in sustainable development has been demonstrated this year in the greater profile of sustainability in its price controls (the regulatory allowances on income and expenditure for the monopoly gas and electricity networks). Networks are, in effect, the trade routes that will carry renewable energy to consumers. So Ofgem has devised ways to enable this sector of the industry to prepare to connect the new renewable generation needed if Britain is to meet European renewable targets. And we have provided networks with incentives to boost their own environmental performance. We have this year proposed smarter ways to use the power transmission grid to speed up connection of renewables projects currently stalled in a queue and we have started to consult on ways to streamline the codes governing connections and use of the energy grids.

Closer to the home, we have pressed hard on Government to remove the uncertainty that is curbing progress on the roll out smart metering – a technology that could bring benefits on several fronts but has yet to move close towards becoming commonplace in Britain's homes.

Smart metering offers opportunities for consumers to use energy more efficiently than they currently do. It provides suppliers too with ways to cut their costs and to offer more innovative products. It could, therefore, be pivotal in protecting the environment by cutting emissions and in helping to reduce consumers' bills. However, progress continues to be frustratingly slow, with key decisions now not likely until late 2008.

Our voice in the rest of Europe has helped to guide the European Commission in its quest to inject competition into energy markets and to create a single European Union (EU) energy market. We have played a central role in helping to develop a regulatory framework to bring on the cross-border investment to form the foundation for a single EU energy market.

Prospective investors in the energy sector look to see a stable and independent regulator in place before committing their funds. Independent regulation is vital if national regulators are to meet the highest standards in protecting customers. Britain remains an exemplar in this and under my chairmanship the European energy regulators' group has added to the weight of argument to ensure a similar standard is the target for the EU.

Britain's acknowledged lead in regulatory practice in Europe has not prevented Ofgem from asking searching questions of its own practices. We have set out this year an appraisal of the incentive-based approach at the core of our regulatory regime to ensure it is still fit for purpose. And we have responded to consumer concern over price increases with a probe into whether Britain's energy retail market is working for all consumers during these difficult times.

The year has been a perfect illustration of the growing complexity of the demands on the energy sector which has been reflected in the demands on the regulator. The promotion of markets, where appropriate, alongside economic regulation of network monopolies remains a powerfully effective combination for tackling these demands. But in the face of escalating global fuel prices, coupled with the costs of tackling climate change, Ofgem has dug deep into its reserves of expertise to rise to what are unprecedented challenges.

Lord Mogg

Chairman

2

The Gas and Electricity Markets Authority

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.

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.

Membership

Lord Mogg
Chairman

Dr Robin Bidwell
Non-executive

Alistair Buchanan
Chief Executive

07

The Gas and Electricity Markets Authority

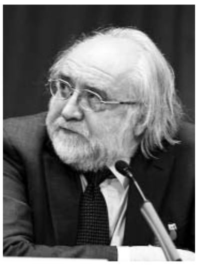
Miriam Greenwood
Non-executive

Sarah Harrison
Executive

Judith Hanratty
Non-executive

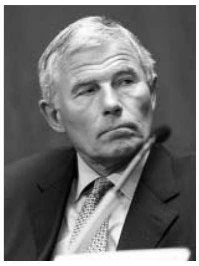
Jayne Scott
Non-executive

Steve Smith
Executive



Professor George Yarrow
Non-executive

Andrew Wright
Executive



John Wybrew
Non-executive

3

Introduction by the Chief Executive

Introduction by the Chief Executive

Since the late 1980s UK energy regulation has thrived because of its ability to evolve to meet consumers' needs while remaining firm on core principles.
I believe 2007-2008 will come to be seen as a pivotal year as Ofgem has had to transform itself while not losing the best of the past. The transformation has been driven by internal initiatives, best exemplified by our desire to review whether the retail price index (RPI)-linked approach is still fit for purpose in our RPI@20 project which will look at thinking that is core to our regulatory regime.
Change has also come in the form of external pressures – particularly the need for Great Britain to meet newly agreed renewables targets and continuing carbon reduction goals.

Introduction by the Chief Executive

We have re-directed Ofgem by refreshing senior and middle management, encouraging creative thinking, promoting our contacts externally, and giving considerable thought to the shape of the energy scene in GB over the medium run.

As Ofgem is working in a very different environment from the late 1980s, or even 2003, we have re-examined our relationship with the energy consumer. Given the cost and lifestyle implications of environment initiatives, the re-wiring of GB and losing our energy-island status, contact between Ofgem and the consumer has never been so important.

In our bread-and-butter work of regulating monopoly networks we delivered in 2007-2008 our fifth price control review in four years. The gas distribution price control was the last of those and was delivered with the professionalism and care that Ofgem had come to associate with the outgoing managing director David Gray. Consistent with the other reviews Ofgem delivered a price package that enabled a significant increase in capital and replacement expenditure, tight control of operating expenditure and a carefully judged cost of capital. The latter being among the lowest set in European utilities – a sign, I believe, of our trusted format of stable, clear and consistent approach to network regulation.

As 2007-2008 progressed we increasingly turned our attention to the future in networks. Our Long Term Electricity Network Scenarios project will look at the challenges for future network investment and regulation. And the Transmission Access Review, offshore regulation programme and 2020 renewables investment studies dealt with renewable related network issues. The clearest signal of our commitment to look forwards was exemplified by our March 2008 announcement of the RPI@20 Project.

Toward the end of 2007-2008 our Markets Division moved quickly and decisively to review how well aspects of the market were working for consumers in a supply market probe. This and our review of Scottish constraints are ongoing and each will illuminate how well the markets are working currently. Set piece projects like these tend to catch the headlines but it is important to re-tell that the division has been working diligently – usually through extensive consultation – on key issues such as smart meters, microgeneration and green tariffs. All this work continues into 2008-2009 when we hope to lock in the achievements of this input in new policies and guidance.

Arguably, the actions of European Directorates for Competition (DG Comp) and for Transport, Energy and Networks (DG Tren) during the past year have made 2007-2008 a turning point for European energy. Ofgem's Markets Division has worked diligently for the past few years to assist and advise Brussels. Our leadership of the European regulators' forum has enabled us to place great pressure on restrictive practices on the Continent.

Ofgem will continue to do all it can to support DG Tren and DG Comp, but will also seek to assist and lead on the 'nuts and bolts' of the Third Package. GB consumers' best interests will be served by high-level diplomacy as well as an understanding of the details.

The Ofgem division with the biggest transformation during 2007-2008 was possibly Corporate Affairs. A high–profile example of this was our Consumer First project which has been driving a new level of consumer awareness within Ofgem. Qualitative analysis has become an important feature of our decision making with advice from consumer groups, workshops and a formal consumer panel. These insights have assisted our expanded role in addressing the plight of the fuel poor – particularly crucial given current energy prices.

Introduction by the Chief Executive

An even more far-reaching programme was the Governance of the Industry Review launched by Corporate Affairs in 2007-2008. This project relates to the rules and regulations that make the industry structure work. Rather like the RPI@20 project it was driven by a belief that the rules and regulations are having to operate against an increasingly different world from that envisaged a few years ago.

If consumers are comforted that we are being creative in Consumer First and the Governance Review, they must also be assured that Ofgem is delivering in its policing role. During 2007/08 the Corporate Affairs team used its full range of powers in:

- the Competition Act case against National Grid's gas metering business which posted the highest fine yet imposed by Ofgem;
- our name and shame tactic used to alert customers to EDF Energy's and Scottish Power's pricing strategies in April 2007 and to highlight Npower's weak performance on debt and disconnection in March 2008; and
- licence changes to assist the consumer – such as limitations on the back dating of charges on recalibrated pre payment meters.

