

# Allocation of voluntary redress payments in the context of enforcement cases

## Consultation

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### Overview

We want to improve the allocation of voluntary redress payments that are made in the context of enforcement investigations conducted using our Gas and Electricity Act powers. Voluntary redress payments are paid by companies investigated by us to suitable charities, trusts and organisations. Such payments are separate from (and can be in addition to) compensation payments made directly to consumers harmed by the companies' wrongdoing. Voluntary redress payments are in lieu of, or in addition to, a financial penalty.

We want to make sure that these payments deliver maximum benefit for Great Britain's energy consumers. This consultation outlines options for improving our current process. Your responses will help us decide on the best process to put in place for any future voluntary redress payments.

## Context

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In our Forward Work Programme for 2016-17, we committed to reviewing our approach to the allocation of voluntary redress payments. This consultation is an essential part of that work.

## Associated documents

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To help you respond to this consultation, we suggest you read the documents below:

- Our open letter of 14 December 2015 on 'Guidance on the allocation of voluntary redress payments' (<https://www.ofgem.gov.uk/publications-and-updates/open-letter-guidance-allocation-voluntary-redress-payments>).
- Our 'Enforcement Guidelines', in particular "Section 5: Settling or contesting a case" starting on page 37 (<https://www.ofgem.gov.uk/publications-and-updates/enforcement-guidelines>).
- Our 'Statement of Policy with respect to Financial Penalties and Consumer Redress', in particular "Section 6: Interaction between financial penalties and compensation and/or other redress payments" (<https://www.ofgem.gov.uk/publications-and-updates/statement-policy-respect-financial-penalties-and-consumer-redress>).

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## Executive Summary

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Energy consumers across Great Britain have benefitted from the substantial voluntary redress payments paid to charities, trusts and organisations by energy companies investigated by Ofgem.<sup>1</sup> We have had an increasing focus on direct compensation and voluntary redress. During the financial year 2015-16 alone, we secured nearly £20 million for charitable recipients as a result of our enforcement action. We want to maximise the beneficial impacts of these payments for energy consumers, and in particular consumers in vulnerable circumstances.

This consultation presents options for how best to handle any future voluntary redress payments. We believe these options are improvements on the current process.

### **Option 1: Current process with enhanced principles**

In this option, the company under investigation would continue to propose the recipient(s) to us, and we would accept or reject the proposal. We would add to the principles for allocation that are already in place. Possible additional principles include: making the number of charitable recipients proportionate to the size of the penalty; precluding voluntary redress payments going to charities or trusts established by energy companies and whose name includes, or is similar to, the name of the energy company; and requiring the use of an open bidding process to select the recipients.

### **Option 2: Third party responsible for managing redress allocation**

In this option, allocating, managing and monitoring the voluntary redress payments would be done by a third party (ie neither Ofgem nor the company under investigation) with appropriate charitable sector expertise and ability to manage the funds itself. The third party would hold the funds and make the payments to recipients. It would run an open bidding process, assess applications and suggest recipients to Ofgem for our approval. One example of such a third party is a Donor Advised Fund (DAF) provider. This is currently our preferred option.

A variation on option 2 is for the voluntary redress payments go to a charitable trust set up by us. The trust would be independent from Ofgem and it would make decisions on how to allocate the money.

### **Outcome of consultation**

Our focus is on ensuring the greatest positive impact for consumers. We are committed to selecting, allocating and monitoring the use of voluntary redress payments in a way that maximises the impact for consumers. We think our current process has worked well and we are looking at building on this. Using responses to this consultation, we will decide how best to proceed. We aim to make a decision by the end of 2016.

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<sup>1</sup> In this document, 'voluntary redress payments' refers to payments to suitable charities, trusts and organisations agreed as part of settlement, which are distinct from compensation schemes or sums of money paid by companies to those directly affected by the breach. Whether or not a voluntary redress payment is agreed, in all cases the company's priority should be to compensate customers adversely affected by the breach.

# 1. Introduction

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1.1. We want to improve how voluntary redress payments are allocated in order to deliver maximum positive impact for energy consumers. This consultation outlines options for doing so, with a focus on ensuring we make the best use of the wide range of charities operating across Great Britain to deliver benefits for consumers. Your responses will help us decide on the best process to put in place for any future voluntary redress payments.

## **Enforcement and voluntary redress payments**

1.2. Voluntary redress payments are made in the context of enforcement investigations conducted using our Gas and Electricity Act powers. They do not relate to our power to impose a consumer redress order, nor to our investigations using our Competition Act powers.

1.3. Voluntary redress payments are made by the company under investigation, if it accepts the case against it and decides to settle rather than contest it<sup>2</sup>, or if we decide to deal with a case using alternative action.<sup>3</sup> The payment is made to a charity, trust, or organisation when Ofgem and the company under investigation agree, during the settlement process, that such a payment could be made in addition to a financial penalty and any direct compensation. If we do not agree that a voluntary redress payment is to be made, a financial penalty is instead paid to HM Treasury.

1.4. The purposes of our enforcement action are to stop consumer harm, ensure as many affected consumers as possible are compensated for any harm experienced and to provide a credible deterrence against further poor behaviour in the market. Within this, the purpose of voluntary redress payments is to use money from the company under investigation to counteract the negative effects of its behaviour by supporting energy consumers in Great Britain, in particular consumers in vulnerable circumstances, through projects or schemes run by charities, trusts, or organisations. This is distinct from direct compensation to affected consumers.

