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Dear Megan

Review of Ofgem's enforcement activities – consultation on strategic vision, objectives and decision makers

I am pleased to attach Energy UK's response to Ofgem's consultation on its strategic vision, objectives and decision-makers with respect to enforcement activities. It is not confidential.

If you have any questions, please do not hesitate to contact me on 020 7747 2962 or alun.rees@energy-uk.org.uk

Yours sincerely

Alun Rees
Policy and External Relations Manager

Review of Ofgem's enforcement activities – consultation on strategic vision, objectives and decision makers

Energy UK response

23 May 2013

1. Introduction

- 1.1. Energy UK is the trade association for the energy industry. Energy UK has over 70 companies as members that together cover the broad range of energy providers and supplies and include companies of all sizes working in all forms of gas and electricity supply and energy networks. Energy UK members generate more than 90% of UK electricity, provide light and heat to some 26 million homes and last year invested £10billion in the British economy.
- 1.2. Energy UK strongly believes in promoting competitive energy markets that produce good outcomes for consumers. In this context, we are committed to working with Government, regulators, consumer groups and our members to develop reforms which enhance consumer protections, trust and effective engagement. At the same time, Energy UK believes in a stable and predictable regulatory regime that fosters innovation, market entry and growth, bringing benefits to consumers and helping provide the certainty that is needed to encourage investment and enhance the competitiveness of the UK economy.
- 1.3. These principles underpin Energy UK's response to Ofgem's consultation on its strategic vision, objectives and decision-makers with respect to enforcement activities. This is a high level industry position; our members may hold different views on individual issues. We look forward to working with Ofgem over the coming months as it develops its strategy and related reforms.

2. Executive Summary

- 2.1. Energy UK warmly welcomes Ofgem's review of its enforcement activities; it is both timely and necessary. It is timely because Ofgem is being granted new powers to order redress and enforce REMIT, as well as introducing a significant element of Principles-Based Regulation via the Standards of Conduct. The review is necessary because Ofgem's enforcement activities up until this point have not been as effective as they might have been. We are keen to discuss how could be improved, based on the framework of proposals that Ofgem provides. This is our intention, and we hope that Ofgem finds our observations and suggestions useful.
- 2.2. Before answering the individual consultation questions, Energy UK would like to highlight some overarching points –
 - a) Energy UK believes that Ofgem's choice of enforcement approach (or combination of approaches) is more important than producing a "Vision for Enforcement" or "Strategic Objectives", and that resources and discussions should be targeted accordingly. Indeed, we do not understand why Ofgem requires specific Strategic Objectives that are distinct from its

general responsibilities. That being said, Energy UK welcomes the fact that Ofgem's proposed Vision puts energy customers first, and believes that this could be applied generally rather than being directed specifically at enforcement activities.

- b) Ofgem's proposed Strategic Objectives seem to imply a deterrence-based approach to enforcement. Energy UK does not believe that this has worked well in the past and considers that a deterrence approach is particularly unsuitable for the complex and subjective rules that are coming through the Retail Market Review (RMR). Energy UK would advocate a primarily Compliance and risk-oriented approach instead, with a focus on constructive dialogue between regulator and firms.
- c) Energy UK agrees that Ofgem should adopt annual strategic priorities. We believe that these should be consulted on and published. We suggest that the strategic priorities might entail thematic work, where Ofgem focuses on an issue or set of issues that it believes may pose particular risks to its statutory objectives. Such work should not, however, start with the presumption that it will ultimately lead to enforcement outcomes.
- d) Energy UK broadly supports Ofgem's proposals for an Enforcement Decision Panel, and looks forward to seeing further detail on its precise role and responsibilities. However, we do not believe that the establishment of the Panel is sufficient to embed high-quality decision-making via institutional arrangements. Energy UK remains of the view that additional controls are required, including the ability to appeal Ofgem's enforcement decisions on the merits of the case and each case being subject to a standard legal review by an Ofgem lawyer not in the investigation team. With respect to the former, Energy UK has provided a detailed submission to DECC explaining why merits-based appeals are required. We would ask Ofgem to review the proposal and consider joining Energy UK's call for legislative changes that would introduce merits-based appeals. If Ofgem felt unable to do so, we would be interested to hear why.
- e) Energy UK strongly believes that the role of publicity should be part of Ofgem's Enforcement Review. For example, Ofgem should consult on (i) whether public announcements regarding enforcement activities should be made, (ii) at what stage in the investigation and in what circumstances, (iii) the objectives of doing so, and (iv) who has control over editorial content. We have one concrete suggestion in this regard; that the investigation team should not be involved in the drafting of press releases in contested cases, so as to institutionally embed a degree of impartiality in how they are presented.

3. Responses to consultation questions

Q1: Do you agree that this is the right Vision for Ofgem's enforcement work? Please provide us with any comments you have on the Vision.

