

Delivering efficient regulation for energy consumers

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Keeping the costs of regulation to a minimum has been a priority for Ofgem. This has seen the regulator restructure itself into two businesses, Ofgem and Ofgem E-Serve, so that it can continue to protect energy consumers' interests and can more efficiently deliver the Government's environmental programmes to help deliver a low carbon economy.

Ofgem E-Serve runs environmental programmes, like the Renewables Obligation, for the Government, while Ofgem continues as the industry regulator.

▶ How is Ofgem funded?

Ofgem is funded by a licence fee levied on the energy industry, and not by taxpayers. The **£31 million** of fines it has imposed on the industry since 2002 is not used to fund Ofgem, but is paid directly to the Treasury.

Ofgem E-Serve's costs of administering environmental programmes are met from a variety of sources. Around half of the costs are funded by the Department for Energy and Climate Change (DECC). The other half is funded by the programmes themselves.

▶ Cutting costs

Ofgem was the first regulator to place itself under the same stringent five year RPI-X price control that it imposes on the companies it regulates. Ofgem's cost control has been set at RPI-3, which requires it to cut its costs each year by three per cent in real terms.

Ofgem also helps other regulators keep their costs down by providing finance services to PostComm and by administering aspects of the renewable programme for the Northern Ireland regulator.

The cost control is set by Ofgem's audit committee and is overseen by an independent accounting firm.

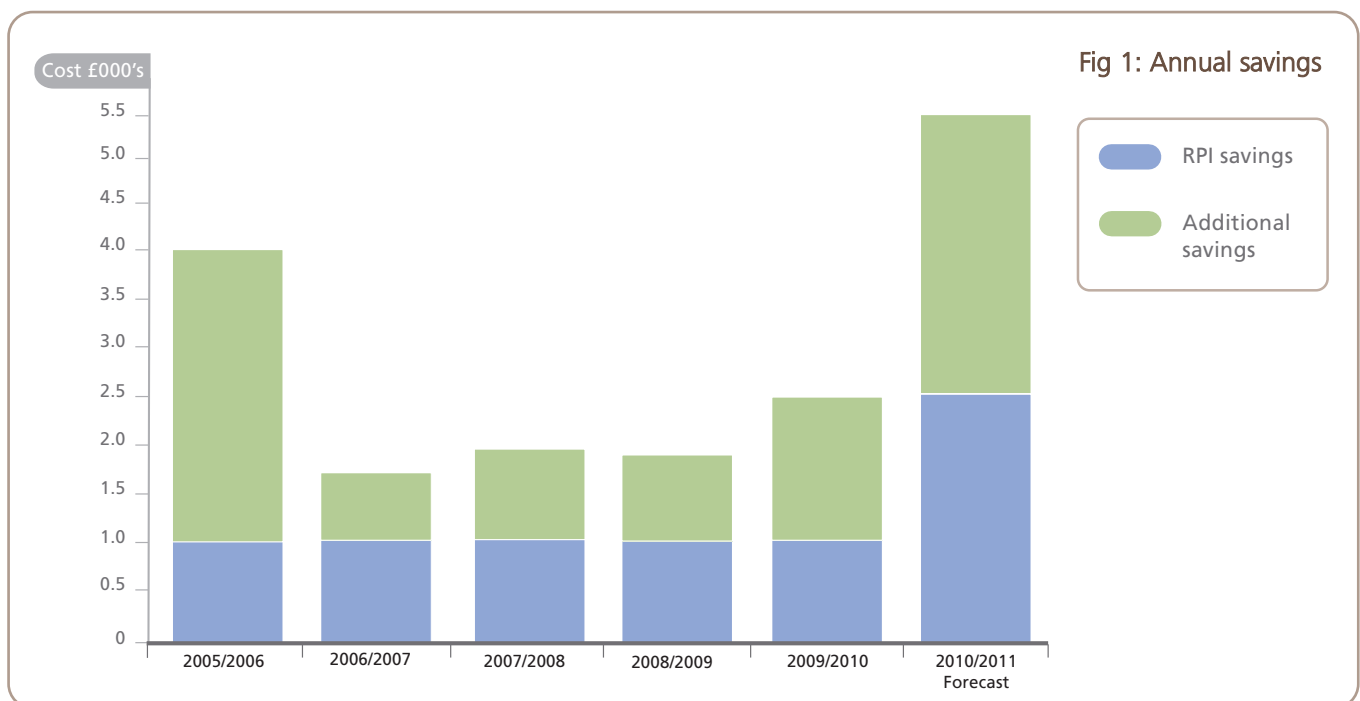
► Ofgem’s cost control performance

In total, Ofgem’s RPI-3 cost control regime, and other measures have delivered savings of **£11.9 million** over five years (2005-2010). Each year Ofgem has outperformed its cost control. Ofgem’s next price control for 2010-2015 will keep the stringent annual three per cent cut in place with planned savings of **£12.5 million**. In a review of Ofgem’s financial performance, published in October 2010, the National Audit Office notes that Ofgem has sound systems of financial control and reporting.