1.5. As a purely hypothetical example, we may consider that a company deserves a penalty of £10 million<sup>4</sup>. We would then agree with the company that they pay £1 to HM Treasury, £6 million to compensate those consumers directly affected by the company's actions (ie where they can be identified) and the remaining £4 million

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<sup>2</sup> As outlined in our Enforcement Guidelines 2014, a party under investigation has the right to contest the matter in front of a panel of decision-makers.

<sup>3</sup> Alternative action is discussed in our Enforcement Guidelines 2014, starting at p. 25.

<sup>4</sup> Note these figures are illustrative only.

(less £1) to charitable recipients that support energy consumers. If the company does not agree, the full £10 million would go to HM Treasury.

1.6. The last few years have seen Ofgem conduct more investigations, and there has been a corresponding increase in the number and value of both direct compensation to affected consumers and voluntary redress payments to charities, trusts and organisations. For example, during the four financial years from 2010-11 to 2013-14, compensation paid directly to affected consumers and voluntary redress payments to third sector organisations was on average 43.7% of the total penalty value. This figure rose to 93.2% in 2014-15 and effectively 100% in 2015-16.

1.7. The importance of the payments to charities, trusts and organisations can be seen from the numbers of consumers who benefitted. Taking just the financial year 2014-15, our analysis shows that over 218,000 consumers and nearly 600 small and medium enterprises benefitted through support funded by this money.

1.8. Although we can't predict the number and outcome of future cases, we believe the value of recent voluntary redress payments merits considering how we can further maximise the consumer benefit from these payments.

### **Current process**

1.9. Currently, the company under investigation is responsible for proposing who the recipient(s) should be, and we then approve or reject the proposal. This process is outlined in our December 2015 open letter, where we have set out high-level principles to guide companies' proposals.<sup>5</sup> Once approved, the identity of the recipient(s) and the amount of money they are to receive are included in the penalty notice published on our website (if that information is known when the penalty notice is published).<sup>6</sup>

### **Opportunities to improve**

1.10. The current process is working well, but we want to make it even better so as to maximise long term consumer benefit from our approach to redress (in line with our objectives in 2.3 - 2.4 below). We believe we can find ways to deliver greater impact for more consumers, and we want to ensure that the charitable recipients are indeed the most appropriate ones to receive the payments and to optimise the benefits through their particular projects.

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<sup>5</sup> Our open letter of 14 December 2015 on "Guidance on the allocation of voluntary redress payments" is available at <https://www.ofgem.gov.uk/publications-and-updates/open-letter-guidance-allocation-voluntary-redress-payments>.

<sup>6</sup> The notice of the decision to impose a financial penalty for each relevant investigation is available at <https://www.ofgem.gov.uk/investigations>.

1.11. In thinking about ways to improve the process, we are also mindful that companies under investigation that choose to make voluntary redress payments instead of paying a penalty to HM Treasury for their wrongdoing should not benefit in any way from making such payments (even through positive publicity created by giving money to charity). We need to consider how best to ensure that doesn't happen.

1.12. Questions we have been considering include:

- How can we ensure that the optimal charities and projects receive funding from voluntary redress payments so that we can maximise the long-term consumer benefit?
- Should people with appropriate expertise in the charitable sector, who are also familiar with energy-related charities, be involved in recommending and deciding who receives the money?
- Could the selection of recipients be done more transparently?
- Should we aim for the payments to go to a greater number and variety of recipients as a way of getting money to charities, trusts and organisations that can best use the money to support energy consumers?
- Should we try to further limit the possibility that a company that was under investigation benefits from paying voluntary redress?

### **What we've heard to date**

1.13. Over the last two years, we have received a growing amount of feedback on the process of allocation of voluntary redress payments. Feedback has come from several sources, including from attendees at our Enforcement Conference in June 2015<sup>7</sup>, recipients of voluntary redress payments (including through monitoring reports sent to us on the use of the money), potential funding recipients and other third sector stakeholders, and from our regular stakeholder engagement with licensees.

1.14. This feedback has generally been positive, and has been supportive of the extra efforts that Ofgem has made to ensure energy consumers are supported through our approach to voluntary redress payments (ie by providing voluntary redress as an option, instead of having all penalties go to Treasury). There have also been suggestions for what we could do to further maximise consumer benefits, which we have taken on board and are now considering.

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<sup>7</sup> For details of our 2015 Enforcement Conference, see <https://www.ofgem.gov.uk/publications-and-updates/ofgem-enforcement-conference-2015>. Our 2016 Enforcement Conference is due to be held in September.

1.15. We engaged with charitable organisations and with our licensees. We engaged with the Cabinet Office to learn how it handled the allocation of the fines imposed on major UK banks for rigging the London Interbank Offered Rate (LIBOR), as well as other regulators to better understand what they are doing. We reviewed relevant literature and engaged with academics with expertise in this area. We also engaged with the Charity Commission to find out more about charitable trusts (including what might be involved in setting up our own charitable trust).

1.16. The information we have gathered has helped shape options for future allocation of voluntary redress payments proposed in this consultation. In doing so, we considered the impact of each option for consumers, companies under investigation, charitable recipients, and Ofgem. We are mindful that any new approach should not place undue burden on industry or ourselves, particularly relative to benefits delivered to consumers.

