



National Audit Office

**BRIEFING FOR THE  
HOUSE OF COMMONS  
ENERGY AND CLIMATE  
CHANGE SELECT  
COMMITTEE**

**OCTOBER 2010**

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# Performance of Ofgem

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This briefing has been prepared for the Energy and Climate Change Select Committee to provide an overview of Ofgem's performance in the financial year 2009-10.

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# Summary

## Aim and Scope

- 1** This briefing has been prepared for the Energy and Climate Change Select Committee to provide an overview of Ofgem's performance in the financial year 2009-10. It is based on Ofgem's Annual Report and Resource Accounts 2009-10 and other documents produced by Ofgem, together with work undertaken by the NAO.
- 2** The briefing comprises of three parts. Part one describes the role and structure of Ofgem, part two discusses its financial performance, and part three covers Ofgem's performance against its objectives.

## Ofgem's role

- 3** Ofgem, which was established in 2000 as a non-ministerial Department after the merger of the Office of Electricity Regulation (OFFER) and Office of Gas Supply (Ofgas), operates under the direction and governance of the Gas and Electricity Markets Authority ('the Authority'). The Authority is responsible for the economic regulation of the electricity and gas industries in Great Britain. Its primary regulatory duty, which it shares with the Secretary of State for Energy and Climate Change, is to protect the interests of existing and future consumers wherever appropriate by promoting effective competition in electricity and gas markets. Ofgem is responsible for carrying out the Authority's regulatory duties on its behalf.<sup>1</sup>
- 4** Ofgem's role has widened during the last decade beyond its core regulatory duties to include the administration of government programmes on behalf of the Department of Energy and Climate Change ('the Department'). These include programmes such as the renewables obligation, which requires electricity suppliers to buy an annually increasing portion of their electricity from renewable sources, and, more recently, Feed-in Tariffs – a scheme in which electricity suppliers pay small-scale generators for the electricity they generate. Ofgem has responded to the widening of its responsibilities by creating a new business unit – Ofgem E-Serve – in 2009. Ofgem is accountable to Parliament for all its statutory functions, which include the programmes delivered by Ofgem E-Serve. In delivering social and environmental programmes, Ofgem needs to work closely with the Department and a memorandum of understanding was prepared in 2009, which has not been finalised pending the outcome of the Department's review of its delivery landscape.

<sup>1</sup> In this document we use Ofgem and the Authority interchangeably when referring to the 'regulator'.

- 5** The Department is undertaking two reviews impacting on Ofgem's roles:
- A review of Ofgem's regulatory role. This review is considering, in particular: the Government's objectives for independent regulation of the energy sector; the boundary of responsibility between Ofgem and Ministers; and whether Ofgem's statutory duties are fit for purpose within the context of the Government's energy and climate change objectives. The review is due to report in Spring 2011, alongside the publication of a White Paper on Electricity Market Reform.
  - A review examining ways of streamlining the delivery of the Department's functions, to meet its energy and climate change objectives. This review is considering a range of options which include ceasing, modifying and moving functions, including those performed by Ofgem E-Serve. The Department expects to publish the conclusions of the delivery review by the end of 2010.

### **Ofgem's Financial Performance**

**6** Ofgem's operating costs in 2009-10 were £51.1 million, an increase of £9.1 million (22 per cent) on the previous year. The increase reflects Ofgem's involvement in new activities such as managing the tendering process for offshore transmission networks and administering new environmental programmes established by the Department. Ofgem has forecast that its total operating costs will increase to £78.7 million in 2010-11, as a result of it taking on responsibility for further schemes created by the Department, including the design of the smart metering scheme. Ofgem's staff costs in 2009-10 were £26.2 million, a 27 per cent increase on the previous year. Its expenditure on consultants also increased during 2009-10 by £2.8 million to £9.1 million.

**7** Ofgem does not separate expenditure on core regulatory functions from spending on schemes administered by Ofgem E-Serve in its Resource Accounts. It has, instead, reported expenditure against seven strategic themes.

**8** Since 2005, Ofgem has aimed to control its costs by limiting cost increases to the Retail Prices Index less a set percentage, which is currently 3 per cent. Ofgem has estimated that this has delivered £11.9 million savings over the past five years, and will deliver savings of £12.5 million over the next five years. Whereas the control for the first five years excluded expenditure on administration of environmental schemes for the Department, the Audit Committee has agreed that the control for the next five years will cover all of Ofgem's expenditure.

**9** Ofgem's regulatory activities are funded by mandatory fees collected from gas and electricity licence-holders, which are adjusted each year to cover planned expenditure and totalled £35.2 million in 2009-10. It also received £5.2 million from the Department to 'cover the costs of administering environmental programmes', and £3.5 million from Defra as a contribution to shared accommodation costs.

**10** The schemes that Ofgem administers on behalf of the Department and the devolved administrations impose obligations on energy suppliers to promote sustainable development through renewable generation sources or energy efficiency measures. Ofgem reported that in 2009-10, the total value of financial flows through these schemes was £3.9 billion.

### **Ofgem's performance against its objectives**

**11** As Ofgem was not part of the Public Service Agreement (PSA) framework, it has designed its own performance measurement system, based around seven strategic themes. Each theme has an associated set of deliverables that describe outputs, such as the publication or completion of key milestones within specified timescales, but do not provide a measure of the effectiveness of its regulatory activities or administration of environmental programmes. Ofgem also has performance indicators that cover corporate activities, for example target response times for responding to complaints and paying for invoices. The information on deliverables is reported by Ofgem in its Annual Report. Ofgem reported that it met 27 of the 31 deliverables it had set itself for 2009-10.

**12** Ofgem has reduced its strategic themes from seven to four from 2010-11, with the aim of aligning them with new challenges of decarbonisation, security of supply, and affordability. Ofgem is working to improve its performance reporting.

# Part One

## Role and structure

### Introduction

**1.1** The Energy and Climate Change Select Committee has asked the National Audit Office to provide it with a briefing on the role, organisation and performance of the Office of Gas and Electricity Markets (Ofgem). We have reported on Ofgem's activities in a series of value for money reports since it was created in 2000.<sup>2</sup> This briefing draws on those reports, our audit of Ofgem's financial statements, and the latest performance information published by Ofgem.

**1.2** In this part of the briefing we describe the status, statutory duties and powers, and organisation of Ofgem.

### Status

**1.3** Ofgem is a non-ministerial Department responsible for the economic regulation of the electricity and gas industries in Great Britain on behalf of the Gas and Electricity Markets Authority ('the Authority'). It operates under the direction and governance of the Authority, which takes all major operational decisions and sets policy priorities. It was formed in 2000 by the merger of the Office of Electricity Regulation (OFFER) and Office of Gas Supply (Ofgas).

**1.4** Ofgem and the Authority, as with other economic regulators, are independent of ministerial control (see **Figure 1** overleaf). The appointment and reappointment of the members of the Authority is, however, made by the Secretary of State for Energy and Climate Change in consultation with the devolved administrations. Ofgem's duties are set out in statute and, in fulfilling these, Ofgem is required to have regard to the Secretary of State's guidance on social and environmental objectives (paragraph 1.7).<sup>3</sup>

