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**Making markets work for consumers:  
Ofgem's approach to securing compliance with supply licence  
obligations and consumer protection legislation**

***A Response by British Gas Trading  
(12<sup>th</sup> September 2003)***

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## 1. **Executive Summary**

British Gas supports the broad thrust of Ofgem's proposed approach but has concerns over some of the drivers and priorities as currently formulated, and real issues with aspects of how the compliance strategy will be applied in practice.

### Ofgem strategic drivers, priorities and principles

- ❑ British Gas broadly supports the strategic drivers but believes that the enforcement arrangements should embody a principle of even-handedness.
- ❑ British Gas also broadly supports the priorities, but suggests that security of supply is not an appropriate priority for a supplier compliance regime. British Gas further recommends the inclusion of a priority that focuses on the severity of consumer harm together with the compliance approach taken by the supplier.
- ❑ British Gas supports the five key principles set out by Ofgem.

### Suitability of the current licensing framework

- ❑ The current licence conditions were drawn up prior to the introduction of increased powers under the Utilities Act 2000. The obligations therein were effectively transferred across, two years ago, without due consideration of Ofgem's proposed compliance regime.
- ❑ Ofgem should consider a fundamental review of the current licence conditions, to ensure that they continue to drive appropriate supplier behaviour to deliver real consumer benefits, appropriate for today's current competitive market environment.

### Publicising investigations

- ❑ British Gas believes there are significant downsides from the Ofgem proposed blanket approach to publicly announcing investigations at the outset, in particular, undermining consumer confidence and disproportionate harm to suppliers if the case were then to be dismissed.
- ❑ Ofgem should adopt an approach consistent with the OFT and FSA whereby publication of investigations should be decided on a case-by-case basis, considering the consumer benefits and the potential harm to the investigated supplier. This is essential with regard to Competition Act cases where Ofgem have concurrent powers with the OFT. Given the imminent establishment of Ofcom, it would be inappropriate to place reliance upon the current Ofel model.

### Equitable application and targeting of priorities

- ❑ Clarity is required as to when Ofgem will or will not act.
- ❑ There is a need for greater assurance that an even handed approach to potential breaches will be applied to all suppliers, balanced against the actual impact of those breaches on consumers.

## 2. Introduction

- 2.1. British Gas fully recognises the requirement for an appropriate and transparent regulatory framework in order to complement the competitive market environment in energy and to encourage appropriate supplier behaviour to deliver the benefits of the competitive market while continuing to protect consumer's interests. British Gas therefore broadly welcomes Ofgem's set of proposals as a helpful step towards this objective and, in principle, supports the proposed approach. However, there are important aspects of the approach that require careful consideration. First, it is essential that Ofgem's strategic drivers and priorities provide an appropriate basis for an effective and equitable compliance regime. Second, British Gas has a number of key concerns with how these drivers and priorities are translated into the operation of the proposed enforcement regime.

## 3. Strategic Drivers and Priorities

### Strategic drivers

- 3.1. British Gas broadly welcomes Ofgem's stated strategic drivers. In this regard, the drivers appear to embody the appropriate sentiments necessary to secure an effective compliance approach. Whilst British Gas has no concerns with the first of these drivers, namely, *"confident and empowered consumers are essential to the operation of a mature competitive market..."* it does however have some concerns with the remaining two.
- 3.2. Ofgem's second strategic driver states *"Consumer confidence is underpinned by supplier compliance with legal and licence obligations"*. Whilst in isolation this statement seems reasonable, it must be considered within the context of the market at present, namely the high numbers of consumers switching and Ofgem's own market reviews suggestive of high levels of consumer confidence. To suggest that this is an important driver in support of the proposals, and therefore a justification for the measures being put forward, particularly in the absence of any specific evidence linked to consumer confidence, is probably overstating the benefits that might follow.
- 3.3. Ofgem's third strategic driver states *"Suppliers can be incentivised to comply through the positive encouragement of compliance cultures and by credible enforcement arrangements"*. British Gas does not believe that this driver will, as stated, best deliver an approach that aligns with Ofgem's supply compliance strategy principles (which follow the Better Regulation Taskforce principles). As such, British Gas believes that an "even-handed" approach to enforcement will better reflect the principles of proportionality, consistency and targeting. Accordingly, this should be reflected in this third driver i.e:

*"Suppliers can be incentivised to comply through the positive encouragement of compliance cultures and by credible and **even handed** enforcement arrangements."*

