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By email only

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Dear Mr MacFaul

Allocation of voluntary redress payments in the context of enforcement cases

Overview

We agree that redress payments should be allocated as far as possible in a way that ensures the greatest positive impact for affected consumers, and that as far as practical takes account of the type of customer affected, and their geographical location. We do, however, acknowledge that as an energy supplier, the charitable sector is not our core business and we do not have specific expertise or experience in that area. In addition, we have found it difficult on occasions to identify a selection of appropriate charities that are able to absorb the substantial redress funds involved. By default this has restricted our choices on which charities are willing and able to receive the money.

As such we believe that in practice suppliers are not always best placed to choose an appropriate charitable recipient. In theory, we believe a third party (Ofgem's option two) could be the answer to these problems, but are not able to fully support option two at this point due to the lack of financial modelling in the consultation; as a bare minimum we would have expected a worked example to give suppliers an idea of what the third party costs are likely to be and how they will be recovered. It is very difficult to support a change of this nature when we are unsure what the final financial liability on suppliers will be.

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Answers to specific questions

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

We agree with Ofgem's objectives for the allocation of voluntary redress.

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?

We believe that there needs to be a firm commitment to make sure that the funds are spread across geographical areas and types of customers affected by the wrongdoing being redressed as far as is reasonably possible. While more customers could benefit pound for pound from money that is targeted towards dense urban areas, we believe it is vital that rural areas are not disadvantaged by the aim to reach as many people as possible. The objective to benefit as many people as possible should not cloud the fact that people that live in more remote areas could be just as in need of support if not more so.

We agree that suppliers should not benefit publically from voluntary redress by making payments to charities or trust funds that bear their name. If, however, a supplier's fund operates under a different alias and the company is willing to give an undertaking that it will not seek good publicity from the payment then we see no issue with this.

However, if option two is progressed, we think it is unlikely that a supplier would be comfortable with a voluntary redress payment being made to a rival supplier's own charity.

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?

The current process, although workable, puts a large amount of emphasis on suppliers to procure, manage and review payments to the charitable sector. The 'enhanced principles' would in our opinion make the burden on suppliers even greater. Understanding economies of scale in a sector it has little knowledge of could be extremely difficult, and placing the emphasis on the supplier to calculate what would be the optimum number of charitable recipients against the size of the penalty could be burdensome. Likewise, it would require specialist skills that the supplier may not have to run an open bidding process. This extra burden could require a supplier to employ additional and specialist staff; if these costs became too onerous there may be pressure to merely pay the penalty direct to HM Treasury rather than incur these additional indirect costs on top of the voluntary redress payment.

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?

See our response to question three.

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?

As referred to in our overview, in principle we believe option two could be beneficial because, as Ofgem has pointed out, the process would be conducted by experts in a transparent way.

We do not agree with Ofgem's suggestion that this option would lead to companies no longer fully considering the impact and consequences of their wrong doing. The threat of a financial penalty and adverse publicity is enough to make a supplier want to avoid non-compliance, and the fact that it would no longer have to go to the trouble of administering the redress payments to charities is immaterial compared to these things. Nor do we agree that companies will stop volunteering to make redress payments as they would no longer have control over the end recipient. We are concerned, however, over the lack of detail regarding how these third parties will be funded (see our response to question six) and what controls will be in place to prevent any misuse of monies. As the third party would be in control of large amounts of money it is not inconceivable that there might be some third parties offering their services who are not trustworthy. It would be unacceptable if money was siphoned off or stolen before reaching the intended charity, so we would expect there to be a minimum level of vetting and auditing of these companies.

In addition we believe that option two should only be implemented on the strict understanding that a supplier's obligation and liability ends at the point of handing the voluntary redress money to the third party, regardless of whether there should be any subsequent issues with the performance of the third party. Furthermore, the supplier should not be expected to cover or manage any activity after the money has been paid to the third party. For example, any reporting of how the money has been spent and which consumers have benefitted from it should be down to the charity/third party and not the supplier.

Finally, we believe the vehicle used to manage the funds should result in a tax neutral impact and the supplier should not be responsible for any taxation impacts of the selected vehicle.

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

It is very difficult to answer this question as Ofgem have not provided any financial modelling to give any indication of likely costs associated with this option. We have attempted to give a view below but this is merely hypothetical due to a lack of clarity in the consultation.