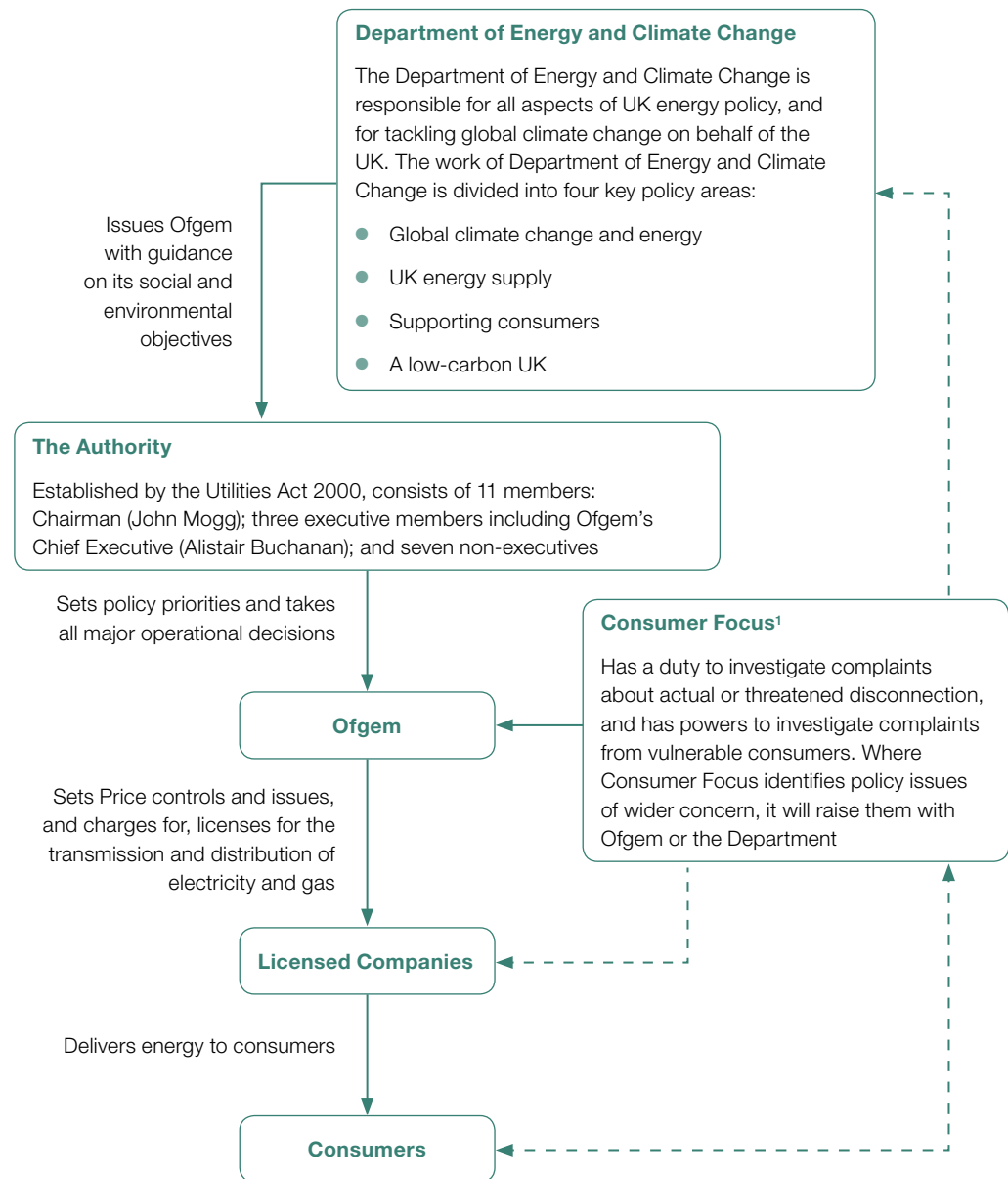
**1.5** Ofgem was established as an economic regulator, but its responsibilities have expanded since its creation to include the delivery of government programmes such as the renewables obligation, a statutory requirement on electricity suppliers to buy an annually increasing percentage of their electricity from renewable sources, and, more recently, Feed-in Tariffs, a scheme in which electricity suppliers pay a generation

<sup>2</sup> National Audit Office, *The Electricity Generating Landscape in Great Britain*, July 2010; *Protecting consumers? Removing retail price controls*, HC 342, 2007-08; *The Office of Gas and Electricity Markets: Sale of gas networks by National Grid*, HC 804, 2005-06; *Ofgem Social Action Plan and Household Energy Efficiency*, HC 878, 2003-04.

<sup>3</sup> The Utilities Act 2000.

tariff to small-scale low-carbon generators for electricity generated. In contrast to its regulatory functions, where Ofgem is independent of ministerial control, Ofgem has direct responsibility to the Secretary of State for Energy and Climate Change for the development and delivery of these programmes.

**Figure 1**  
Ofgem's relationship with government and consumers



**NOTE**

1 In October 2010, the Government announced that, as part of its reform of Public Bodies, it will consult in early 2011 on proposals to abolish Consumer Focus and transfer its function to Citizens Advice.

**1.6** Ofgem has also adopted a role of contributing towards the development of energy policy, for example, by setting out policy options in ‘Project Discovery’ for reforming British energy markets in order to secure supplies and help meet climate change targets.

## Statutory duties

**1.7** Ofgem is responsible for meeting the statutory duties placed on the Authority through various pieces of legislation, including the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002, the Energy Acts of 2004, 2008 and 2010, and relevant European Union legislation. A summary of these duties, which the Authority shares with the Secretary of State for Energy and Climate Change, is shown in **Figure 2** overleaf.

**1.8** Although the Authority shares certain duties with the Secretary of State, in practice, the Secretary of State has set the objectives and framework of regulation, while the Authority, through Ofgem, has independently fulfilled its duties within this framework.<sup>4</sup> Ofgem E-Serve has prepared a memorandum of understanding with the Department, which has not been finalised, pending the outcome of the Department’s review of its delivery landscape (paragraph 1.21).

**1.9** The Secretary of State issues the Authority with social and environmental guidance, which it must ‘have regard to’. The guidance sets out the Government’s expectations for the Authority, which include making an ‘appropriate contribution’ to:

- enabling timely delivery of an effective offshore transmission regime;
- enabling timely investment in necessary capacity for the electricity transmission and distribution networks (the ‘electricity networks’);
- ensuring connection to the electricity networks for new generation, including renewable, nuclear and other low carbon generation, in a timeframe consistent with their development programme whilst maintaining security of supply;
- eliminating unnecessary regulatory and market barriers to the economic deployment of distributed energy;
- further progress towards the Government’s statutory target of eliminating fuel poverty as far as reasonably practicable, and as set out in the Government’s Fuel Poverty Strategy; and
- ensuring that infrastructure and networks are sufficiently resilient to future climate impacts to maintain security of supply.<sup>5</sup>

<sup>4</sup> National Audit Office, *Office of Gas and Electricity Markets: Giving Domestic customers a choice of electricity supplier*, HC 85, 2000-2001.

<sup>5</sup> Department of Energy and Climate Change, *Social And Environmental Guidance To The Gas And Electricity Markets Authority*, January 2010.

## Figure 2

### Ofgem's statutory duties

The Authority's principal objective, which it shares with the Secretary of State for Energy and Climate Change, is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. The interests of such consumers are their interests taken as a whole, including their interests in the reduction of greenhouse gases and in the security of the supply of gas and electricity to them.

The Authority is generally required to carry out its functions in the manner it considers is best calculated to further the principal objective, wherever appropriate by promoting effective competition between persons engaged in, or commercial activities connected with:

- the shipping, transportation or supply of gas conveyed through pipes;
- the generation, transmission, distribution or supply of electricity; or
- the provision or use of electricity interconnectors.

Before deciding to carry out its functions in a particular manner with a view to promoting competition, the Authority has to consider the extent to which the interests of consumers would be protected by that manner of carrying out those functions and whether there is any other manner (whether or not it would promote competition) in which the Authority could carry out those functions that would better protect those interests.

The Authority and Secretary of State must, when carrying out those functions, have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them;
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.

Subject to the above, the Secretary of State and the Authority are required to carry out the functions referred to in the manner which they consider is best calculated to:

- promote efficiency and economy on the part of those licensed under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply.

In carrying out the functions referred to, the Secretary of State and the Authority must also have regard, to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity; and
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice.

The Authority must also have regard to certain statutory guidance on social and environmental matters issued by the Secretary of State.

*Source: Gas Act 1986, Electricity Act 1989 (as amended), Utilities Act 2000 and Energy Act 2004*

## Statutory powers

**1.10** The main statutory powers that Ofgem has to support its duties are to:

- issue, modify, enforce and revoke licences. All energy generation, transmission, distribution and supply companies in Great Britain are regulated through these licences;
- investigate and issue fines of up to 10 per cent of licensees' turnover, where they have been found to breach licence conditions, which Ofgem surrenders to the consolidated fund; and
- set price controls over the prices charged by monopoly network operators, which gives Ofgem a direct influence on network charges that account for around 18 per cent of average household energy bills.<sup>6</sup>

**1.11** Ofgem also has powers under the Competition Act 1998 to carry out investigations into companies suspected of being engaged in anti-competitive behaviour, and take action for breaches of the legislation in respect of the gas and electricity sectors in Great Britain. It is a designated National Competition Authority under the European Commission Modernisation Regulation and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission. The National Audit Office published a report on the UK competition landscape in March 2010, which found that the system of competition and judicial oversight in the UK is generally effective. However, we concluded that the competition authorities needed to work together to develop a richer body of case law in the use of competition enforcement powers, and use resources and expertise in the competition regime more flexibly and efficiently.<sup>7</sup>

**1.12** Ofgem also liaises with Consumer Focus, a non-departmental public body, which has powers to investigate and report on complaints about actual or threatened disconnection, and complaints from vulnerable consumers. Where Consumer Focus identifies policy issues of wider concern it reports them to Ofgem or the Department. In October 2010, the Government announced that, as part of its reform of Public Bodies, it will consult in early 2011 on proposals to abolish Consumer Focus and transfer its function to Citizens Advice.