- 3.1. It is unclear to Energy UK why a distinct vision is required for Ofgem's enforcement. In this regard, we would like Ofgem to explain whether the vision constitutes a reframing, refocusing or some kind of departure from its more general duties and objectives.
- 3.2. Notwithstanding the comments made in 3.1, Energy UK welcomes the priority given to putting energy consumers first, and believes that this should be reflected in its approach, stating clearly that this means targeting areas of greatest consumer harm.
- 3.3. Energy UK is concerned with the way in which Vision is split into two distinct parts: putting energy consumers first and acting in line with obligations. This implies that the fulfillment of the latter may not ensure the former, thus still warranting enforcement action. We would question whether this is consistent with the statutory powers provided to Ofgem and the regulatory obligations placed on licensees. Should Ofgem progress with the vision, "and" should be replaced with "through" or "by" so as to link the two elements together.

Q2. Do you agree with Ofgem's proposed Strategic Objectives, and principles for achieving them, and do you think it would be helpful to adopt annual strategic priorities? Please explain the reasons for your answer and any aspects which you think we should consider.

- 3.4. The same comment made in 3.1 above with respect to the Vision applies to the Strategic Objectives.
- 3.5. Energy UK considers that it is more important for Ofgem to focus its time and resources on developing a more effective compliance and enforcement regime. In this regard, the wording of the first two proposed Strategic Objectives, including the delivery of "credible deterrence" and ensuring "visible and meaningful consequences" imply a deterrence-based approach.
- 3.6. Based on conversations with our members and publicly-available information on past investigations, Energy UK considers that Ofgem already employs a deterrence-based approach to enforcement. Ofgem is reviewing its existing approach; Energy UK is concerned therefore that the current wording of the Strategic Objectives risks prejudicing the outcome of that review, inhibiting change.
- 3.7. Energy UK is aware that KPMG's recommendations are yet to be published and Ofgem is yet to consult on its "Enforcement Principles" and "range of enforcement tools". However, our initial view is that Ofgem should adopt a strategy that is both risk-based and Compliance-oriented. The latter would seem to align with Ofgem's Simplification Plan, which states that its Enforcement Review will include "a greater emphasis on compliance work"¹. The former would seem to be supported by Ofgem's proposed third Strategic Objective which states that it will "target enforcement resources and powers" to "achieve the greatest impact".
- 3.8. Energy UK agrees that Ofgem should focus its enforcement on issues causing (or that have the potential to cause) greatest harm to consumers, and where intervention is expected to bring maximum benefits. We believe that the adoption of annual strategic priorities would support this aim, and we would support their introduction, provided they are consulted on. Having said this, it is not clear from the consultation how the strategic priorities will determine what Ofgem does in practice on a year on year, day to day basis and it would be helpful to clarify this..
- 3.9. A compliance-based approach is particularly suitable for enforcing rules that are either complex or subjective. Conversely, a deterrence-based approach is of little use if it is not clear what behaviour is unacceptable (i.e. that which Ofgem intends to deter). The Retail Market Review is introducing both complexity (via the tariff, TCR and information remedy rules), and subjectivity via the Standards of Conduct (SOC). If Ofgem wishes to secure compliance with these new obligations, then it will need to help educate firms as to what is expected from a compliance and enforcement point of view.
- 3.10. Another problem with the deterrence-based approach is that the kinds of behaviours that Ofgem considers worthy of investigation are not shared publicly until the case is closed. This is a particular problem where cases take a long time to conclude because there is a long delay in other firms being able to learn from them. This inhibits both continuous improvement and can also give the impression that the offending practices are still in place.
- 3.11. As to what a compliance-oriented approach might look like, Energy UK has previously recommended a two-stage approach. We still believe that this would be beneficial to customers, Ofgem and suppliers alike. We do not believe that the merits of such an approach have been fully appreciated and we would urge Ofgem to revisit the case.
- 3.12. Notwithstanding the comments made above, should Ofgem introduce Strategic Objectives then we believe the following should be added, in this order:
- a) Achieve compliance

¹<http://www.ofgem.gov.uk/About%20us/BetterReg/SimpPlan/Documents1/Ofgem%20Simplification%20plan%20WEB.pdf> p. 9

- b) Promote confidence amongst market participants that they will be treated fairly
- c) Encourage investment, market entry and growth

3.13. As to how Ofgem should achieve those objectives, Energy UK would add the following to Ofgem's proposals:

- a) Being transparent in what is communicated between the investigation team and Enforcement Committee
- b) Being transparent in communicating to those under investigation what stage it has reached
- c) Educating licensees and engaging in constructive dialogue
- d) Sharing examples of good and bad practices to drive continuous improvement

Q3. What obstacles do you consider that Ofgem may encounter in achieving its Vision and Strategic Objectives?

3.14. It is difficult to answer this question until the wording of Ofgem's Vision and Strategic Objectives are finalised. However, at this stage we would suggest that a lack of clarity in the rules that energy companies have to abide by, either because of complexity or subjectivity, could pose an obstacle to Ofgem achieving its Vision and Strategic Objectives. It would be difficult for the enforcement team to enforce if it is not clear to them what behaviour is required by the rules.

