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Direct Dial: 020 7901 7355

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Industry Codes Compliance Review – Way forward

In June 2006 Ofgem published its [Industry Codes Compliance Review Consultation](#) document. This sought views from the industry on the appropriate roles for regulatory enforcement and self governance of the industry codes. An important reason for issuing this document was to set out options which could, consistent with the principles of better regulation, involve Ofgem either reducing the extent to which certain conduct is regulated through licence conditions or withdrawing from regulation altogether. The ICCR consultation closed in September 2006. The document outlined five options on how to take the review forward. These are set out in more detail in Annex 1. A summary of the responses to the consultation is set out in Annex 2.

Ofgem has decided that it would be appropriate to pursue an Option 2 approach (namely to provide additional guidelines regarding Ofgem's enforcement role on the various regulated contracts). We therefore intend to clarify our intended treatment of code breaches by issuing some new enforcement guidelines. We consider this approach will help address the uncertainties faced by market participants whilst requiring minimal resource commitment from the industry. We also note that this option received the most support amongst the responses received to the ICCR consultation.

We recognise that the enforcement provisions vary between the gas and electricity licences, but having considered the benefits and the costs of aligning the licences we are not persuaded that these should be aligned at this time. This is because, for example, of the lack of evidence of consumer harm relative to the resources required to reform these arrangements. However, if this position were to change or should evidence emerge of difficulties in enforcing these conditions which might put consumers interests and the effective operation of the market at risk, then we would revisit our position.

Options 4 and 5 were more radical solutions which were not widely supported by the industry, although some respondents considered them good aspirational targets. We share this perspective but consider that, given the range of matters facing the market, it would not be appropriate to pursue either of these options at the current time. Indeed, we would not intend to revisit Options 4 and 5 until such time as industry came forward with a convincing case to do so.

The Option 2 approach will be delivered by Ofgem's document ["Proposed Enforcement Guidelines on Complaints and Investigations."](#)¹ This aim of this document is to give greater clarity and transparency to Ofgem's enforcement policies and practices, consistent with better regulation principles and the role that enforcement plays in meeting Ofgem's wider duties. The document applies to Ofgem's general enforcement role but is also relevant to the enforcement of the industry codes. We note there are a limited number of areas where Ofgem's enforcement role as it pertains to the industry codes and agreements needs to be specifically addressed. We have therefore included a section in the enforcement guidelines addressing these issues.

If you have any questions please contact me on the number above.

Yours faithfully,



Mark Feather

Associate Director, Industry Codes and Licensing

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<http://www.ofgem.gov.uk/ABOUT%20US/ENFORCEMENT/Documents1/Enforcement%20Guidelines.pdf>

Annex 1

ICCR Options

Option 1 - Maintain the current arrangements

This option would mean no change. The majority of industry responses to the Supply Licence Review suggested that improvements should be made.

Option 2 - Maintain the current arrangements but with guidance from Ofgem on its enforcement policy.

Under this option Ofgem would enforce serious breaches of the Codes through the licence but in the interests of transparency would publish guidance or principles on its enforcement policy. It was anticipated these guidelines could acknowledge the need to take into account self-governance enforcement that may be in progress.

Option 3 - Retain similar obligations, but with a different test for non-compliance.

Most codes and agreements require parties to accede and comply with them. However, the gas shippers licence sets a different requirement to other Codes by not simply requiring that parties must not to do anything to knowingly or recklessly jeopardise or compromise the efficient operation of the arrangements. Option three considered standardising these licence obligations, either by applying the typical accede and comply obligations to the UNC, or by adopting a 'knowingly or recklessly jeopardise' test on other codes. Another possible approach was to use a formulation of words, such as a materiality and persistency test, that captures a new and possibly more appropriate balance.

