

<b>Title:</b> Ofgem Consumer Redress  <b>IA No:</b> DECC0074  <b>Lead department or agency:</b> DECC  <b>Other departments or agencies:</b>	<b>Impact Assessment (IA)</b>		
	<b>Date:</b> 21/11/2012		
	<b>Stage:</b> Final		
	<b>Source of intervention:</b> Domestic		
	<b>Type of measure:</b> Primary legislation		
<b>Contact for enquiries:</b> claire.cormie@decc.gsi.gov.uk			

<b>Summary: Intervention and Options</b>	<b>RPC:</b> GREEN
--	-------------------

**Cost of Preferred (or more likely) Option**

Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB in 2009 prices)	In scope of One-In, One-Out?	Measure qualifies as
£0	£0	£0m	No	N/A

**What is the problem under consideration? Why is government intervention necessary?**

Gas and electricity businesses have to comply with licence conditions (unless they are exempt) and other regulatory requirements. Breaches can result in consumer losses. In the event of a breach, Ofgem can fine a business up to 10% of its annual turnover. However, Ofgem has no powers to compel businesses to pay redress to consumers or other businesses in compensation for losses. This means that whether redress is paid will often depend upon individual action (e.g. through the legal system). Ofgem does seek to negotiate voluntary redress in appropriate cases, but energy businesses have sometimes resisted this option. Other regulators such as Ofcom and the Financial Services Authority already have powers that allow them to require redress.

**What are the policy objectives and the intended effects?**

The overall objective is to help ensure that consumer interests are better protected by the enforcement system through the use of pound for pound redress payments to domestic and business consumers that have suffered losses as a result of a breach. The policy is intended to improve equity: those who have suffered losses should receive redress (by contrast fines flow to the HMT Consolidated Fund and hence to the general taxpayer purse). The policy may increase compliance by energy businesses which would bring an efficiency benefit.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**

The Government consulted on 4 options on Ofgem Consumer Redress powers: Option 1: Do nothing. Option 2: Introduce consumer redress powers covering licence holding electricity and gas businesses only. Option 3: Introduce consumer redress powers covering licence holding electricity and gas businesses and other market participants. Option 4: Introduce redress powers covering redress for consumers and redress between market participants. Option 4 was the preferred option as it provided the greatest scope for Ofgem to protect consumer interests through redress.

Following consultation the Government now believes option 3 to be the most proportionate response to providing consumer redress powers. Further to this we have developed an alternative option (3A) which includes a cap of 10% annual turnover, which mitigates against concerns that an uncapped liability could increase costs for energy businesses which in the end would be borne by energy consumers. This IA therefore assesses Option 3A: Introduce consumer redress powers covering licence holding electricity and gas businesses and other market participants with a cap on the level of penalty and redress payments, and option 3B, as before without a cap. The Government has decided to introduce powers covering consumer redress between licensed and non-licensed electricity and gas businesses with a cap on the level of penalty and redress payments (Option 3A) as this provides the necessary consumer redress, is a proportionate response and addresses concerns raised during the consultation.

<b>Will the policy be reviewed?</b> It will not be reviewed. <b>If applicable, set review date:</b> Month / Year						
Does implementation go beyond minimum EU requirements?			N/A			
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.		<b>Micro</b> Yes	<b>&lt; 20</b> Yes	<b>Small</b> Yes	<b>Medium</b> Yes	<b>Large</b> Yes
What is the CO2 equivalent change in greenhouse gas emissions? (Million tonnes CO2 equivalent)			<b>Traded:</b> NA		<b>Non-traded:</b> NA	

***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.***

Signed by the responsible Minister: Michael Fullon Date: 30/04/2013

# Summary: Analysis & Evidence

# Policy Option 3A

**Description:** Introduce consumer redress powers covering licence holding electricity and gas businesses and other market participants with a cap on the level of penalty and redress payments

## FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2012	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: £0	High: £0	Best Estimate: £0

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	NA	NA	£0
High	NA	NA	£0
Best Estimate		£0	£0

### Description and scale of key monetised costs by 'main affected groups'

We do not expect an increase in redress awards to have any impact on the costs of compliant energy businesses.

### Other key non-monetised costs by 'main affected groups'

There is expected to be a transfer away from the HMT Consolidated Fund in favour of consumers that have suffered losses. The annual impact could be some fraction of annual fines in the counterfactual (£10m) and will depend on Ofgem's specific analysis of each individual case.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	NA	NA	NA
High	NA	NA	NA
Best Estimate			

### Description and scale of key monetised benefits by 'main affected groups'

The benefits below have not been monetised due to a lack of quantitative evidence.

### Other key non-monetised benefits by 'main affected groups'

Consumers that have suffered losses as a result of non-compliance are expected to benefit from an increase in redress payments (as part of the above discussed transfer). The annual impact could be some fraction of annual fines in counterfactual (£10m) and will depend on Ofgem's specific analysis of each individual case. Society may benefit from increased social welfare (a reduction in deadweight loss), if the policy helps drive a reduction in non-compliant practices and hence a small (effective) reduction in energy prices.

### Key assumptions/sensitivities/risks

Discount rate (%) 3.5

It is assumed that in aggregate the policy will lead to increased redress and reduced fines because there is evidence that to date Ofgem have been unable to apply redress payments instead of fines in every case where they have judged it most appropriate. The impacts are sensitive to the incidence of non-compliance and the actions of Ofgem. A risk to the realisation of the benefits is that the powers are not used in the manner envisaged.

## BUSINESS ASSESSMENT (Option 3A)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: £0	Benefits: £0	Net: £0	No	N/A

# Summary: Analysis & Evidence

# Policy Option 3B

**Description:** Introduce consumer redress powers covering licence holding electricity and gas businesses and other market participants

## FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2012	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)			
			Low: £0	High: £0	Best Estimate: £0	
<b>COSTS (£m)</b>	<b>Total Transition (Constant Price) Years</b>		<b>Average Annual (excl. Transition) (Constant Price)</b>		<b>Total Cost (Present Value)</b>	
Low	NA		NA		£0	
High	NA		NA		£0	
Best Estimate			£0		£0	
<p><b>Description and scale of key monetised costs by ‘main affected groups’</b></p> <p>An increase in redress awards would not increase the costs to compliant energy businesses, apart from the increase in risk faced by the uncapped nature of the redress powers noted below.</p>						
<p><b>Other key non-monetised costs by ‘main affected groups’</b></p> <p>There is expected to be a transfer away from the HMT Consolidated Fund in favour of consumers that have suffered losses. The annual impact could be some fraction of annual fines in counterfactual (£10m) and will depend on Ofgem’s specific analysis of each individual case. The uncapped nature of the redress powers would result in an increase in the risks faced by those market participants included in the scope of these powers which could increase the required rate of return of investors or require increased insurance. These costs would potentially be passed through to consumers.</p>						
<b>BENEFITS (£m)</b>	<b>Total Transition (Constant Price) Years</b>		<b>Average Annual (excl. Transition) (Constant Price)</b>		<b>Total Benefit (Present Value)</b>	
Low	NA		NA		NA	
High	NA		NA		NA	
Best Estimate						
<p><b>Description and scale of key monetised benefits by ‘main affected groups’</b></p> <p>The benefits below have not been monetised due to a lack of quantitative evidence.</p>						
<p><b>Other key non-monetised benefits by ‘main affected groups’</b></p> <p>Consumers that have suffered losses as a result of non-compliance are expected to benefit from an increase in redress payments (as part of the above discussed transfer). The annual impact could be some fraction of annual fines in counterfactual (£10m) and will depend on Ofgem’s specific analysis of each individual case. Society may benefit from increased social welfare (a reduction in deadweight loss), if the policy helps drive a reduction in non-compliant practices and hence a small (effective) reduction in energy prices. The uncapped nature of the redress powers could provide an additional signal to market participants and consumers regarding Ofgem’s ability to protect consumer interests through enforcement.</p>						
<b>Key assumptions/sensitivities/risks</b>					<b>Discount rate (%)</b>	3.5
<p>It is assumed that in aggregate the policy will lead to increased redress and reduced fines. For the purposes of monetisation, we do not assume the policy will increase the overall level of penalty (fines plus redress) or increase compliance by energy businesses, due to the uncertainty around these impacts. The impacts are sensitive to the incidence of non-compliance and the actions of Ofgem. A risk to the realisation of the benefits is that the powers are not used in the manner envisaged.</p>						