## The European context

**1.13** Some regulations that apply to the electricity and gas markets apply at the level of the European Union. The EU has ongoing reforms which aim to promote liberalised and competitive energy markets across Europe and ensure greater independence in the operation of transmission networks from generation and supply interests.<sup>8</sup> These reforms include the 'Third Package', which is due to come into effect in March 2011. This will create an EU Agency for the Cooperation of Energy Regulators, funded by the EU budget, which will aim to complement actions taken by national regulators to remove obstacles to a single EU energy market.

<sup>6</sup> Ofgem, *Reforming Network Regulation*, Factsheet, January 2010.

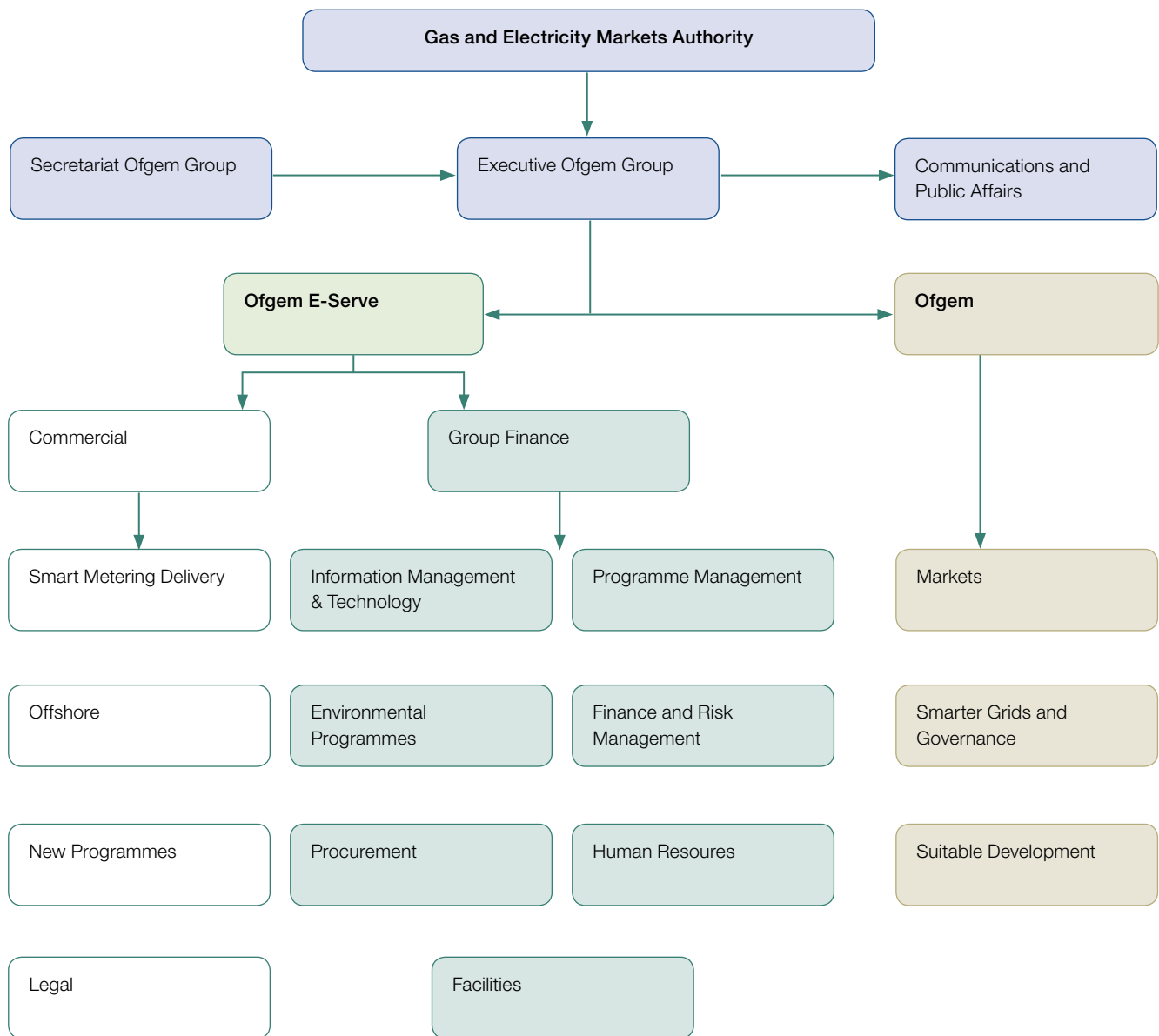
<sup>7</sup> National Audit Office, *Review of the UK's Competition Landscape*, 22 March 2010, pp 6-7.

<sup>8</sup> National Audit Office, *The Electricity Generating Landscape in Great Britain*, July 2010.

### Organisation

**1.14** In September 2009, Ofgem split its business into two separate units in response to its increased role in delivering new government programmes such as smart meters (**Figure 3**). ‘Ofgem E-Serve’ administers environmental programmes on behalf of the Government, while ‘Ofgem’ is responsible for statutory regulation. Both business units are managed by a Senior Management team and, in the case of E-Serve, a Management Committee.

**Figure 3**  
Revised Ofgem structure



## Accountability requirements

**1.15** Ofgem's Treasury-agreed estimates of its annual costs are presented to Parliament for approval and subsequently voted on. The Authority has a statutory duty under the Utilities Act 2000 to report to Parliament on its activities and progress during the year. Ofgem does not, however, have associated statutory targets or indicators against which it must report on its performance. Ofgem designed its own framework for reporting to Parliament, based on seven corporate themes. From 2010-11, it is reducing the number of themes from seven to four, with the aim of giving greater prominence to reducing carbon emissions and ensuring the security of energy supplies (**Figure 4**). In addition to its annual report to Parliament, Ofgem also separately publishes information on the performance of energy companies across a wide range of indicators, for example in annual reports that it publishes on network operators' costs and quality of service.

**1.16** The Government has stated that it expects the Authority to account separately for its role in contributing towards Government targets and aims set out in the social and environmental guidance issued by the Secretary of State, and has requested that the Authority do so in writing for publication on an annual basis.<sup>9</sup>

**Figure 4**  
Ofgem corporate themes

Seven corporate themes used prior to 2010-11	Four corporate themes used from 2010-11
<ul style="list-style-type: none"> <li>● Creating and sustaining competition</li> </ul>	<ul style="list-style-type: none"> <li>● Contribute to the achievement of a low carbon energy sector</li> </ul>
<ul style="list-style-type: none"> <li>● Regulating networks effectively</li> </ul>	<ul style="list-style-type: none"> <li>● Help to maintain the security of Britain's energy supplies</li> </ul>
<ul style="list-style-type: none"> <li>● Helping to achieve sustainable development</li> </ul>	<ul style="list-style-type: none"> <li>● Promote consumer choice and value and protect vulnerable customers</li> </ul>
<ul style="list-style-type: none"> <li>● Helping to protect the security of Britain's energy supplies</li> </ul>	<ul style="list-style-type: none"> <li>● Ensure the timely and efficient delivery of Government programmes for a sustainable energy sector (via Ofgem E-Serve)</li> </ul>
<ul style="list-style-type: none"> <li>● A leading voice in Europe</li> </ul>	
<ul style="list-style-type: none"> <li>● Helping to tackle fuel poverty</li> </ul>	
<ul style="list-style-type: none"> <li>● Better regulation</li> </ul>	

Source: Ofgem 2009-10 Annual Report

<sup>9</sup> The Department Of Energy And Climate Change, *Social And Environmental Guidance To The Gas And Electricity Markets Authority*, January 2010.