Operations Division too will regard 2007-2008 as a pivotal year – a year in which it took control of delivering the new offshore regulatory regime, along with having to handle the implications of the changes to the Renewables Obligation scheme under the Energy Bill, and oversaw the end of the Energy Efficiency Commitment scheme and the creation of its successor.

However in one critical regard 2007/08 was not a pivotal year for the Operations Division. The team continued to deliver – as it has for the past four years – excellence in financial and operational management. Ofgem beat its spending limits of RPI-3 per cent again this year, without cancelling projects just to hit the target. Indeed we would have handed back even more money to consumers had we not incurred significant legal costs associated with a difficult technical case. While we take such costs seriously we want to assure consumers – through our actions – that we will continue take on legal cases if we believe it is in the best interests of the consumer.

For Human Resources 2007-2008 was also a pivotal year as it started to get to grips with management training and succession management in a way that has eluded Ofgem in the past. Our Generating Excellence in Management (GEM) programme has started well and is a useful calling card to attract staff into Ofgem. With our focus on the future the organisation has been looking to our needs across the range of posts.

At the senior management level we were delighted that Andrew Wright joined us from UBS to lead our Markets Division and recently we have announced three new external appointments as directors at Ofgem. Almost at the other end of the scale, Ofgem continues to attract top-flight graduates into our graduate programme and we were recently excited to be among the Top 100 best employers named by the universities.

In Corporate Communications, the increasing importance of energy to the Holyrood Government has led us to increase our representation in Scotland, and a lesson from the Northern Rock affair was for us to formalise a City Liaison unit. The Northern Rock affair has also led us to revisit the adequacy of our tool kit for use in the case of a network company getting into financial difficulties.

As an organisation that represents consumers we continue to place very high regard and emphasis on communicating with all types of consumer. On 1st October 2008 New NCC (National Consumer Council) will succeed Energywatch as the front line consumer representative and we are working with both organisations to ensure an orderly transition.

Ofgem's staff has again delivered an excellent year but in 2007-2008 they did so against a significantly changing backcloth. My thanks go to all those who have enabled us to achieve our objectives of delivering current projects and preparing for tomorrow's challenges and I am very much looking forward to working with them on those challenges that now face us.

Alistair Buchanan
Chief Executive

4

Creating and sustaining competition

Key achievements for 2007-2008

- Launched an overhaul of the rules at the core of the energy industry
- Improved understanding of customer needs and expectations as our Consumer First programme gained momentum
- Launched probe into the energy supply market

Creating and sustaining competition

Introduction

Ofgem's policy of looking to competition in wholesale and retail markets to protect consumers' interests has continued to bring benefits. In bringing pressure on prices, competition forces suppliers to rein in costs and incentivises them to innovate and diversify their products and services to deliver choice and better deals for customers.

Wholesale markets

Rising wholesale prices of oil, gas and coal have been key drivers behind increases in household and business energy bills. The indexation of gas prices to oil price in the rest of Europe has meant the escalation of oil prices to record levels has increased gas prices there. And Britain's growing dependence on imported gas has meant those increases are being felt here. With gas-fired plant making up some 38 per cent of Britain's power generation capacity, electricity wholesale prices have also climbed.

Electricity wholesale prices have been subject to further upward pressure from environmental measures. The European Union (EU) Emissions Trading Scheme has moved into a higher-impact second phase while the EU's Large Combustion Plant Directive has restricted the use of high-sulphur emitting power stations. And suppliers have had to up the power bought from renewable energy sources under the UK Renewables Obligations.

During this time Ofgem has maintained its lead role in feeding information into the market to keep users abreast of the key market influences through its publications and industry seminars.

New sources

Britain's shift to greater import dependence has generated investment in diversified sources of gas which could improve security of supply. This diversification has included growth in the number of facilities for Liquified Natural Gas (LNG).

LNG is carried by ship from producers in, for example, North Africa and the Middle East and so creates new sources of gas for Britain. But the LNG shipments will go to wherever the price is highest which exposes Britain to gas prices in the global market.

The market has responded to investment opportunities with proposals for several new storage facilities. But growth in storage has been slowed by planning difficulties.

Winter Outlook

Ofgem has continued this year to publish National Grid's outlook for winter energy supplies and to hold its successful accompanying seminar. These events are designed to improve transparency of market operations.

Market rules

Cash Out arrangements

Generators and suppliers have a commercial incentive to balance the electricity they contract to take or make with their actual use or output of power at any given time. Parties who are not in balance incur so-called cash-out charges that are designed to reflect the costs incurred by National Grid in dealing with any imbalance on the network.

We have reviewed the cash out arrangements and found that the current cash out prices often do not reflect supply and demand conditions. Two proposed changes to the rules are being developed through the industry's rule modification process. These proposals will shortly come to Ofgem for a decision.

Governance Review

During the report year Ofgem launched a fundamental review of the energy market rules which will include the codes that govern the balancing mechanism in the power market and the gas Network Code.

The review will speed up delivery of major policies and tackle the complexities in existing processes for changing market rules. And it will strengthen competition by making it easier for small industry players to get involved and support changes.

Retail markets

After a brief respite last year in which retail prices fell, a spate of new increases led to growing anxiety among consumers. In response Ofgem has been vigorous in fulfilling its duty to represent customers.

Retail market probe

Ofgem's monitoring of the retail market had suggested there was no evidence that the price increases announced at the start of 2008 were the product of explicit anti-competitive behaviour by the suppliers. And customer participation remained robust with more than nine million accounts being switched during the year – a five-year record.

However, following those price rises we were concerned that the similarity of the increases, and the fact that they were announced in close succession, indicated a shift in company pricing strategies. Earlier price cuts had varied and were spread over months. These two changes along with intense, growing public concern led us to undertake searching analysis into how effective competition is in reining in energy bills in Britain.

As a result, in February, Ofgem launched a probe into the market for gas and electricity for householders and small businesses. The probe is the first time Ofgem has used its Enterprise Act powers which give us access to detailed information that is not routinely made available.

The investigation will cover:

- the customer's perspective and experience of the market including access to information and barriers to switching supplier;

- suppliers' market shares, switching rates for different groups of customers (such as online, dual fuel, single fuel and pre-payment);
- the competitiveness of suppliers' pricing in the different market segments and customer movement between payment types as well as suppliers;
- the relationship between retail and wholesale energy prices; and
- the economics of new entry and the experience of companies trying to enter the energy market.

Possible outcomes of the probe include a referral of the market to the Competition Commission, enforcement under Ofgem's own powers, campaigns to promote customer awareness and participation in the market, recommendation to government for legislative changes or a clean bill of health for the market.

Pre payment meters

Ofgem analysis over the year has raised a number of questions relating to energy customers who pay their bills using a prepayment meter (PPM). Providing a PPM service costs a supplier more than the cost of a direct debit service. But Ofgem found that a number of suppliers' PPM charges were higher than their direct debit tariffs by margins that outstripped the greater cost to serve the PPM customers.

And our studies have shown that a large percentage of PPM customers who switched supplier moved to suppliers offering deals that were more expensive than the one they left. Given that households using a PPM tend to be on low incomes, this remains a concern.

This research will feed into the energy supply market probe.

Consumer First

Ofgem launched its Consumer First programme at the start of the year covered by this report. The programme seeks to improve the regulator's understanding of the developing interests and concerns of household energy consumers.

Early work under Consumer First included workshops to test consumer attitudes to environmental considerations. Other valuable areas of research included studies related to:

- customers' experiences, expectations and willingness to pay for quality of service improvements by the electricity distribution businesses;
- customers' views of suppliers' complaint handling processes;
- debt and disconnection;
- green tariffs;
- understanding behaviour of vulnerable consumers when switching supplier; and
- setting up a consumer panel and consumer challenge group to boost customer involvement in Ofgem policy making.