## BUSINESS ASSESSMENT (Option 3B)

<b>Direct impact on business (Equivalent Annual) £m:</b>			<b>In scope of OIOO?</b>	<b>Measure qualifies as</b>
Costs: £0	Benefits: £0m	Net: £0	No	N/A

# Evidence Base

## One In One Out

RPC has advised that the proposed powers would be outside of the scope of the OIOO rule, since HMG guidance (paragraph 16 ix) states that fines and penalties are outside of the scope of OIOO.

Costs to business are discussed later in the evidence base.

## Problem under consideration

### *Summary*

Gas and electricity businesses have to comply with licence conditions (unless they are exempt) and other regulatory requirements (even if licence exempt). Breaches can result in direct or indirect consumer harm. Currently if a business breaches a requirement, Ofgem can fine it up to 10% of its annual turnover.

An enforcement regime should deliver an appropriate enforcement threat, as determined by the perceived probability of detection and the size of the penalty. Enforcement should also be fair, which would require those who suffer losses to receive compensation or redress.

While fines have a punitive and deterrent effect, they do not compensate consumers. Ofgem has no powers to compel businesses to compensate consumers or other businesses for losses suffered as a result of a breach. This means that whether consumers are compensated will often depend upon them taking individual action. Ofgem has on occasion secured voluntary redress through negotiation with energy businesses, but in other cases has been unable to do so.

### *Consumer harm*

Whether a breach of a licence condition or requirement results in consumer harm will depend on the circumstances of the case. Consumer harm may take the form of direct financial loss or may be less tangible or direct.

Below are examples of the types of Ofgem investigation that have had a consumer harm element:

- **Overcharging** – These cases concern the overcharging of consumers by energy suppliers, some of which represent non-compliance with Ofgem regulations on the calculation of bills. Examples have included overcharging of customers due to technical problems with automated telephone meter reading systems. By definition, overcharging implies a direct financial loss for consumers.
- **Complaints handling** – A number of energy suppliers have been found to be in non-compliance with complaints handling regulations. Failures have included failure to record all the details of customer complaints, not informing customers about the option of redress through the Energy Ombudsman and lacking adequate policies to ensure complaints were dealt with efficiently. As well as being damaging for consumers in a general sense, complaints handling failures can lead to financial losses. For instance, legitimate consumer requests for refunds go unattended.
- **Mis-selling** – These cases concern the mis-selling of energy contracts to consumers by energy suppliers. Mis-selling is captured by licence conditions relating to the marketing of energy contracts. A number of door-stop selling cases have seen consumers inadvertently move to more expensive contracts having been provided with misleading information about available savings. This can lead to higher energy costs for those consumers and potentially contract exit fees. While mis-selling can lead to consumer detriment, the financial loss can be difficult to quantify. For instance, if it is not clear what energy costs the consumer would have incurred in the absence of the mis-selling.

It is proposed that the main role of the new redress powers would be to secure pound for pound redress for consumers where a measurable consumer loss has occurred. Redress powers may be particularly relevant for overcharging cases, however the role of redress will depend on the circumstances of each case. In some instances of mis-selling or faulty complaints handling, identifying a clear detriment suffered by a particular group of affected consumers may be relatively straightforward. However, it may be appropriate for Ofgem to require other forms of redress, such as nominal goodwill payments or informing affected customers about how the breach has affected them, in some cases.

### *Deadweight loss*

In economics, when prices are increased such that consumption is below the competitive equilibrium, there is said to be a deadweight loss. Social welfare is not maximised since some consumption that would be associated with more marginal benefit than marginal cost is not taking place.

In the context of energy markets, an increase in compliance leading to an (effective) reduction in energy prices should result in a small increase in the amount of energy consumed<sup>1</sup>. This would represent a net welfare gain since the value that consumers are willing to pay for the increased consumption, as embodied by the retail electricity

---

<sup>1</sup> Depending upon the responsiveness of consumption to prices.

price, is greater than the increased resource costs (including traded sector emissions) from (slightly) increased consumption.

Therefore, enforcement that reduces overcharging is desirable in order to maximise social welfare.

### *Current enforcement system*

#### Identifying consumer harm cases

Ofgem identifies some consumer harm cases through its monitoring of the licence conditions and requirements that energy businesses must adhere to. Other cases are brought to Ofgem's attention by referrals<sup>2</sup>, customer complaints, whistleblowers or the media.

Not all non-compliance leads to direct consumer harm. Ofgem's Enforcement Guidelines state that harm, or potential harm, to consumers resulting from an alleged breach of licence is a key consideration in Ofgem's decision on whether or not to take enforcement action. The Guidelines request that complainants provide a clear explanation of the harm that has been caused or may be caused, as a result of the behaviour or alleged incident, supported by all available relevant evidence.

The main route for individual consumers to seek individual redress is through the Energy Ombudsman or legal action. The Energy Ombudsman provides an independent dispute resolution service between individual consumers and licence holding energy businesses.

Consumer Focus is a statutory consumer champion acting across the whole of the economy. Consumer Focus has powers to investigate consumer complaints that are of wide public interest.

#### Ofgem's powers

The existing enforcement regime means that if an energy business breaches a requirement or licence condition, Ofgem can fine it up to 10% of its annual turnover<sup>3</sup>. Having established that a fine is appropriate, the Authority<sup>4</sup> will consider all of the circumstances of the case in deciding how to set the quantum of the fine. In general, Ofgem is likely to first consider the following factors:

- the seriousness of any contravention or failure;
- the degree of harm or increased cost incurred by consumers or other market participants after taking account of any compensation paid;
- the duration of the contravention or failure; and
- any gain (financial or otherwise) made by the licensee.

While Ofgem has no powers to require redress for consumers or other market participants, it raises the possibility of voluntary redress payment in appropriate cases. Ofgem has had some success in negotiating voluntary redress payments, however businesses have resisted this option on other occasions. When businesses dispute that a breach has taken place, they may view redress payments as an admission of wrongdoing that would undermine any appeal.

In order for the energy supply markets to work efficiently, it is necessary for energy businesses to be subject to an appropriate enforcement threat in relation to practices that are harmful for consumers. As mentioned above, the level of threat depends on the probability of detection and the level of overall penalty (be it redress or fines). Information presented below indicates that there have been greater levels of overall penalty in 2011 compared to prior years. A key reason is that Ofgem has increased its focus on enforcement (see Appendix B), however this does indicate that non-compliance remains a problem.