## The review of Ofgem

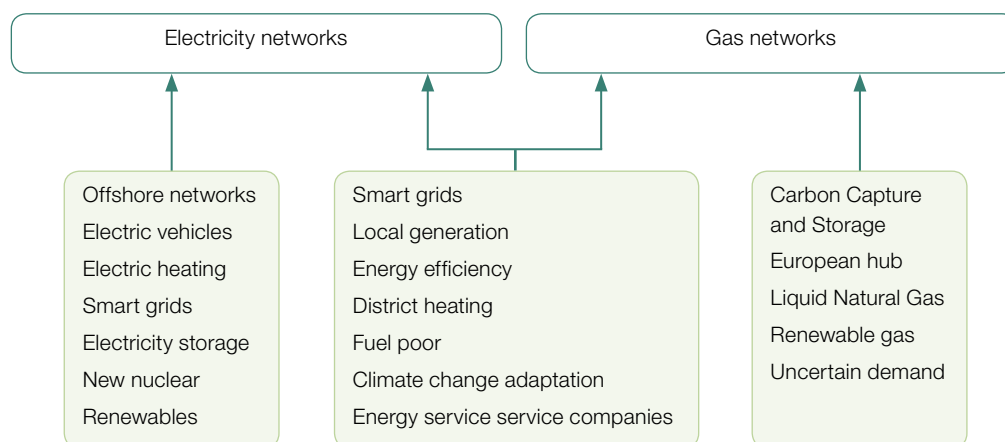
**1.17** In July 2010, the Department announced in its first Annual Energy Statement to Parliament plans to review Ofgem’s regulatory role. The Ofgem review will explore whether any changes are needed to align the regulatory framework with the Government’s strategic policy goals. It will consider, in particular: the Government’s objectives for independent regulation of the energy sector; the boundary of responsibility between Ofgem and Ministers; and whether Ofgem’s statutory duties are fit for purpose within the context of the Government’s energy and climate change objectives.

**1.18** Key challenges for the energy sector that set the context for the review include:

- Declining indigenous gas supplies and the planned closure of existing nuclear and coal-fired power stations over the next decade that will put increasing pressure on the security of energy supplies (**Figure 5**).
- A significant increase in the supply of low carbon and renewable energy sources will be required to meet international obligations to reduce carbon emissions. Transmission and distribution networks will need to be upgraded to support a new generating mix.

### Figure 5

Challenges facing the energy sector: decarbonised electricity sector; affordability; ageing assets; and security of supply



Source: Ofgem, *Regulating energy networks for the future: RPI-X@20 Recommendations*, July 2010

**1.19** The energy sector is in a period of significant change and faces significant regulatory and investment challenges to deliver a low carbon economy, increase the use of renewable energy and maintain security of supply, while ensuring that increases in consumer bills are mitigated. Substantial investment will be needed in new network and generation infrastructure to deliver secure and low carbon energy supplies over the next decade. Ofgem has estimated that investment of up to £200 billion may be required by 2020,<sup>10</sup> which will significantly increase prices for consumers, increasing the challenge the Government faces in meeting the statutory obligation to avoid people living in fuel poverty.

**1.20** The Department's review of Ofgem is to consider:

- Government's objectives for independent regulation of the energy sector, taking account both of the Government's broader principles for economic regulation and its energy and climate change objectives.
- The boundary of responsibility between Ofgem and Government, reflecting the need for clarity, accountability for strategic choices, and for Ofgem's regulatory decisions to remain independent of Government so as to provide a stable and predictable regulatory regime.
- The boundary of responsibility between Ofgem and the Office of Fair Trading.
- Ofgem's statutory duties, whether they are fit for purpose and how they are reflected through industry governance processes, particularly within the context of the Government's energy and climate change objectives.
- The effectiveness of the Government's social and environmental guidance to Ofgem and how it is translated through Ofgem's decision making.
- The value for money Ofgem provides.
- Ofgem's approach to minimising the burdens from its regulatory activity; and
- The scope for learning lessons from other regulatory models and examples of good regulatory practice.

The Review of Ofgem is due to report in Spring 2011, alongside the publication of the White Paper on Electricity Market Reform.

**1.21** A separate review led by the Department is examining ways of streamlining the delivery of functions needed to meet its energy and climate change objectives, considering a range of options which include ceasing, modifying and moving functions, including those performed by Ofgem E-Serve. The Department is intending to publish the conclusions of the delivery review by the end of 2010.

<sup>10</sup> Ofgem, *Project Discovery: Options for delivering secure and sustainable energy supplies*, February 2010.

# Part Two

## Financial performance

**2.1** In this part of the report we examine Ofgem's financial performance in 2009-10, covering expenditure, income, assets and liabilities. We also discuss financial flows through environmental schemes administered by Ofgem that totalled £3.9 billion in 2009-10, of which only a relatively small proportion passes through Ofgem's accounts.

**2.2** Our financial audit work indicates that Ofgem has sound systems of financial controls and reporting. Its accounts are audited by the National Audit Office in accordance with International Standards on Auditing.<sup>11</sup> Ofgem's Resource Accounts for 2009-10, and in all previous years, received an unqualified audit opinion. Ofgem also successfully complied with the Government's requirement that public sector bodies should move from UK Accounting Standards to International Financial Reporting Standards (IFRS) in producing their 2009-10 Accounts.

**2.3** As part of HM Treasury's alignment project to remove reporting inconsistencies across government departments, HM Treasury proposes that for the accounting year ending 31 March 2011, where departments collect revenue which is due to the Consolidated Fund, these revenues are separately accounted for in a "trust statement" instead of being reported as part of the department's resource accounts. The details of the "trust statement" for Ofgem and what it contains are currently under discussion.

### Ofgem's costs in 2009-10

**2.4** In its 2009-10 resource accounts, the Authority reported on spending against the supply estimates and expenditure under each of its seven themes (paragraph 1.15). It did not separately report on the cost of its two main business units – Ofgem and e-Serve.

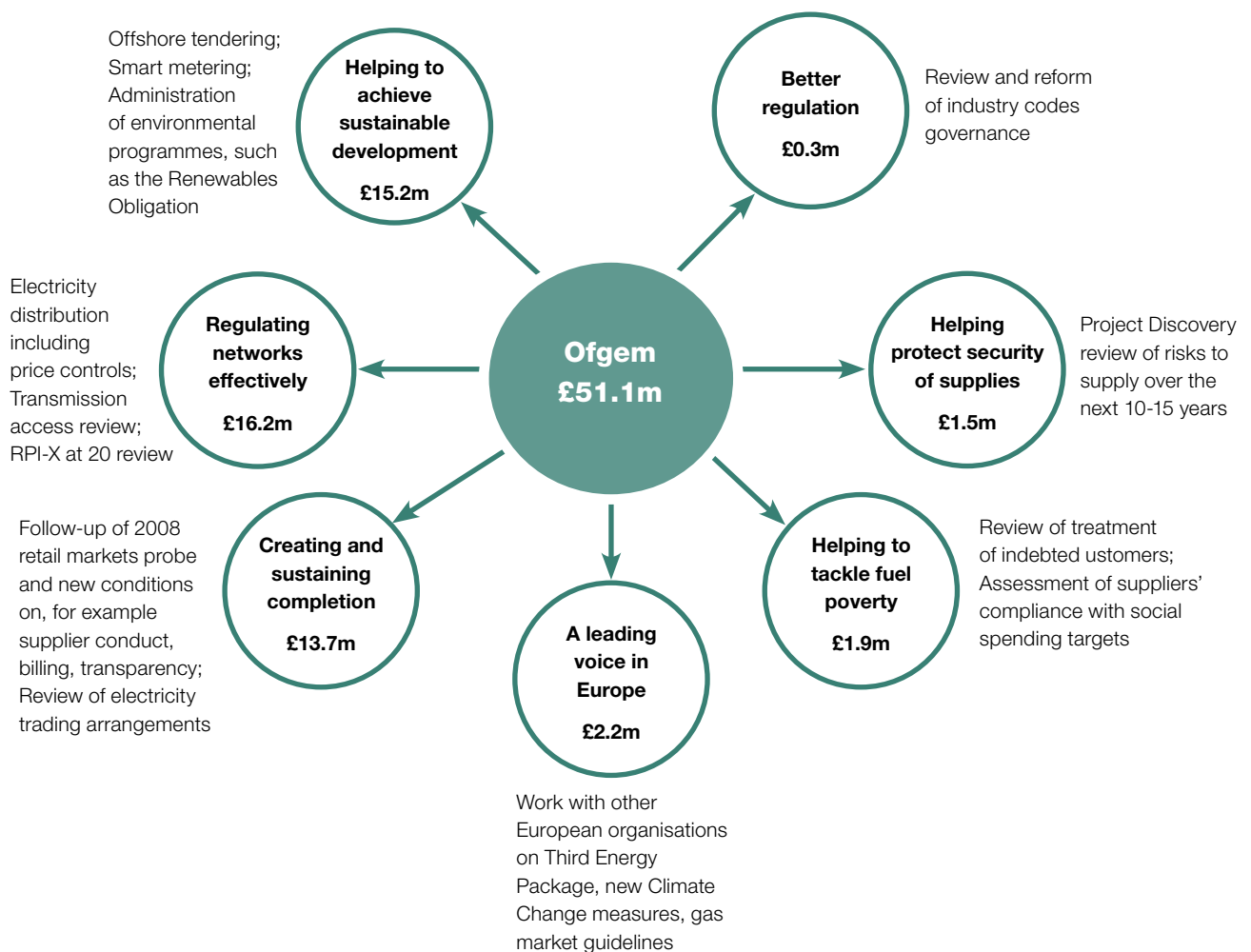
**2.5** Ofgem's operating costs in 2009-10 were £51.1 million. This was £9.1 million (22 per cent) higher than in 2008-09, largely because of an increase in the number of environmental programmes administered by Ofgem on behalf of the Department. Ofgem's budget is approved by Parliament following a consultation process with industry and other interested parties. For 2009-10, Parliament approved a gross resource budget of £53.9 million. Ofgem's costs were £2.8 million (5 per cent) below its overall Parliamentary Supply Estimate, mainly due to lower than forecast expenditure on administering environmental schemes and offshore transmission tendering.

