

**Regulation of gas and electricity marketing:  
a more rigorous approach**

**A decision document**

August 2002

## Summary

Direct selling has made a significant contribution to the current dynamism of the energy supply sector. Ofgem recognises that the number of complaints about direct selling is a small proportion of the total number of transfers, but believes that instances of misselling can cause significant consumer distress and is therefore committed to taking tough action against suppliers who do not comply with their licences. In addition, Ofgem recognises that misselling can have a particular impact on vulnerable consumers.

In June 2002 Ofgem consulted on proposals to change its approach to the enforcement of the marketing licence condition. The proposals considered how the approach could be more transparent, timely and effective.

This document considers the comments received in response and sets out Ofgem's final decision. Ofgem will use marketing complaints data published by energywatch as its primary, although not sole, indicator that suppliers may not have complied with their obligations under the marketing licence condition. A threshold will be applied, above which a supplier's activity will lead to investigation by Ofgem. This document contains details of threshold to be applied in the interim period, until a medium term threshold is proposed and consulted upon. This document also provides details of the investigation process which will be followed by Ofgem.

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# 1. Introduction

## *Purpose of this document*

- 1.1 This document describes the approach Ofgem will take to compliance monitoring and enforcement of standard licence condition 48, the 'marketing licence condition'. It describes the responses Ofgem received to our recent consultation on this subject<sup>1</sup>, and how these have been taken into account.

## *Background and process to date*

- 1.2 Direct selling has made a significant contribution to the current dynamism of the energy supply sector. Ofgem recognises that the number of complaints about direct selling is a small proportion of the total number of transfers, but believes that instances of misselling can cause significant consumer distress and is therefore committed to taking tough action against suppliers who do not comply with their licences. In addition, Ofgem recognises that misselling can have a particular impact on vulnerable consumers.
- 1.3 Misselling is an abuse of customers' trust; this is in itself unacceptable to Ofgem. Ofgem is also aware that continuing public concern about misselling could undermine customers' confidence in the competitive market. This could prevent customers from capturing the financial and service benefits available from switching.
- 1.4 The marketing licence condition was amended in January 2001 and subsequently extended for a further two years from April 2002. Ofgem has consulted on how the licence condition can be made more effective, and is now conducting research on customer experience. In the last three months, the industry has begun work to build more robust arrangements for self-regulation, and a pilot of the "Energysure" scheme has been launched to help suppliers and customers identify sales agents who have been appropriately trained. Ofgem will take account of the implementation of this and other schemes in future proposals to modify standard licence condition 48 (SLC 48).

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<sup>1</sup> Regulation of gas and electricity marketing: a more rigorous approach  
A consultation document, June 2002 (43/02)  
Office of Gas and Electricity Markets

- 1.5 Ofgem's powers to impose financial penalties were introduced in April 2002, under the Electricity Act 1989 and the Gas Act 1986. In the light of this development, Ofgem published the consultation document 'Regulation of gas and electricity markets: a more rigorous approach' in June 2002, which considered how the existing marketing licence condition could be enforced more speedily and effectively.

### ***Rationale***

- 1.6 Ofgem's objective is to regulate suppliers in such a way that they manage their sales force tightly, so as to avoid misselling. Ofgem believes this is best achieved by creating the correct incentives for suppliers, and acting predictably and transparently. SLC 48 sets out what is required of suppliers' management processes. Ofgem aims to be equally transparent as to how it decides to investigate a supplier for non-compliance, and what will be the consequences of non-compliance.
- 1.7 Ofgem therefore considers that publication of the compliance and enforcement process will be of value to both suppliers and consumers. Ofgem aims to give suppliers clarity about its approach, and to provide a signal that failure to resolve the problems of misselling may lead to the imposition of financial penalties and result in negative publicity for the companies concerned. Ofgem believes this is the best way to improve the industry's performance in this area, to the benefit of customers. By shortening the timescale for enforcement action, Ofgem intends to accelerate the pace of improvement, and also to reassure consumers.