Ofgem will deliver substantial savings in 2010-11 against budget. This has been achieved through rigorous cost control across all divisions, implementing efficiency programmes as well as the Government’s austerity measures. This includes

freezing pay and constraining recruitment and use of consultants. Major programmes such as the policy design phase for the roll out of smart metering and the competitive tendering for offshore transmission links have been delivered at a cost significantly lower than was planned.

For its 2011-12 budget and beyond, Ofgem faces significant uncertainty. This is due to the action that will be taken to protect consumers following the outcomes of the Retail Market Review and the expectation that work will be required as a result of DECC’s electricity market review to ensure on-going security of supply.



► Delivering Government environmental programmes efficiently

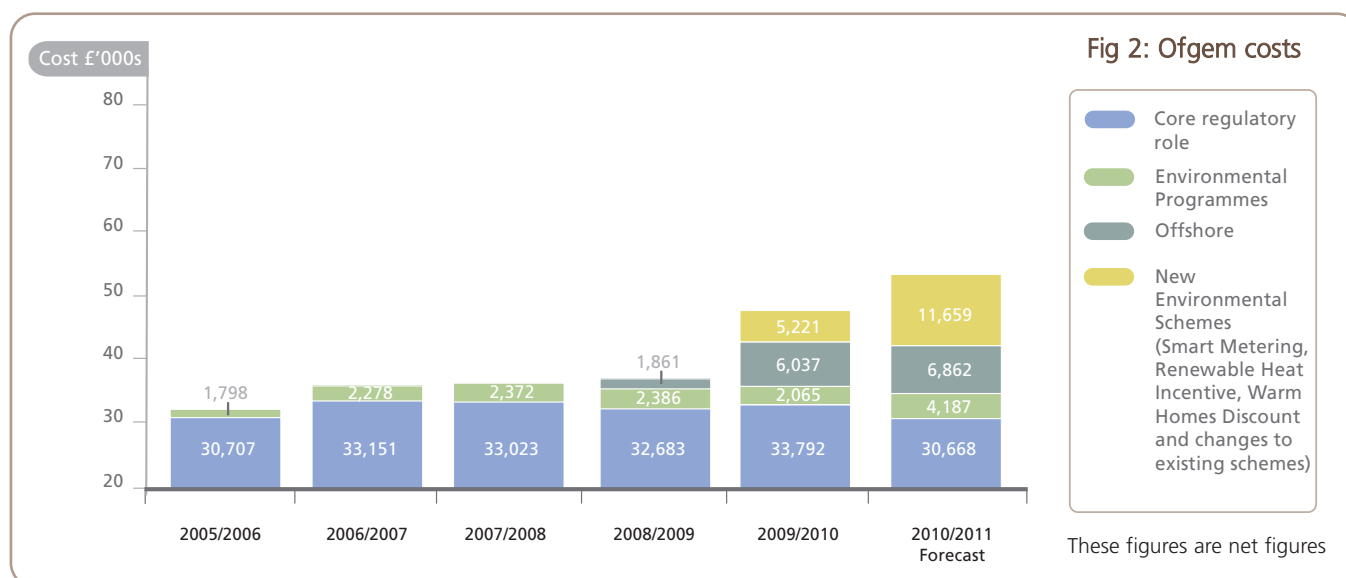
Ofgem E-Serve administers environmental schemes in all cases for less than 1% of the programme cost, and on average for 0.22% of scheme value. This is significantly less than benchmarks for other programmes run within government.

Ofgem E-Serve is able to deliver around **£5 billion** of environmental schemes for just **£11 million** because:

- its cost control keeps costs low
- it has the expertise and experience in developing robust and effective administration for environmental programmes

- Ofgem does not charge a fee for administering these schemes. It only charges for its running costs and does not seek to make a profit.

Ofgem has expanded its delivery work rapidly as the need to tackle climate change has become more urgent. In 2001-02 Ofgem administered environmental programmes worth **£150 million** per annum on a non-profit basis with 12 members of staff - now the value of the programmes has risen to **£5 billion** per annum and staff numbers to 96.



This work is set to expand further as the Government has asked Ofgem E-Serve to run the following new schemes:

- Renewable Heat Incentive (RHI)
- Warm Homes Discount

► Project delivery

Delivering efficient regulation is not just about keeping costs as low as possible – it is also about delivering well managed projects and policies. Ofgem has consistently delivered the projects it has set out in its Corporate Plan (figure 3). For example, Ofgem has delivered key policy projects including:

- The Retail Market Review

This was published on March 21. Ofgem found that the market is in need of a radical overhaul to tackle poor supplier behaviour, sweep away confusing tariffs and break the stranglehold that the Big Six have over it. The key reforms Ofgem is now consulting on include restricting the number of tariffs for standard evergreen products from each supplier, to just one per payment method in relation to domestic customers. The big six will also be required to auction off up to 20 per cent of their power generation output

- Project Discovery

This looked at whether Britain’s current energy market could deliver sustainable and secure energy supplies at an affordable price to consumers.