<sup>11</sup> On behalf of the Comptroller and Auditor General, who is appointed as the statutory auditor under the Government Resources and Accounts Act 2000.

**2.6 Figure 6** shows Ofgem's expenditure in 2009-10 under each of its seven themes. 'Regulating networks effectively' accounted for the largest area of spending, totalling £16.2 million. This was £2.5 million less than in the previous year, as Ofgem's expenditure on regulatory activities varies according to the specific projects that are under way.

## Figure 6

Ofgem costs 2009-10 across its seven corporate themes



### NOTES

- 1 Numbers do not sum due to rounding.
- 2 Activities shown under each theme are illustrative and not an exhaustive description.

Source: National Audit Office

**2.7** Ofgem has increased expenditure on staff and consultants in response to the rising scale of its activities. Staff costs in 2009-10 were £26.2 million, an increase of £5.6 million (27 per cent) compared to 2008-09, which reflected a 20 per cent increase in average staff numbers to 403. The increase was mainly attributable to offshore transmission tendering and to Ofgem E-Serve administering additional environmental programmes on behalf of the Department. Expenditure on consultants during 2009-10 also increased, from £6.3 million (15 per cent of the operating costs) to £9.1 million (18 per cent of the operating costs) (**Figure 7**).

**2.8** Ofgem estimated in January 2010 that its costs will increase by 54 per cent to £78.7 million in 2010-11,<sup>12</sup> with the administration of environmental schemes accounting for £41.2 million of this total, including £15 million for the smart-metering programme.

**Figure 7**  
Ofgem operating costs

	2009-10 (£m)	2008-09 (£m)
Staff costs	26.2	20.6
Contractor costs	9.1	6.3
Rental under operating leases <sup>1</sup>	5.6	5.6
Other accommodation costs	3.5	3.0
Other costs <sup>2</sup>	6.7	6.5
Total	51.1	42.0

**NOTES**

- 1 £3.45 million of accommodation costs were recharged to the Department of Environment Food and Rural Affairs.
- 2 The largest items within other costs were depreciation and recruitment costs, each at just under £1 million for 2009-10.

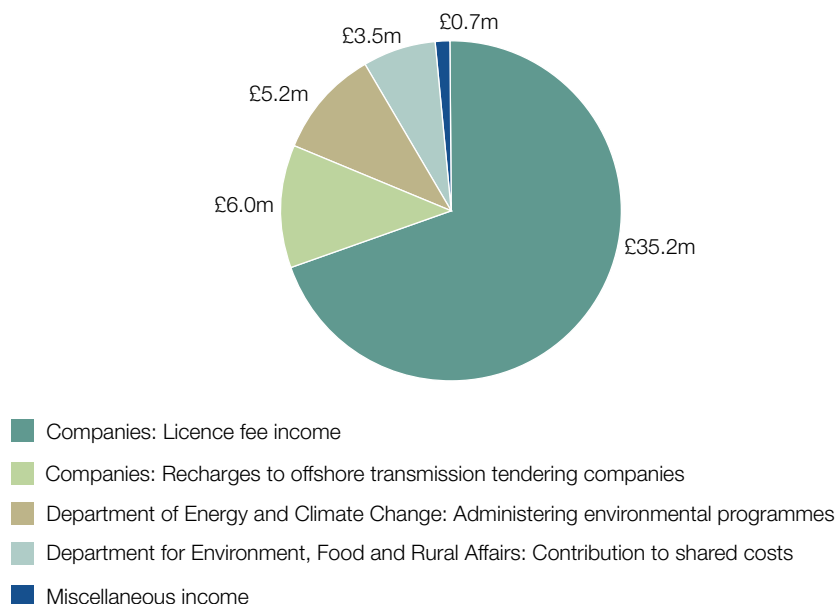
Source: Ofgem, *Resource Accounts 2009-10*

### Ofgem's income in 2009-10

**2.9** Ofgem's income in 2009-10 was £50.6 million, an increase of £9.3 million (22 per cent) from 2008-09. Ofgem's funding is designed to match its operating costs, and the increase reflected its increased role in administering environmental programmes.

**2.10** Ofgem's regulatory activities are funded mainly by mandatory fees collected from gas and electricity network licence holders, which totalled £35.2 million in 2009-10 (**Figure 8**). Ofgem also received £5.2 million from the Department in 2009-10 to cover the costs of administering environmental programmes, and recovered £3.5 million from the Department for Environment, Food and Rural Affairs as a contribution to shared accommodation costs.

**Figure 8**  
Ofgem income by source



**NOTE**

1 Miscellaneous income mostly derives from activities, including shared services, that Ofgem undertakes on behalf of other organisations.

Source: Ofgem, Resource Accounts 2009-10

**2.11** Net assets according to Ofgem's Statement of Financial Position were £4.0 million at 31 March 2010, compared to a net liability of £2.4 million at 31 March 2009. Total assets were £19.8 million, an increase of £11.2 million on the previous year-end.

- Trade and other receivables amounted to £12.8 million, an increase of £8.2 million from 31 March 2009 due to Ofgem invoicing the Department for the administration of its environmental schemes just before the 2009-10 year-end, and accrued income associated with the Offshore Transmission Tender project.
- Cash and cash equivalents held at 31 March 2010 amounted to £3.2 million, an increase of £3.1 million on the previous year. This was due to annual expenditure being below budget, and a higher than expected number of contractors' invoices not being received until after the year end (particularly on the Offshore Transmission Tender project).
- Total liabilities were £15.8 million, an increase of £4.8 million on the previous year. With a higher than expected number of contractors' invoices received after the year-end, current liabilities increased compared to the previous year-end, amounting to £12.1 million at 31 March 2010, £5.2 million higher than at 31 March 2009.

**2.12** As at 31 March 2010 Ofgem also held £182.7 million as owed to third parties in respect of the Fossil Fuel Levy in Scotland. The Levy was paid by electricity suppliers from non-renewable energy sources to fund the Non-Fossil Fuel Obligation which, until the introduction of the Renewables Obligation in 2002, required suppliers to purchase electricity from renewable generators. The Energy Act 2004 enabled Ofgem to pay residual amounts from the Scottish Levy account to the Scottish Consolidated Fund, but Ofgem cannot pay over the money until it is requested by the Scottish Government, which it has not done. This balance, although reported in a note in the Resource Accounts,<sup>13</sup> does not belong to Ofgem and does not form part of its Statement of Financial Position.