## 2 Review of responses

- 2.1 13 responses were received and a list of respondents is attached at Appendix 1. Those not marked 'confidential' are available on the Ofgem website, at:

[http://www.ofgem.gov.uk/responses2002/mktng\\_regul.htm](http://www.ofgem.gov.uk/responses2002/mktng_regul.htm)

The majority of responses were from suppliers, 3 were received from organisations representing a consumer perspective and one from a company offering an on-line price comparison service.

This chapter will summarise comments on specific aspects of the proposals and will consider the points raised. A summary of Ofgem's decision is at Chapter 3.

### ***Threshold for investigation – use of energywatch data***

- 2.2 Ofgem proposed that the primary source of information used in assessing which companies should be subject to a full investigation would be the number of complaints about this issue made to energywatch.
- 2.3 Respondents largely accepted a role for energywatch data, although expressed some reservations:

energywatch said that 'Investigation and enforcement should not be based solely upon waiting for a large quantity of cases on any particular issue to emerge. Serious malpractices should be dealt with immediately...'

A respondent argued that Ofgem was under a duty to investigate breaches of the licence condition and asked 'Where there is prima facie evidence of non-compliance from consumer complaints how can the Regulator decide that it will not investigate?'

Suppliers generally supported the use of a complaint data threshold, but expressed concerns about the reliability of data provided by energywatch.

One supplier suggested that the use of an automatic threshold was too rigid.

- 2.4 Ofgem has considered these views carefully, in particular the views expressed by energywatch on this point.

- 2.5 This proposed role for energywatch data was designed to meet the objectives of transparency described above. Ofgem has access to a wide range of sources of information about sales activities, and uses them to enrich its understanding of customers' experiences of misselling. However, no other source has the potential advantages of energywatch complaints, of providing a data series which is consistent over time, national, and based on a process agreed and understood through the industry.
- 2.6 energywatch's data is now produced from a single database, but this was not the case until recently. Ofgem understands that energywatch is consolidating the value of this new database, by developing a high-quality process for agreeing with the relevant supplier how each complaint should be categorised. This process is expected to be complete by January 2003, and we understand that the robustness of energywatch data should then be considerably greater.
- 2.7 It is important to note that Ofgem is not using complaints data as evidence of non-compliance with SLC 48, but only as indicators of where Ofgem should focus investigative resources. Ofgem considers that the level of robustness required for this purpose is considerably less than what would be required as evidence of non-compliance.
- 2.8 For these reasons, we have concluded that it is appropriate to rely on energywatch's data for focussing resource. The original Ofgem proposals made it clear that this would not be the sole indicator and that Ofgem would investigate in other circumstances, if other sources of information suggested that it was appropriate; this remains the case. (See paragraph **2.41** below for the timing of the introduction of the new approach.)
- 2.9 Ofgem recognises its duty under the Gas and Electricity Acts to take action to secure compliance with licence obligations. However, a customer complaint is not in itself evidence of a breach of SLC 48. Moreover, as described above, Ofgem believes the interests of customers are best served by strengthening incentives for suppliers to comply with the licence condition. This requires suppliers to believe that non-compliance will result in a reasonably speedy response. Ofgem considers it reasonable therefore, to focus its compliance resources on those activities that are causing the most significant consumer detriment or distress. Consumers would not be well served if Ofgem attempted to take forward so many enforcement actions at once that each proceeded

extremely slowly. The use of the energywatch complaint statistics will ensure that this prioritisation is seen to be both fair and transparent.