Consumer Panel

Under the Consumer First programme Ofgem plans to set up a Consumer Panel to draw on direct consumer opinion to strengthen our engagement with consumers. The panel members will be drawn from domestic energy consumers who will help us to sharpen our focus on consumer concerns.

In addition, Ofgem is setting up a pilot "consumer challenge group" made up of consumer experts who will review our work at critical stages and provide feedback to the regulator. This pilot group will support the next price controls for distribution networks, and address some of the complex trade-offs such as those relating to willingness to pay for measures to benefit the environment.

Consumer representation

Preparations for Government changes to consumer representation and redress have featured highly in the year. A new Energy Supply Ombudsman has been set up, building on the successful voluntary redress scheme set up by the industry in 2006 to a timetable set by Ofgem.

New complaints standards have been established under recent legislation changes. These apply for the first time to suppliers as well as to regional network companies and are based on criteria established by Ofgem. And the standards will be backed up by Ofgem having the power to fine companies up to 10 per cent of sales.

5

Regulating network monopolies

Regulating network monopolies

Key achievements for 2007-2008

- Started review of network regulation regime
- Launched the electricity Distribution Price Control 5 for 2010-2015
- Completed Gas Distribution Price Control Review
- To run tendering for offshore wind transmission connections
- Proposed Transmission Access Review
- Launched Governance review

Introduction

In sections of the industry where competition is not a realistic option Ofgem protects consumers' interests by setting price controls in which we approve the structure of network charges and a package of incentives. This applies to the monopoly businesses that run the networks of pipes and wires that carry gas and electricity to homes and businesses. In this way we ensure that homes and businesses get value for money and reliable supplies. And regulation is beginning to encourage the network companies to to play their part in tackling climate change.

Review of the regulatory regime for energy networks

Ofgem has opened a review of the 20-year-old regime governing its regulation of the gas and electricity networks. The two-year review will seek to establish whether the existing approach – based on pegging increases below the retail price increase (RPI) – is still the best way to ensure that networks are well-run and provide good service to customers and will continue to do so faced with the challenges that come with climate change.

RPI-X

The current system provides incentives for companies to outperform efficiency targets set in a series of five-yearly Price Control Reviews. These reviews establish allowances for expenditure and income for the companies based on a fundamental formula: RPI minus X where X is worked out at each review for each segment of the network business. Where there is a need to incentivise investment the formula can become RPI plus X. But in all cases the incentive is to outperform allowances in similar way companies seek to outperform rivals in a competitive market.

The need for the review arises out of the new challenges faced by the energy network companies in financing and running their business. Those challenges emerge from the need to upgrade and replace ageing infrastructure and to connect new sources of gas supply, storage and low-carbon electricity generation to fulfil:

- ambitious Government targets for wind power and other renewable energy;

- proposals for greater energy network interconnection in Europe;
- greater use of imported gas and greater storage capacity in Britain; and
- a growing emphasis on small-scale regional energy production.

The review will test the RPI-X regime against the demands these developments will place on the businesses to ensure consumers continue to get value for money, good customer service and reliable energy supplies.

The review will report in 2010. Developments identified in the next five-year price control review for electricity distribution – scheduled to come into play for five years in 2010 – will feed into the RPI-X review. But it is unlikely that the outcome of the RPI-X study will significantly influence our approach to the distribution price controls.

The form of network regulation may change post 2015 as a result of this review but we will not introduce any change to the regulatory framework without full consultation, which will obviously include the capital markets and investors. And at all times we will have regard to our duty to regulate in a way that allows efficient network companies to finance their businesses.

Recommendations from the review will not be limited and could range from no change to substantial transformation. Where change is recommended there will be full consultation.

Transmission

Transmission is the long-distance transportation of electricity and gas along the national grids for each.

Transmission Access Review

Anticipated growth in renewable energy and other low-carbon generation will place unprecedented new demands on the electricity transmission grids north and south of the Border. In Scotland alone there are 12GW of mostly wind plant awaiting connection to the networks. A joint review by Ofgem and the Department for Business, Enterprise and Regulatory Reform has put forward proposal for a radical shake-up of the rules for giving generators access to the power grid. It will look at ways to deliver the Government's aspiration of 20 per cent of electricity supplied by renewable generation as well as other European targets.

Issues it will address include:

- new ways of sharing transmission capacity between different types of generator;
- the way grids are built and run; and
- whether the incentives to connect or disconnect are right to maintain security of supply.

Access to the transmission network is currently governed by rules devised to connect large gas, coal and nuclear power stations. These rules are poorly suited for the swift connection of smaller, more geographically remote plant required in Britain.

We will change the financial incentives on the transmission companies to invest in the new capacity needed to connect low-carbon and renewable generation and to have the capacity available when the new generation comes on stream. The review will also protect customers from having to pay for unnecessary investment in new transmission capacity.

These reforms will take two years to develop and implement so Ofgem is proposing short-term measures to allow more generation to connect to the existing transmission system before new capacity is built. This could make it possible to add more than 1GW of renewable capacity if developers are able to accelerate their existing plans. This will substantially reduce the queue of generators waiting to get onto the grid and increase the share of our energy coming from renewables.

Offshore Transmission regime

Following a consultation carried out jointly with Government, Ofgem concluded that Britain's transmission network owners should tender competitively with others to build, own and maintain the links that will connect planned offshore wind farms to the mainland grid. These offshore transmission networks are pivotal to the UK's objectives for renewable energy and will add to the security of UK energy supplies.

Since the decision, Ofgem has been appointed to run the tendering process and has set up a new directorate to do so.

Distribution

Distribution is the transportation of gas or electricity from the transmission grid along regional branch networks to the households, businesses and other premises where it is used.

Gas

The gas distribution industry went through a major restructure in 2005 after National Grid sold four of the eight gas distribution networks (GDNs) in England Scotland and Wales to three separate buyers. The creation of new companies in the sector meant that, in the price control review that concluded in April 2008, Ofgem was able to make comparisons between them and force all the companies to become much more efficient. Before this time Ofgem had no such comparisons available with all the companies in the ownership of one group under a single management team. The sale process allowed us to set much more challenging price controls for all of the companies.

Gas distribution price control review

Ofgem's final proposals for its first full five-year Gas Distribution Price Controls were accepted by the industry at the start of the year, and the proposals were enacted in the networks' licences on 1 April. The controls – which run to 2013 – allow the GDNs to spend an average of more than £1 billion a year on investment in the networks – up 36 per cent on the previous price controls. Some £3.6 billion of this £5.3 billion of investment is safety related and includes the replacement of distribution mains pipes with new plastic pipes as required by the Health and Safety Executive.

The GDNs were given incentives to decrease any detrimental impact they have on the environment as well as incentives for sustainable development of their businesses.

Electricity

Fifth distribution price control review

Ofgem launched its fifth electricity price control review for the Distribution Network Operators (DNOs) with the initial consultation in March 2008. There are three key themes that will run throughout the review: the environment, customers and networks.

The environment

We must ensure that the price control gives the DNOs strong financial incentives to play their full part in tackling climate change. This price control needs to be flexible enough to accommodate technology change and new opportunities that may arise for DNOs between 2010 and 2015.

Customers

The review must encourage the DNOs to respond to the needs of current customers and future ones, and to strike the appropriate balance between delivering quality of service and managing network costs.

Networks

DNOs must have the incentives to invest efficiently so that security of supply is provided at reasonable costs.

Ofgem is encouraging DNOs to consult with all stakeholders including local communities before submitting their business plans for 2010-2015 while exploring ways to introduce greater consumer involvement in the price control process.

There are direct and indirect ways that DNOs can reduce detrimental effects on the environment that can arise from their operations. Direct measures include reduction of their own emissions resulting from the operation of their gas network, for example by reducing network losses. Other direct measures include measures applied to the operation of their business, such as reducing the environmental impact of their transport fleets.