### Environmental Schemes administered by Ofgem

**2.13** Ofgem administers a range of environmental schemes on behalf of the Department and devolved administrations. These impose obligations on energy suppliers to promote sustainable development through renewable generation sources or energy efficiency measures. Ofgem reported that in 2009-10, the total value of these schemes was £3.9 billion (**Figure 9**).

#### Figure 9

Environmental programmes administered by Ofgem and associated costs/value in 2009-10

Scheme		£ billion
Renewables Obligation	Cost to suppliers	1.5
Offshore transmission	Aggregate value of transmission assets that are being tendered in the first tender round	1.1
Carbon Emissions Reduction Target (CERT)	Cost to suppliers	1.0
Climate Change Levy (CCL) exemption	Avoided cost to suppliers	0.2
Community Energy Savings Programme (CESP)	Cost to suppliers	0.1
<b>Total</b>		<b>3.9</b>

Source: Ofgem

**2.14** During 2009-10 Ofgem administered the following environmental schemes:

- The Renewables Obligation (RO), introduced in 2002 using powers under the Utilities Act 2000, which requires electricity suppliers to source a certain proportion (which increases over time) of their electricity from renewable generation. A Renewables Obligation Certificate (ROC) is a certificate issued by Ofgem to an accredited generator for eligible renewable electricity generated and supplied to customers by a licensed electricity supplier. Suppliers must meet their obligations by presenting sufficient ROCs, or pay an equivalent amount into a fund. Ofgem receives payments into the fund and redistributes all of the proceeds on a pro-rata basis to those suppliers that have presented ROCs. The cost to suppliers of ROs in 2009-10 was £1.5 billion.
- Ofgem, in collaboration with the Department, has established a new regulatory regime for offshore transmission networks with the purpose of ensuring that new offshore renewable generation projects are connected to the electricity grid in Great Britain economically and efficiently. In July 2009, Ofgem E-Serve commenced the first transitional tender round for nine offshore wind projects, with a capacity of around two gigawatts, and transmission assets worth £1.1 billion, and for which, under the Energy Act 2008, it recovered its incurred costs of £6 million from the tenderers. Ofgem plans to commence a second transitional round of tenders later this year for assets for around a further two gigawatts of capacity, with a potential asset value of around £1.8 billion.
- The Carbon Emissions Reduction Target (CERT), creates obligations for both gas and electricity suppliers to meet household carbon savings targets through energy efficiency measures such as insulation of lofts and cavity walls, and Compact Fluorescent Lamp (CFL) light bulbs. Companies undertake Ofgem-approved delivery schemes and report to Ofgem on numbers of measures delivered and carbon savings achieved. The Department estimates the cost to suppliers of delivering their CERT obligations in 2009-10 was £1 billion.
- The Climate Change Levy (CCL) is a charge on non-domestic supply of electricity in the United Kingdom under the Finance Act 2000, at a rate (from 1 April 2009) of £4.70 per Megawatt hour. Ofgem issues suppliers with Renewables Levy Exemption Certificates (LECs) that provide evidence to HM Revenue & Customs (which collects the levy) to demonstrate the amount of renewable source electricity supplied to non-domestic customers, and provides accreditation to qualifying renewable generators. The value of CCL exemptions to companies in 2009-10 was some £220 million, compared to CCL receipts of £695 million.

- The Community Energy Savings Programme (CESP), which went live on 1 October 2009,<sup>14</sup> is aimed at improving energy efficiency and reducing fuel bills for households in specified low income areas. It requires certain gas and electricity suppliers and large electricity generators to meet a carbon emissions reduction target set by the Department. The Scheme is intended to run until December 2012, and delivered expenditure of £100 million in efficiency measures during 2009-10.

**2.15** The Feed-in Tariff (FIT) Scheme was launched by the Department on 1 April 2010, using powers under the Energy Act 2008. It is intended to promote the development of small scale (less than five megawatts) low carbon electricity generation by requiring electricity suppliers to pay tariffs to small scale generators to make this type of installation financially viable. The Department has estimated the net cost of the scheme to electricity consumers will total £8.2 billion by 2030.<sup>15</sup>

**2.16** Ofgem also expects to take responsibility for administering the following schemes, subject to the outcomes of the Spending Review:

- To help vulnerable customers unable to afford their bills, the Government negotiated a voluntary agreement with energy suppliers to increase their expenditure on social programmes, which was £125 million in 2009-10. This assistance from companies included social tariffs, known as social price support. Ofgem has a role in administering and monitoring the current voluntary agreement. The Department has announced that when the voluntary agreement comes to an end in March 2011, social price support will be placed on a statutory footing, and plans to consult on the detailed arrangements of the scheme.
- In 2007 the Government set out its expectation that smart electricity and gas meters would be installed in every home in the UK over the next decade. The Government subsequently announced in October 2008 its decision to proceed with the roll out of smart meters for domestic consumers. Ofgem was commissioned by the Department to manage the first phase of the programme on its behalf. The Department has estimated that the programme will cost £10 billion. The costs to energy suppliers of delivering the programme are expected to be recovered through higher energy prices, although any benefits to suppliers should also be passed on to consumers.
- The Renewable Heat Incentive will, from April 2011, provide financial support for those who install renewable heating including qualifying households, businesses, offices, public sector buildings and industrial processes in large factories. It will support a range of technologies, including air and ground-source heat pumps (and other geothermal energy), solar thermal, biomass boilers, renewable combined heat and power, use of biogas and bioliquids and the injection of biomethane into the natural gas grid; and it will support heating at all scales. The Department estimates the annual cost of the scheme to consumers will be between £0.6 billion and £1.2 billion, although it estimates annual benefits of up to £0.5 billion in carbon savings.

<sup>14</sup> Following the Electricity and Gas (Community Energy Saving Programme) Order 2009.

<sup>15</sup> The estimated net present value of the Scheme published by the Department, *Impact Assessment of Feed-in Tariffs for Small-Scale, Low Carbon, Electricity Generation*, February 2010.

- The Carbon Capture and Storage (CCS) Levy was introduced in the Energy Act 2010 to support the demonstration of CCS through a charge on electricity suppliers. Under the Act, the levy will be paid by electricity suppliers to the administrator of the levy, with the contribution of each supplier based on their share of the electricity supply market in Great Britain. Ofgem expects that it will administer the levy. The details of the levy will be set through regulations that will be the subject of consultation before coming into force in 2011.

**2.17** Ofgem has also established a 'Low Carbon Networks Fund', to be funded through customer bills, which will allow distribution network operators to spend up to £500 million between 2010 and 2015 on trials of new technology, operating and commercial arrangements that further moves to a low carbon economy. The Fund is intended to support projects sponsored by the distribution network operators (sometimes through partnerships) to explore how networks can facilitate the take up of low carbon and energy saving initiatives such as electric vehicles, heat pumps, micro and local generation and demand side management. A condition of participating is that distribution network operators will have to share what they learn with other participants. The Fund was introduced with the beginning of Ofgem's five-year control of distribution network operators' prices on 1 April 2010, and balances on the Fund will be held separately from Ofgem's Accounts.

## Controlling costs

**2.18** Since 2005 Ofgem has sought to control its own costs through a mechanism whereby annual cost increases are limited to the Retail Prices Index less 'X',<sup>16</sup> an annual efficiency saving set in advance by Ofgem at 3 per cent over the first five years of the control. During the first five years of the control Ofgem calculated that it had saved £11.9 million, £6.6 million more than the target for savings when the control was first set, including £2.4 million (£1.4 million more than planned) in 2009-10. The National Audit Office has not directly audited these savings figures. Ofgem plans to operate the regime for a further five-year period starting on 1 April 2010, and that 'X' should be maintained at 3 per cent, which translates to planned savings of £12.5 million over the period. Whereas the control for the first five years excluded expenditure on administration of environmental schemes for the Department, the Audit Committee has agreed that the control for the next five years will cover all of Ofgem's expenditure.

<sup>16</sup> The mechanism is similar in principle to the method Ofgem uses to control the prices of network operators that it regulates over five-year control periods.

# Part Three

## Performance against objectives

**3.1** In this Part of the report we set out good practice in performance measurement. We then describe Ofgem's performance in 2009-10, drawing on its own performance measurement, and action that Ofgem is taking to strengthen its performance measurement system.