#### *Problem with current enforcement system*

The current enforcement system does not always protect consumer interests in the best way possible. Businesses do not always pay redress where it would be appropriate to do so.

In economic terms, this can be viewed as a problem with the form of penalty. Fines levied by Ofgem go to the HMT Consolidated Fund and hence to the general taxpayer purse. Therefore in cases of consumer harm where Ofgem is only able to impose a fine, there is a distributional problem in that the proceeds flow only to the taxpayer and not to those who have suffered losses. Ideally, harm would be corrected through direct redress payments to those who

---

<sup>2</sup> The Energy Ombudsman has MOUs with Ofgem and Consumer Focus which require the service to notify these bodies of systemic issues arising within the industry and emerging generic issues. Source: Consumer Focus Report (2011)

<sup>3</sup> Ofgem's approach to financial penalties is set out in its Policy Statement (October 2003): <http://www.ofgem.gov.uk/About%20us/Documents1/Utilities%20Act%20-%20Statement%20of%20policy%20with%20respect%20to%20financial%20penalties.pdf>

<sup>4</sup> Ofgem is governed by the Gas and Electricity Markets Authority (the Authority). The Authority determines strategy, sets policy priorities and takes final decisions on matters such as enforcement.

have suffered losses. A fine would also be levied to provide an additional disincentive where appropriate. There would be transparency benefits to conducting enforcement through these two distinct tools.

Several considerations suggest the current system may not have delivered sufficient redress in the past:

- Ofgem has indicated that in some investigations businesses have an incentive to avoid voluntary redress, in that it may be seen as an admission of wrongdoing. Businesses may prefer to dispute the case, and risk payment of a larger fine at the end of the dispute. This indicates that, without new redress powers, a continuation of the trend for increased enforcement activity by Ofgem will not in itself deliver sufficient consumer redress.
- In a case concerning npower, the redress payment secured by Ofgem in 2009 (£1.2m) was far smaller than the eventual award in 2010 following the work of Consumer Focus (£70m)<sup>5</sup>. This would tend to indicate that redress awards have not always been sufficient in the past. It should be noted that Ofgem's investigation was limited to considering the relevant licence breach.

Consumer redress can also be achieved through individual legal action, arbitration by the Energy Ombudsman or by Consumer Focus campaigns. However, it is clear that these routes alone are not best suited to solving the wider problem.

- Whether consumers seek individual redress through the Energy Ombudsman or legal action depends on their willingness to pursue their cases. Individual losses are often relatively small and hence consumers may not wish to participate in a time consuming arbitration or legal process. The Ombudsman resolved over 5,000 complaints during 2010/11 and over 6,600 in 2011/12. This is likely to be very small relative to the actual footprint of consumer harm; past cases investigated by Ofgem have concerned hundreds of thousands or millions of consumers at a time (see Appendix A). While the Ombudsman plays an important role in the system, it is more efficient for Ofgem to intervene in cases where a very large number of consumers have suffered relatively small individual losses. Furthermore, the Ombudsman can only offer arbitration between individual consumers and licence holding businesses.
- The large campaign run by Consumer Focus resulting in the £70m award by npower in 2010 is considered to be an exceptional case. Consumer Focus is only able to conduct a limited number of campaigns at a time across its whole portfolio of interests. Furthermore, it has no powers to compel redress and there would be no guarantee that a similar campaign in the future would be successful in extracting voluntary redress from energy businesses.

#### *Scale of problem*

It is difficult to quantify the total losses to consumers as a result of breaches of licence conditions and relevant requirements in the energy markets. It is in turn difficult to quantify the extent to which voluntary redress has been sufficient in the past.

The table below indicates the fines and voluntary consumer redress payments secured by Ofgem in recent years<sup>6</sup>. More details of these enforcement cases are provided at Appendix A.

As can be seen below, Ofgem has levied around £23.5m in fines since 2007. Each of the fines imposed have been well below the 10% of turnover limit that Ofgem faces<sup>7</sup>.

The voluntary redress payments negotiated by Ofgem have totalled around £10.7m since 2007. As mentioned, a £70m redress award was secured by Consumer Focus from npower in 2010, building on an initial Ofgem investigation although considering a different aspect of the case.

It is likely that an increased focus on enforcement by Ofgem (see Appendix B) has been a driver of the penalty increases in 2011 compared to prior years.

---

<sup>5</sup> In 2007 npower changed the way it applied its charging system. The change was not communicated effectively and an estimated 1.8 million customers were likely to have paid for more higher-priced units than they expected. In February 2009, npower initially repaid an average £6 to 200,000 of its customers (£1.2million), following an Ofgem investigation. Following further investigation by Consumer Focus, it was announced in October 2010 that npower would make average repayments of £35 to 1.8m customers (£63 million, or £70m including VAT and interest). <http://www.bbc.co.uk/news/business-11449744>

<sup>6</sup> We have aggregated relevant cases that we are aware of but this list may not be exhaustive.

<sup>7</sup> For instance, the £1.8m fine imposed by Ofgem on npower in 2009 represented 0.04% of the combined turnover of npower licensees (£5,098m). The level of the fine in this case took account of the improvements to npower's sales practices which were implemented during the course of the investigation, in line with Ofgem's policy statement on financial penalties.

Table 1 – fines and redress payments to consumers or consumer funds per year

	Fines levied by Ofgem	Redress payments negotiated by Ofgem	Total
2012 (to date)	£9.7m	£4.5m	£14.2m
2011	£10m	£0.2m	£10.2m
2010	-	£0.2m	£0.2m
2009	£3.8m	£1.2m	£5.0m
2008	-	£2.1m	£2.1m
2007	-	£2.5m	£2.5m
<b>Total</b>	<b>£23.5m</b>	<b>£10.7m</b>	<b>£34.2m</b>

In light of the data above, the following comment can be made about the ‘form of penalty’ problem:

- Form of penalty – It seems reasonable to assume that the ‘form of penalty problem’ is some fraction of the fines levied (around £23.5m since 2007). That is, some part of the fines levied that notionally represents consumer loss (as opposed to the disincentive element) would ideally have flowed to consumers in the form of redress payments.

It is difficult to judge the adequacy of the enforcement threat, however it is clear that there remains scope to increase compliance.

### Rationale for intervention

Ofgem can impose fines when businesses have breached licence conditions or regulatory requirements but lacks redress powers. Ofgem has increased its enforcement in recent years and has on occasion secured redress for consumers through negotiation with energy businesses (see Appendix A and B). On other occasions, businesses have resisted the option of providing voluntary redress. Providing Ofgem with redress powers would strengthen Ofgem’s hand in negotiations with gas and electricity businesses and help ensure that the form of penalty is appropriate in cases of consumer loss. Ofgem will continue to assess the relative balance between redress and fines in the same way they do currently. However, these powers will enable them to explore their preferred split which they are presently unable to do.

Other regulators such as Ofcom and the Financial Services Authority already have consumer redress powers and have found these to be beneficial (see Appendix C for more information). Providing Ofgem with consumer redress powers would bring its powers more into line with other regulators.

### Policy objective

The overall objective is to help ensure that consumer interests are better protected by the enforcement system through the use of pound for pound redress payments to consumers or market participants that have suffered losses.

