

**Government response to the consultation on
a proposed new power for Ofgem to compel
regulated energy businesses to provide
redress to consumers**

29 November 2012

Introduction

In April 2012, the Government consulted on a proposal to provide the gas and electricity regulator Ofgem with a new power to order energy companies which breach their obligations under their licences or relevant energy legislation to provide redress to any consumers who suffer loss, damage or inconvenience as a result of the breach. These would be known as Consumer Redress Orders.

Under the current regulatory framework, Ofgem can impose penalties of up to 10% of a company's annual turnover for such breaches but it has no power to award compensation for consumers. Any penalty is paid into the Consolidated Fund and there is no mechanism for these sums to be paid to consumers.

Ofgem is able to impose a penalty that is reasonable to the circumstances of each case. It can negotiate with companies to secure compensation payments and will take any compensation that an energy company has offered to pay to affected consumers into consideration when it determines the amount of the penalty. It has been able to use this as an informal lever to encourage energy companies to compensate consumers but this approach depends upon the willingness of the companies to agree to provide redress to consumers and some have not been willing to do so. The Government believes that where consumers have suffered detriment as a result of a company's breach it is appropriate that they be compensated or receive other appropriate redress. The new power which we are proposing to provide to Ofgem will enhance Ofgem's ability to ensure that this happens.

The consultation paper raised a number of questions:

1. Do you agree that Ofgem should be able to order an energy business that is in breach of relevant obligations to make appropriate redress to consumers who have suffered a loss as a result of the breach?
2. Do you agree that Ofgem should be able to compel both licensed and licence-exempt energy undertakings to provide redress when they breach relevant obligations?
3. Do you agree that Ofgem should be able to order compensation to be paid to other market participants, not just individual consumers?
4. Do you agree that Ofgem should have discretion to decide what form of redress is appropriate to address the detriment caused by regulatory breaches?
5. Can energy businesses provide us with any information about administration or other costs they anticipate they might face should Ofgem require them to provide redress to consumers?

During and after the consultation period we met with energy suppliers, networks and trade associations to discuss our proposals and their responses. Overall, we received 27 responses, 21 from industry bodies and 6 from bodies representing or providing advice to consumers. DECC also met with a number of the main suppliers and network companies and trade associations and with Consumer Focus.

Key Findings and future actions

Consumer bodies supported the proposal for Ofgem to be provided with the proposed new power. However, some respondents thought that although the principle was correct, Ofgem was not the right body to adjudicate on redress.

Some energy industry respondents while supportive of the principle of compensation, felt that existing redress mechanisms were adequate and that the fines raised for existing penalties should be used as compensation. Many said that if redress was available via this power it should preclude consumers from seeking compensation via other mechanisms such as by submitting a claim to the ombudsman. Others thought that redress was more effective if negotiated as a dialogue between energy company and consumer.

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 and argued that this could lead to higher costs which would impact on consumer bills. 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.

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 respondees felt that they should be.

There was a mixed response to the question about which market participants could receive redress. 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.

Government Response

The Government believes that many consumers do not receive appropriate redress under the current arrangements which largely depend upon energy businesses agreeing to take 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 a condition or requirement of a licence held by the business. We intend to bring forward the necessary legislation in the Second Session Energy Bill.

Summary of responses and Government response

Question 1. Do you agree that Ofgem should be able to order an energy business that is in breach of relevant obligations to make appropriate redress to consumers who have suffered a loss as a result of the breach?

Generally, there was support from a range of stakeholders for Ofgem having a power to require energy businesses to provide redress to consumers. This included all but one of the consumer bodies who supported the principle of redress but thought Ofgem was the wrong body to administer it. A number of suppliers stated that in their view existing redress mechanisms were adequate, citing the potential fines of up to 10% of global turnover and increasing instances of energy companies providing voluntary compensation. Some industry respondents suggested that the fines should be used to provide compensation. There was some concern that enforced redress would provide a disincentive for energy companies to treat their customers fairly and one respondent warned of the risks of creating a compensation culture.

Many industry respondents thought the power should be used very much as a backstop and only after a full and proper investigation of the alleged breach. It should not be used for minor human error resulting in little consequence and should not be applied retrospectively. Some thought it should only be applied where there was demonstrable physical damage as a result of a breach of licence conditions.

Many energy business respondents were concerned that existing appeal rights in respect of penalties were inadequate and that this would also be the case if Ofgem was able to make redress orders. Several called for appeal to be available on the merits of the case

Government Response

As stated in the original consultation, the Government's view is that existing means of redress largely rely upon the consumers taking individual action in the courts or by complaining to the Energy Ombudsman. This means that if for some reason consumers do not or are unable to take individual action they could miss out on receiving appropriate redress which in some cases could leave consumers suffering a financial loss.