### ***Interim threshold***

- 2.10 Ofgem recognises the importance of energywatch's new database and the associated processes currently being devised. We welcome these developments, but recognise they are likely to create a discontinuity and some short-term instability in energywatch's data series. For this reason, Ofgem proposed the introduction of an interim threshold, to be reassessed once the energywatch data settle into a recognisable pattern. This interim threshold would result in the investigation of any supplier that had been one of the two worst performers for two consecutive months (subject to being above both a *de minimis* level, and above the industry average).
- 2.11 Supplier respondents had mixed views on this proposal. For example, one said that the interim threshold implied that any retained inaccuracy in energywatch's statistics is systematic and not specific to any particular supplier, and that it was for Ofgem to provide evidence that the proposed interim threshold was equitable to all suppliers. Another suggested that the interim threshold was too rigid and proposed automatic investigation if complaints exceeded 1.0 complaints per thousand transfers; but that Ofgem should consider investigation of complaints in excess of 0.5 per thousand, if other indicators suggested a need to do so.
- 2.12 energywatch supported an incremental approach to the introduction of thresholds, but suggested a more vigorous approach might be the investigation of all companies with a complaint ratio of  $x$  times the industry average (for example 1.5).
- 2.13 Another respondent said that the proposed approach would be of no comfort to those consumers that have experienced misselling by other companies, even though they are not above the threshold.
- 2.14 In addition there was concern that the approach could be manipulated by suppliers. For example, if a supplier's complaint level in one month was high, it might reduce sales activity the next month, so as to avoid an investigation



- 2.15 Ofgem recognises that the proposed interim threshold has some drawbacks and has considered these views carefully. However, respondents did not in general suggest how else Ofgem should proceed (given our objectives, the energywatch developmental work, resource limitations and other factors). In addition, Ofgem believes that many of the concerns about the lack of robustness of energywatch data are over-stated, given that the threshold is being used to determine which suppliers will be investigated, not as evidence of non-compliance.
- 2.16 Ofgem continues to see the proposal to be a reasonable and practical application of the information and resources available during this interim period. Ofgem recognises that there is an expectation that the problems associated with misselling will be resolved and believes that further delay in considering alternative interim measures would be unacceptable to consumers.
- 2.17 So, the interim threshold will result in the investigation of a supplier if, for two consecutive months, it is one of the two worst performers, (i.e. it has the largest proportion of direct sales complaints to energywatch per thousand transfers), providing that its performance is worse than the industry average and subject to a de-minimis threshold (discussed below).

### ***Aggregated gas and electricity complaint data***

- 2.18 Ofgem proposed to use an aggregate of all gas, electricity and dual fuel complaint data for its threshold.
- 2.19 Supplier respondents were broadly in agreement, although they stressed the need to ensure that complaints were not counted more than once. energywatch suggested that the use of aggregated data could lead to a wave of mis-selling in one fuel being undetected.
- 2.20 Ofgem understands this argument but believes the use of aggregated data is a practical and transparent application that does not preclude a separate analysis of the individual fuel figures and further action, if there were grounds for concern.

### ***De minimis threshold***

- 2.21 Ofgem proposed to implement a threshold subject to a de-minimis figure of nine complaints. Several respondents suggested that this was an arbitrary figure, and one proposed that it should be expressed as a number of complaints per thousand transfers.
- 2.22 Ofgem fears this response reflects a mis-understanding of the purpose of the *de minimis* level. The proposal was intended to use resources where they will have the most impact, i.e., on investigations of suppliers generating many rather than a few complaints. Ofgem will still be able to consider the actions of suppliers with very low levels of complaints, if it is provided with information that suggests an immediate investigation is warranted.

### ***Medium term threshold***

- 2.23 In the medium term Ofgem proposed to introduce a threshold for investigation based on a fixed number of complaints to energywatch per thousand transfers, calculated by the industry average performance plus or minus an  $x$  value.
- 2.24 Respondents generally accepted this approach, but stressed the need to apply a fixed threshold using accurate data. Respondents had varying views on the application of an  $x$  factor. There was agreement that the imposition of a medium term threshold should be the subject of further consultation.
- 2.25 Ofgem will consult further, at the appropriate time, on the way in which a fixed threshold is determined and applied.

### ***Rebasing the denominator***

- 2.26 Ofgem suggested that the way in which transfer data was used to provide a context for the absolute number of complaints should be re-considered to reflect the time lag between sales activity and the reporting of a complaint to energywatch.
- 2.27 energywatch was able to verify its belief that the time lag between contact with a sales agent and a complaint to energywatch was usually two months, by calculating the correlation co-efficient between transfer numbers and complaints.

