

Measures to strengthen Ofgem's enforcement powers

Department for Energy and Climate Change

RPC rating: fit for purpose

Description of proposal

The Department proposes to introduce a package of reforms to strengthen Ofgem's (Office of Gas and Electricity Markets) ability to enforce compliance with licence conditions and other regulatory requirements. The Department explains that rapid change within the energy sector, driven by the adoption of new technology and the entry of new market players, has rendered current enforcement powers and procedures inadequate. For example, Ofgem cannot act against companies with zero turnover and there are overly tight time limits on some enforcement processes.

The package of reforms is intended to strengthen existing powers and create new powers to reduce instances of serious and persistent non-compliance by the energy industry and especially by energy suppliers. The measures would address two areas of Ofgem activity:

- improve Ofgem's ability to conduct investigations when there is a suspicion of non-compliance with the regulatory framework (including the proposed changes to Compliance Orders, Information Gathering, Special Audit Arrangements, Changes in REMIT Information Gathering and CMA Gateway); and
- ensuring Ofgem is able to apply penalties when non-compliance has been proven (penalties for regulatory breaches).

Impacts of proposal

The Department intends to consult on the following changes:

1. **Compliance Orders:** Ofgem is considering options to extend the period of time it has to do investigative work on various types of Compliance Orders to 6 months or remove time limits completely to ensure proper consideration of evidence. Because Ofgem does not separately record the cost to industry of issuing an order, it does not have any estimate of the cost to business of removing or extending investigations, but it is planning to gather this evidence as part of the consultation.

2. **Information gathering for unlicensed supply:** Under the proposal, Ofgem would be given new powers to enable it to compel the provision of information from organisations that appear to be operating in the market without the appropriate licence. At present it is unable to require information from unlicensed entities. This provision will not place any additional burden on licensed suppliers.
3. **Special audit arrangements:** Under this proposal, the Department would give Ofgem the statutory powers to enable it to commission third parties to carry out audits on its behalf as part of its investigations into allegations of non-compliance. The cost of that work would be borne by the firm under investigation. Based on experience of using audits in the enforcement context, Ofgem estimates that the most expensive special audits might cost the business under investigation tens of thousands of pounds.
4. **Penalties for regulatory breaches:** Ofgem can currently impose a penalty of up to 10% of a regulated business's applicable annual turnover when a licensee is found to be non-compliant with requirements enforced under the Gas Act or Electricity Act. However, where a company is a new entrant and effectively has zero turnover, it is not practically possible to impose a fine. This proposal will consider options for removing or amending the 10% cap, such as enabling Ofgem to take parent company turnover into account when a non-compliant subsidiary firm has no turnover or, where there is no parent, to impose a fine that is not dependent upon turnover.
5. **Change REMIT information gathering and CMA information gateway:** The EU REMIT Regulation prohibits insider trading and market manipulation in wholesale energy markets across the EU and the Enforcement Regulations give Ofgem the ability to impose unlimited financial penalties, access to information and the power to enter premises. This proposal will amend Ofgem's information gathering powers in respect of REMIT by giving it the power to carry out the examination and separation (or "sifting") of relevant material offsite. Ofgem does not expect there to be any extra costs to industry as a result of these measures, as they do not increase the requirements on companies. This will need to be tested further through consultation, as it would appear that there are likely to be some costs to compliant businesses, for example through greater disruption/removal of documents following more expansive information gathering in cases where the business is subsequently found to be compliant.

Overall, the IA explains that for each of the individual options within the overall proposal, the costs of any additional administrative and enforcement work is likely to be offset by enabling more efficient use of existing resources. As such, the Department does not anticipate that there will be an increase in fees as a result of the proposal.

Quality of submission

The IA is well written and provides a detailed analysis for consultation stage. The Department has identified the main impacts on business expected from the proposal and provided qualitative information regarding the likely scale of these impacts. The Department will need to use the consultation to test the assumptions in the IA and to gather more evidence to strengthen the analysis of the impacts on business.

In particular, because Ofgem is industry funded, any additional costs to Ofgem from the proposals will be considered to be a direct cost to business. Therefore, at final stage, the Department will need to provide more information to confirm that the costs to Ofgem of the proposals will be offset by efficiency gains resulting from the proposals.

The Department explains that costs to non-compliant businesses are non-qualifying for the purposes of the business impact target (BIT). However, if costs arising from changes to the enforcement regime fall on compliant firms the proposal will be considered as a qualifying regulatory provision for BIT purposes, with costs to compliant businesses being accounted for in the BIT. The Department should use the consultation to strengthen its assessment of the extent to which compliant companies will be forced to bear additional costs as a result of the proposals, for example in relation to the proposed introduction of special audits and the extension of REMIT information gathering powers.

The IA acknowledges that the proposal will potentially affect small and micro businesses disproportionately, due to the relative lack of resource and expertise in smaller businesses and new entrants, increasing the potential for enforcement action to be taken against them. The Department intends to use the consultation process to explore the scale of these potential impacts. If there is evidence that smaller and micro businesses are likely to be disproportionately affected, the final stage IA will need to discuss potential exemptions and mitigations and the extent to which such actions would affect the policy objectives.

Initial departmental assessment

Classification	Qualifying regulatory provision (IN)
Equivalent annual net cost to business (EANCB)	Not provided
Business net present value	Not provided
Societal net present value	Not provided

RPC assessment¹

Classification	Qualifying regulatory provision (IN)
Small and micro business assessment	Sufficient



Michael Gibbons CBE, Chairman

¹ The RPC verification of the estimated equivalent annual net cost to business (EANCB) and assessment of whether the measure is a qualifying regulatory provision are based on current working assumptions.