### **Options**

1.17. The options we are consulting on are:

- Keep the process similar to what is currently in place and publish additional principles to support decision-making, or
- Have an independent third party responsible for allocating, managing and monitoring voluntary redress payments. (This is currently our preferred option.)

### **Purpose of this consultation**

1.18. We want to make an informed, evidence-based decision on the process for any future voluntary redress payments. We welcome responses from licensees, consumer groups, third sector organisations and any other interested parties on the objectives and options in this consultation. While we have done considerable research and engagement to inform these options, we recognise that readers will have additional expertise and may have further information to support our assessment of costs and benefits of each option.

1.19. Please send your responses to Kieran Coleman at [redress@ofgem.gov.uk](mailto:redress@ofgem.gov.uk) by **24 August 2016**.



## 2. What we want to achieve

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2.1. Energy consumers benefit from voluntary redress payments because the money is targeted at charities, trusts and organisations that support energy consumers. This is in line with our statutory duty to protect the interests of energy consumers. Where possible we have tried to ensure that there is a link between the breach and the type of charitable recipients or projects that receive funding, to help consumers facing similar issues in the marketplace. This is particularly important in instances where it is not possible to identify some, or any, individual consumers harmed as a result of a company's actions – in these cases, charitable action can focus on similar issues as a proxy for direct compensation. Within this, we are particularly committed to supporting consumers in vulnerable circumstances (in line with our Consumer Vulnerability Strategy<sup>8</sup>).

2.2. Depending on the harm caused by the breach, this could mean that benefits are maximised in different ways (for example through providing a particular type of advice or support to a large number of general energy consumers, or by providing more targeted support or assistance to a particular subset of consumers). We also aim to maximise consumer benefit through an appropriate geographic spread of consumers receiving benefit across Great Britain. We note that benefits can also be intangible, such as restoring trust and confidence in the energy markets.

2.3. The primary objective of our voluntary redress funding is to **maximise long-term benefits for energy consumers by ensuring that funding is well targeted.**

2.4. We want to do this by:

- Continuing to target charities, trusts and organisations that support energy consumers.
- Continuing to link the charitable recipients / projects to the harm generated by the company as much as possible.
- Focusing, where possible, on charitable recipients / projects that support consumers in vulnerable circumstances.
- Ensuring allocation decisions are made by experts who are well placed to identify and assess charitable options and select those that will deliver maximum benefit.
- Using open, transparent bidding processes to identify and select funding recipients to ensure that a wide range of potential funding recipients have an opportunity to receive funding and deliver benefits.

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<sup>8</sup> Ofgem's Consumer Vulnerability Strategy is available at <https://www.ofgem.gov.uk/ofgem-publications/75550/consumer-vulnerability-strategy.pdf>.

2.5. We believe that the above will ultimately maximise consumer benefits via a wider number and spread of charitable recipients than has been the case to date, and we consider this to be a good thing as it is likely to maximise the spread of consumers will also be supported (including via innovative ways and approaches).

2.6. In selecting an appropriate approach we will also need to ensure appropriate monitoring and reporting is in place, so that we are confident in the benefits being delivered and the value for money being achieved.

2.7. We are also keen that our approach does not enable companies to benefit in any way from making a voluntary redress payment in lieu of financial penalty. Voluntary redress is a result of our enforcement action, and making such payments is part of the sanction a company faces. We will favour an approach that minimises the chances of companies gaining positive publicity from the voluntary redress payments.

2.8. Finally, our approach must not place undue burden on Ofgem or our licensees, including through the selection, allocation or monitoring processes. We recognise that charitable organisations also have finite time and resources, and are keen that our forward approach does not place undue burden on them either.

**Question 1:** Do you agree with our objectives for the allocation of voluntary redress? If not, please explain why.

**Question 2:** Are there any additional objectives or criteria we should consider when making a decision on our forward approach to voluntary redress? Are there things our approach should definitely include or absolutely avoid?

## 3. Current redress allocation process

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3.1. Currently, the process works as follows:

- The company under investigation proposes the charitable recipient(s).
- We approve or reject the proposal(s) according to the set of principles outlined in our December 2015 open letter<sup>9</sup> (see below).
- The identity of the recipient(s) and the amount of money they are to receive is included in the notice of the decision to impose a financial penalty published on our website (if that information is known when the penalty notice is published).
- Post-allocation monitoring reports are sent periodically to us.

3.2. In December 2015 we published an open letter to make the way voluntary redress payments are allocated more transparent. The open letter set out a number of high-level principles which now support decision-making and the allocation process for voluntary redress. These are reproduced below:

1. It is for the company entering into a settlement agreement to propose suitable charities, organisations or projects to support. This may include one or more recipients.
2. The proposed recipient(s) of the voluntary redress payment should always be reputable and of sound financial solvency.
3. Wherever possible there should be a link between the breach(es) and the types of project(s) supported by the recipient(s) of the voluntary redress payment(s).
4. A company should not gain benefit, financial or other, from voluntary redress. For example, a company should not derive positive publicity from voluntary redress payments, and voluntary redress payments must be truly additional to any charitable donations made, or expected to be made by that company.
5. Where the harm caused has a particular geographic scope then, where practicable, the voluntary redress payments should take this into consideration.