The policy is intended to improve equity: those who have suffered losses should receive redress (by contrast fines flow to the HMT Consolidated Fund and hence to the general taxpayer purse). The policy may increase compliance by energy businesses, which would bring an efficiency benefit.

### Description of options considered (including do nothing)

The Government consulted on 4 options on Ofgem Consumer Redress powers. These are presented in table 2 below along with how they are being taken forwards.

Table 2 Update to Options

Option	Description	Update
1	Do nothing	Counterfactual
2	Introduce consumer redress powers covering licence holding electricity and gas businesses only	Ruled out following consultation – it was decided that non-licensed energy businesses should fall within scope of the proposed redress power. As non-licensed energy businesses are not required to belong to the Energy Ombudsman Scheme, including them within scope of the power will increase the likelihood that their customers will receive redress when they suffer a loss as a result of a regulatory breach. This does not add to the regulatory burden upon them as they are already required to comply with the underlying legislation (which they could potentially breach).

3	Introduce consumer redress powers covering licence holding electricity and gas businesses and other market participants	This option is developed further in this IA into two options, 3A applying a financial cap to the penalty and consumer redress payments, and 3B uncapped as originally presented in the consultation IA.
4	Introduce redress powers covering redress for consumers and redress between market participants (this was the Government's preferred option at consultation stage)	Ruled out - following consultation now we believe in general, disputes between energy businesses are best resolved between the businesses, before the courts if necessary. As a result, we have decided that the focus of the power should be on redress for domestic and non-domestic energy consumers. In so much as other market participants are energy consumers they will be covered.

#### Why Government is not considering the preferred option from the consultation (options 4) in this final IA

Description of option 4 as presented in the consultation IA:

Ofgem would receive powers to obtain redress for consumers who suffer losses as a result of a breach of a licence condition or energy regulation by licensee businesses or by other market participants. Ofgem would also be able to require redress to be paid between market participants when a breach by one business has caused harm to another business.

Reason for not pursuing option 4:

Our consultation impact assessment proposed that Ofgem would be able to order redress to be provided in cases where a licence or regulatory breach by one energy supply company had impacted on another energy supply company or business energy consumer. In light of the responses to the consultation, we have now decided that the focus of the power should be on protecting domestic consumers and businesses in their capacity as energy consumers, particularly small businesses which are less likely to have the same resources as larger businesses to pursue redress on an individual basis.

#### Options Analysed

Further to this change to favouring option 3, there was a strong preference in the consultation for a financial cap on the powers. Therefore option 3 has been developed to cover this and is presented below.

Options analysed in the final IA

- Option 1: Do nothing is the counterfactual the other options are assessed against.
- Option 3A: Introduce consumer redress powers covering licence holding electricity and gas businesses and other market participants with a cap on the level of penalty and redress payments, has been developed following the consultation.
- Option 3B: Introduce consumer redress powers covering licence holding electricity and gas businesses and other market participants (uncapped) – this is the same as Option 3 from the consultation.

#### **Option 1: Do nothing**

Ofgem would continue to seek to negotiate redress when breaches lead to consumer losses, but would lack the powers to compel businesses to provide such redress. Other avenues for consumer redress would remain open (e.g. Energy Ombudsman, Consumer Focus, and legal action by individuals).

Ofgem would continue to have the power to fine an energy business up to 10% of its annual turnover if it breaches a requirement or licence condition.

#### **Option 3A: Introduce consumer redress powers covering licence holding electricity and gas businesses and other market participants with a cap on the level of penalty and redress payments.**

Ofgem would receive powers to obtain redress for consumers who suffer losses as a result of a breach of a licence condition or energy regulation. Under this option, these powers would extend not only to licensee businesses, but to other market participants (e.g. small, licence exempt suppliers, such as small independent Distribution Network Operators) that have the potential to cause consumer losses.

In order to minimise regulatory burdens some small energy businesses (including small generators, private networks and small-scale supply activities) are exempt from holding a licence, but do have a limited number of obligations imposed by statute. Ofgem can take enforcement action if these exempt businesses are in breach of those requirements. In many cases these exempt companies are businesses that provide energy services as an ancillary part of their activities. Consumers can be affected by regulatory breaches by these exempt businesses so there is a case for the redress powers to apply to them. This case is strengthened by the fact that Energy Ombudsman does not offer an arbitration service between consumers and licence exempt businesses.

The present cap of 10% turnover will continue to apply to fines and also cover consumer redress payments. Therefore the combined total of fine and consumer redress payments would not exceed 10%. The cap would apply to enforcement cases on an individual basis as it does at present so compensation would not be limited because of previous redress orders. It should also be noted that most energy businesses which deal with consumers have large turnovers and so we would expect that substantial amounts of compensation should be available in most cases where Ofgem decides this is appropriate.

### **Option 3B: Introduce consumer redress powers covering licence holding electricity and gas businesses and other market participants**

Ofgem would receive powers to obtain redress for consumers who suffer losses as a result of a breach of a licence condition or energy regulation as specified in 3A. However, there would not be a cap on the level of redress payments.

Ofgem would continue to have the power to fine an energy business up to 10% of its annual turnover if it breaches a requirement or licence condition.

### Monetised and non-monetised costs and benefits of each option

Quantification of costs and benefits is problematic: there is significant uncertainty around the counterfactual and around the impact of the redress powers. In reality costs and benefits will depend on the use that Ofgem makes of the redress powers<sup>8</sup> and on the threat of use as perceived by market participants. Consequently, the impact of the options will primarily be non-monetised. Quantitative analysis has been undertaken based on current evidence in order to provide an indication of the scale of the impacts.

The costs and benefits of Options 3A and 3B are described relative to Option 1 (the counterfactual). Given the difficulties of monetising costs and benefits, it is important to note that identification of the final proposal relies on some subjectivity and judgement.

### **Option 1: Do-nothing option (counterfactual)**

#### Discussion

As noted above, Ofgem would continue to use a combination of fines and voluntarily consumer redress negotiations to deal with licence or requirement breaches that involve consumer harm.

It is assumed that Ofgem dedicates increasing resource to enforcement in the coming years (continuing the trend outlined in Appendix B). For indicative purposes, the following simple assumptions can be made about the counterfactual:

- Total annual fines are: £10m (the highest annual total since 2007)
- Total annual redress is: £4.5m (the highest annual total since 2007)

There is assumed to be a 'form of penalty' problem in the counterfactual; some enforcement that should ideally take the form of redress payments to consumers who have actually suffered losses is going to the taxpayers' purse in the form of fines.

#### Impacts

By definition the policy has no impacts in the do-nothing scenario.

### **Option 3A**

Option 3 would see Ofgem granted consumer redress powers covering licence holding electricity and gas businesses, and also other market participants (e.g. small, licence exempt suppliers, such as Distribution Network Operators). The cap of 10% of annual turnover that applies presently to the fines Ofgem can apply at present would continue to apply and cover both the fines and consumer redress payments.

#### Impacts

<b>Impact: Transfer from taxpayer to energy consumers (both domestic and non-domestic)</b>	
<i>Discussion</i>	<i>Scale</i>

<sup>8</sup> Ofgem will continue to assess the relative balance between redress and fines in the same way they do currently. However, these powers will enable them to explore their preferred split which they are presently unable to do.