- 2.28 However, suppliers did not all support the proposed change and expressed widely varying views of the length of the time lag. One supplier suggested that an analysis of its complaints had demonstrated that the average age of energywatch complaints was nine months, others asserted that the time lag was as short as one month.
- 2.29 However, one supplier suggested that a two month time lag between sales activity and a complaint to energywatch, did not take account of the delay between sales activity and transfer. The supplier suggested that it can take on average one month for a transfer to be registered. If this is the case it might suggest that the appropriate time lag between transfer registration and complaint to energywatch is one month.
- 2.30 Ofgem believes that it does not have sufficient information to come to a firm conclusion, but that for the interim period it is reasonable to rely on the energywatch analysis and apply a two month time lag. Before setting a medium term threshold, Ofgem will ask energywatch to undertake some more detailed analysis and this evidence will be presented as part of the consultation on a fixed threshold.
- 2.31 Further consideration will also be given to the way in which transfer figures are collected and used by Ofgem.

### ***The investigation***

- 2.32 Ofgem outlined the proposed investigation process. Several respondents welcomed the transparency that this offered while commenting on the detail of process.
- 2.33 The timescales proposed were considered to be unrealistically short by some respondents in that they would not allow sufficient time for suppliers to demonstrate improvements in performance. Other respondents considered the timescales to be too long in addressing misselling activity.
- 2.34 In devising its initial, proposed timescale, Ofgem had considered both of these pressures. The process is intended to investigate whether or not a supplier has complied with its licence obligations and if appropriate, will result in the imposition of a sanction. Its purpose is not to highlight areas for improvement,

and then assess whether suppliers act on the suggestions. The possibility of the imposition of a sanction is intended to be an incentive to suppliers to comply with their licence obligations.

- 2.35 Ofgem has taken account of some respondents' views that the process did not allow suppliers the opportunity to see and comment on the conclusions of the report presented to the Authority and to make representations which might include evidence of improved performance. Accordingly we have decided that Ofgem will produce a Statement of Findings which will form part of the report to the Authority. The supplier under investigation will be given a chance to comment on (although not edit) the Statement of Findings.
- 2.36 Ofgem does not believe that it can realistically reduce the length of the process and still give full consideration to any evidence of misselling.

### ***Publicity***

- 2.37 Ofgem had proposed to publicise the fact that it would be investigating potential breaches of the marketing licence condition. Consumer representatives were very supportive of this approach, while the majority of suppliers argued that it was inappropriate to expose a supplier to adverse publicity before it was established that licence breaches had occurred.
- 2.38 Ofgem has considered these opposing views carefully and recognises that there is a risk that media reporting of an announced investigation would give consumers the impression that a supplier is in breach of its licence, when this has not been established. Such a misunderstanding would not generally be in consumers' interests. However, in some cases consumers' confidence in the market will be strengthened by knowing that an investigation is underway. Moreover, Ofgem believes that the timely announcement of an investigation may produce further evidence of licence breaches that it would be important to take into consideration
- 2.39 Ofgem has concluded that it will not as a matter of routine publicise an investigation until the Authority has decided that the supplier is in breach of its licence. However, Ofgem reserves the right to announce that it is investigating a company before that stage, for example if the company's activities are the

subject of widespread public concern. In any case, Ofgem will inform a supplier before it publicises an investigation.

- 2.40 It should be noted that supplier performance will be published on the energywatch website and it would be possible for any person to view this and come to a conclusion about the action that Ofgem is taking, based on the published procedure.

### ***Implementation***

- 2.41 Ofgem had proposed to introduce the new process on 1 August 2002. The majority of respondents said that it would be unreasonable to do so, given the steps being taken by energywatch to consult on its plans for a dispute and reconciliation process before publishing complaint figures.
- 2.42 Ofgem has taken account of these views. Given that energywatch's quality process for building the robustness of its complaints data will not be complete until January 2003, Ofgem will not begin using these statistics until the completion of that process. We will therefore implement the new threshold from 1 January 2003. The first set of figures available for use will be in February 2003.
- 2.43 In the interim, any decision to begin new enforcement action will be driven by the wide range of sources of information to which we have access. If new enforcement action is begun, it will follow the new approach (i.e., will be an investigation, not negotiation of undertakings). It should not be assumed that no enforcement action will begin before February 2003.

