

# **REVIEW OF OFGEM'S ENFORCEMENT ACTIVITIES – CONSULTATION ON STRATEGIC VISION**

## **INTRODUCTION**

1. On 28 March 2013 Ofgem published an open letter in which it consulted upon possible changes to its processes that may lead to the making of enforcement orders.
2. In this note we draw attention to some policy considerations that we think merit further thought and to certain legal requirements that Ofgem may wish to consider to be sure that the proposals on which it is consulting are consistent with administrative law generally and with the statutory remit of the Gas and Electricity Markets Authority (the Authority) in particular. We think they may not be for the reasons set out below.

## **THE BROAD INTENT OF THE PROPOSALS**

3. Enforcement is central to the design of the British regulatory system. Its centrality is easily overlooked because the making of enforcement orders by the Authority is not a particularly frequent occurrence. But without the power of enforcement the regulatory regime would lack one of its most essential attributes. Enforcement has an important relationship with policy because the experience gained from investigations and enforcement activities may usefully inform policy and lead the Authority to exercise its other functions – in particular the function of modifying licences – but the reverse is not true. When the Authority is carrying out an enforcement function it is acting in a quasi-judicial manner and it would usually be unlawful if policy considerations were to influence enforcement action where decisions should turn on whether there has been a breach of an enforceable obligation rather than whether a policy preference of the Authority would be furthered by taking a particular view of an alleged breach of an enforceable obligation.
4. The broad thrust of the proposals in the open letter is to introduce a further degree of separation between the enforcement functions of the Authority and its policy activities. In one respect we can see that the institutionalising of a greater degree of separation has the merit of reinforcing the distinct quasi-judicial nature of the enforcement function. In this respect we can see some merits in the proposals set out in the open letter.

5. However, we are concerned that the proposals appear to introduce too much distance between the Authority itself and the carrying out of the enforcement functions that have been given to it by Parliament. Although the open letter refers to the Authority giving ‘decision-making guidance’ to the panel populating the committees that will carry out these statutory functions of the Authority, and the Authority will periodically review the actions taken in its name by these committees, it is hard not to form the impression that the Authority would prefer to pass the workaday matters that make up investigation and enforcement to another body, thereby freeing itself to concentrate on the strategic policy matters that are also within its statutory remit.
6. We are not convinced that the extent of the delegation envisaged in the open letter gives due consideration to the centrality of enforcement in the design of the regulatory regime. It seems to us to be quite possible for the Authority to be mindful of the special nature of the enforcement functions and the need for these to be carried out without being improperly influenced by policy considerations, without going so far as to delegate the entire investigation and enforcement activity to a committee on which no member of the Authority is to serve. This seems to us to place too much distance between the Authority and the discharge of one of its most important functions.
7. The giving of general decision-making guidance by the Authority, accompanied by a free hand for each Enforcement Committee comprising members of the Enforcement Decision Panel (the panel) thereafter, is unlikely to make up for the absence of the active involvement of members of the Authority in the carrying out of the enforcement function.

#### **THE PROPOSAL TO DELEGATE ALL CONTESTED ENFORCEMENT CASES TO THE PANEL**

8. The broad intent of the proposed arrangements as set out in the open letter is to delegate investigation and, we infer, enforcement action to the panel members comprising each Enforcement Committee acting, we presume, with the delegated authority of the Authority itself.
9. The open letter makes no distinction between investigations relating to matters raised by individual complainants which, while important to the complainant, may not be of central importance to the regulation of the industry and matters that have significance

for the regulation of the industry. Since the open letter makes no such distinction we assume that it is proposed that *all* potential enforcement matters (if contested) will be investigated and decided upon by the members of the panel that comprise the Enforcement Committee. If we are right in drawing this inference we would advise some caution here. While it may be appropriate and proportionate, as well as legal, to delegate the investigation of individual complaints to a committee of the Authority or to a single senior Ofgem employee, it is quite another matter to pass all contested enforcement issues to members of such a panel as a matter of routine.