3.3. Our December 2015 open letter outlined how the process has worked to date. When we published the above principles, we stated that we would continue to look for ways to promote transparency and confidence in the allocation process. At that time, we also noted we were increasingly looking to encourage diversity amongst the organisations which receive voluntary redress payments.

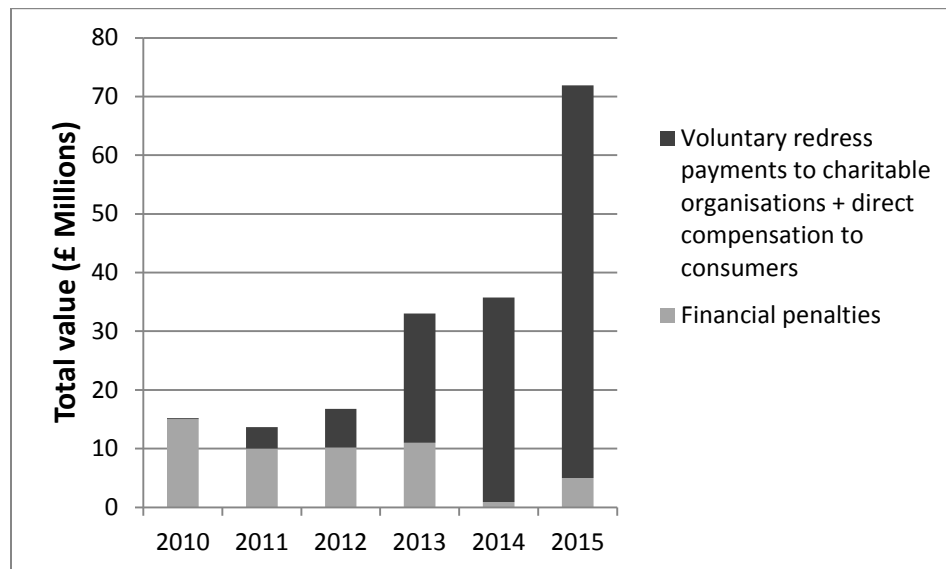
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<sup>9</sup> The open letter set out publicly the process we've been using for several years before December 2015.

### The current process in practice – benefits delivered

3.4. Many energy consumers have benefitted from voluntary redress payments, and we believe our process has worked well.

3.5. This graph illustrates the recent increases in both voluntary redress payments and direct compensation to consumers resulting from enforcement action.



3.6. To give an idea of the numbers of consumers who benefitted from the above voluntary redress payments, our analysis, based on post-allocation monitoring and projections just for cases in 2014 and 2015 that resulted in settlement (excluding alternative action cases), estimates that approximately 522,000 consumers received direct compensation worth a total of £20.1 million and a further £73.5 million was given to charitable organisations.<sup>10</sup> Those charitable recipients used the money to provide support, including providing energy advice services such as advice on energy efficiency, switching and prepayment meters, and the provision of good and services such as home safety checks, emergency heating, methods of alerting consumers when the temperature in their home drops and the installation of insulation and new boilers.<sup>11</sup> The work undertaken by charitable organisations as a result of voluntary redress funding ultimately benefited a further 223,000 consumers.

3.7. The current process has resulted in some voluntary redress payments from different investigations going to the same charitable recipients. Given the increasing value of these funds we think it is appropriate to ensure that diverse charitable

<sup>10</sup> These figures do not include the £26 million that npower agreed to pay as compensation to customers and to charitable organisations which was announced in December 2015, as that case was not officially closed until January 2016.

<sup>11</sup> Further information is in our 'Enforcement Review 2015-16' which is available at <https://www.ofgem.gov.uk/publications-and-updates/enforcement-overview-201516>.

recipients have an opportunity to deliver wide consumer benefit from our enforcement action.

3.8. We also note that some energy companies have established energy-related charities and trusts, which are generally set up to be independent from the energy company. The name of some such charities or trusts includes the name of the associated energy company. Not all companies have their own charitable arms, but there have been several payments to such charities and trusts since 2010. It's possible that this could lead consumers to believe that the company that was under investigation had in fact made a charitable contribution of its own volition (thus providing the company with positive publicity or a bolstered reputation as a result).

3.9. Furthermore, such a company could seek to promote the overall benefits delivered through its related charity or trust, which could include benefits largely funded through its voluntary redress payments. We want to avoid this, as it means that the company could ultimately receive a benefit from the outcome of enforcement action.

3.10. It may also be possible for the company to use the data or information from programmes operated via this charitable trust as a means of informing the development of its own commercial products or services. While we wholeheartedly support companies undertaking research to understand and meet the needs of their customers (and particularly those in vulnerable circumstances), information sourced via such a trust should not exclusively be available to the company that paid the voluntary redress. We would have to consider how these learnings could be more widely shared.

3.11. We recognise that, to ensure the most appropriate recipients are chosen, the allocation process could be enhanced by further considering:

- The level of knowledge of the charity sector that those selecting and approving charitable recipients should have.
- The transparency of the selection of charitable recipients (and ability for a wider range of recipients to access voluntary redress funding).
- The relatively short amount of time that is generally available to propose and agree on recipients during the settlement process (which aims to resolve cases quickly, as detailed in our Enforcement Guidelines).

3.12. We believe the current process could be further improved to meet all of the objectives outlined in 2.3 – 2.4. We believe that energy consumers benefit from voluntary redress payments, and we want to maximise those benefits.

