



(by email)

Head Office
Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ

steven.findlay@sse.com

01738 516253

24 August 2016

Dear Kieran,

Allocation of voluntary redress payments in the context of enforcement cases

Thank you for providing SSE with the opportunity to respond to the above consultation. I am pleased to enclose our response. We have provided a response to each of the questions posed in the consultation document within the attached annex.

Ofgem's consultation document states the overall case for change, noting that the improving the current process will help deliver maximum benefit for Great Britain's energy consumers. SSE does not believe either option should be adopted until such point a full cost-benefit analysis has been completed. SSE believes that the current redress process is fit-for-purpose and Ofgem has not outlined, in any detail, the case for change. Without further analysis and certainty of the additional costs and processes, SSE is not in a position to support either Option 1 or 2

In relation to Option 1, we consider that the additional principles proposed could render the voluntary redress process unworkable and fraught with difficulties. We are also concerned that the proposed Option 2 has too much uncertainty associated with it to be considered viable and has the potential to create a contradictory situation for Ofgem in the context of enforcement cases. We have explored this point in more detail in response to Ofgem's questions below.



Whilst SSE agrees that delivering maximum benefit for consumers is paramount, we do not believe that the redress process warrants the additional burden that Option 1 or Option 2 will bring. Indeed, Ofgem state within the consultation document that ‘the current process is working well’¹ without any further impact assessment or needs case to define the need for change.

In diversifying the nature and number of recipients, it is naturally going to cost more to administer, monitor and demonstrate that the redress is being donated in the most efficient manner in to secure maximum benefit for consumers. SSE is firmly of the opinion that the current redress process is fit-for-purpose and Ofgem has not outlined, in any detail, the case for change. Without further analysis and certainty of the additional costs and processes, SSE is not therefore in a position to support either Option 1 or 2.

I have provided further detail in response to the specific questions posed within Ofgem’s consultation document. I would be happy to discuss any of the points made within this consultation document in more detail.

Kind regards

Steven Findlay
Regulation

¹ Consultation document, Page 6, Paragraph 1.9

Annex

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

In principle, SSE agrees with the majority of Ofgem's objectives for the allocation of voluntary redress. However, as noted above, we do not believe that the additional objectives are a prerequisite for changing the current voluntary redress process. The primary objective requires that funding maximises the long term benefit through well-targeted funding. SSE considers that this should not be at the expense of an excessively complicated administration and reporting process that has the potential to divert funds towards staffing costs or reporting requirements as opposed to benefitting consumers.

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?

SSE believes Ofgem could consider an additional objective to ensure that the voluntary redress process is as efficient as possible. This objective will help drive the maximum benefit of voluntary redress being realised by those affected and, in particular if where appropriate or necessary, vulnerable consumers. It will provide an appropriate check and balance against Ofgem's proposed additional objectives. For example, Ofgem consider 'that the benefits of using a bidding process outweigh the cost'². The additional efficiency objective would require Ofgem to fully consider the net-benefit of such a decision prior to its formal implementation. It would also help ensure that Ofgem's proposed bands of total voluntary redress payments are appropriately weighted.

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?

SSE is not supportive of the proposed principles under Option 1. Individually, the principles would appear to be reasonable. However taken together as a package, the potential benefits Ofgem identifies, are likely to be outweighed through the additional cost and administration burden on both the company under investigation and the recipient of any redress.

During an enforcement case, the number of recipients and amount of redress is normally proposed by the company under investigation. This approach is, generally, preferable to the company under investigation seeking early settlement. It is desirable for any redress to be

² Consultation document, Page 15, Paragraph 4.9.

provided to those consumers affected (via charitable donations) rather than going directly to HM's Treasury as a penalty. However, the introduction of the additional principles and in particular the open bidding process will result in a firm reconsidering whether volunteering to make redress payments is an overly burdensome and onerous process.

Ofgem notes that linking the number of charitable recipients to the size of the total voluntary redress payment would increase the number and diversity of recipients. Whilst SSE would agree this to be the case, with each additional recipient proposed the administrative cost will inevitably increase. Whilst the company under investigation will be expected to shoulder the burden the costs of such an approach, the charitable organisation that receives the funding will allocate a proportion of it towards administering the donation. This will further reduce the total amount of redress that is being directly targeted towards those consumers affected as a result of the company under investigation's failure.