Ideally we would like to see the third party self-funded from interest earned on the money held or through alternative investment schemes. That said, there are some concerns with this:

- i. Interest rates are at an all-time low;
- ii. If interest rates go negative then it would cost money to bank the money;
- iii. There could be tax implications on the interest earned;
- iv. To get the best rates it is normal to have to deposit monies for a certain period of time. This could incentive putting the money in a bank for a set period which could prevent it being used to benefit customers as soon as possible. We would expect there to be a cap on how long a third party could bank the money (six months would seem a sensible time limit). Likewise the charity should make a firm commitment to spend any money they receive within a set period in order to give confidence that it will be returned to customers as soon as possible and not banked by them in order to boost their revenue through interest earned;
- v. What happens if there aren't any fines? There would be no interest earned. We assume the third party will not just appear as and when there is a fine. How would it be funded in this scenario?
- vi. Interest alone is unlikely to fund the third party;
- vii. Who will monitor the third party to make sure they have banked monies in the most attractive bank account?

Given all the above it is likely that there would need to be a process to fund any shortfall. It would seem unfair for this shortfall to be made up from money due to consumers, or indeed for it to be recovered from suppliers in addition to funds already provided as part of enforcement action.

We are strongly of the opinion therefore that any third party should act within defined financial budgets to minimise the likelihood of any shortfall. The third party needs to be able to account for their costs and show that they are competitive compared to the overall market, and to be regularly audited by a recognised external auditor of appropriate standing to make sure that they are providing value for money.

Suppliers picking up the third party costs (after any shortfall from the interest) could be more acceptable if there was some mechanism or logic applied. For example, costs that the third party could recover from the supplier are capped at

X for every £10,000.00 received. At least this way the supplier would have an idea of the overall liability it would be exposed to. We would expect Ofgem to consult on any logic of this type rather than unilaterally imposing it on suppliers.

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

We do not believe there is a requirement under option two for the company that made the redress payment to have an input into the approval of the recipient. We are of the opinion that option two should only be progressed if the supplier's involvement and liability ends at the point of handing the money to the third party.

However, this is on the basis that it is a condition of option two (or any other variation to this option) that the third party should never allocate a supplier's voluntary redress payment to a rival supplier's own charity.

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

Larger companies, due to economies of scale and resource, may fare better when bidding for money if the main drivers are 'delivering the most for less', and are likely to be able to cover more customers and a wider geographical area. Smaller companies may, however, have specialist skills and local knowledge that are unique to them, and which may be appropriate in some situations or specific geographic locations. Ofgem would need to tailor its guidance to the third party to take account of the specific circumstances involved in the case in hand, which could centre on finding a recipient that has 'local knowledge/links with a specific geographical area'.

In our experience smaller charities may fare less well when bidding for large amounts of money, often because a large portion of the money would have to be used to scale up and recruit additional staff, rather than being used to benefit consumers directly. The pool of charities that can absorb large financial sums is small. To address this, the redress money could be broken up into smaller amounts to allow different, smaller or regional charities a chance to bid for some of the money.

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?

From our perspective we do not see much difference between how option two or the proposed variation would impact us. As such we have no preference over one

or the other so long as the vehicle used to manage the funds results in a tax neutral impact and the supplier is not responsible for any taxation impacts of the selected vehicle. However, we would have expected this variation to have been an option on its own with the relevant detail set out in the consultation.

The benefits and disadvantages from our perspective would be the same as those referred to in our response to question eight. Ofgem is clearly best placed to know whether the variation is a workable solution as far as it is concerned; if the variation is taken forward we would expect to see further detail on it.

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

Please see our response to question eight.

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?

In theory we think it is a good idea to support well deserving schemes. This could result in the money being spread out across different organisations in a more effective way and could help with delivering the overall objective of maximising long-term benefits for energy customers by ensuring that funding is well targeted. Regarding the point around uncertainty of funding we do not see this as an issue, as charities or schemes should not be budgeting on the assumption that they will be in receipt of future income from enforcement action. This money is an extra source of income that is only available on an intermittent basis and there are no guarantees it will be available on an on-going basis. Charities and schemes should therefore not be acting on the assumption that it will be.

On a practical basis, however, we are a little more sceptical of how confidence in Ofgem can be upheld if schemes that are already funded by government departments (such as Big Energy Saving Network) start to be the beneficiary of fines. We struggle to see how Ofgem can appear independent in making decision on fines if that money is then used to support schemes funded by government departments. We are not, for the reasons set out previously, against money going to other forms of schemes that are not charities, and in some instances this might be the correct thing to do, but we believe this should only be the case if there is no link between the scheme and government. Public confidence needs to be upheld in Ofgem's motives for issuing fines.

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

In principle, option two but due to the lack of detail provided around the costs associated with this option we are unable to support it fully at this stage.

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).

We do not think that other options need considering but the costs associated with option two need to be looked into further with more information provided to suppliers before a decision can be made.

Yours sincerely,

Mr Paul Watson
Regulatory Executive