### ***Compensation***

- 2.44 Ofgem had expressed the view that the industry code of practice on misselling should include the automatic payment of significant amounts of compensation for consumers in cases of misselling. Not all responses covered this point. Consumer representatives were supportive of the suggestion while those suppliers that expressed a view, had reservations about the need to apply compensation automatically and the impact that it may have on the number of complaints.

- 2.45 Ofgem believes it is in the first instance for the industry to consider the role of compensation in devising its self-regulatory code of practice. Ofgem will re-consider this point when it knows the contents of and enforcement processes associated with the code of practice.
- 2.46 One respondent suggested that financial penalties should be used to provide compensation to consumers who have been subjected to misselling. However, any financial penalty paid is returned to the Consolidated Fund held by the Treasury and there is no mechanism to pass this directly to consumers.

### 3 The decision

- 3.1 In May 2002 Ofgem announced that it would be publishing a process for the monitoring of compliance with and enforcement of standard licence condition 48 of the supply licences, the marketing licence condition.
- 3.2 Ofgem will use marketing complaints data, published by energywatch, as its primary, although not sole, indicator that suppliers may not have complied with their obligations under the licence condition. A threshold will be applied, above which a supplier's activity will lead to investigation by Ofgem.
- 3.3 An interim threshold will apply until changes in the way energywatch report complaints have been fully implemented and outstanding issues have been resolved, following which a medium term threshold will be set, after consultation
- 3.4 The interim threshold will result in the investigation of a supplier where it:
- ◆ it is one of the two worst performers (i.e. it has the largest proportion of direct sales complaints to energywatch per thousand transfers); provided that its performance is worse than the industry average, and it has more than nine complaints; and
  - ◆ falls above this threshold for two consecutive months.
- 3.5 The interim threshold will apply from when data covering January 2003 become available. Until then, Ofgem will use a wide range of data in determining whether to begin investigation into compliance with SLC 48. Any investigation into compliance with SLC 48, started between 1 August and 31 January 2003, will follow procedural steps 3-10, outlined in paragraph 3.6.
- 3.6 From January 2003 any investigation into compliance with SLC 48 will follow the procedural steps below:

#### **month 1**

Step 1 energywatch reports data showing that complaints against supplier *y*, per thousand transfers, have exceeded the threshold.

## **month 2**

Step 2 energywatch reports data showing that complaints against supplier *y*, per thousand transfers, have exceeded the threshold.

Step 3 Ofgem asks energywatch for details of all direct selling complaints, about supplier *y*, that have been received in the relevant period.

Step 4 Ofgem sends an information request to the supplier.

Step 5 Ofgem will not routinely publicise the fact of an investigation having begun, but may do so if it believes this is in consumers' interests.

## **month 3**

Step 6 Ofgem investigates the individual cases.

## **Month 4**

Step 7 Ofgem produces a Statement of Findings which is sent to supplier *y*.

## **Month 5**

Step 8 A report is made to the Gas and Electricity Markets Authority, which will decide in accordance with its published policy, if it considers that it is appropriate to impose a financial penalty. The Authority may equally determine to impose no sanction or make an enforcement order, as well as, or instead of a financial penalty.

Step 9 Ofgem will give appropriate publicity to the Authority's decision.

## **Month 6**

Step 10 If the Authority decides to impose a financial penalty it will follow the procedural steps outlined in the April 2001 document "Financial Penalties – The Process".

3.7 Ofgem will give appropriate publicity to the Authority's decision.



### ***Practical application***

- 3.8 This process is intended as a general guide to suppliers, consumers and consumer organisations. However, Ofgem will always have to have regard to the seriousness of individual cases that are referred for consideration from whatever source. If, at any time, Ofgem is provided with the details of a potential breach which it believes warrants immediate investigation, it will initiate such an investigation, which can lead to the imposition of financial penalties.

## List of respondents

Atlantic Electric and Gas

British Gas Trading Ltd

energywatch

Innogy

London Electricity plc

NACAB

NEA

Powergen

ScottishPower

Seeboard plc

TXUEnergy

uSwitch.com

One confidential response was received