Indirect measures include paving the way for environmentally beneficial activities such as low- or zero-emission electricity generation, integration of low-carbon heat schemes, energy efficiency and management by users of their power demand.

Ofgem wants DNOs to be more in touch with the needs of their customers, not least because of the growing customer interest in managing their own energy use, for example by installing rooftop wind turbines and other forms of so-called microgeneration. This could lead to significant amounts of generation connecting directly to the distribution network rather than the national grid.

The new price control will need to be flexible because tackling climate change and responding to customers' requirements could lead to profound changes in the way distribution networks are run.

Structure of charges

The structure of charges which DNOs apply determines how allowed revenue is recovered from different customer groups.

We are consulting fully and working with DNOs to encourage them to adopt better approaches to charging. In particular, we are concerned that current charging structures do not properly reflect the impact and benefits from generation connected to their networks and could be standing in the way of more small-scale, low-carbon generation coming onto the system.

Governance review

At the close of the report year Ofgem was near to completing a major overhaul of the rules governing participation in the gas and electricity markets.

The review will speed up the delivery of major policy changes and reduce Ofgem's role in routine amendments. It will take out complexities that create obstacles for small players and new entrants.

6

Helping protect the security of Britain's energy supplies

Key achievements for 2007-2008

- Launch of the Long Term Electricity Network Scenarios programme
- Launched Energy Markets Outlook
- Emergency arrangements
- Transmission Access Review

6. Helping protect the security of Britain's energy supplies

Introduction

The keystone for security of energy supply is an energy sector that can attract investment. Through its maintenance and promotion of competitive wholesale and retail markets in Britain and its sound regulation of network monopolies Ofgem has laid the foundations for investment in energy infrastructure.

Long Term Electricity Network Scenarios

The main objective of the Long Term Electricity Network Scenarios (LENS) project is to pave the way for debate on the outlook for Britain's energy networks. It is developing a range of plausible electricity network scenarios for Great Britain for 2050, around which industry participants, Government, Ofgem and other stakeholders can discuss future network issues. LENS will not provide forecasts; it will look at what networks we might need in 40 years time and what the impact would be on the way we regulate the networks today so that we do not close off any options.

Energy Markets Outlook

Ofgem and the Government have launched a yearly programme to produce energy market information and analysis – the Energy Markets Outlook – which made its first report in autumn 2007. The programme reviews prospects for the medium- and long-term security of supply, looking at infrastructure planning and other constraints as well as the availability of primary fuels such as coal and gas. In a way that mirrors the LENS programme EMO will provide credible long-term market scenarios to assist industry in strategic planning.

Emergency arrangements

Having been the driving force behind the creation of the industry Energy Emergencies Executive which supervises emergency planning arrangements Ofgem continued to play a key role in ensuring the industry is prepared for the worst.

Ofgem took part in an industry-wide, Government-led simulation of a so-called black start national power loss in summer 2007 to test plans to deal with such an event that were drawn up by the Energy Emergencies Executive.

Transmission Access Review

A radical shake-up of the rules governing access to the national electricity transmission network were proposed this year by Ofgem and the Department for Business, Enterprise and Regulatory Reform.

With ageing coal-fired power plant coming to the end of its lifetime; an urgent need to connect new renewable and low-carbon plant to meet government targets; and the possibility of new nuclear power plant construction, pressure is mounting on the transmission network to provide connections to maintain secure electricity supplies.

The proposed reforms will make it easier to provide links to the transmission network for new renewable generators; for the conventional power stations needed to back up intermittent renewable plant; and for new nuclear plant.

7

A leading voice in Europe

Key achievements for 2007-2008

- Maintained a central influence on European energy policy through our role in advising the Government and other European institutions during the negotiations on the third energy package and the green package

- Leading the move toward market integration with the launch of a regional initiative with France, the Republic of Ireland and Northern Ireland

- Leading a project to increase transparency in market information in the North West region, which will promote European competition

A leading voice in Europe

Introduction

European energy policy has grown in its influence on Britain in recent years and continues to do so. Britain's waning North Sea gas stocks leave it more exposed than ever to the energy prices in the rest of the continent. We play a central role in European Union energy policy development through Ofgem chairman Lord Mogg who holds the chairmanship of the regulators' advisory group, the European Regulators' Group for Electricity and Gas and presidency of the Council of European Energy Regulators.

European policy

Ofgem has continued to press for greater competition and transparency in the European energy markets. This policy drive has been furthered this year by Member State governments reaching an initial agreement on the broad principles of the third energy package. Ofgem supports the adoption of the package as a step towards the mechanisms for greater liberalisation.

The package contains provisions for greater separation of the network businesses from supply and generation/ wholesale activities. It proposes a review, after two years, of companies that opt for less than full ownership unbundling. It also proposes a European Agency and seeks to break down barriers to cross-border trade through new legally-binding codes.

Regional gas initiative

The regional initiative involves 27 European Union (EU) member states and is being led and managed by the regulators. It is a key area of work for the European Regulators' Group for Electricity and Gas (ERGEG).

The initiative seeks to realise improvements in the market by focusing on key elements such as transparency and access to capacity. It is an opportunity to bring on improvements while EU-wide liberalisation legislation is being developed.

Ofgem is the lead regulator in our electricity region, which is seeking to facilitate cross-border flows of electricity.

There are three gas regions across the EU. The UK is in the North-West region along with France, Netherlands, Germany, Ireland, Northern Ireland, Denmark, Sweden, Belgium and Norway. The region accounts for arbout 60 per cent of total EU gas consumption. Ofgem is leading the drive for increased transparency in the region through its management of the voluntary project to encourage transmission network operators to publish greater market information.

Sustainable development

Ofgem is leading the European regulators' input to the European Green Package. We also suggested and approved work to develop a Europe-wide Sustainable Development Report to provide an indication of the progress that is being made in the environmental, social and other areas that constitute sustainability. Work on this project is underway and is scheduled for publication in 2009.

Ofgem has continued to chair the Sustainable Development Taskforce within the Council of European Energy Regulators (CEER). Ofgem has led the contribution of CEER to discussions regarding the future of the EU cap-and-trade scheme for emission permits (the EU Emissions Trading Scheme) and the Renewables Directive to bring on the achievement of the 2020 targets.

8

Helping to protect the environment

Key achievements for 2007-2008

- Introduced new incentives on energy networks to reduce their impact on the environment
- Developed guidance for customers on green tariffs
- Worked to reduce the barriers to growth of generation connected to the regional networks
- Administration of the Government environmental programme

Helping to protect the environment

Introduction

Ofgem aims to help the gas and electricity sector to improve its performance toward the environment in a way that ensures customers pay no unnecessary costs. We push for market mechanisms that put a cost on carbon emissions to create an incentive to reduce them. Our work in networks is vital to ensure that infrastructure is there to transport energy from new and replacement sources planned as part of the industry's drive to improve its environmental performance. We also promote energy efficiency and administer a range of Government environmental schemes to develop low-emission power generation and to install energy efficiency measures in the home.

Network incentives

Ofgem has proposed and introduced measures to incentivise network companies to improve the environmental performance through greater efficiencies and decreased losses and emissions.

In the year of this report we concluded a review of income and expenditure (price controls) for the regional gas distribution networks; we opened the next such review for their electricity counterparts; and we finalised incentives on National Grid in its role as system operator running the national transmission networks for gas and electricity. Each of these included significant new environmental incentives.

Gas distribution

In the first gas distribution price control we placed a much stronger incentive on the sector to reduce the impact the networks have on the environment. The chief incentive comes through from using the Government shadow price of carbon to evaluate gas used in transport (known as shrinkage). This adds to the cost of shrinkage gas and so rewards measures to abate the associated greenhouse gas emissions. We also introduced a new incentive which means that the companies can invest £60 million on research and innovation targeted at projects that promote sustainability.