## 4. Overview of options

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4.1. We welcome your views on the options we propose in this consultation, especially what you think about their advantages and disadvantages. Our preferred option is currently option 2. This is based on engagement with stakeholders and consideration of possible approaches taking into account the likely costs and benefits of each.

### **Option 1: Current process with enhanced principles**

4.2. Under this option, the process of voluntary redress allocation would be similar to the current one, but we would publish principles additional to those contained in our December 2015 open letter (as outlined in section 3.2). The company under investigation would propose the recipient(s). We would approve or reject the proposal.

4.3. Additional principles that may be included are listed below:

- The number of charitable recipients should be proportionate to the size of the penalty.
- The allocation of voluntary redress payments to charities or trusts that were established by the company under investigation and/or whose name contains a reference to that company should be precluded.
- An open bidding process should be used to select recipients.
- Money should be used to support vulnerable energy consumers (with a specific focus on supporting their energy-related needs).
- Recipient organisations, including indirect recipients, should be told that the money they receive is a result of enforcement action.
- Potential recipients must demonstrate they can and will monitor and regularly report on the impact of the funding they receive.

*The number of charitable recipients should be proportionate to the size of the penalty*

4.4. Linking the number of charitable recipients to the size of the total voluntary redress payment would increase the number, and therefore the diversity, of recipients. We believe that this diversity is a good thing insofar as it could maximise consumer benefits. However, we note the risk of losing economics of scale if increasing the number of charitable recipients results in smaller grants to each recipient. We welcome stakeholder views on this.

4.5. Ofgem could provide further detail on the smallest number of charitable recipients that we are likely to consider acceptable. This could be done for bands of total voluntary redress payments. For example, for total payments of less than £X million, there should be at least N number of charitable recipients; for total payments of more than £X million and less than £Y million, there should be at least N + M number of charitable recipients etc. We welcome views on this approach, including suitable values for these figures.

4.6. We know that in some cases the initial charitable recipients further allocated the money to several charities, trusts and organisations. We would be open to such proposals where ultimately a proportionate number of charitable recipients benefit.

*Preclude allocation of voluntary redress payments to charities or trusts that were established by the company under investigation and/or whose name contains a reference to that company*

4.7. The purpose of enforcement action is to put things right if businesses breach their obligations and to deter such breaches from occurring in future. As outlined in paragraphs 3.8 – 3.10, we are concerned that companies under investigation may benefit, for example through positive publicity, when they give voluntary redress payments to charities or trusts that they established and/or whose name contains a reference to that company. We would therefore preclude allocating voluntary redress payments to such charitable organisations.

*Use an open bidding process to select the recipients*

4.8. A bidding process should be used that is open, fit-for-purpose, as simple and straightforward as possible, and accessible to applications from all suitable charities, trusts and organisations that help energy consumers. Applications should be judged on appropriate criteria, with the emphasis being on ability to deliver benefits to consumers.

4.9. While we think that the benefits of using a bidding process outweigh the costs, there may be situations where the size of the total voluntary redress payment is considered not large enough to justify the costs of running an open bidding process. We need to consider what approach to take in such a situation.

4.10. The settlement process (detailed in our Enforcement Guidelines) aims to resolve cases quickly. Running an open bidding process takes time. We would need to consider if these two processes could work together.

*Money should be used to support energy consumers in vulnerable circumstances, with a specific focus on energy-related needs*

4.11. One of our current principles is that wherever possible there should be a link between the breach(es) and the types of project(s) supported by the recipient(s) of the voluntary redress payment(s). Where a breach has occurred in the domestic

market, we would look to target funding at supporting energy consumers in vulnerable circumstances.

*Recipient organisations, including indirect recipients, should be told that the money they receive is a result of enforcement action*

4.12. This particularly applies to charitable organisations that receive funding via a larger charitable trust that was the direct recipient of the voluntary redress payments. Again, this principle concerns the possibility that a company might derive positive publicity from paying voluntary redress. We believe that this requirement would make it less likely that a company under investigation would benefit from the voluntary redress payments it makes. As an illustrative example, we would not want charitable recipients that benefit from the 'Fantastic Supplier Energy Trust' to then believe that 'Fantastic Supplier' was funding all of these services out of the goodness of its heart, leading to consumers having an improved perception of the supplier as a result.

*Potential recipients must demonstrate they can and will monitor and regularly report on the impact of the money they receive*

4.13. We want to continue to monitor how voluntary redress payments are used. Monitoring helps ensure that the money is being used appropriately, measure the positive impact it has for consumers and assess the value for money achieved. Monitoring can also be used to amend future payments, where necessary<sup>12</sup>, to maximise impact.

4.14. Periodic reports compiled by the company under investigation should be sent to us. Charitable recipients should be able to provide the information required to facilitate the production of such reports. The timeframes for such reports should be agreed when we approve the proposed recipients.

4.15. We could publish these reports to further increase transparency and, where they also include key lessons about addressing consumer needs, to help others in the sector to also learn such lessons. This could help not only those directly supported by the voluntary redress payments but also a wider range of consumers.

### **The costs of this option**

4.16. As with the current process, the company under investigation would bear the costs of allocating the money. The total amount of the voluntary redress payments would therefore not be reduced by such costs.

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<sup>12</sup> For example, monitoring can be used to amend future payments where the voluntary redress payments are received in phases rather than all up front.