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?

Our views on the proposed principles are set out above.

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?

SSE does not agree with or support Option 2. Ofgem's consultation document lacks a thorough financial analysis or impact assessment on which to determine whether a Donor Advised Fund (DAF) or another third party is likely to bring additional benefits for consumers at little (or no) extra cost.

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

Ofgem's research indicates that the costs of using a third party to be somewhere in the region of 0.5% to 1.5% of the money in the fund. Using information from Ofgem's website³, based on the total amount of redress payments in 2015, the overall cost of the third party is likely to be over £1m per annum (based on 1.5%). SSE would question, without further cost-benefit analysis, whether this is an efficient use of money that would otherwise be provided directly to a charitable organisation. The consultation document states an expectation that

³ <https://www.ofgem.gov.uk/investigations/investigations-and-enforcement-data>

costs will 'fall at the lower end of this range' however no additional information or rationale is provided to support this statement.

It is proposed that the costs of the fund be covered either partly or completely through investing or earning interest on the money in the fund. Investments can be, by their very nature, fraught with difficulties and risk. Ofgem must therefore ensure that appropriate and robust governance is in place for the organisation tasked with investing the funds' resources. If Ofgem is to allow the investment of potential redress prior to the allocation of funds to charitable organisation, it must consider whether it is appropriate, particularly from a Corporate Social Responsibility perspective, for a Donor Advised Fund to be reinvesting money that has been obtained on the basis of it being used for charitable donations.

In relation to earning interest on the money in the fund, SSE would question whether this approach is currently viable. The Bank of England Base Rate currently stands at 0.25%⁴ as of 15 August 2016. This is below Ofgem's calculations above, suggesting that, even at the lower end of 0.5%, the costs of using a third party to be somewhere in the region of 0.5% to 1.5% of the money in the fund. SSE is of the view that this could potentially create contradictory incentives for Ofgem in the context of enforcement if the fund was unable to finance its own activities. SSE would welcome further clarification from Ofgem on how it intends to protect against the risk of funds becoming lower than anticipated.

Both of these issues need to be need to be fully considered as part of an impact assessment before Ofgem takes a final decision on which option to pursue (if any are deemed appropriate).

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

Yes, SSE believes the company that made the redress payment should have an input on the approval of recipients. Whilst we appreciate Ofgem's view that the company under investigation should not receive positive publicity we believe that completely removing input towards the allocation process will lead to fewer companies volunteering to make redress payment with consequences of a more protracted and time consuming approach. This is potentially to the detriment of the company, Ofgem and consumers.

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

⁴ <http://www.bankofengland.co.uk/Pages/home.aspx>

Whilst SSE does not have a strong view in response to this question, assuming Ofgem ensure that the process is efficient and as streamlined as possible, it should not disadvantage smaller 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?

Ofgem notes that the main advantage of the 'variation on Option 2' is that the trust would be solely focused on supporting energy consumers. However, under the previous Option 2 Ofgem also states that an advantage of the DAF is 'there would be more time to select recipients⁵...' This would suggest that Ofgem would retain an element of control over where the DAF is donating money and could also ensure that funding is targeted at energy consumers.

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

The costs of running a charitable trust set up by Ofgem should be funded by Ofgem.

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?

SSE does not believe it is appropriate for an independent regulator (through a third party) to use redress payments to support Government schemes. In addition, SSE considers that the funding provided should be linked to breach and subsequent consumer detriment experienced as a result.

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

For the reasons set out within this consultation response, SSE does not believe either option should be adopted until such point as a full cost-benefit analysis has been completed. SSE believes that the current redress process is fit-for-purpose and Ofgem has not outlined, in any detail, a compelling or case for change. Without further analysis and certainty of the additional costs and processes, SSE is not in a position to support either Option 1 or 2

⁵ Consultation document, Page 21, 'Advantages'

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).

Whilst SSE is not supportive of Option 1 or Option 2, we cautiously support the intention behind a number of the individual principles contained within Option1. In particular:

- 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.
- 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.

SSE could potentially support a lesser version of Option 1 consisting of the above principles on the basis of a full impact assessment and cost-benefit analysis being completed.