### **Performance measurement: good practice**

**3.2** A robust performance measurement system will clearly set out what the organisation is seeking to achieve and report on progress against its objectives.<sup>17</sup> For a regulator this means translating its statutory objectives into strategic objectives, with accompanying indicators of performance that take into account the extent to which it can influence the outcomes that each indicator aims to measure.

**3.3** Objectives should link clearly to the supporting activities and indicators, and should be clear and measurable. Indicators should include measures of outcomes and success criteria, and should be organised as a hierarchy so that lower level indicators can be built up into an overall assessment of performance. A well constructed performance measurement system will help management in running its business and promote transparency by showing the outcomes being achieved through the resources expended.

**3.4** Assessing the performance of regulators in part relies on an assessment of the performance of the companies they regulate. It is common, and good practice, for regulators to use a basket of indicators to judge companies' performance, and to analyse trends in data not just year-on-year performance. This is because annual performance measures, particularly in infrastructure industries, can be strongly influenced by exceptional external events, and can mask underlying problems which may only become apparent in the longer term.

<sup>17</sup> Improve, quoted in *Choosing the Right FABRIC: A Framework for Performance Information*, March 2001, page 16.

## Ofgem performance in 2009-10

**3.5** Ofgem has designed its performance measurement system around its seven themes (paragraph 1.15). Each theme has an associated set of deliverables that describe outputs, such as a publication or the completion of key milestones within specified timescales. They do not provide a measure of the effectiveness of Ofgem's regulatory activities or its administration of environmental programmes. Ofgem also has separate performance indicators which cover corporate activities, for example target response times for responding to complaints and paying for invoices. The information on deliverables is reported by Ofgem in its Annual Report.

**3.6** Ofgem reported that it had achieved 27 of the 31 deliverables that it had set itself for 2009-10. Of the remaining deliverables, three were deferred to 2010-11 – one of which has been achieved, and one no longer applies. These achievements have not been externally validated, as Ofgem was not part of the Public Service Agreement (PSA) framework and so its performance reporting fell outside the scope of National Audit Office examinations of PSA data systems.

**3.7** In the following sections we examine performance reported by Ofgem against deliverables under each of the seven themes.

### Theme 1: Creating and sustaining competition

**3.8** Ofgem's principal statutory objective is to protect the interests of existing and future business and domestic consumers, wherever appropriate by promoting effective competition. This theme is directly related to that objective. For 2009-10 Ofgem reported that it met its four deliverables under this theme:

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<b>Theme 1</b>	
Deliverables	<b>Status</b>
Probe – remedies	Met
Publish 2009 Energy Markets Outlook report	Met
Publish final Winter Outlook Report	Met
Publish proposals for System Operator incentives to apply from 1 April 2010	Met

*Source: Ofgem*

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**3.9** Ofgem monitors energy markets and periodically publishes information on competition issues such as the health of retail competition and wholesale market transparency and liquidity. Where Ofgem identifies that consumers need help to gain the full benefits of competition, it intervenes using regulatory and competition law powers where necessary. We have previously reported on Ofgem's use of its powers to ensure that markets protect consumers.<sup>18</sup>

**3.10** Ofgem began an investigation ('probe') into domestic and small business energy supply markets in February 2008. The investigation found that the 'Big 6' suppliers' pricing patterns tracked one another closely, with signs of 'leader-follower' behaviour, with British Gas frequently acting as the first mover. During 2009-10, Ofgem started to implement various remedies identified in the course of its investigation, including improving the transparency of consumers' bills and introducing licence conditions prohibiting companies from using undue discrimination in their terms and conditions.

**3.11** Ofgem in its most recent analysis of energy supply margins in September 2010<sup>19</sup> concluded that the margin between wholesale costs and retail prices had levelled off. It estimated that the net annual profit margin for supplying a typical standard tariff dual fuel customer as at August 2010 was approximately £65, down from £105 in February 2010. Following British Gas' reduction in gas and dual fuel prices, there have been similar reductions by all the other major suppliers, lowering overall dual fuel bills. In September 2010, Ofgem launched a new investigation into mis-selling by four of the top energy supply companies.

## Theme 2: Regulating networks effectively

**3.12** This theme is primarily linked to Ofgem's statutory objectives and duties in relation to customer protection, and to the ability of operators to finance their activities, although it applies to all of Ofgem's statutory duties to varying degrees. In 2009-10 Ofgem reported that it met nine out of its 12 planned deliverables during that year, while the three deliverables that it did not meet were superseded or deferred awaiting a Department decision.

<sup>18</sup> National Audit Office, *Protecting consumers? Removing retail price controls*, HC 342, 2007-2008.

<sup>19</sup> Ofgem, *Electricity and Gas Supply Market Report*, September 2010.

## Theme 2

### Deliverables

	<b>Status</b>
Implement longer-term enhanced Transmission Operator (TO) incentives	Met
Publish Regulatory Reporting Pack for the Transmission Operators	Met
Make decisions on Connection and Use of System Code modifications relating to the Transmission Access Review	Not met (superseded)
Implement short-term enhanced TO incentives	Met
Approve gas entry substitution Q4 arrangements	Met
Distribution DPCR5 – methodology and initial Q1 cost assessment update	Met
DPCR5 – publish initial proposals	Met
DPCR5 – publish final proposals	Met
Publish Connections industry Review	Met
Publish DNO costs and outputs report to 2010-11	Not met <sup>1</sup>
Publish GDN costs and outputs report to 2010-11	Not met <sup>1</sup>
Publish financial distress process manual	Met

#### **NOTE**

<sup>1</sup> Deferred to 2010-11 financial year.

Source: Ofgem

**3.13** A key output under this theme was the review of the transmission access regime, which aims to rectify problems in connecting new generation, particularly renewable, to the high voltage long-distance transmission network. The existing arrangements were designed to connect large, conventional gas, coal and nuclear stations, and Ofgem considers that they are poorly suited for connecting renewables, which tend to be a large number of small generators. Ofgem has introduced short term measures to connect 450 Megawatts of wind plant, and new access arrangements to incentivise transmission companies to build networks ahead of more renewable generation being built.

**3.14** In 2006 our report on Ofgem's role in the sale of gas distribution networks by National Grid concluded that the sale could provide substantial benefits to consumers through lower prices, but that this was dependent on Ofgem setting tough price controls for operators at subsequent price control reviews.<sup>20</sup> Ofgem's subsequent price review for the 2008 gas distribution network price review responded to this recommendation by setting a 2.5 per cent efficiency gain.

**3.15** After a long period of relative stability, energy regulation is faced with some major challenges associated with the requirement to move to a decarbonised energy system. In March 2008 Ofgem commenced a two-year project (RPI-X at 20) to examine its current regulatory approach in the light of these challenges. We reported in 2002 that Ofgem's use of this RPI-X framework to control monopoly suppliers' prices had resulted in substantial efficiency savings and price reductions for consumers, but found that regulators should continue to consider risks inherent in the RPI-X approach, which could distort incentives for investment.<sup>21</sup> The project that Ofgem launched in 2008 considered the current incentive-based system for companies to outperform efficiency targets set at five-yearly price control reviews and aimed to establish whether this was still the best approach given the major challenges in energy markets and the economy. In July 2010, following the completion of the project, Ofgem proposed implementing a new price control model known as the "RIIO" (Revenue=Incentives+Innovation+Outputs). Final decisions were published in October 2010.

### Theme 3: Helping to achieve sustainable development

**3.16** During 2008 Parliament enacted changes to Ofgem's statutory duties to increase its focus on sustainability. This theme is primarily linked to Ofgem's duties on contributing to the achievement of sustainable development. Ofgem reported that it met all three of its planned sustainable development deliverables for 2009-10.

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## Theme 3

### Deliverables

	<b>Status</b>
Energy Efficiency. Publish a review of the Energy Efficiency Commitment 2005-08	Met
Community Energy Savings Programme (CESP). Following the Government's consultation, publish the procedures for the administration of the CESP scheme	Met
Renewables & Combined Heat and Power. Publish annual report on Renewables Obligation	Met

*Source: Ofgem*

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<sup>20</sup> National Audit Office, *The Office of Gas and Electricity Markets: Sale of gas networks by National Grid*, HC 804, 2005-06.

<sup>21</sup> National Audit Office, *Pipes and Wires*, HC 723, 2001-02.

