

# 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.