4.17. We would continue to expend the staff resources required to assess and approve/reject the company's proposals and to assess the post-allocation reports sent to us. If we were to share information from the monitoring reports, that would require additional Ofgem resources. We need to consider how to balance this with our core business.

### **Advantages**

- By continuing to have the companies come up with proposals for recipients, the onus would be on them to think for themselves about the negative impact of their behaviour on consumers.
- As it is similar to the current approach, it would be easy to implement as we have some experience of how this would work.

### **Limitations**

- The companies under investigation have to propose recipients, even though they may have limited knowledge and expertise in the charity sector.
- Companies under investigation may not volunteer to make redress payments due to the increased resource requirement for them in having to run an open bidding process, respond to enquiries from bidders, and sift applications.
- It is unclear how to resolve the potential conflict between wanting to resolve cases quickly through our settlement process and the time it takes to run an open bidding process.

**Question 3:** What are your views on 'Option 1: Current process with enhanced principles'? Are there any other advantages, disadvantages, risks or costs relating to this option that we should consider?

**Question 4:** What are your views on the possible additional principles outlined in 'Option 1: Current process with enhanced principles'? Are there further additional principles that would help meet our objectives?

### **Option 2: Third party responsible for managing redress allocation**

4.18. This is currently our preferred option.

4.19. Under this option, allocating, managing and monitoring the voluntary redress payments would be done by a third party (ie neither Ofgem nor the company under investigation) with appropriate expertise and ability to manage the funds themselves. The company under investigation would pay the total redress payment to the third party or into an account set up by the third party.

4.20. The third party would hold the funds and make the payments to recipients. They would run an open bidding process, assess applications and suggest recipients to Ofgem for approval. Companies under investigation would no longer be responsible for proposing recipients. The third party would also monitor the use of the money and report back to Ofgem.

4.21. One example of such a third party is a Donor Advised Fund (DAF) provider. A DAF is a financial vehicle administered by a third party and created for managing charitable donations on behalf of an organisation, family or individual. DAF providers can either be charitable bodies or privately run. DAF providers have expertise in sourcing recipients and running open bidding processes to meet objectives. DAF providers follow the guidance and objectives set by the donor when selecting recipients.

4.22. A variation of this option is for the third party to be an independent charitable trust set up by Ofgem specifically for allocating voluntary redress money. This will be discussed at the end of this section.

#### *Which third party?*

4.23. Under this option, all suitable external third parties would be considered. A procurement process would select the third party. This procurement would be done periodically, rather than case-by-case.

4.24. As an example of such a third party, we have explored the use of a DAF provider. We are also aware of other third parties who have experience administering various energy-related schemes on behalf of energy companies and charities. If such third parties could also provide a way that money to be allocated doesn't sit with either the company under investigation or Ofgem, we think that such a set-up could bring similar positive impacts for consumers as a DAF provider.

#### *Who makes the allocation decision?*

4.25. The allocation decision could be made by either Ofgem or the third party. This would be established at the time of agreeing the contract between Ofgem and the third party.

4.26. Taking the example of DAF providers, we understand that the donor or the body setting up the DAF makes the allocation decision in the majority of cases. Following that model, Ofgem would set out guidance and objectives for the third party to follow when considering the selection of recipients. We would first give general guidance, along the lines that the money should be used to support consumers in vulnerable circumstances across Great Britain. We could then also give specific guidance on the nature of the breaches to help link those harmed to those who benefit from the redress. The third party would propose recipients to us and we would make the final decision.

4.27. Alternatively, the third party could make the allocation decisions, line with the guidance and objectives set by us. We welcome stakeholder views on who should make the allocation decision.

*How frequently would the money be paid out?*

4.28. The frequency of allocation could be case-by-case (ie following each individual case) or periodically (ie the money from all cases within a certain period would be paid out as part of the same process).

4.29. If allocation was done case-by-case, Ofgem could provide guidance on the specific case in addition to the general allocation guidance during the set-up phase. For each case, the third party would run an open process for charities, trusts and organisations to apply for funding.

4.30. Alternatively, allocation could be on a periodic (eg yearly) basis. This would involve companies under investigation making voluntary redress payments to the third party as soon as settlement or alternative action is agreed. The third party would manage one open process per period for charities, trusts and organisations to apply for funding. This would help them find a pool of organisations which could be selected according to the nature and harm of the breach. Ofgem could provide guidance on the nature of the breaches to help link those harmed to those who benefit from the redress. Having a pool of organisations would give the third party a more complete picture when considering how to allocate the money to ensure that maximum benefit is delivered across a diverse range of recipients.

4.31. We understand that for DAF providers the costs are generally not significantly different between case-by-case or periodic allocation.

*What services would the third party provide?*

4.32. We envisage the entire process, including the set-up, allocation, management and monitoring, being handled by the third party.<sup>13</sup>

4.33. From our engagement with DAF providers we understand that the services offered by them to meet these requirements are:

- Providing a financial account to receive the money from the company under investigation and transfer it to recipients.
- Setting-up a governance structure with a framework and guidance.

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<sup>13</sup> It is also possible to consider procuring multiple third parties, working together, who would provide these services. We would be minded to procure whichever third party service model offers the greatest benefits at lowest cost.