System Operator Incentives

In its incentives for 2008-2009 on the national gas and electricity grid operators – National Grid Gas and National Grid Electricity Transmission – Ofgem has stepped up incentives to sharpen the companies' focus on their environmental impacts.

In electricity transmission we have increased the reference price used to evaluate energy lost in transmission – again to include the shadow price of carbon element. In gas we have made a similar increase in the reference prices used to evaluate shrinkage gas. We have proposed too, incentives to reduce greenhouse gases released from the transmission network in a deliberate and necessary process known as venting.

Electricity distribution

In the opening proposals for what will be the fifth five-year period of price controls for the regional electricity distribution companies, two of the key elements of the proposals have an environmental component. They are:

- giving Distribution Network Operators (DNOs) strong financial incentives to help tackle climate change; and
- delivering good value for consumers by ensuring that DNOs provide secure and more sustainable networks.

Ofgem wants distribution network companies to be more in touch with the needs of their customers, not least because of growing customer interest in managing their own energy use, by for example, installing household scale generation such as rooftop wind turbines. This and other forms of demand-side management as well as growth in renewable energy connected direct to the regional networks could have a significant impact on the way the distribution network firms run their businesses.

Transmission Access Review

The Transmisison Access Review is a radical shake-up of the rules governing access to the high-voltage electricity. It will speed up the connection of more than 35GW of renewable generation to meet the Government's target of generating 15 per cent of Britain's energy from renewable sources by 2020. The reforms will also make it easier for low-carbon generation to connect to the transmission network as existing power stations reach the end of their operating lives or need to be replaced with lower carbon forms of generation.

Local generation

At the end of 2007 Ofgem launched a consultation on options to remove unnecessary barriers for distributed energy projects – generators connected to the regional distribution networks.

The barriers had been identified by a working group set up by Ofgem and the Department for Business, Enterprise and Regulatory Reform. The group worked closely with renewable generators, microgenerators and local government. Its joint consultation outlined options for modifying the current regulatory arrangements so that they are more suitable for distributed energy.

Options for consultation included:

- making it easier for local schemes to sell small amounts of electricity in the wholesale market;
- putting more pressure on DNOs to charge in a way that fairly reflects the costs and benefits of distributed generation;
- inviting electricity companies to propose and trial ideas that will benefit distributed generators; and

- making it easier for small operators to be licensed, by allowing the complicated and costly obligations of being licensed to be sub-contracted to another larger licensed supplier.

Ofgem's review of the licence conditions for supply companies has removed regulatory obstacles from household-scale generation – known as microgeneration. And Ofgem has made it easier for microgenerators to take part in the Government's renewable energy support mechanism – the Renewable Obligation – under which they can claim a premium on the price for their output.

Green tariffs

Ofgem has been consulting extensively with stakeholders to revise its guidelines to suppliers on marketing so-called green tariffs – deals that are based on supplying energy from wind power and other forms of renewable generation. The guidelines seek to address the difficulty consumers encounter in comparing the offers available. The issue is complex because any guidance needs to clarify how much a supplier's offer goes beyond its legal obligations to take their electricity from renewable sources.

In November 2007 we proposed the setting up of an independent accreditation system to clear up the confusion that exists. We aim to publish revised proposals later in 2008 which will make it clearer to customers which tariffs offer real environmental benefits.

Smart metering

The potential benefits to consumers from advanced energy meters – known as smart meters – include an end to the need for estimated bills; enabling consumers to track where their energy is being used; and opportunities for suppliers to offer new deals.

Progress toward the introduction of this technology has been sluggish as key players have failed to agree on how it should be introduced.

To bring down barriers to the use of smart meters Ofgem has formed an industry-wide group to agree minimum standards for smart meters and to revise industry rules to pave the way for their use.

Ofgem has played a lead role in bringing on smart metering through its advice and guidance to Government. A breakthrough is emerging as changes in the draft Energy Bill could bring clarity that will guide a decision on the technology by the close of 2008.

The first trial in Britain of smart metering was launched in July 2007. The two-year trial is administered by Ofgem under a £10 million government programme match-funded by four energy suppliers.

Sustainable Development Report

In Ofgem's second Sustainable Development Report published in September 2007 we flagged our intention to adopt the government's Shadow Price of Carbon in evaluating the impact of future carbon abatement incentives – a move that will align the treatment of greenhouse gas emissions in Ofgem's regulatory regime with that in general Government policy-making.

Environmental programmes

Renewables Obligation

The Renewables Obligation and Renewables Obligation (Scotland), require licensed electricity suppliers to buy at least part of their electricity from renewable generation.

The obligation was designed so the target increases each year from 3 per cent at its instigation in 2002 to, under the current legislation, 15.4 per cent in 2015-2016. This target could increase further under the Government's review of renewable energy policy. The target for 2007-2008 was 7.9 per cent.

Over 14.6 million Renewables Obligation Certificates (ROCs) were issued during 2006-2007, compared with just over 13.7 million in 2005-2006. Ofgem also administers the Renewables Obligation in Northern Ireland, via an agency agreement. This came into force in 2005 and the target for electricity supply companies in Northern Ireland was 2.6 per cent in 2006-2007 and is 2.8 per cent in 2007-2008. This reaches 6.3 per cent in 2012-2013 and stays at this level until 2027.

Climate Change Levy

Ofgem continued to administer the Climate Change Levy (CCL) exemption for renewables. 2007-2008 was the seventh year of the CCL exemption and over 15.2 million Renewables Levy Exemption Certificates (LECs) were issued

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 25 million CHP LECs in 2006-2007 to complying CHP schemes this year.

Renewable Energy Guarantees of Origin

Ofgem continues to administer the Renewable Energy Guarantees of Origin (REGOs) scheme on behalf of the Government. This scheme was introduced as part of a European Union directive and REGOs are issued by Ofgem to generators to prove that their electricity is being produced from renewable sources.

Energy Efficiency Commitment

Ofgem continued to administer, on behalf of the Department for Environment, Food and Rural Affairs (Defra), the Energy Efficiency Commitment (EEC) programme. The EEC obliges domestic electricity and gas suppliers to deliver energy savings from domestic consumers. Half of the energy savings must come from priority customers who receive benefits or certain tax credits.

This was the last year of the EEC – it was succeeded in April 2008 by the Carbon Emissions Reductions Target.

9

Helping to tackle fuel poverty

Key achievements for 2007-2008

- Evaluated suppliers' reporting of social initiatives
- Led a Fuel Poverty Summit
- Completed debt and disconnection review

Introduction

By promoting competitive energy markets, regulating network monopolies and through our promotion of efficient use of energy, Ofgem helps to keep a rein on energy bills. Beyond those measures Ofgem has facilitated activity by industry and other stakeholders to ease the burden of rising energy prices on consumers on low incomes and other vulnerable consumers. These include those who are disabled or chronically sick, older people and those living in rural areas.

Escalating energy prices have, in recent years, added to the low incomes and poor housing stock that have carried more people into fuel poverty – where energy bills account for more than a tenth of their income. In keeping with our duty to have regard to the interests of vulnerable customers we have put pressure on industry to reduce debt and disconnection and encouraged the development of services for vulnerable customers.

Fuel Poverty Summit

A summit led by Ofgem in spring agreed a package of measures to improve the targeting of help on customers facing increasing hardship created by the rising cost of energy. The summit was attended by Government ministers, chief executives of the main suppliers as well as consumer and voluntary agencies and a representative from the European Commission.

The summit produced an action programme which included measures under four themes:

- improve the way the fuel poor are identified and targeted to ensure the available help gets to them;
- ramp up the level of help available;
- support vulnerable customers to enable them to get the best deals in the market; and
- ensure that tariff differentials for different payment methods are justified.