Option 4 - Retain the current obligations, but only in relation to specific sections and clauses

This approach would introduce a two tier approach to compliance within the Codes by identifying in the first tier sections and clauses that could initially be subject to Self-governance but would be ultimately subject to Regulatory enforcement. The second tier would contain the remaining sections and clauses and would only be subject to compliance by means of self-governance. One way of implementing this approach was suggested to be that industry take a pro-active role by proposing modifications to the codes to remove terms that may not be appropriate for regulatory enforcement and to move them into subsidiary documents. These subsidiary documents may then be amenable to more robust compliance actions by means of Self-governance.

Option 5 - Industry Self-governance of Codes

This option was first suggested in the context of the Supply Licence Review. Under this option, parties, via the Code Panels or some other mechanisms to be devised, would undertake enforcement action for any breaches of the Code, with no backstop by way of licence obligation.

Ofgem suggested that a prerequisite for implementing such an option along these lines would be the establishment of a suitably constituted body to administer the

arrangements and to enforce sanctions. The decisions of the body applying the sanction would need to be accepted as final and binding perhaps through a specific commitment to this effect in the relevant Code or else would need an appropriate avenue of appeal against its decisions. The body applying the sanctions may also be subject to appeal or judicial review.

Annex 2

Summary of responses to consultation

In our consultation document we invited industry participants to comment on the options for reform we had identified. The consultation closed on 1 September 2006, and 22 responses were received. The following summary explains the responses in terms of the amount of support received for each option - those with most support appear first.

None of the options received the clear support of the majority of the industry. Notwithstanding this, an analysis of the responses received revealed most support for Option 2 (to maintain the current arrangements and for Ofgem to provide guidance on its enforcement policy). Most respondents stated that industry would significantly benefit from clarification of Ofgem's enforcement policy. Those respondents considered that the current compliance regime presents a risk of double jeopardy. The double jeopardy which they referred to was the prospect of concurrent enforcement actions being taken against a code party by (i) a code panel under the provisions of that code, and (ii) Ofgem under a licence provision requiring adherence to the provisions of the code. A number of participants which were, on balance, in favour of Option 1 (retaining the status quo) felt there may be worthwhile exploring Option 2 as this had merit in terms of setting out the criteria under which breeches would be assessed, but without incurring significant cost. Whilst there was also a suggestion that pursuing Option 2, whilst a potentially worthwhile exercise it may not be the best use of finite resources, but respondents also acknowledged that this approach could bring about useful outcomes.

Some respondents who felt that Option 2 was worth exploring also felt that Option 3 might have some merit. The responses of both this group and the parties which favoured Option 3 outright were characterised by the desire to reduce regulatory uncertainty, make code compliance arrangements more consistent with the principles of better regulation. Whilst this was the case, a number of respondents spoke out specifically against the implementation of Option 3. One industry participant suggested that Option 3 would require significant resources without providing an appreciable change in behaviour.

A number of parties felt that Option 1 (the status-quo) would be the appropriate path to take. The reasons cited by industry participants which were in favour of Option 1 included that the current compliance arrangements are effective, that Ofgem should retain its current enforcement role in relation to the codes, that it is not clear what material benefits would be realised by changing the current code compliance arrangements, and because it was not clear that the benefits which might be gained by reviewing the arrangements would justify the costs of making those changes.

Limited support existed for Option 4. Some respondents considered it the optimal outcome, but others, whilst supporting the concept as an ultimate goal, suggested that self-governance may not be a realistic near-term outcome. Another respondent suggested evaluating the DCUSA arrangements once they had been operational for some time before adopting Option 4. A number of participants made comments to the effect that, of the current codes, the BSC would be most suited to the reforms envisaged in Option 4. Very little support was offered for Option 5. In the main respondents which commented on Options 4 and 5 were concerned with what they perceived to be the significant resource implications in these approaches. Another common theme was that the costs of such reforms, which would necessitate a restructuring of the industry codes

would easily outweigh the benefits associated with them. There was also limited support for an approach that would move from Option 4 to Option 5 over time.

Several respondents noted that there was room for improvement in most of the codes, but that the problems faced were not shared between them. One respondent suggested that a more bespoke approach should be taken to improving the codes, identifying particular areas for development in each contract. Some suggested that changes to the codes themselves should only be focussed on those codes that do not contain robust compliance procedures.