10. Enforcement matters include all the obligations set out in the licences granted under the relevant Acts. These conditions can be complex and considerable expertise in construing their meaning may be required. There are, for example, conditions that require the licence holder to abide by the industry codes that prescribe in some detail the way that industry participants must behave. We note that each Enforcement Committee will be supported by a newly created Enforcement Decision Secretariat within Ofgem, but we wonder whether the degree of separation between this Secretariat and the rest of Ofgem will mean that the Secretariat will lack the familiarity and the expertise that the panel members (whose experience will have been gained in different worlds) will need to complement their own expertise and experience if they are to reach sound judgements on the matters before them. In short, the more clearly enforcement is institutionally separated from the rest of Ofgem and from the Authority itself, the greater the risk will be that the judgement of the panel will lack the benefit of an informed perspective that comes from the involvement of staff with a remit that has taken them beyond the roles of investigation and enforcement.
11. This has a legal as well as a practical dimension: the Authority may not make an enforcement order where it is satisfied that it is precluded from doing so by its general duties. A proper appreciation of what this means is more likely to come from the presence of personnel with a wider remit than by establishing a more formal separation between the panel and its secretariat on the one hand and the Authority and the rest of Ofgem on the other.

## **THE ENFORCEMENT DECISION PANEL, THE ENFORCEMENT COMMITTEE AND THE REQUIREMENTS OF THE UTILITIES ACT 2000**

12. In the open letter Ofgem declares its intention to establish the panel from which the members of each Enforcement Committee will be drawn in the following terms:

‘We are proposing new arrangements designed to allow cases to be decided by dedicated specialists, with an easily visible separation between the investigation and decision-making functions. We propose to establish an Enforcement Decision Panel of specialist decision makers, recruited to Ofgem for this purpose. Panel members would have relevant experience, which might include the energy industry, consumer affairs, law or finance backgrounds. One of the Panel members would be appointed as the Panel Chair and would be accountable to Ofgem’s Executive and to the Authority for the work of the Panel. Panel members are likely to be given fixed-term appointments.’

13. The name of the panel (the ‘Enforcement Decision Panel’) suggests that its members, when assigned to Enforcement Committees, will make *decisions* that involve the exercise of the discretion given to the Authority by the Gas Act 1986 and the Electricity Act 1989 to make enforcement orders, or at least to make decisions from which an order would logically follow.

14. It is an established principle of English administrative law that an act will be *ultra vires* where it is done by the wrong person: thus a power can be exercised only by the person on whom it has been conferred. One legal text book puts it thus:

‘The problem is sometimes expressed in terms of improper delegation, and the maxim, *delegatus non potest delegare* is invoked. But the more fundamental question is whether a power conferred on one person can be exercised by another. In principle it cannot. It is to be assumed that a recipient of a statutory power has been chosen for its qualities and suitability for the task in mind. In each case the statute has to be examined to see whether a power to delegate is conferred or withheld and if so to what extent.’<sup>1</sup>

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<sup>1</sup> *Foulkes Administrative Law*, Seventh edition, p198.

15. The Gas Act 1986 and the Electricity Act 1989 have conferred powers and duties on the Authority. We must therefore look to those statutes, and to the Utilities Act 2000 which amended them in important respects, to see the extent to which the Authority may delegate those functions to an employee or to a committee or sub-committee.
16. We would draw Ofgem's attention particularly to the provisions of Schedule 1 to the Utilities Act 2000.
17. Paragraph 6 of this schedule provides that:

‘(1) The Authority may establish committees and any committee of the Authority may establish sub-committees.

(2) The members of a committee of the Authority *may include* persons who are not members of the Authority (and the members of a sub-committee may include persons who are not members of the committee).’ (emphasis added)
18. It follows from the use of the word ‘include’ that a committee of the Authority would be *ultra vires* if it comprised only persons who were not members of the Authority.
19. Paragraph 9(1) of the same schedule permits the Authority to delegate certain of its functions under that Act to:

‘(a) any member or employee of the Authority who is authorised for that purpose by the Authority, whether generally or specially; [or]

(b) any committee of the Authority which has been so authorised.’
20. It is important that paragraph 9(3) of the same schedule provides that for these purposes:

“‘committee of the Authority” does not include a committee whose members include any person who is not a member or employee of the Authority.’
21. It follows from these extracts that if the members of the Enforcement Decision Panel when formed into Enforcement Committees are to exercise any of the statutory functions of the Authority with respect to enforcement matters – such as the making of enforcement orders or the making of orders requiring information to be provided – *all*

of the members of the panel must be either members or employees of the Authority. The inclusion of anyone on an Enforcement Committee who is neither an employee nor a member of the Authority would render unlawful the exercise of any power given by the statute to the Authority. Moreover, any such committee must include at least one member of the Authority for its constitution to be *intra vires*.<sup>2</sup>

