

# Past, present, future?

The government last week launched a formal review of Ofgem's role. David Birchall and Alistair Dunstan look back at the evolution of the energy regulator

**T**he future of Ofgem as the regulator of Great Britain's gas and electricity markets looks more uncertain than ever. Prior to the election, the Conservative Party made it clear it was intending to reform Ofgem, including separating its green and sustainable arm, Ofgem E-Serve, and transferring its competition powers to the Office of Fair Trading (OFT), leaving it solely with an economic regulatory function.

Last week (27 July), the coalition government called for evidence to launch a review of Ofgem's role as the independent regulator of the energy markets. This will consider whether changes are needed to align the regulatory framework with the government's strategic policy goals (see box). The regulator's "delivery" functions – administering a number of environmental and sustainability programmes through E-Serve – will not be considered as part of this review because the Department of Energy and Climate Change is "looking separately at how best to streamline delivery of the functions needed to meet its energy and climate change objectives".

A decade has passed since Ofgem was formally created. The regulator has taken on more and more roles and become unrecognisable in scope

and ambition from the days of Ofgas and Offer, its predecessors. The big question now is whether Ofgem will be stripped back to its bare bones by a government that believes it has become too big for its boots.

So, what of the story so far? Long ago, when the Conservatives were in power in their own right, they established separate regulators for gas and power, Ofgas and Offer, after privatising the gas and power industries.

During the 1990s, their role was largely that of economic regulators and the appeals bodies for changes to core industry documents. The competition role of these organisations was significantly strengthened by the arrival of the Competition Act 1998, which required them to work in tandem with OFT in their respective markets.

When in 2000 Ofgas and Offer merged to form a single energy regulator, Ofgem, its role was expanded but it still appeared at that time to be substantially the same creature. At the beginning of the millennium some commentators were suggesting that Ofgem no longer had a significant regulatory role and had ceased to have any meaningful presence. Significantly, at this time the interests of consumers were put at the heart of Ofgem's decision-making process. Its primary duty now was

to protect the interests of consumers, wherever appropriate by promoting competition.

Over the years, Ofgem's remit has been expanded, primarily driven by an evolving energy world that has required the government and regulators to balance the potentially conflicting challenges thrown up by climate change and carbon reduction, security of supply, generation mix, and technological developments and technology choices.

Key features of its growing role include:

**Renewables:** with the advent of the Renewables Obligation in 2002, Ofgem was charged with administering the scheme and operating an electronic registry system for Renewables Obligation Certificates (Rocs). This placed the regulator at the heart of the government's key subsidy for encouraging renewables. Ofgem was also called upon to administer the Climate Change Levy exemption scheme, introduced by the Finance Act 2000, which applied to energy from renewable sources, and which serves with the Roc regime to encourage renewable generation.

Ofgem is also involved in other emissions schemes, including the Carbon Emissions Reduction Target and, this year, a green energy certification label and a feed-in tariff scheme. In recognition of its increasing role in this sector, Ofgem's primary duty under the Electricity Act has been supplemented with the requirement to take into account the need to reduce greenhouse gas emissions, and to ensure security of supply.

**Sustainability:** the Energy Act 2004 introduced the "achievement of sustainable development" as a new goal for the regulator. Extending this role, the Energy Act 2008 prioritised sustainable development at the forefront of its duties, making it subject only to its principal duty to protect the interests of consumers. Pursuant to this, Ofgem has introduced an array of policies, including recent proposals to roll out smart meters (see feature, page 14).

In response to its increased role in renewables and sustainability, in September 2009, Ofgem announced it would be hiving off the portion of its organisation dealing with these aspects into a subsidiary, Ofgem E-Serve. This restructuring is testament to the extent to which the regulator's original role had changed.

**European presence:** Ofgem was a founding member of the Council of European Energy Regulators (Ceer), a position bolstered when Ofgem chairman Lord John Mogg was voted in as vice-chairman of Ceer, and also vice-chairman

of the European Regulators' Group for Electricity and Gas (EREG). Through both ERGEG and Ceer, Ofgem continued to help develop European policymaking and lobby on harmonisation rules, cross-border issues, and European energy market liberalisation. With the possible arrival of a European supergrid, and the consolidation of the European energy markets generally, Ofgem may have a far greater role to play on the international scene in years to come.

**Offshore transmission:** the most startling illustration of how Ofgem's role has developed can be seen in the offshore transmission network owner (Ofto) regime. The Energy Act 2004 made provision to establish an offshore electricity transmission regulatory framework, which would be overseen by Ofgem. By virtue of the same Act, the regulator was given the discretion to run an Ofto licence tendering regime, awarding contracts for hundreds of millions of pounds. While not without its teething troubles, this exercise represents a major departure from Ofgem's original role of passive regulation.

**Carbon capture and storage (CCS):** the Energy Act 2010 gave Ofgem the responsibility of administering the CCS scheme. It provides for financial assistance for certain CCS demonstration projects and the charging of an electricity supply levy to pay for it. Reinforcing its new emissions reduction role, Ofgem is overseeing both these schemes.

**I**t is uncertain whether Ofgem will continue its role as an almighty regulator for the energy markets, especially if some of the Conservative announcements made prior to the election are pushed through Parliament. Depending on what reforms go ahead, Ofgem's core role may end up coming full circle, reverting to its days as largely an economic regulator. That said, government is constantly re-evaluating the conflicting demands of security of supply, transmission access and investment, and green issues, and so there is every prospect that Ofgem's current role will continue to develop.

The call for evidence closes in September, with the Ofgem review expected to report in spring 2011, alongside a white paper on electricity market reform. ●

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## Under consideration:

- 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 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.
- The scope for learning lessons from other regulatory models and examples of good regulatory practice.