## Priorities

- 3.4. British Gas also welcomes the publication of Ofgem's priorities. The priorities within this compliance strategy must seek to balance the benefit for consumers, within the context of the obligations set out in gas and electricity suppliers licences, with the costs of compliance which will ultimately be borne by consumers.
- 3.5. In particular, the first of these stated priorities (and this assumes no order of preference is inferred by Ofgem) makes reference to 'security of supply' and the 'safety of consumers'. British Gas fully supports the priority on safety – this is the top concern of all players in the market, not only suppliers. However, given the wider industry interpretation of 'security of supply', this priority might be better framed within a network operator compliance regime. Accordingly, it would be helpful for Ofgem to provide greater clarity on why it is a priority within this framework, or indeed how it would be enforced. For example, experience of the SOLR arrangements to date has shown that the market is the more efficient means of securing continuity of supply.
- 3.6. As an alternative, British Gas would suggest that more focus should be placed on protecting consumers from licensees that may deliberately flout their licence obligations for commercial benefit. Furthermore, priorities should also be led by the severity of such breaches and the level of impact on consumers.
- 3.7. The other priorities proposed by Ofgem support this amended focus, namely, delivering effective competitive markets and protecting vulnerable consumers.

## **4. An outline of British Gas's key concerns**

- 4.1. British Gas has three broad areas of concern with regard to the implementation of this strategy. These are:
  - the appropriateness of considering these far reaching compliance proposals in isolation when underpinned by the current licensing framework, the fundamentals of which did not fully anticipate the effects and increased powers of the Utilities Act 2000, being largely based on the transposition of the previous licence conditions;
  - the impact of publicising an investigation in progress and, in particular, the extent to which this may or may not secure more confident consumers; and
  - the basis on which the strategy will be implemented in practice is unclear and does not appear to demonstrate consistency or even-handedness of approach. In particular, British Gas remains unclear about the circumstances in which Ofgem intends to take action and against whom, and is keen to ensure comparable treatment of similar contraventions by all suppliers.

## **5. Suitability of the current licensing regime**

- 5.1. The current licensing framework was developed at the time the gas and electricity markets respectively were liberalising, and prior to Ofgem gaining its current, extensive investigatory and penal powers. Many of the licence conditions introduced at that time, and still in place today (essentially transposed into the new framework as part of the Utilities Act 2000), require absolute compliance; for example the duty to inform all consumers at least once a year that energywatch can resolve disputes and how they can be contacted.
- 5.2. As part of the Utilities Act, Ofgem gained significantly greater powers, and is now, two years on, confirming a significant change in the way it intends to use those powers. It is British Gas' view that the full magnitude of the impact that Ofgem's proposed approach to compliance will have upon suppliers, as outlined in this response, may not have been fully considered or appreciated by DTI, Ofgem or the industry. Indeed, it is noted that Ofgem consider that a Regulatory Impact Assessment is inappropriate, which seems to support this view.
- 5.3. In addition, Ofgem has not considered whether, in the light of these proposals, corresponding changes may be required across the gas and electricity supply licence conditions. Licensees may therefore find themselves in breach of their licence and subject to enforcement action under Ofgem's proposed supply compliance strategy through a trivial or inadvertent omission involving very few consumers. This concern is heightened by the statement in paragraph 4.7 of the consultation that Ofgem places 'great store' on securing compliance with particular "absolute" licence conditions on the grounds that their objective is to ensure that consumers are empowered to engage with the competitive market. This is despite the fact that consumers can readily obtain information simply by contacting the company.
- 5.4. Whilst Ofgem has previously signalled that mitigating circumstances will be taken into consideration, this would appear only to apply to the penalty setting phase of the investigation, rather than a decision about whether or not to launch a formal investigation. This can be very resource intensive both on the part of the regulator and the supplier and this is particularly relevant where the case is not subsequently made out.
- 5.5. Ofgem's strategy should recognise that non-compliance can result despite the actions of both senior management and front line staff, and the existence of a strong compliance culture within an organisation. For example, non-compliance can occur as a result of deficient industry processes. Therefore, as suggested earlier, priority should be focused on any licensee that fails to adopt such a compliance culture rather than those who are seeking, to the best of their ability, to meet their regulatory obligations.