22. We are not sure whether Ofgem has overlooked these two requirements, but in our view they cannot easily be set aside or circumvented. Parliament has clearly placed limits on the power of the Authority to delegate its functions and has taken the trouble to ensure that all *bona fide* committees of the Authority must include at least one member of the Authority and any committee that exercises a function of the Authority may not include anyone who is neither a member of the Authority nor an employee of the Authority.
23. The statement in the open letter that panel members ‘are likely to be given fixed-term appointments’ could be consistent with an intention that panel members will become actual employees of the Authority for the duration of their term of office. However, that seems to be unlikely because drawing the members of the panel only from those who are prepared to become employees of the Authority would limit the pool of talent from which panel members may be recruited and may not be consistent with Ofgem’s intent to appoint as panel members external specialists with experience of consumer affairs, law or finance. Moreover, this would do nothing to satisfy the requirement that a committee of the Authority must include at least one member of the Authority.
24. The approach set out in the open letter whereby a number of specialist panel members would be appointed, and from this panel each Enforcement Committee would be formed, has similarities with the way that the Competition Commission operates. In the case of the Commission there is a panel of members, some of whom are specialist members, and a subset of these panel members is selected and assigned to perform the functions of the Commission for a particular reference.

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<sup>2</sup> We note that it is intended that uncontested cases will still be dealt with by a Settlement Committee, which comprises one non-executive member of the Authority and one executive member or permitted senior employee. This meets the requirements of the statute but it strikes us as odd that, where the parties have agreed concerning a relevant breach, the matter is to be overseen by a committee that includes a member of the Authority but, where things are more controversial and there is no agreement over an alleged breach, the Authority appears to wish to give the power of decision to a committee on which no member of the Authority sits.

25. If this model has informed the approach being proposed in the open letter it appears to us that an important distinction may have been overlooked by Ofgem.
26. Appointment of ‘appeal panel members’ of the Commission is made by the Secretary of State under paragraph 2(1)(a) of Schedule 7 to the Competition Act 1998. Appointment of ‘reporting panel members’ of the Commission is made by the Secretary of State under paragraph 2(1)(b) of the same schedule and the appointment of ‘specialist panel members’ of the Commission is made by the Secretary of State under section 104 of the Utilities Act 2000.
27. If we take the specialist members of the Commission to illustrate the point, the Utilities Act provides that these members are to be appointed by the Secretary of State:
- ‘for the purpose of the exercise by the Commission of any function under or by virtue of [certain sections of the Gas Act 1986 and the Electricity Act 1989].’
28. The formation of the panel proposed in the open letter cannot benefit from a similarly secure statutory foundation and without a proper statutory basis its activities would be *ultra vires*.

#### **THE REMIT OF THE PANEL CONSIDERED IN RELATION TO OTHER FUNCTIONS OF THE AUTHORITY**

29. We have already observed that the function of making enforcement orders has been given to the Authority by statute. For simplicity we shall cite the provisions of the Electricity Act 1989 (as amended) (the Act), but the position is essentially the same under the Gas Act 1986. Exercise of the enforcement function is linked with a number of other functions given to the Authority, such as the exercise of the power to require information (section 28), the imposition of financial penalties (section 27A) and the consideration of whether or not it is more appropriate to proceed under the Competition Act 1998 and whether or not the making of an order is precluded by the general duties of the Authority.
30. It is not clear from the open letter where the remit of any Enforcement Committee formed from members of the panel will begin and where it will end. It appears that, at the very least, it will reach a ‘decision’ on whether there has been a breach of an obligation that is subject to the enforcement regime under section 25 of the Act. It is

not clear, however, whether, having made that ‘decision’, it will also enjoy the delegated power of the Authority to enforce the decision by the making of an order under section 25.

31. If we suppose that only the investigation and the decision as to whether there has been a breach of an enforceable obligation are delegated to the Enforcement Committee, but the statutory functions of deciding whether to make an enforcement order and, if so, whether it should be a final or a provisional order, are retained by the Authority itself, another issue arises.
32. We know from the open letter that the Authority will not seek to influence “‘live’ cases’. This suggests that the Enforcement Committee will reach its own decision on an investigation. However, when the Authority comes to decide whether to make an enforcement order, the Authority *itself* must be ‘*satisfied*’<sup>3</sup> that the licence holder ‘is contravening, or is likely to contravene’ the relevant condition or requirement.
33. If the remit of the panel ends with a ‘decision’ that a breach has occurred, and the Authority itself then has to decide on the question of enforcement, it is clear that the Authority will have to satisfy itself that the decision reached on its behalf by the Enforcement Committee was indeed the correct one. It is not difficult to imagine circumstances where the panel would reach a decision that there had been a breach taking, perhaps, a particular view of the precise nature of a relevant requirement that is alleged to have been breached, whereas the Authority itself might take a different view of precisely the same facts and the same relevant requirement when it considered these as part of its decision-making on whether or not an enforcement order was requisite.
34. We do not think it would be legal for the Authority simply to presume that the decision reached by the Enforcement Committee on its behalf must be correct, so the possibility of inconsistency in findings surely cannot be ruled out. The open letter does not explore what would happen in these circumstances.
35. If instead we suppose that Enforcement Committees formed from the Enforcement Decision Panel will decide both whether there has been a breach of an enforceable obligation and whether an enforcement order is requisite, this would deal with the

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<sup>3</sup> Emphasis added.



initial problem of potentially inconsistent findings with respect to whether there had been a breach, but it simply leads to another, very similar, problem explained below.