<ul style="list-style-type: none"> <li>An expected impact of the policy is that financial losses to consumers would be addressed to a greater extent through redress payments rather than fines. This would result in a transfer of income from general taxpayers (who are assumed to be beneficiaries of fines paid into the HMT Consolidated Fund) to the energy consumers receiving redress.</li> <li>Ofgem has indicated that it accounts for redress payments when setting fines, which supports the assumption that the policy may reduce fines relative to the counterfactual. Where redress is paid, fines would still be imposed to dissuade future breaches where appropriate.</li> </ul>	<ul style="list-style-type: none"> <li>Annual impact could be some fraction of annual fines in counterfactual (£10m) and will depend on Ofgem's specific analysis of each individual case.</li> </ul>
<p><b>Impact: Administrative costs to energy businesses</b></p>	
<p><i>Discussion</i></p>	<p><i>Scale</i></p>
<ul style="list-style-type: none"> <li>A number of potential administrative costs are associated with fines and redress. These can be categorised as follows: <ol style="list-style-type: none"> <li>Costs to business and Ofgem of investigating potential breach and identifying what went wrong</li> <li>Costs to non-compliant business of identifying precisely which customers affected and measuring individual losses</li> <li>Costs to non-compliant business of making fines or redress payments</li> </ol> </li> <li>With regards to 1 above, the policy is not expected to increase these costs. These costs, including expenses as a consequence if a wrongful claim is made, would be incurred in both a fine and a redress situation. Ofgem does not plan to recruit extra staff in light of the powers and does not expect companies under investigation to have to recruit staff as a result of the introduction of the powers in respect of the investigation, other than to the extent that they would do so in the counterfactual.</li> <li>With regards to 2 above, the policy is likely to increase these costs for non-compliant businesses. To a degree, these costs are also incurred in the counterfactual as Ofgem already requires companies under investigation to provide information relating to detriment for the purposes of setting any fine. Furthermore, in some cases, there will be no cost attached to identifying affected customers and measuring the degree of detriment, for example where existing records can be used to identify customers who have been wrongfully charged a standard termination fee for cancelling a contract.</li> <li>With regards to 3 above, the policy is likely to increase these costs for non-compliant businesses. Redress payment may involve postal and other admin costs, which would not be the case with fines.</li> <li>Costs 2 and 3 to non-compliant businesses may be mitigated by the fact that Ofgem follows proportionality principles and may permit less burdensome forms of redress (e.g. nominal goodwill payments or public apologies) in cases where it would be disproportionate to provide individual redress. This may be more appropriate in cases such as complaint handling failures where the consumer loss is less direct.</li> </ul>	<ul style="list-style-type: none"> <li>We do not expect there to be any new administrative costs to compliant businesses.</li> <li>For estimates of the administrative costs to non-compliant businesses see Appendix D. However, only costs to compliant business are considered in the cost benefit analysis and so these are not included in the summary sheets at the front of this IA.</li> </ul>

Other non-monetised impacts

- If the policy increased the overall level of penalty (fines plus redress) relative to the counterfactual, a transfer from businesses to consumers would apply.
- If the enforcement threat to businesses increased (for instance, due to an increase in the overall level of penalty on businesses), this could lead to an increase in compliance and efficiency (a reduction in deadweight loss).
- However, based on available evidence, it is not clear whether the policy will in fact increase the enforcement threat faced by business or lead to an increase in the overall level of penalty. In order to be conservative, these benefits are not assumed to apply for the purposes of monetisation.
- These Ofgem consumer redress powers should not result in any new precautionary expenditure by business. Businesses should already take care not to breach any licence conditions. It is noted in the non-monetised benefits that society could benefit if the policy helps drive a reduction in non-compliant

practices. Following from this if any reduction in non-compliant practices is the result of businesses taking more care there could be a cost, but there is no requirement for this from the power.

- Any familiarisation costs felt by business from this power would be negligible. There are no new regulations or licence conditions for businesses to familiarise themselves with, only the fact that Ofgem will be able to compel consumer redress payments alongside fines. Issues relating to consumer detriment are already an integral part of any investigation and consideration of penalty if a breach is established. Ofgem will publish a short statement of policy setting out how they will apply consumer redress.

### Option 3B

Option 3B would see Ofgem granted consumer redress powers covering licence holding electricity and gas businesses, and also other market participants (e.g. small, licence exempt suppliers, such as Distribution Network Operators). However, no cap would apply.

#### Impacts

<b>Impact: Transfer from taxpayer to energy consumers (both domestic and non-domestic)</b>	
<i>Discussion</i>	<i>Scale</i>
<ul style="list-style-type: none"> <li>• The nature of the impact is expected be the same as discussed under Option 3A above.</li> <li>• The size of the impact may be marginally greater than under Option 3A, since more suppliers would be caught by the powers. This difference is likely to be very small given that licence exempt suppliers make up a small part of the market (with the big 6 licensed suppliers alone accounting for around 99% of the domestic GB market).</li> </ul>	<ul style="list-style-type: none"> <li>• Annual impact could be some fraction of annual fines in counterfactual (£10m) and will depend on Ofgem’s specific analysis of each individual case.</li> </ul>
<b>Impact: Costs to business</b>	
<i>Discussion</i>	<i>Scale</i>
<ul style="list-style-type: none"> <li>• Under this option the redress payments would be uncapped. The uncapped nature of the redress powers would result in an increase in the risks faced by those market participants included in the scope of these powers were a concern during the consultation.</li> </ul>	<ul style="list-style-type: none"> <li>• Potential increase in costs from this extra risk. This could be from insurance or a higher required rate of return for investors. Such cost could then be passed through to consumers.</li> </ul>
<b>Impact: Administrative costs to energy businesses</b>	
<i>Discussion</i>	<i>Scale</i>
<ul style="list-style-type: none"> <li>• The nature of the impact is expected to be the same as discussed under Option 3A above.</li> </ul>	<ul style="list-style-type: none"> <li>• We do not expect there to be any extra administrative costs to compliant businesses.</li> </ul>

#### Other non-monetised impacts

- The nature of the other non-monetised impacts are expected be the same as discussed under Option 3A above.
- Also, the uncapped nature of the redress powers could provide an additional signal to market participants and consumers regarding Ofgem’s ability to protect consumer interests through enforcement.

#### Risks and assumptions

##### Counterfactual

The counterfactual assumes that:

- Ofgem does not have consumer redress powers;
- Businesses continue to breach licence conditions and requirements;
- Ofgem dedicates increasing resource and attention to enforcement in the coming years, using its fining powers and attempting to secure voluntary redress where appropriate;
- There is a problem with the form of penalty; sometimes fines are used when redress would be appropriate.

These assumptions are based on the information outlined above under 'problem under consideration'.

#### *Interventionist options*

For the purposes of monetisation, the impact assessment for the interventionist options assumes that:

- Businesses continue to breach licence conditions and requirements;
- Ofgem dedicates increasing resource and attention to enforcement in the coming years;
- Ofgem uses the new redress powers such that financial losses to consumers are addressed to a greater extent through redress payments rather than fines, compared to the counterfactual;
- The policy does not change the overall level of penalty (fines plus redress) or increase compliance by energy businesses.

#### *Risks*

- If Ofgem did not use the powers effectively (e.g. due to resource constraints) then this would undermine the realisation of the benefits.