- Researching recipients that meet the allocation objectives, including small or niche charitable organisations.
- Running an open bidding process.
- Responding to any enquiries and assisting charities with their applications.
- Sifting applications according to the allocation objectives and principles.
- Making informed decisions/recommendations based on the guidance.
- Monitoring the use of the money and providing reports to Ofgem.
- Reviewing the effectiveness of the process and suggesting changes.

4.34. Third parties such as DAF providers also have expertise in allocating money over a number of phases, rather than recipients receiving a single lump sum. This enables long-term support to charitable recipients. When combined with monitoring, this flexibility can help ensure that the money is being used both as agreed and to achieve the greatest impact.

4.35. If those phases are across several years, there are better opportunities for smaller charities to receive funding, as they may not have the framework in place to accept or manage a single large payment. The yet-to-be-allocated funds are held by the third party. If such a phased / multi-year funding approach was taken under option 1, we would need to consider whether it would be appropriate for the company under investigation to retain the yet-to-be-allocated funds.

4.36. As outlined in 4.15 under option 1, the monitoring and evaluation reports from the third party could be published.

### **The costs of this option**

4.37. The costs of using a third party can only be known for certain after a procurement process. Based on our research, we expect these costs to be somewhere between 0.5% and 1.5% of the money in the fund. We would need to run a competitive procurement process to confirm final costs, but we would currently expect them to fall at the lower end of this range.

4.38. These costs could be covered partly or completely through investing or earning interest on the yet-to-be-allocated money in the fund. This could occur either where payments made to the fund are not to be allocated until the next periodic open process, or where recipients receive multi-year or phased funding. To give an example of where funds were invested to cover the costs of the DAF provider, the Cabinet Office used an asset manager to invest the funds from the LIBOR fines that were held in a DAF prior to allocation.

4.39. We need to consider how the costs would be covered if they are not fully recovered through investment returns or interest earned. They could come out of the total redress money. That would mean that less money would be available for allocation. Or they could be covered by the company that was under investigation. This would be similar to the current approach where the companies absorb the staff

costs they incur in selecting who to propose to us and in preparing the post-allocation monitoring reports for us.

### **Advantages**

- The allocation process would be conducted by experts in the process of making grants to the charitable sector, with access to knowledge, infrastructure and networking (including tailored knowledge of energy sector charities) to ensure that money is well allocated, managed and monitored.
- The selection process would be transparent.
- There would be more time to select recipients as the time limits of the settlement process would not have an impact.
- It would require fewer resources from us compared to option 1 as we would approve the third party's recommendations based on their detailed assessments or we would leave the decision to the third party, allowing us to focus on our core business.
- The third party would have experience of conducting value for money assessments and evaluating how money is used by charitable organisations.
- Companies under investigation would be less likely than option 1 to receive positive publicity as they would be a further step removed from allocation process.
- It would likely lead to an increase in the diversity of recipients.

### **Limitations**

- Companies under investigation may not fully consider the impact and consequences of their wrongdoing if they do not have to consider and identify appropriate recipients.
- If the costs of the third party are not fully covered by investment returns or interest earned on the fund, the costs would reduce the amount of redress money that goes to recipients.
- Companies under investigation may not volunteer to make redress payments as they would have no control over where the money goes.

**Question 5:** What are your views on 'Option 2: Responsibility given to a third party with appropriate expertise'? Are there any other advantages, disadvantages, risks or costs relating to this option that we should consider?

**Question 6:** How should the costs of the third party associated with allocating redress be funded?

**Question 7:** Should the company that made the redress payment have an input into the approval of recipients under this option?

**Question 8:** How can we ensure that smaller potential recipients can bid and are not disadvantaged compared to larger potential recipients?

### **Variation on Option 2 – Voluntary redress payments go to a charitable trust set up by Ofgem**

4.40. Under this variation of option 2, Ofgem would set up a charitable trust specifically to manage and allocate voluntary redress money from enforcement action. Companies under investigation would pay voluntary redress to this charitable trust. The trust would then allocate the money to suitable charities, trusts and/or other organisations.

4.41. The trust would be independent from Ofgem, with its own legal personality and an independent chair.<sup>14</sup> However, Ofgem would have input into the objectives in setting up the trust's constitution. It is likely that the objectives would emphasise supporting energy consumers in Great Britain, in particular consumers in vulnerable circumstances.

#### *Costs*

4.42. Ofgem would provide the resources required to set up the trust. Ofgem could then provide the trust with ongoing administrative support with the cost of this support being covered by Ofgem. Other costs, such as expenses of the trustees, could possibly be funded out of the redress money.

#### *Advantages and limitations*

4.43. Most of the advantages and limitations listed directly beneath paragraph 4.39 apply, to varying degrees, to this variation of option 2.


4.44. We consider the key advantage of this variation of option 2 to be that the trust would be solely focused on supporting energy consumers.

4.45. We consider the main limitations to be:

- The substantial resources required by Ofgem to set up and provide ongoing support to the trust, including resources required for monitoring and reporting on the use of the money, would take us away from our core business.

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<sup>14</sup> A trust must have a minimum of three trustees. To ensure that a quorum can be made when the trust needs to make decisions, we think the trust would have approximately seven trustees. A minority of the trustees could be employees of Ofgem, though we note it is best practice for the trust to be entirely independent of Ofgem.



## Allocation of voluntary redress payments in the context of enforcement cases

- A potential perception could be that the trust is not independent from Ofgem and that the funding is being used to carry out Ofgem's policy objectives.