Corporate Social Responsibility review

Low incomes and poor housing remain the central causes of fuel poverty. But the energy companies have a role to play in tackling it and their corporate social responsibility programmes fulfil some of that role. Earlier Ofgem research indicated that awareness of those programmes was poor.

Ofgem conducted a review of suppliers' voluntary initiatives to help vulnerable customers which it reported in August 2007. That revealed more about what was available and examples of best practice.

Following the report an update highlighted other company initiatives on offer to vulnerable customers which fell outside the social tariff, rebate and trust fund categories which were the focus of the August review. This research demonstrated a range of steps taken by suppliers for vulnerable customers which go beyond their statutory obligations.

Debt and disconnection review

Following a study of suppliers' debt and disconnection practices Ofgem named and shamed the poorest performers while highlighting best practice.

The review showed that suppliers were making real progress in improving their debt and disconnection procedures. But research under Ofgem's Consumer First programme found that some vulnerable consumers were not receiving adequate assistance.

The review found scope for improvements in suppliers' communications with consumers such as use of simpler language in correspondence.

Energy efficiency

The Energy Efficiency Commitment (EEC) requires energy suppliers to improve energy efficiency among their customers. It is administered by Ofgem. This year it aided about 580,00 British households with the installation of industry subsidised energy saving measures. About 280,000 of those helped were on low incomes.

10

Better regulation

Key achievements for 2007-2008

- Reviewed codes and licences to remove complexity
- Completed Impact Assessment review
- 94 per cent of deliverables met in year
- Continued to outperform our self-imposed cost reduction regime

Better regulation

Introduction

The key tenets of Better Regulation – to promote competition where possible and regulate only when necessary – are central to Ofgem's operations. Furthermore we set out the costs and benefits, and the social and environmental impacts, of everything that we do.

Cost control

Ofgem has continued to reduce its costs in the third year of its self-imposed, retail prices index (RPI)-linked cost control regime which has now made savings of £7.7 million. This has been achieved at the same time as meeting all our corporate targets set out in the corporate plan. The regime limits cost increases to 3 per cent below RPI.

Licence and code reviews

Ofgem completed or launched a number of projects in the report year that aim to achieve more for consumers through less regulatory intervention – a key tenet of Better Regulation principles.

Supply Licence Review

In a landmark piece of work Ofgem overhauled the Supply Licence conditions and removed those that no longer provide the best protection for customers. This will halve the red tape faced by electricity and gas suppliers and reduce the cost of compliance while improving customer protection through clearer, easier to understand licence rules which are simpler to enforce.

Electricity Distribution Licence Review

A thorough review of the licence for regional electricity network operators has reduced the number of standard licence conditions from 77 to 49 and identified areas where the licence could be reviewed later. The reforms made the licence clearer and easier to use by removing obsolete conditions and consolidating others.

Governance review

Ofgem has launched an overhaul of the rules at the heart of the operation of the electricity and gas industries.

Impact assessments

Drawing up impact assessments for all important new policy proposals contributes greatly to the quality of our analysis and helps us to be consistent in our consultations on major decisions. We have continued to evolve our impact assessments processes and this year completed a review of our approach to impact assessments to ensure that outcomes remain fit for purpose.

As part of this review we have introduced a requirement that each impact assessment that we publish will state whether we intend to conduct a major post-implementation review or rely on routine monitoring. Ofgem may undertake a major review where the policy area in question involves major structural changes or where the outcomes are more difficult to predict through our normal monitoring.

Freedom of information

During the period 2007-2008 we received 149 questions under the Freedom of Information Act, of which 92 per cent were answered within the statutory deadlines (20 days in most cases).

Throughout the period Ofgem consistently answered 81 per cent of the questions received in full.

People Development

Recruitment and Retention

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

In 2007-2008 average staff numbers were almost unchanged from 295 than the previous year. Staff turnover was 20 per cent in 2007-2008, up 2 per cent on the previous year. We have a 15 per cent target level for turnover.

Diversity

Ofgem continues to encourage diversity through its employment practices and at the end of the financial year:

- 45 per cent of all staff were women;
- 42 per cent of staff in managerial grades were women;
- 30 per cent of Senior Civil Service members in Ofgem were women;
- 18 per cent of staff were known to be of ethnic minority origin;
- 15 per cent of staff known to be of ethnic minority origin were in managerial grades; and
- 1 per cent of staff were known to be disabled.

Financial review

In 2007-2008, Ofgem received fees of £39.2 million, of which £34.7 million was received from licence fees. In addition, £10.8 million was collected on behalf of the Department for Business Enterprise and Regulatory Reform (DBERR) to meet Energywatch and other DBERR costs. Other income, mainly from property totalled £4.5 million.

Operating costs in 2007-2008 amount to £39.9 million and included £4.0 million accommodation costs recharged to tenants. Payroll (48 per cent), contractors (13 per cent) and accommodation (23 per cent) accounted for 84 per cent of the total.

A saving of £0.9 million from licence fees was made in 2007-2008. This will be offset against future licence fees charges in 2008-2009 as determined under the RPI-X cost control regime. The carry-forward amount is £3 million.

Ofgem's budget is approved by Parliament following a consultation process with industry and other interested parties. For 2007-2008 Parliament approved a resource budget of £40.2 million. In addition, DBERR directed that a sum of £10.8 million should be collected on behalf of Energywatch. This amount was transferred to DBERR, in full. Our performance against deliverables is detailed in Appendix 1.

Ofgem's financial statements are shown in Appendix 4. More detailed information on costs can be found in our Resource Accounts published separately (HC 497).

Sustainability

In September 2007 Ofgem published its first Internal Sustainable Development Action Plan (SDAP). Of the 33 sustainability targets, nine were set by the Government and most of those have completion dates beyond this reporting year. Of these, six have been achieved with the balance forecast to be completed earlier than Government guidelines require. Of the remaining 24 internal targets, 21 have been achieved during this reporting period.

Ofgem's sustainability work focuses on five key areas: climate change and energy efficiency; waste management and recycling; procurement; travel; and people. Major targets in these areas that have been achieved in this year are:

- introduction of a binless office;
- the purchase of all copier paper from recycled sources (minimum 75 per cent recycled content);
- 90 per cent of all travel to Brussels is now by train; and
- a revamp of the induction programme to raise awareness of sustainable development and to demonstrate how sustainable development is incorporated into everyday activities and jobs.

Copies of the Internal Sustainable Development Action Plan, as well as the 2007-2008 report showing progress towards meeting the targets can be found on our website under About Us. Also published and on the website are the 20 new targets for 2008-2009.

We have implemented many energy saving initiatives, for example:

- replacing four boilers has provided a 35 per cent improvement in heating efficiency
- sensors have been installed to switch off all non-emergency lighting automatically in unoccupied office areas
- water saving measure are saving 8,000 cubic metres a year

Appendix

Ofgem's performance against 2007-2008 deliverables

Ofgem's Plan and Budget for 2007-2008 included a number of key deliverables to be achieved in each quarter.

Listed below are details of Ofgem's performance in meeting those deliverables, excluding ongoing deliverables which do not have specific target dates.