#### Rationale and evidence that justify the level of analysis used in the IA (proportionality approach)

The level of analysis in this IA is relatively light touch and primarily qualitative. Considerations supporting this include:

- There is limited available evidence to assist the quantification of the likely impacts of the powers.
- We used the consultation to seek additional evidence; however there was a lack of forthcoming suitable evidence obtained, although where possible evidence has been used. The final proposal has taken into account the strong consultation response to cap the fines and redress payments as the fines and capped presently.
- The scale of the impacts are likely to be relatively small.
- The policy proposal does not impose new licence conditions or regulations, but rather provides Ofgem with new teeth to enforce existing licence conditions and regulations.
- The level and form of penalties extracted by Ofgem will depend on a variety of factors as well as the proposed powers (e.g. the compliance of energy businesses, the approach to enforcement adopted by Ofgem, the level of resource dedicated to investigations by Ofgem). In many circumstances, fines are likely to remain the key mechanism by which Ofgem conducts enforcement.

#### Direct costs and benefits to business and discussion of OIOO

The proposed powers are considered outside of the scope of the OIOO rule, since HMG guidance states that fines and penalties are outside of the scope of OIOO.

As noted we do not believe that there will be additional administrative costs to compliant business. See Appendix D for more detail on the impact on non-compliant businesses.

Ofgem currently follows principles of proportionality when conducting its investigations and the proposed powers would not change this. Where individual loss cannot reasonably be established a reasonable solution may be to permit a nominal goodwill payment to consumers (we understand that Ofcom uses this approach).

It should be noted that small license exempt suppliers whom redress powers would extend to are already covered by regulatory requirements and the redress powers will not add to these.

#### Wider impacts

We do not consider there to be additional impacts that should be noted here.

### Competition impact analysis

The policy would apply across all of the licence holding energy businesses and across the licence exempt market participants. The 6 largest energy suppliers account for more than 98% of the domestic GB gas and electricity supply market. We do not anticipate that this policy will change the competitive positions of the respective market participants.

### Micro businesses

Micro businesses are not exempt. Whilst in theory they are in scope of the policy, in practice the policy is not expected to affect micro businesses significantly.

### Equality impact test

We have undertaken an initial screening for equality impacts and concluded that this policy proposal will not have a significant effect on equality.

### Justice impact test

We have undertaken a justice impact test and concluded that these proposals will have a minimal impact on the justice system.

## Summary and final proposal

The Government has decided to introduce consumer redress powers covering licence holding electricity and gas businesses and other market participants with a cap on the level of penalty and redress payments (Option 3A). The final proposal gives Ofgem the power to fine and require redress payments to be made up to the (combined) cap of 10% of the company's annual turnover if an energy business breaches a regulatory requirement or licence condition which results in consumer harm.

Under this proposal there will be a transfer to those that suffer the harm of the breach from than the general taxpayer<sup>9</sup>. We do not believe there will be any costs to compliant businesses.

Following the consultation it was decided that the cap that applies currently to the fines Ofgem can order should also apply to the combined total of fines and consumer redress payments required by Ofgem in future. Without the cap there could be higher costs from insuring against the risk, or a higher required rate of return for investors, due to the risk of being liable for uncapped compensation payments, which could then be passed through to consumers. Due to the evidence that no fine or voluntary redress payment made to date has neared the cap we believe the small potential benefit of increased compliance and efficiency due to the additional market signal of the uncapped nature of consumer redress payment does not outweigh the costs associated with it.

Introducing powers covering redress for consumers with a cap on the level of penalty and redress payments (Option 3A) provides the equitable solution required of necessary consumer redress, is a proportionate response to the problem and addresses concerns raised during our consultation responses.

---

<sup>9</sup> The fine flows into the HMT Consolidated Fund

## Appendix A

### Evidence on recent fines and redress<sup>10</sup>

As can be seen below, Ofgem has levied £23.5m in fines since 2007. Each of the fines imposed have been well below the 10% of turnover limit that Ofgem faces<sup>11</sup>.

The voluntary redress payments negotiated by Ofgem have totalled around £10.7m since 2007. As mentioned, a £70m redress award was secured by Consumer Focus from npower in 2010, building on an initial Ofgem investigation, albeit considering a different aspect of the case.

The overall level of penalty imposed by Ofgem increased in 2011 compared to prior years.

Table 2 – fines and redress payments to consumers or consumer funds per year

	Fines levied by Ofgem	Redress payments negotiated by Ofgem	Total
2012 (to date)	£9.7m	£4.5m	£14.2m
2011	£10m	£0.2m	£10.2m
2010	-	£0.2m	£0.2m
2009	£3.8m	£1.2m	£5.0m
2008	-	£2.1m	£2.1m
2007	-	£2.5m	£2.5m
<b>Total</b>	<b>£23.5m</b>	<b>£10.7m</b>	<b>£34.2m</b>

The data is presented in more detail in the tables below. The table below lists fines levied by Ofgem since 2009.

Table 3 - list of fines

Date	Party	Description	Outcome
May 2012	EDF	Mis-selling	<b>Penalty [£1] (plus redress of £4.5 million)</b>
February 2012	National Grid Gas plc	Failure to comply with a standard special condition of its gas transporters licence.	<b>Penalty £4.3 million</b>
February 2012	Northern Gas Networks Ltd	Failure to comply with a standard special condition of its gas transporters licence.	<b>Penalty £900k</b>
January 2012	npower	Failure to comply with the Complaints Handling Regulations.	<b>Penalty £2 million</b>
January 2012	British Gas	Failure to comply with the Complaints Handling Regulations.	<b>Penalty £2.5 million</b>
November 2011	British Gas Business	Misreporting under the Renewables Obligation <sup>12</sup>	<b>Penalty £1 million plus redress</b>
May 2011	National Grid Gas	Misreporting regulatory information on mains replacement	<b>Penalty £8 million</b>

<sup>10</sup> This information has been updated by Ofgem to also include cases since the consultation IA and reflect timings that the cases were confirmed.

<sup>11</sup> For instance, the £1.8m fine imposed by Ofgem on npower in 2009 represented 0.04% of the combined turnover of npower licensees (£5,098m). The level of the fine in this case took account of the improvements to npower's sales practices which were implemented during the course of the investigation, in line with Ofgem's policy statement on financial penalties.

<sup>12</sup> <http://www.ofgem.gov.uk/Media/PressRel/Documents1/Ofgem%20Press%20Release%201%20July%202011.pdf>

Date	Party	Description	Outcome
April 2011	SHEPD, Central Networks, Electricity North West	Failing to provide timely offers for network connections	<b>Respective penalties of £500k, £400k and £100k</b>
November 2009	EDF Energy	Failure to provide connections within prescribed time limit	<b>Penalty £2 million</b>
January 2009	npower	Mis-selling <sup>13</sup>	<b>Penalty £1.8 million</b>
			<b>Total: £23.5 million</b>

Source: Ofgem press notice announcing £2m fine for npower, 31 October 2011

Table 4 –fines per year

2012 (to date)	£9.7m
2011	£10m
2010	-
2009	£3.8m
2008	-
2007	-
<b>Total</b>	<b>£23.5m</b>

### Evidence on recent redress payments to consumers or consumer funds

The table below lists recent cases where financial redress has been provided to consumers or consumer funds following the involvement of Ofgem. This does not cover redress obtained by consumers through other routes (e.g. individual compensation through the Energy Ombudsman).