4.46. We consider using an existing third party rather than establishing our own trust has greater advantages and fewer limitations.

**Question 9:** What are your views on this 'Variation on Option 2 – Voluntary redress payments go to a charitable trust set up by Ofgem'? Are there any other advantages, disadvantages, risks or costs relating to this option that we should consider, particularly in relation to the DAF provider model set out above?

**Question 10:** How should the costs of running a charitable trust set up by Ofgem be funded?

## 5. An additional consideration

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5.1. An alternative approach would be for part of voluntary redress payments to be allocated to selected energy schemes funded by third parties that are not charitable organisations. One such example is the Big Energy Saving Network (BESN), funded by the Department of Energy and Climate Change (DECC). The BESN is an outreach initiative which aims to engage and empower vulnerable people to make informed decisions on reducing their energy expenditure.

5.2. If this approach was taken as part of voluntary redress, it would apply alongside whichever of the above options is chosen. So a dedicated portion of the total voluntary redress payment would go to fund such a scheme and the remainder would go to the selected charities, trusts or organisations.

5.3. Given the uncertainty around the number and outcome of future Ofgem enforcement cases, the value of any future voluntary redress payments is also uncertain. Such schemes would not therefore be able to rely on voluntary redress payments for funding on an ongoing basis.

**Question 11:** What are your views of the idea of using part of voluntary redress payments to support specific schemes? What are the advantages, disadvantages, risks or costs relating to this idea? What existing schemes could be considered under this approach?



## 6. Overall view

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6.1. Having considered the options presented in this consultation, we would like to know which option you think would achieve our objective of maximising the positive impact and benefits from voluntary redress payments for energy consumers, in particular consumers in vulnerable circumstances.

**Question 12:** Which of the options in this consultation do you think should be used and why?

**Question 13:** Should any other options be considered? If so, please provide an outline explanation of your suggested alternative option(s). Please also outline any associated benefits and costs with the alternative option(s).

## 7. Next steps

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### **Deadline for responses**

7.1. Please send your responses to us on or before **24 August 2016**. We welcome contact from stakeholders during the consultation period so that we can help you respond.

### **Engagement during the consultation period**

7.2. We know that many stakeholders, particularly those in the charitable sector, have different capacities to engage with our proposals. We will continue to proactively engage a wide range of stakeholders during the consultation period, and will work to ensure that they understand our proposals and can meaningfully contribute to shaping our way forward.

### **Outcome of consultation**

7.3. We will analyse the responses we receive and aim to make a decision by the end of 2016 on the process to be put in place for any future voluntary redress payments. We will announce it publicly.

## Appendix 1 - Consultation Response and Questions

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Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. We would especially welcome responses to the specific questions which we have set out which are replicated below.

Responses should be received by 24 August 2016 and should be sent to Kieran Coleman at [redress@ofgem.gov.uk](mailto:redress@ofgem.gov.uk).

Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality.

To the extent information provided in any response contains personal data under the Data Protection Act 1998, the Gas and Electricity Markets Authority will be the data controller. Ofgem (which supports the Authority) intends to use information contained in responses in performance of its statutory functions, including those applicable to voluntary redress payments, and in accordance with section 105 Utilities Act 2000.

### **CHAPTER 2: What we want to achieve**

**Question 1:** Do you agree with our objectives for the allocation of voluntary redress? If not, please explain why.

**Question 2:** Are there any additional objectives or criteria we should consider when making a decision on our forward approach to voluntary redress? Are there things our approach should definitely include or absolutely avoid?

### **CHAPTER 4: Overview of options**

**Question 3:** What are your views on 'Option 1: Current process with enhanced principles'? Are there any other advantages, disadvantages, risks or costs relating to this option that we should consider?

**Question 4:** What are your views on the possible additional principles outlined in 'Option 1: Current process with enhanced principles'? Are there further additional principles that would help meet our objectives?

**Question 5:** What are your views on 'Option 2: Responsibility given to a third party with appropriate expertise'? Are there any other advantages, disadvantages, risks or costs relating to this option that we should consider?

**Question 6:** How should the costs of the third party associated with allocating redress be funded?

**Question 7:** Should the company that made the redress payment have an input into the approval of recipients under this option?

**Question 8:** How can we ensure that smaller potential recipients can bid and are not disadvantaged compared to larger potential recipients?

**Question 9:** What are your views on this 'Variation on Option 2 – Voluntary redress payments go to a charitable trust set up by Ofgem'? Are there any other advantages, disadvantages, risks or costs relating to this option that we should consider, particularly in relation to the DAF provider model set out above?

**Question 10:** How should the costs of running a charitable trust set up by Ofgem be funded?

#### **CHAPTER 5: An additional consideration**

**Question 11:** What are your views of the idea of using part of voluntary redress payments to support specific schemes? What are the advantages, disadvantages, risks or costs relating to this idea? What existing schemes could be considered under this approach?

#### **CHAPTER 6: Overall view**

**Question 12:** Which of the options in this consultation do you think should be used and why?

**Question 13:** Should any other options be considered? If so, please provide an outline explanation of your suggested alternative option(s). Please also outline any associated benefits and costs with the alternative option(s).

## Appendix 2 - Feedback Questionnaire

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Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Do you have any further comments?

Please send your comments to:

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