	Total in Corporate Plan	Total Achieved			Not Applicable
		In target Qtr	In Later Qtr	Total	
Year Total	**36**	**30**	**4**	**34**	**2**
	-	**83%**	**11%**	**94%**	**6%**
Quarter 1	8	7	0	7	1
	-	88%	0%	88%	12%
Quarter 2	9	7	1	8	1
	-	78%	11%	89%	11%
Quarter 3	12	11	1	12	0
	-	92%	8%	100%	0%
Quarter 4	7	5	2	7	0
	-	71%	29%	100%	0%

Creating and sustaining competition

Activity	Action	Delivery period	Achieved
Wholesale Markets	Publish final Winter Outlook report	Q2	Q2
Retail Markets	Implement revised standard conditions for gas and electricity supply licences	Q1	Q1
	Publish updated domestic retail market report	Q2	Q2
	Review of the Energy Supply Ombudsman	Q3	Q3

Regulating networks monopolies

Activity	Action	Delivery period	Achieved
All Networks	Publish scoping letter for the development of long term scenarios for electricity networks	Q1	N/A
Transmission	Publish conclusions of the review of the transmission price control review process	Q2	Q3
	Publish summary cost information for transmission companies for 2006-07	Q4	Q1 08/09
	Publish policy statement on the development of a regulatory regime for offshore electricity transmission	Q2	Q2
	Publish detailed arrangements for the offshore electricity transmission regime	Q4	Q1 08/09

Regulating networks monopolies

Activity	Action	Delivery period	Achieved
Electricity Distribution	Publish scoping letter for the next price control review	Q1	Q1
	Publish initial consultation on the next price control	Q4	Q4
	Publish electricity distribution quality of service report	Q3	Q3
	Publish electricity distribution cost review	Q3	Q3
	Publish price control review initial proposals	Q1	Q1
Gas Distribution	Publish price control review final proposals	Q3	Q3
	Publish gas distribution quality of service report	Q3	Q3
Wholesale Markets	Review system operator (SO) functions in gas and electricity	Q2	Q2
	Publish initial SO incentives proposals	Q3	Q3
	Publish final SO incentives proposals	Q4	Q4

A leading voice in Europe

Activity	Action	Delivery period	Achieved
Gas regional initiative	Prepare report to the Madrid Forum (expected late 2007)	Q3	Q3
Gas infrastructure investment (Task Force Chair, TFC)	Finalise Guidelines for LNG Open Season	Q2	Q2
	Finalise Guidelines for Article 22 exemptions	Q4	Q4
Gas Interoperability (TFC)	Publish final report on interoperability issues	Q2	N/A
Electricity regional market initiative - Integration (TFC)	Prepare report to the Florence Forum	Q3	Q3
3rd EU legislative package – proposals	Influence ERGEG to achieve a positive agreed position on the main planks of European primary legislation	Q2	Q2
	Influence ERGEG to achieve a positive agreed position on the main guidelines	Q4	Q4

Helping to protect the environment

Activity	Action	Delivery period	Achieved
Sustainable Development	Publish 2nd Ofgem Sustainable Development Report	Q3	Q3

Helping to protect the environment

Activity	Action	Delivery period	Achieved
Renewables and CHP	Publish updated guidance on the administration of the Renewables Obligation to reflect legislative changes	Q1	Q1
	Publish annual Renewables Obligation report	Q4	Q4
Energy Efficiency	Publish a review of the second year of the Energy Efficiency Commitment 2005-08	Q2	Q2

Helping to tackle fuel poverty

Activity	Action	Delivery period	Achieved
Social Action Strategy	Publish updated Social Action Strategy	Q1	Q1
	Publish debt and disconnection best practice review	Q3	Q4

Better Regulation

Activity	Action	Delivery period	Achieved
Customer Contact	Launch new Consumer First arrangements for consumer engagement	Q1	Q1
Enforcement	Publish guidelines on Ofgem's approach to enforcement	Q2	Q2
Better Regulation	Publish updated guidance on impact assessments	Q3	Q3
Finance	Set the Fossil Fuel Levy Rate for 2008-09	Q3	Q3

Appendix II

Impact Assessments undertaken 2007-2008

Ofgem published four impact assessments (IAs) between 1 April 2007 and 31 March 2008.

For further information on the following documents, visit www.ofgem.gov.uk and search using the appropriate reference number.

(265/07) **LDZ System Charges Capacity Commodity Split and Interruptible Discounts – Draft Impact Assessment**

On 30 October 2007 Ofgem published a draft IA assessing a joint DN proposal to alter the structure of charges such that the capacity element was increased from 50 per cent to 95 per cent and the commodity element reduced from 50 per cent to 5 per cent.

(299/07) **TPCR gas entry baseline review proposals document**

On 30 October 2007 Ofgem published a draft IA assessing a joint DN proposal to alter the On 20 December 2007 Ofgem published an options document which contained, in the appendices, an initial IA assessing their impact.

(302/07) **Electricity cash-out reform**

On 20 December 2007 Ofgem consulted on its IAs of Proposed Balancing and Settlement Code Modifications P211 and P212. Both modifications sought to remove potential distortions in the cash-out arrangements by amending the calculation of energy imbalance prices.

(28/08) **TPCR gas entry baseline review - IA**

Further to the initial IA published in December (see 299/07 above), on 20 March 2008 Ofgem published an IA taking account of the issues raised in the responses to the December 2007 proposals document.

Summary of decisions taken to which IAs relate

The following sets out the decisions taken in relation to proposals for which an IA was carried out. The Authority referred to in each is the Gas and Electricity Markets Authority.

(80/07) **Uniform Network Code: Reform of the NTS offtake arrangements**

On 5 April 2007 the Authority directed the implementation of UNC modification proposal 116V and the rejection of proposal 116A. (This decision was appealed to the Competition Commission, which remitted the decision back to the Authority for further consideration).

(94/07) **Methodologies for the determination of NTS entry and exit prices**

On 24 April 2007 the Authority decided not to veto proposal GMC01 in relation to the gas transmission transportation charging methodology.

(172/07 & 173/07) **Modification of supply licences after the supply licence review**

On 9 July 2007 the Authority gave notice of its decisions to modify the gas and electricity supply licences following the supply licence review.

(291/07) **LDZ System Charges Commodity Split and Interruptible Discounts**

On 13 December 2007 the Authority decided not to veto the joint GDN charging proposal DNPC03 to increase the capacity element of gas distribution Use of System charges from 50 per cent to 95 per cent.

(13/08) **Gas distribution price control: statutory consultation on the licence modifications**

On 21 February 2008 Ofgem published the licence modifications to the gas transporters' licences that were necessary to implement the gas distribution price control proposals published on 3 December 2007.

Electricity cash-out reform

Settlement Code proposal P212: Main Imbalance Price based on Market Reference Price.

Appendix III

Investigations and enforcement action 2007-2008

Company	Issue	Decision	Date of decision
CE Electric licenses: Northern Electric Distribution Limited and Yorkshire Electricity Distribution plc	Investigation into non-compliance with standard licence condition 49 (Quality of Service Incentive Scheme and Associated Information) by Yorkshire Electricity Distribution plc and Northern Electric Distribution Ltd.	Finding of breach - modifications to special condition C2 (Calculations of charge restriction adjustments arising from performance in respect of quality of service) proposed	06 June 2007
EDF Energy Networks (LPN) plc, EDF Energy Networks (EPN) plc & EDF Energy Networks (SPN) plc	Investigation into compliance by EDF Energy Networks with Standard Condition 4C of their Electricity Distribution Licences (Non-discrimination in the Provision of Use of System and Connection to the System)	Insufficient evidence to find breach. Decision taken to close investigation with finding of no breach but review undertaken into reason for low levels of competition within EDF Energy Networks' area	13 July 2007
Central Networks (East) plc & Central Networks (West) plc	Investigation into compliance by Central Networks plc with Standard Condition 4C of their Electricity Distribution Licences (Non-discrimination in the Provision of Use of System and Connection to the System).	Finding of breach - no penalty imposed.	11 Dec 2007
Northern Gas Networks (West) plc (NGN)	Investigation into compliance by NGN with standards of performance in the provision of gas connections as required by SS D10 and Regulation 10 the Performance standards in the Gas Regulations 2005	Finding of breach - £25,000 imposed	4 Feb 2008