Table 5 - list of redress payments to consumers or consumer funds

Date	Description
March 2012 EDF	<p><b>Type of case: Mis-selling</b>  <b>Value of redress: £4.5m</b></p> <p>Ofgem found that EDF Energy had breached some aspects of the licences governing the provision of sales information through weaknesses in its processes and controls, as a result of which: customers were not always provided with complete information during the sales process; telesales agents made premature claims in relation to savings. Of the £4.5 million package, £1m was donated to support the Energy Best Deal public awareness campaign run by Citizen's Advice; £3.5 million was used to further reduce the bills of EDF Energy customers at risk of fuel poverty (who are eligible to receive pension credit and the Warm Home Discount).</p>
August 2011 EDF <sup>14</sup>	<p><b>Type of case: Overcharging</b>  <b>Value of redress: Around £0.2m<sup>15</sup> to customers</b></p> <p>The overcharging problem occurred due to a fault with EDF's automated telephone meter reading system following price changes between October 2003 and the end of April 2010. It was agreed that current customers would receive a refund a credit on their next bill and the company agreed to write to all of the past customers who had lost out by £3 or more (including interest).</p>

<sup>13</sup> <http://www.ofgem.gov.uk/Media/PressRel/Documents1/221208OFGEM38.pdf>

<sup>14</sup> <http://www.edfenergy.com/media-centre/press-news/EDF-Energy-resolves-meter-reading-process-error-affecting-a-very-small-proportion-of-our-customers.shtml>

<sup>15</sup> EDF set aside £200k plus interest for the purposes of redress.

Date	Description
October 2010 Npower <sup>16</sup>	<p><b>Type of case: Overcharging / unclear tariff changes</b>  <b>Value of redress: £70m to consumers</b></p> <p>In 2007 npower changed the way it applied its charges for the first block of higher-priced gas units which households pay. The change was not communicated effectively and an estimated 1.8 million customers are likely to have paid for more higher-priced units than they expected. In February 2009, npower initially repaid an average £6 to 200,000 of its customers (£1.2million), following an Ofgem investigation. Following further investigation by Consumer Focus it was announced in October 2010 that npower would make average repayments of £35 to 1.8m customers (£63 million, or £70m including VAT and interest).</p>
June 2010 EDF <sup>17</sup>	<p><b>Type of case: Breach of complaints handling requirements</b>  <b>Value of redress: £0.2m to consumer funds</b></p> <p>The authority found that EDF had failed to record complaints correctly, which amounted to a breach of complaints handling requirements between October 2008 and March 2009. The authority noted that EDF had made £0.2m of payments to consumer funds and considered that these obviated the need for a fine in this instance.</p>
April 2009	<p><b>Type of case: Failure to notify customers in relation to variations made to tariffs</b>  <b>Value of redress £1.2m</b></p> <p>Following discussions with Ofgem an energy supplier agreed to pay compensation totalling £1.2m to the customers affected adversely by the overall effect of the changes in tariff.</p>
March 2008	<p><b>Type of case: Overcharging</b>  <b>Value of redress: £2.1m to a vulnerable customers trust fund</b></p> <p>An energy supplier failed to comply with the relevant Regulations on calculation of bills from October 2003 to July 2007 with the result that gas customers were overcharged approximately 68p/year. The full amount of the sum in question was donated to a trust fund for the benefit of vulnerable customers.</p>
October 2007	<p><b>Type of case: Overcharging</b>  <b>Value of redress: £2.5m to gas pre-payment customers</b></p> <p>The supplier failed to comply with the relevant Regulations on calculation of bills with the result that customers were overcharged. The duration of the non-compliance was estimated to have been approximately two years. Redress was targeted on gas prepayment customers in order to benefit those gas customers who paid the highest prices, by reducing the gas prepayment meter standing charge by £20/customer.</p>

Table 6 – redress payments to consumers or consumer funds per year

	Excluding npower / consumer focus case
2012 (to date)	£4.5m
2011	£0.2m
2010	£0.2m
2009	£1.2m
2008	£2.1m
2007	£2.5m
<b>Total</b>	<b>£10.7m</b>

<sup>16</sup><http://www.bbc.co.uk/news/business-11449744>

<sup>17</sup><http://www.ofgem.gov.uk/About%20us/enforcement/Investigations/ClosedInvest/Documents1/EDF%20decision%2010610.pdf>

The table below provides an example of where redress was paid between market participants.

Table 7 – example of redress payment between market participants

Date	Description
July 2011 British Gas Business <sup>18</sup>	<b>Type of case: Misreporting under the Renewables Obligation</b> <b>Value of redress: Around £2.8m to market participants</b> Ofgem found that from 2002-03 to 2008-09, BG understated the amount of electricity it supplied to customers in England & Wales and Scotland. As a result of the misreporting other market participants suffered an aggregate loss of £2.8m over the 7 year period. BG committed to making appropriate redress to other market participants by retiring around 87,000 ROCs in the current reporting obligation year.

---

<sup>18</sup>[http://www.ofgem.gov.uk/About%20us/enforcement/Investigations/CurrentInvest/Documents1/BG\\_RO\\_misrep\\_penalty\\_not\\_ice.pdf](http://www.ofgem.gov.uk/About%20us/enforcement/Investigations/CurrentInvest/Documents1/BG_RO_misrep_penalty_not_ice.pdf)

## Appendix B

### The trend for increasing enforcement<sup>19</sup>

- Ofgem has undertaken two market reviews in recent years; the Ofgem Probe led to some new licence conditions/changes to existing licence conditions (such as the Marketing Licence Condition, under which Ofgem is investigating 4 of the Big 6 for mis-selling, with one case further similar case concluded) and Ofgem will consult on a number of further changes in the Retail Market Review. These changes facilitate enforcement action.
- The headcount for the Enforcement team has increased from 4 staff (Bands C and D) to 16 (+ 4 vacancies) in October 2012
- The Enforcement team is supported by a team of 5+ lawyers plus paralegals who are closely involved in investigations.
- The seniority of the team lead has gone up a band, from Band E to Associate Partner.
- In the financial year from 2009 to 2010:
  - 5 formal investigations were carried over from the previous year
  - 6 further formal investigations were opened
  - 2 were closed
- In the financial year from 2010 to 2011:
  - 9 were carried over from the previous year
  - 15 formal investigations were opened
  - 1 was closed
- In the financial year from 2011 to 2012
  - 23 were carried over from the previous year
  - 5 formal investigations were opened.
  - 15 closed or settled.
- Since April 2012 to date 1 further formal investigation has been opened and 2 have closed or settled. 12 investigations are ongoing.
- At any one time, the Enforcement team will also be working on a number of informal matters which may be settled/closed/launched as formal investigations.

---

<sup>19</sup> This information presented in this Annex has been updated by Ofgem. Regulatory compliance and effectiveness rests not only with the regulated businesses; agency behaviour is important. Source: Amodu Tola (2008), The determinants of compliance with laws and regulations with special reference to health and safety, A Literature Review, <http://www.hse.gov.uk/research/rrpdf/rr638.pdf>

## **Appendix C**

### **The consumer redress powers of other regulators**

#### Ofcom

Under the Communications Act 2003, Ofcom can issue a 'notification of contravention' to a licensee, allowing it the opportunity to rectify any contravention and the consequences of any contravention. If the licensee does not rectify the contravention Ofcom may then issue an enforcement order requiring the licensee to do so. For example, in a mis-selling case, Ofcom could require that customers be let out of the contract without penalty and can also ask the company to repay customers.