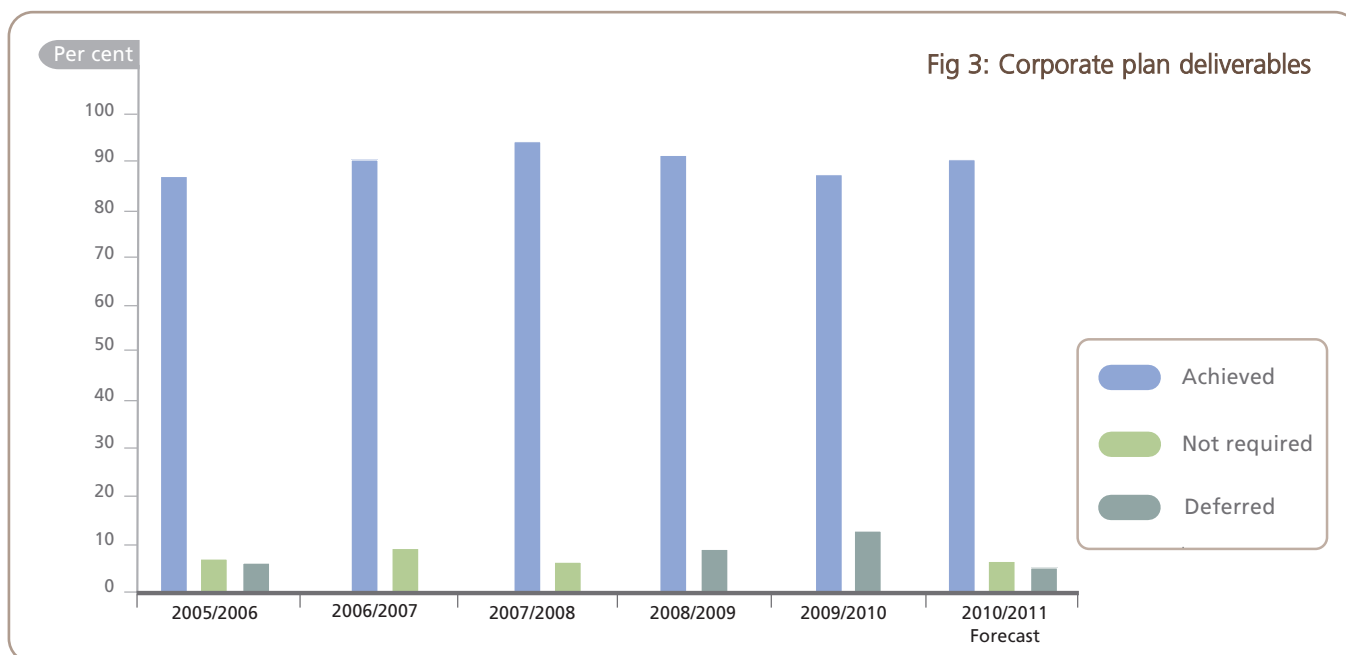
Existing schemes like the Renewables Obligation are expanding to provide more funding for offshore renewables, and to reflect changes for example in the use of bioliquids.

It concluded that the amount of investment needed in the next 10 years - **£200 billion** – was so large there was reasonable doubt that the current arrangements would be able to deliver secure supplies. It put forward options for reform for Government consideration

- RIIO

Ofgem has also established a new framework for setting price controls so that the network companies can adapt to the huge challenge of delivering more than **£30 billion** of the **£200 billion** investment need in Britain’s energy sector in the next 10 years.

The RIIO (Revenue=Incentives+Innovation+Outputs) framework replaces the previous RPI-X formula. Under RIIO, the network companies will face strong incentives and penalties to stimulate greater efficiency in delivering network investment. Successful companies that perform well for customers will be rewarded. Any that do not will be penalised



► Case Study: Delivering innovative environmental programmes

Ofgem has also taken an innovative approach to helping the government deliver its environmental targets. For example, to reach Britain's 2020 environmental targets the Government is aiming to encourage the construction of 40GW of offshore wind generation. To lay high-voltage cables to connect this amount of generation to the main land is estimated to cost around **£15 billion**.

Ofgem and DECC have put in place a scheme where companies compete to build and run these critical transmission links. Ofgem is running the tenders to attract investment for these connections, and the first tender round attracted about **£4 billion** of tenders for around **£1 billion** of assets. This competitive approach is estimated to save consumers around **£350 million** for the first tender round alone. The competitive tender model has attracted over £300 million funding from the European Investment Bank.

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