Company	Issue	Decision	Date of decision
SP Distribution Ltd	Investigation into compliance by SP Distribution Ltd with Standard Condition 4C of its Electricity Distribution Licence (Non-discrimination in the Provision of Use of System and Connection to the System).	No grounds on which to find an infringement of SLC 4C. Decision taken to close the case.	15 Feb 2008
National Grid	Investigation under Competition Act 1998 - abuse of a dominant position, contrary to section 18 of the Competition Act 1998 (the Chapter II prohibition) and Article 82 of the EC Treaty, by entering into long-term exclusive contracts for the provision of domestic gas meters with energy suppliers.	Finding of breach issued on 25/02/2008 and penalty of £41.6m imposed. Decision under appeal to the Competition Appeal Tribunal.	Ongoing
Scottish & Southern Energy plc, Scottish Power Ltd	Investigation under Competition Act 1998 - alleged abuse of dominance by Scottish Power Limited and Scottish and Southern Energy plc in the electricity generation sector contrary to section 18 of the Competition Act 1998 (the Chapter II prohibition) and Article 82 of the EC Treaty.	n/a	Ongoing
Npower	Investigation into compliance by companies in the Npower group with Standard Condition 25 of their Gas Supply and Electricity Supply Licences (Marketing Gas and Electricity to Domestic Customers)	n/a	Ongoing
Npower	Investigation into compliance by companies in the Npower group with obligations with Standard Condition 44 of their Gas Supply Licences (Notification of terms) as in force on 1 May 2007	n/a	Ongoing

This has been a **pivotal** year

"Since the late 1980s UK energy regulation has thrived because of its ability to evolve to meet consumers' needs while remaining firm on core principles.

I believe 2007/08 will come to be seen as a pivotal year as Ofgem has had to transform itself while not losing the best of the past."

Operating cost statement

for the year ended 31 March 2008 (£000s)

	2007–2008			2006–2007
	Staff Costs	Other Costs	Income	
Administration costs				
Request for resources 1:				
Staff costs	**19,198**			18,610
Other administration costs		**20,709**		20,843
Operating income			**(39,212)**	(38,807)
Programme costs				
Request for resources 1:				
Staff costs	**-**			55
Income			**-**	(55)
				-
Totals	**19,198**	**20,709**	**(39,212)**	646
Net operating cost			**695**	646

All income and expenditure are derived from continuing operations.

Statement of recognised gains and losses
for the year ended 31 March 2008 (£000s)

	2007–2008	2006–2007
Net loss on revaluation of tangible fixed assets	-	(19)
Actuarial loss on revaluation of pension liabilities	**(97)**	(59)
Recognised losses for the financial year	**(97)**	(78)

Cash flow statement
for the year ended 31 March 2008 (£000s)

	2007-2008	2006-2007
Net cash outflow from operating activities	**(12)**	(4,167)
Capital expenditure and financial investment	**(364)**	(754)
Receipts due to the Consolidated Fund which are outside the scope of the Department's activities	**120,025**	255,000
Payments of amounts due to the Consolidated Fund	**(120,873)**	(256,647)
Financing	**-**	6,019
Decrease in cash in the period	**(1,224)**	(549)

Printed in the UK for The Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office
ID5840820 07/08
Printed on Paper containing 75% recycled fibre content minimum.

This has been a pivotal year

"Since the late 1980s UK energy regulation has thrived because of its ability to evolve to meet consumers' needs while remaining firm on core principles.

I believe 2007/08 will come to be seen as a pivotal year as Ofgem has had to transform itself while not losing the best of the past."

Third package of measures for European liberalisation

Leading the way: the European Union has been working to introduce a competitive, single European energy market. Ofgem has been a leading light in that through a mix of practical assistance and influencing the debate.

A year of **signposts** for t

Consumer First

Check out: Consumer First was launched to give Ofgem a clearer picture of consumer attitudes and expectations. Research has included customers' willingness to pay for network service improvements, suppliers' complaint handling processes and green tariffs. And we have set up a consumer panel and a consumer challenge group to boost customer involvement in Ofgem policy making.

Energy supply markets probe

Tightening the scrutiny: Ofgem responded to growing anxiety among consumers about increases in energy prices by announcing a probe into the energy supply market. The probe has gone beyond Ofgem's routine market monitoring to see whether the market is working for all consumers including the vulnerable.

the **future**

Distributed energy

Small players: householders and businesses have started a growing trend of home-made energy with on-site heat and power generators, wind turbines on rooftops and solar panels providing their power needs. Many are selling surplus electricity via the local distribution networks. Ofgem has made it easier for such small-scale plant to reap financial benefits for its owners and help the environment through greater efficiency and lower transportation losses than conventional power stations.

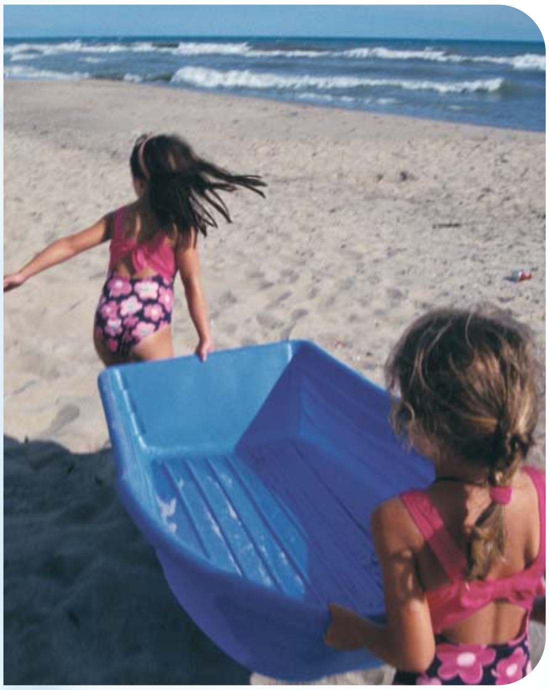
Governance
Review

Code highway: Ofgem has started an overhaul of the rules and codes that make the industry structure work. These rules were devised for an industry that was considerably different to the one currently in play. So a review is underway to speed up code changes, pave the way for new entrants and small players and bring the codes in line with the challenges that come with sustainable development.

Transmission
access review

Wire less: working with government Ofgem has devised ways to get more out of existing networks and to bring on investment in new infrastructure. The moves will speed up the connection of new wind farms and other renewable energy sources to the national electricity transmission network.

These short- and long-term measures will be vital if Britain is to realise its green targets in the battle against climate change.



Offshore
transmission

Tender age: wind turbines sited off the British coastline promise to provide much of the renewable energy needed to meet GB targets. Ofgem will run the tendering process to build the transmission links needed to connect these generators to the national grid.

Review of regulatory regime

Looking ahead: the incentive-based regime used to regulate the income and expenditure of the monopoly networks has been with us for nearly 20 years. Those companies now have new environmental and other challenges so Ofgem has started to take a hard look at the regime to make sure it is still right for the job.

Smart meters

Work it out: smart metering offers tremendous potential as a way to help customers to reduce their energy consumption and cut their bills while bringing benefits to the environment. Ofgem has played a central role in pushing for the technology's implementation.

Published by TSO (The Stationery Office) and available from:

Online

www.tsoshop.co.uk

Mail,Telephone, Fax & E-mail
TSO
PO Box 29, Norwich, NR3 1GN
Telephone orders/General enquiries 0870 600 5522
Order through the Parliamentary Hotline Lo-Call 0845 7 023474
Fax orders: 0870 600 5533
E-mail: customer.services@tso.co.uk
Textphone: 0870 240 3701

TSO Shops
16 Arthur Street, Belfast BT1 4GD
028 9023 8451 Fax 028 9023 5401
71 Lothian Road, Edinburgh EH3 9AZ
0870 606 5566 Fax 0870 606 5588

The Parliamentary Bookshop
12 Bridge Street, Parliament Square,
London SW1A 2JX

TSO@Blackwell and other Accredited Agents

ISBN 978-0-10-295605-4
9 780102 956054