In one case relating to the billing by a telephone company of customers for services that had not been provided, Ofcom required the company to repay customers and to pay compensation where it was appropriate. As a result, 62,000 customers received a total of around £2.5m in refunds and good will payments. Ofcom's powers to secure redress are not limited to consumers and could extend to other market participants.

Ofcom has indicated that it has found its consumer redress powers to be useful for protecting consumer interests.

#### Financial Services Authority (FSA)

The FSA's range of consumer redress powers can be triggered by different things, from an admission of liability by a company under investigation to the identification of an industry-wide problem. The FSA has a power to apply to court for an order mandating restitution of profits in addition to having an administrative power to require restitution itself (section 384 FSMA). A further statutory power has also recently been introduced to enable the FSA to implement industry-wide schemes to address cross-sectoral problems.

The FSA has a power (in section 384(1) Financial Services and Markets Act 2000) to require restitution of profits that have accrued to a company as a result of the breach of a relevant requirement and where one or more persons has suffered loss as a result of the contravention. The FSA must be satisfied that a licensee has contravened a relevant requirement and seeks to use this power first before seeking a court order mandating restitution, which it can also do under sections 382 or 383 Financial Services and Markets Act 2000.

The specifics of the financial services sector would appear to facilitate restitution as profits can be easily assessed. The FSA's powers are not regarded this as a suitable model for Ofgem, since it would be more difficult to assess the extent to which an energy company has profited from a licence breach.

The FSA also has powers (under section 404(1) of the Financial Services and Markets Act 2000) to order companies to create a redress scheme in cases where more than one company is involved or an industry-wide/systemic issue is identified. We are not aware of any cases where it might have helped to have such a power which wouldn't be addressed by redress powers similar to those of Ofcom.

## Appendix D

### Administrative costs of fines and redress for non-compliant businesses

#### Discussion

A number of potential administrative costs are associated with fines and redress. These can be categorised as follows:

1. Costs to business and Ofgem of investigating potential breach and identifying what went wrong
2. Costs to non-compliant business of identifying precisely which customers affected and measuring individual losses
3. Costs to non-compliant business of making individual repayments

With regards to 1 above, the policy is not expected to increase these costs. These costs would be incurred in both a fine and a redress situation. Ofgem does not plan to recruit extra staff in light of the powers and does not expect companies under investigation to have to recruit staff as a result of the introduction of the powers in respect of the investigation, other than to the extent that they would do so in the counterfactual.

With regards to 2 above, the policy is likely to increase these costs to non-compliant businesses. However, to a degree, these costs are also incurred in the counterfactual as Ofgem already requires companies under investigation to provide information relating to detriment for the purposes of setting any fine. Furthermore, in some cases, there will be no cost attached to identifying affected customers and measuring the degree of detriment, for example where existing records can be used to identify customers who have been wrongfully charged a standard termination fee for cancelling a contract.

With regards to 3 above, the policy is likely to increase these costs for non-compliant businesses. Redress payment may involve postal and other admin costs, which would not be the case with fines.

Costs 2 and 3 which apply only to non-compliant businesses may be mitigated by the fact that Ofgem follows proportionality principles and may permit less burdensome forms of redress (e.g. nominal goodwill payments or public apologies) in cases where it would be disproportionate to provide individual redress. This may be more appropriate in cases such as complaint handling failures where the consumer loss is less direct.

#### Evidence

In past redress negotiations, Ofgem has received some submissions from energy businesses on the administrative cost of calculating redress and refunding customers directly. For example, one business submitted that providing compensation following a billing system problem would have administrative costs of around £3 per customer. This would include postal costs, the cost of cheques to customers who had since switched suppliers, and overheads such as staff costs.

Ofgem has indicated that £3 is likely to represent a high end estimate of cost 3 above. For instance, cheques would not be required in cases where a business is providing redress to its current customers, as oppose to past customers. However, £3 may be a reasonable proxy for costs 2 and 3 together (noting that cost 2 would to some extent arise even in the counterfactual).

Consultation responses confirmed that there would be a further administrative cost from this proposal for non-compliant businesses.

#### Indicative calculations of the administrative costs to non-compliant businesses

Variables	Assumptions	Comment
Additional redress awards per year with policy	L: 100,000 awards M: 200,000 awards H: 300,000 awards	<ul style="list-style-type: none"> <li>• Simple assumption based on evidence in appendix A</li> <li>• For instance, in February 2009, npower made redress awards to 200,000 of its customers, following an Ofgem investigation</li> </ul>
Additional administrative cost for non-compliant businesses of each redress award	£3 per award	<ul style="list-style-type: none"> <li>• Simple assumption based on evidence above</li> </ul>

Calculations	Assumptions
--------------	-------------

Calculations		Assumptions
Additional administrative cost to non-compliant businesses per year with policy	L: £3 x 100,00 = £0.3m M: £3 x 200,00 = £0.6m H: £3 x 300,00 = £0.9m	<ul style="list-style-type: none"> <li>• NA</li> </ul>
Estimate of NPV to non-compliant businesses of additional administrative costs with policy	£5m	<ul style="list-style-type: none"> <li>• Assumes impacts persist for ten years (2013-2022)</li> <li>• Given the historical trend for periodic market and regulatory changes, ten years is considered a reasonable period over which to estimate the policy impacts</li> <li>• Assumes 3.5% discount rate</li> </ul>

## Appendix E

### Outcome of DECC consultation

During and after the consultation period we met with energy suppliers, networks and trade associations to discuss our proposals and their responses.

#### Key Findings and future actions

Although some respondents felt that existing redress mechanisms were adequate, there was support for Ofgem being provided with the proposed new power, particularly from consumer bodies.

However, most industry respondents felt that there should be some constraints on the application of the power. Energy networks were concerned about the extent of the risk they would be exposed to under the proposed new power. One network company argued that all networks should be exempt from the power while others thought that the amount of redress should be capped in the same way as penalties – these are effectively capped at 10% of annual turnover. Similarly, some smaller suppliers argued that the power would mean that they would have to pay increased insurance premiums to cover their potential liability if the new power was uncapped and this could place them at a competitive disadvantage compared to larger suppliers. Businesses were unable to say exactly what the increased costs would be but it is likely these would be borne by energy consumers in the end

Other suppliers suggested that if the new power was to be introduced, it should be accompanied by a new right for those subject to a redress order to be able to appeal on the basis of the merits of Ofgem's decision.

Licence exempt energy businesses argued that they should not be included within the scope of the new powers but other respondents felt that they should be.

There was a mixed response on the question of which bodies Ofgem should be able to make a redress order in respect of. While there was a general consensus that domestic consumers and small businesses should be within scope, some respondents felt that larger businesses, including other energy market participants, should not be within scope of the new power.

Generally, respondents agreed that Ofgem should have discretion to decide what forms of redress were appropriate in specific cases, but there was an appetite for either the Government or the regulator to publish guidance on how the power would be used.

**The Government believes that many consumers do not receive appropriate redress under the current arrangements which largely depend upon them taking action on an individual basis. Giving Ofgem the proposed new power should mean that more consumers receive redress when they suffer a loss as a result of a breach of energy regulations.**

**However, the Government does accept that the amount of the combined fine and penalty in respect of an individual breach should be capped at 10% of a business's annual turnover. Substantial amounts of compensation should still be available for consumers even under the cap while this will also mean that as energy businesses maximum liability for a breach will be unchanged – this should keep their costs down and mean that there will be no adverse impact on consumer bills.**