36. If we suppose that the Authority retains to itself the function of imposing financial penalties under section 27A of the Act, essentially the same problem reappears. Once again the Authority must itself be satisfied that a licence holder has contravened or is contravening any relevant condition or requirement before it may proceed to impose a financial penalty. Once again, therefore, it is possible to conjecture circumstances where the Authority may reach a different view from the relevant panel members that formed the Enforcement Committee as to whether there has been such a breach.
37. The risk of inconsistent findings might again be solved by delegating to each Enforcement Committee the power to impose financial penalties under section 27A of the Act. There appears to be no legal obstacle to such a delegation of powers – subject to the committee’s being properly constituted - but we question whether the Authority would wish to delegate such an important and contentious function to the panel members.
38. Similarly, section 25(5) of the Act precludes the Authority from making a final order or making or confirming a provisional order if it is satisfied that the most appropriate way of proceeding is under the Competition Act 1998 or if the general duties of the Authority preclude this. If the Authority is not going to influence “‘live” cases’, as indicated in the open letter, this might suggest that the relevant panel members that comprise each Enforcement Committee will also exercise this judgement on behalf of the Authority. However, since the open letter does not indicate the limits of the remit to be given to the Enforcement Committees, it is not possible for us to tell whether panel members or the Authority will make this judgement.

## **REFRAINING FROM INFLUENCING “‘LIVE” CASES’**

39. We do not think that it is possible for the Authority to fetter its discretion and to indicate that it will refrain from influencing “‘live” cases’ in the manner suggested in the open letter. For example, if the Authority received representations from a licence holder that the panel might be about to act unlawfully in the exercise of one of the functions of the Authority, it would be appropriate and necessary for the Authority to satisfy itself that this was not the case or, if it were the case, to step in and guide those

who were exercising that statutory power in the name of the Authority. Accordingly, we question whether it is correct for the Authority to proceed on this basis.

## **THE REVIEW OF PAST CASES**

40. The open letter makes reference to a periodic review by the Authority of the panel's decisions on past cases. That review must surely admit the possibility that the Authority would consider that the panel had reached the wrong decision in a particular case. What would then happen?
41. It is our understanding that the Authority may revoke, modify or change a decision that it has taken in the past<sup>4</sup> and we do not think it would be legally possible for the Authority to promise that it would never revisit a decision that had already been taken in its name by an Enforcement Committee formed from the panel. Since a review of past cases would be somewhat artificial, perhaps even pointless, if it started from the presumption that all previous decisions of the panel members must be correct, this raises the real prospect that the Authority ought to remake a decision if it concluded that the wrong decision had been made and that, despite the passage of time, it was still possible to make a better decision. We wonder if Ofgem has considered the implications of the proposed review of past cases and the potential for it to give rise to some rather difficult judgements. This appears to be an unavoidable problem when a body that has been given a statutory duty delegates that duty to another body and then reviews the exercise of that delegated power by its delegatee at some future date in circumstances where it cannot fetter its own discretion to make the decision again. Ofgem may wish to reflect further upon this point.

## **CONCLUSIONS**

In summary we are concerned that the proposals set out in the Ofgem letter are misguided, or wrong in law, in the following respects:

- the proposals introduce too great a separation between the enforcement function and the other functions given by Parliament to the Authority;

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<sup>4</sup> Section 12 of the Interpretation Act 1978.

- the proposed panel and secretariat, may lack the expertise necessary to carry out the enforcement function properly;
- the composition of the proposed panel from which each Enforcement Committee will be drawn appears to render the committee *ultra vires* in regard to the provisions of the Utilities Act 2000;
- the proposals have not addressed the potential problem of inconsistent findings as between the Enforcement Committee and the Authority itself that may arise at whatever point jurisdiction is retained by the Authority;
- the proposals appear improperly to fetter the discretion of the Authority to become involved in “live” cases’; and
- the proposals do not address the issues that may arise following a review by the Authority of past decisions taken by the panel.