- 5.6. It is therefore British Gas's view that, whenever a contravention by a supplier is considered by Ofgem, part of that consideration should include an objective review of the effects of the failure to adhere absolutely to the licence condition(s) in question, measured against Ofgem's compliance priorities. British Gas believes that a balance needs to be struck between the compliance action that Ofgem will take, the degree to which that supplier has adopted a compliance culture, the severity of the breach and the real impact on consumers.
- 5.7. In the absence of clear guidance, Ofgem should take into account the extent to which a supplier has adopted a reasonable approach to the interpretation of the licence requirements and sought to meet those obligations according to that interpretation. In particular, where Ofgem commences a formal investigation it must at least provide clarity around its expectations regarding the obligations in question. Indeed, before Ofgem is able to confirm whether or not a supplier is in contravention of its licence obligations, and therefore has a case to answer, it should, as part of the formal information request, have formed a clear view of the interpretation against which to measure compliance, and communicated that to the licensee. British Gas believes it would be unreasonable for such requirements to remain unclear.
- 5.8. Accordingly, British Gas believes that, when considering whether to launch an investigation or apply sanctions, Ofgem should consider the appropriateness of the requirements in the relevant licence condition in today's competitive market. This is consistent with one of Ofgem's stated aims to review regulatory requirements to support a withdrawal from prescriptive regulation.
- 5.9. There may be a case for general review of licence conditions by Ofgem and the industry in order to assess the continuing appropriateness of licence conditions with perhaps guidance as to what "compliance" is generally understood to be. In this way, greater transparency should lead to more consistency of approach across the industry and enable more efficient targeting of particular areas likely to affect consumers.

## **6. Publicising investigations**

- 6.1. British Gas has significant concerns over Ofgem's proposal to publicise all investigations at the point when a formal investigation commences. These concerns relate to the impact of consumer confidence in the market and the "innocent until proven guilty" approach, the disproportionate potential harm to the supplier under investigation and the potentially adverse effect on cooperation between suppliers. These concerns are expanded below followed by a summary of the approaches regarding publicising investigations adopted by comparable regulatory bodies.

### **Consumer confidence**

- 6.2. Ofgem recognises within its consultation that compliance activity with a high public profile i.e. publicised, could "undermine [consumer] confidence unnecessarily". British Gas concurs with this view and believes that greater publicity of supplier investigations is likely to have the effect of undermining

consumer confidence in suppliers to the detriment of competition i.e. may deter a consumer from switching.

- 6.3. Consumers are not sufficiently well informed about the minutiae of licensing and consumer legislation to be able to differentiate the seriousness of any alleged wrongdoing. Some are therefore likely to view the launching of an investigation against their supplier as being a reflection of the overall service offered by that supplier or even the market as a whole.
- 6.4. That is not to say that concluded investigations where the Authority has determined that a supplier has been in breach and sanctions are deemed appropriate should be withheld from the public arena. British Gas supports such publication where the case is proven. There may also be cases where Ofgem may publish the findings of an investigation where no enforcement action was taken. This may, in fact, help consumer confidence and should be considered on a case by case basis. However, announcing all investigations at the outset is likely to engender a “guilty until proven innocent” environment i.e. pre-judgement, where the number of investigations against each supplier will tend to weigh against them irrespective of the outcome.

#### Disproportionate harm

- 6.5. Such an environment is likely to damage consumer confidence in a supplier with listed investigations (whether proven or dismissed) but also impact the brand reputation of that supplier. This could potentially depress the share price causing significant financial damage to a supplier. While it could be argued that this is appropriate where the case is proven, it is clearly not so where it is not proven, or the outcome shows the breach is trivial.
- 6.6. It should also be recognised that the impact upon the few suppliers who are listed on the UK Stock Exchange would be disproportionate to non UK listed companies, which are likely to experience no adverse reaction to their share prices whatsoever in their country of listing.

#### Supplier cooperation

- 6.7. Furthermore by introducing these proposals, there is a risk that suppliers may be much less inclined to resolve issues on a bi-lateral basis, but instead will seek to gain competitive advantage by drawing perceived competitor contraventions to Ofgem’s attention. This would undermine trust and opportunities for mutually beneficial actions, at a time when the industry is attempting to pull together under Energy Retail Association to improve industry customer transfer processes – a project which has the strong support of Ofgem and energywatch. Ofgem could also become isolated through reduced “informal” supplier dialogue.

#### Approaches of Comparable Regulatory Bodies

- 6.8. British Gas has considered the approach adopted by other regulatory bodies regarding the public listing of investigations i.e. the Financial Services Authority (FSA), the Office of Fair Trading (OFT) and Ofel, in order to benchmark Ofgem’s proposed approach.