**3.17** Ofgem considers that it has an important and developing role in shaping the future of gas and electricity industries in a sustainable manner. For example, during 2009-10 Ofgem managed the first phase of planning for the Government's mandatory roll-out of 'smart meters' to all domestic energy consumers in Great Britain by 2020. On 1 October 2009 Ofgem also launched the Community Energy Savings Programme (CESP), a three-year, £350 million scheme which requires suppliers and large generators to implement energy efficiency activities targeted at vulnerable consumers.

#### Theme 4: Helping to protect the security of Britain's energy supplies

**3.18** Theme 4 is primarily linked to Ofgem's statutory duty in relation to meeting all reasonable demands for energy. We have previously examined the potential implications of energy markets on security of supply. For example, in 2003 we reported on Ofgem's introduction of the New Electricity Trading Arrangements, and concluded that there was no guarantee that the response to market signals would always work as intended. We recommended that Ofgem should report regularly on whether there were barriers that could prevent market participants responding to market signals, to ensure security of supply.<sup>22</sup>

**3.19** In 2009-10 Ofgem did not set any specific deliverables under this theme. Ofgem did, however, publish the conclusions of its Project Discovery in February 2010. This explored whether the current arrangements are capable of delivering both security of supply and environmental objectives at affordable prices, given the nature and scale of challenges facing the British energy market. It concluded that leaving the current arrangements unaltered is not in the interests of consumers, given the risks and issues identified and examined a range of policy measures. Ofgem combined the different policy measures into five possible policy 'packages' to be considered by Government, in consultation with consumers, industry and government.

#### Theme 5: A leading voice in Europe

**3.20** This theme is not directly linked to specific statutory objectives or duties. In 2009-10 Ofgem reported that it had met both of its planned deliverables.

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### Theme 5

#### Deliverables

	<b>Status</b>
European Strategy. Agree plans for phase 2 of gas transparency in the North West Gas Regional Initiative	Met
Submit National Report to European Commission	Met

*Source: Ofgem*

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<sup>22</sup> National Audit Office, *The New Electricity Trading Arrangements in England and Wales*, HC 624, 2002-03.

**3.21** Ofgem engages with other European regulators and the European Commission, in addition to its work with the Department to review and consider proposals for new EU legislation, in particular supporting EU liberalisation of energy markets. Ofgem aims to use its membership of the Council of European Energy Regulators (CEER) and the advisory group of European Energy Regulators (ERGEG) to make the case for full and rapid implementation of the Directives and Regulations. Ofgem's Chairman, Lord Mogg, is currently Chair of ERGEG and President of CEER.

## Theme 6: Helping tackle fuel poverty

**3.22** This theme is primarily linked to Ofgem's statutory duty in relation to protection of vulnerable consumers. Ofgem reported that it met six out of its seven planned deliverables in 2009-10. Ofgem deferred the other deliverable, pending receipt of additional consumer research, and published its review of the new Energy Ombudsman in June 2010. The Ombudsman resolves disagreements between gas and electricity companies regarding their domestic and small business customers.

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### Theme 6 Deliverables

	<b>Status</b>
Publish report on incentives for saving energy	Met
Review of suppliers disconnection of vulnerable consumers	Met
Update on Social Action Strategy	Met
Publish Sustainable Development Report	Met
Review of suppliers' debt management*	Met
Publish a review of the new ombudsman arrangements consumer research	Not met <sup>1</sup>
Update on vulnerable customer engagement with the market	Met

#### NOTE

<sup>1</sup> Met in June 2010, following receipt of additional consumer research.

Source: Ofgem

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**3.23** Ofgem published a Social Action Strategy, since updated for 2010-11, setting out how it would meet its social responsibilities and help the government tackle fuel poverty.

**3.24** Ofgem's energy supply probe (paragraph 3.10) contained measures to protect vulnerable consumers, as Ofgem considered that certain industry practices were failing this group. Ofgem introduced licence conditions in the autumn of 2009 to ban unfair differences in prices. Ofgem calculates that around £500 million of unjustified price differences have been removed. Many of the customers paying unjustified higher costs

had prepayment meters or were off the gas grid. Ofgem also introduced tighter rules on doorstep selling and new obligations on suppliers to improve customer information. Ofgem has not yet assessed the impact of these measures.

**3.25** In partnership with Consumer Focus, Ofgem conducted a review of vulnerable customer disconnections which led to a tightening of the licence obligations on suppliers. Ofgem and Consumer Focus also reviewed suppliers' approaches to debt prevention and management. Ofgem has now set new best practice principles that are in line with Citizens Advice standards. Ofgem also monitored and reported on suppliers' voluntary social spending and promoted good practice by the electricity and gas network businesses through its Discretionary Reward Schemes.

**3.26** The Department models the number of fuel poor. The latest data available is from 2007, which found that four million households in the UK were in fuel poverty. In March 2010, the Energy and Climate Change Select Committee concluded in its report on Fuel Poverty that the Government is going to miss its target to end fuel poverty amongst vulnerable households in England in 2010, and the target to end fuel poverty for all households in England by 2016 also looks difficult to meet, despite the efforts made by the Government.<sup>23</sup>

## Theme 7: Better regulation

**3.27** This theme is primarily linked to Ofgem's statutory duty to have regard to best regulatory principles and practice. Ofgem set itself three deliverables in 2009-10 constructed around the principles of better regulation and met all of these deliverables. These included publishing the final proposals of the Industry Codes Governance Review and setting the Fossil Fuel Levy.

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### Theme 7 Deliverables

	<b>Status</b>
Industry Codes Governance Review – publish initial proposals relating to major policy reviews/self governance and the role of industry code administrators	Met
Industry Codes Governance Review – publish final proposals relating to major policy reviews/self-governance and the role of industry code administrators	Met
Set the Fossil Fuel Levy Rate for 2010-11	Met

*Source: Ofgem*

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**3.28** In our 2007 review of economic regulators' impact assessments for the House of Lords Select Committee on Regulators, we noted that Ofgem has a statutory duty to produce Impact Assessments for regulatory proposals. We found that only Ofgem was producing self-contained impact assessments equivalent to those produced by Government departments; and that only Ofgem and Ofcom had prepared guidance and training for staff on how to produce formal impact assessments.<sup>24</sup>

### **Development of Ofgem's performance measurement system**

**3.29** Ofgem's seven strategic themes for 2009-10 and earlier years provide a framework for organising its activities rather than a set of clear objectives against which performance could be measured. Ofgem has replaced its seven themes with four new themes for 2010-11, which go some way to addressing this, by providing a clearer statement of what Ofgem seeks to achieve.

**3.30** Ofgem's deliverables are currently activity-based, and its success criteria relate to the timely delivery of those activities rather than providing a measure of the effectiveness of its regulatory activities or administration of environmental programmes. In some areas Ofgem has set targets for regulated companies to achieve in relation to the achievement of specific outcomes, for example the number of minutes of supply interruptions for electricity distribution network operators. Ofgem intends to develop this further under its proposed 'Revenue = Incentives + Innovation + Outputs' (paragraph 3.15) model for network regulation.

**3.31** Ofgem has initiated a process to improve its performance measurement and reporting, and is taking steps to provide a stronger focus on outcomes. Ofgem already reports performance against a number of indicators in its annual Sustainable Development report, which could provide a basis for a more comprehensive assessment including desired outcomes and progress against articulated success criteria.

**3.32** Ofgem shares responsibility with other public bodies for some of the outcomes, and it may be difficult to isolate the effects of Ofgem's action. The Department, for example, has responsibility for statutory targets in relation to combating climate change which is similar to Ofgem's sustainable development work.

**3.33** An additional consideration that Ofgem has as regulator is that it is dependent on the actions of energy companies to deliver many of the outcomes it seeks to achieve, for example companies make the decisions which determine whether continuity of energy supply is maintained, within the regulatory framework of markets, rules and incentives established and overseen by Ofgem. Many changes proposed by Ofgem require industry consensus to implement, often through licence changes.

**3.34** Validation of performance information is also an important element of an effective performance measurement system. Ofgem validates company data using its own resources, including Internal Audit, but has also used consultants and company reports. Data validation will become increasingly important as Ofgem begins to introduce potentially more subjective performance indicators covering, for example, the health of network assets. It will also be important for Ofgem to adopt a risk-based approach to validation, given the volume of data it already collects from the companies it regulates.

<sup>24</sup> National Audit Office, *A review of economic regulators' impact assessments*, November 2007.

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