3.15. To address this problem we would advocate strong links between the policy and enforcement teams within Ofgem so that the original context is clearly understood. Given this and the fact that clearer rules should be quicker and cheaper to enforce, Energy UK recommends that Ofgem's policy and enforcement teams share a single budget. This institutional arrangement would embed an extra incentive for Ofgem's policymakers to write clear rules that are easy to understand. In this regard, we would also suggest that Ofgem should aim to make licence conditions understandable without reference to the underlying policy papers.

Q4. Do you agree with the proposals for an Enforcement Decision Panel and Secretariat to take decisions in contested enforcement cases? Please explain the reasons for your answer.

3.16. Energy UK agrees with Ofgem's initial proposals for an Enforcement Decision Panel and Secretariat to take decisions in contested enforcement cases. We agree that its establishment is necessary to help ensure objective decision-making. However, we note that the Panel would not be independent of Ofgem, only of the investigation team. This shows why an appeal route to an expert third party tribunal that can review cases on the merits rather than on narrow Judicial Review grounds should be introduced. We would ask Ofgem to consider joining Energy UK's call for legislative changes that would introduce merits-based appeals. If Ofgem felt unable to do so, we would be interested to hear why.

3.17. Energy UK would like to offer some suggestions as to how objectivity and quality in decision-making may be reinforced:

- a) The Panel should be encouraged to adopt a "court culture", with its position analogous to that of a judge, where it is encouraged to incisively examine and challenge the cases of both sides before it reaches a decision. The requirement to adopt such a culture should be laid out in the Panel's Terms of Reference.
- b) The investigation team should issue "preliminary findings" to the company under investigation to respond to before moving to the statement of case.
- c) The Panel members should not be employees of Ofgem, apart from the Chairman.
- d) If guidance is provided to the Panel, it should be consulted on, published and included in the Enforcement Guidelines.
- e) Before submissions regarding contested cases are sent by the investigation team to the Enforcement Panel/Committee, they must first be reviewed by a lawyer that is not involved in the case in order to help ensure consistency. The Financial Conduct Authority (FCA) has this process in place.
- f) A register of interests of Panel members should be established and made publicly available.
- g) A qualified lawyer with experience of compliance issues should be appointed to every Enforcement Committee.

- h) Someone who has significant knowledge and experience of the energy industry, who understands the practical issues being investigated, should be appointed to the Enforcement Panel.

3.18. Energy UK would also encourage Ofgem to provide further clarity on the precise role and responsibilities of the Panel, Secretariat and individual Committees. We believe that Ofgem should publish Terms of Reference for each. Some specific questions include:

- a) Do Enforcement Committees make enforcement decisions in their entirety or do they make recommendations to the Authority?
- b) Would the Authority be able to overturn, reject or amend the Enforcement Committee's decision, and on what grounds?
- c) What would the criteria for appointment to the Panel be, what would the selection process look like, and who would carry it out?
- d) Could the Enforcement Panel or delegated Committee refuse to look at a case, and on what grounds? (E.g. that the case does not reflect the Authority's Strategic Priorities)
- e) On what basis would the Panel Chair select which Panel Members will constitute each Enforcement Committee?
- f) How will the Enforcement Panel adapt to different tests of compliance for different rules? For example, there is a "reasonable person" test for compliance with the SOC, which is different to REMIT.
- g) What is the role and constitution of the Enforcement Oversight Board?

3.19. Energy UK believes that greater independence should be applied to the decision-making process associated with launching formal investigations under the Electricity/Gas Acts (e.g. s28 of the Electricity 1989). We would like to explore the options for achieving this additional independence via discussions with Ofgem.

Q5. Do you agree with the proposals for settlement decisions? Please explain the reasons for your answer.

3.20. Energy UK understands that the FCA does not consult on settlement agreements reached with companies. Ofgem is obliged to consult on any settlement that includes a financial penalty under the Electricity and Gas Acts. Although consultation to some degree allows for licensees to review consistency and make representations where any concerns arise, we are concerned that the uncertainty created by the fact of consultation disincentivises settlement, since the terms may change. We would therefore ask Ofgem to review the merits of settlement consultations and consider whether representations to Government may be required on their continuation.

Q6. Do you agree with the proposed arrangements for the Authority's oversight of the Panel's work? Please explain the reasons for your answer.

3.21. Energy UK broadly agrees with the proposed arrangements for the Authority's oversight of the Panel's work. As Ofgem notes, this is particularly important in promoting consistency of decision-making. We would also encourage Ofgem to establish arrangements whereby the Authority ensures that the Panel's work reflects the Strategic Priorities, intervening as and where necessary.

3.22. Energy UK believes that Ofgem should consult on and publish any high-level written guidance that the Authority provides to the Panel.