- 6.9. The **FSA** publicises the facts of an investigation in circumstances only where it feels that it is desirable to do so in order to protect consumers, maintain public confidence in the financial system, prevent widespread malpractice or to progress the investigation, and in deciding whether or not to make such an announcement it will consider potential prejudice to any of the parties (FSA Handbook, Chapter 2, section 2.13).
- 6.10. The **OFT** adopts a similar approach to the FSA. Where a decision about publicity is taken, the OFT's current policy broadly reflects the principles in the Freedom of Information Bill: that possible harm to a business is weighed against the needs of transparency. The same approach is adopted for investigations under the Competition Act 1998 but recent experience has demonstrated that such cases are generally not publicised (unless an adverse decision has been made).
- 6.11. **Oftel** publicises the commencement of its investigations on its website-based Competition Bulletin, except where the complainant withholds its consent to publication. However, these are generally focused on detailed points of the operation of the competitive market place rather than an investigation into individual suppliers with an associated inference of significant wrongdoing. Nevertheless this appears out-of-line with the FSA and OFT approach. Given that Oftel will be subsumed within Ofcom at the end of this year, it would seem inappropriate to base Ofgem's approach on that of Oftel, particularly as Ofcom's policy has not yet been established or made public.

### British Gas Proposals

- 6.12. British Gas strongly believes that Ofgem should adopt an approach consistent with the OFT and the FSA (rather than that of Oftel), whereby it considers the benefits to consumers that could reasonably be expected to accrue from a decision to publicise and, equally, the harm that such a decision might cause, particularly to the party under investigation. In order to implement this policy in a transparent and consistent manner, a clear set of criteria needs to be established to be utilised when reaching a decision on whether to publicise particular investigations. In the interests of regulatory accountability, these criteria should be developed in the public domain so consumer bodies and suppliers alike can contribute to their development.
- 6.13. British Gas believes the proposed Ofgem approach regarding publicity, should only be adopted for future investigations which have yet to commence. The suggested advantages of public listing e.g. additional information from third parties, should not apply to historic investigations. Furthermore, a retrospective application of a policy is not in keeping with the general regulatory approach e.g. revised licence conditions apply to future activities not past. Clearly the approach to publishing either retrospectively or at the outset should not be implemented until this, or a modified, Ofgem strategy has been formally announced.

## 7. Equitable application and targeting of priorities

7.1. In line with the previous comments on the strategic drivers Ofgem should, in the use of its investigatory powers, focus on the degree of harm to consumers arising from contraventions of the licence conditions in question and whether a supplier has deliberately and knowingly contravened those obligations. In this way, Ofgem can determine the most appropriate action to take. For example, where a supplier had inadvertently breached an obligation and the consumer impact is low, an informal approach, as described in Ofgem's document would be appropriate. Conversely, a deliberate severe breach would warrant a formal investigation. Accordingly, while the number of consumers affected may be a relevant consideration, it is only one factor in the decision making process. This will enable Ofgem to target its limited resources on the areas that maximise consumer benefit.

7.2. With this in mind and Ofgem's intention to secure transparency and certainty around the compliance enforcement regime, it is a concern that there are elements of Ofgem's consultation document which still leave room for confusion about the circumstances in which Ofgem will act and against whom. Examples of this confusion are:

- *"...deciding whether or not to take action against a specific supplier"* (paragraph 6.2)
- *"...taking enforcement action against suppliers who may not be in a worse compliance position than others"* (paragraph 6.2)
- *"...decisions on whether or not to take action against other suppliers being made on a case by case basis"* (paragraph 6.2)
- *"If Ofgem becomes aware of non-compliance then it is required to act."*

In addition, Paragraph 3.7 of the Paper states that: *"if [Ofgem] is satisfied that a contravention has occurred it must take action. But where a breach is not clear without further investigation, [Ofgem] must decide whether or not to devote resources to finding out. When considering its enforcement options [Ofgem] will be guided by its principal objective and the statutory terms of the particular enforcement actions."*

7.3. There is a potential tension here between the principles for the compliance strategy as set out by Ofgem. While trying to target resources, as is right and proper, there is a danger that consistency may suffer. In order to avoid this, two other principles are the key – transparency and proportionality. First, there needs to be transparency on Ofgem's criteria on whether to use the investigatory powers (clearly Ofgem's document goes some way in this regard although greater clarity is required in a number of areas as discussed in this response). Second, the criteria should include proportionality i.e. is it a proportionate action in relation to the alleged licence contravention to instigate a full regulatory investigation?

7.4. The equitable application of the compliance strategy will not only meet the stated principles of the strategy (which align with those of the Better Regulation Taskforce) but bring a number of other benefits:

- ❑ predictability for the energy market in order to give stability and certainty to those being regulated;
- ❑ enhancement of consumer confidence not only that the most severe and flagrant contraventions are being targeted but compliance activities are applied even-handedly to all suppliers in the market; and
- ❑ all suppliers in the market will be incentivised to adopt a more pro-active compliance culture, as investigations will not just be focused on dominant suppliers.