When Ofgem takes enforcement action, it is well placed to determine whether consumers have suffered detriment as a result of licence or other regulatory breaches when it takes enforcement action and indeed the extent of any detriment will be a key factor in determining the seriousness of the breach. It is more likely to lead to fairer outcomes for consumers if Ofgem is able to compel businesses to provide financial compensation or other redress where this is appropriate. The new power is intended to act as a last resort: our preference would be for businesses to reach agreement with Ofgem on redress. This corresponds with the current approach Ofgem takes but the new power should encourage businesses to participate more willingly in the negotiation. If a negotiated agreement cannot be reached, Ofgem will be able to use the new power to compel redress to be provided.

With regard to appeals, Ofgem decisions are not normally subject to an appeal on the merits. To introduce such an appeal mechanism would risk introducing changes which might impact on Ofgem's ability to carry out its functions as an independent regulator. The Government has therefore decided not to introduce an appeals mechanism based on merit. However, a business which is ordered to provide redress will be able to challenge Ofgem's decision and any specific requirements Ofgem seeks to impose on it. A business will be able to do this by

way of an appeal to a court. One of the grounds upon which an appeal might be brought is that the decision to compel redress is unreasonable. This sort of appeal mechanism is similar to the one available to businesses for appealing against penalties for breaches of their licence conditions.

The Government has considered the concerns of industry about the potential unlimited nature of consumer redress. The Government agrees there are arguments in favour of limiting the amount of redress which may be ordered. These include: limiting the liability to which companies may be exposed; consistency with the Energy Ombudsman Scheme which also applies a limit (albeit through a different approach); and mitigating the adverse impact on consumer bills. Consequently the Government has decided to introduce a cap limiting compensation. This will be combined with the cap for the penalty for regulatory breaches such that the maximum amount in total of the penalty and compensation combined may not exceed 10% of a business's annual turnover. We believe that the cap set at this level will still provide sufficient funds for compensation to be paid in appropriate cases (penalties imposed by Ofgem are usually well under 10% of annual turnover) but will give greater certainty to energy companies by limiting the liability. It should also mitigate the impact on consumer bills.

Many respondents asked for guidance on how Ofgem will exercise their powers for ordering consumer redress. The legislation will impose a duty on Ofgem to publish a statement of policy setting out how they will apply consumer redress.

Question 2. Do you agree that Ofgem should be able to compel both licensed and licence-exempt energy undertakings to provide redress when they breach relevant obligations?

There was a polarity of views on this question. One supplier, as well as the licence-exempt businesses (such as ports) which currently rely upon exemptions from the requirement to obtain a gas or electricity licence felt licence-exempt businesses should not come within scope of the new power. This was because they were not primarily energy businesses and because they were operating in an environment where infrastructure was expensive to provide. They argued that licence exemption was largely a function of geography and that customers benefited from being able to utilise the networks to access power. A further argument was that customers of licence exempt networks at ports were almost entirely businesses. The energy Ombudsman does not have a role to play in exempt networks and any disputes would be resolved through the courts. The increased burden of the proposals would increase the costs of operating and ensuring networks which would increase costs for consumers.

On the other hand, other respondents, where they expressed an opinion, including consumer groups, suppliers and networks, all thought that licence-exempt businesses should be included within scope of the new power. Industry respondees' views were generally based on the premise that there should be a level playing field.

Government Response

The Government carefully considered the arguments in response to the consultation that licence-exempt energy undertakings should not be required to provide consumer redress. However, customers of licence-exempt businesses may also suffer financial losses as the result of regulatory breaches. Furthermore, licence-exempt energy businesses are not required to belong to the Energy Ombudsman Scheme, so individual consumers who have suffered as a result of regulatory breaches have to pursue the matter through the courts. The Government has therefore decided that consumer redress orders may be issued for licence-exempt energy businesses. This does not add to the regulatory burden upon these businesses

as they are already required to comply with the underlying legislation, breach of which might give rise penalties. A business which is in compliance with its regulatory obligations should therefore face no additional costs as a result of this change. In addition, as stated above, the Government has decided to cap the maximum total amount of the penalty and compensation combined at no more than 10% of a business's annual turnover. This limit will also apply to licence exempt energy undertakings and should mitigate against adverse impacts for these businesses

Question 3. Do you agree that Ofgem should be able to order compensation to be paid to other market participants, not just individual consumers?

There were mixed views on this question. Some respondents, particularly the consumer bodies, argued for equal treatment of all market participants but others, including some suppliers, network companies and industry representative bodies thought that redress should be restricted to domestic consumers and small businesses. These respondents thought that there were other mechanisms for other market participants to seek redress and that the larger players would have the financial wherewithal to pursue the matter through the courts.

Government Response

Following the response to the consultation, the Government has decided to restrict consumer redress to domestic and non-domestic consumers rather than where a breach by one energy company impacts on another energy company. This would exclude other market participants such as generators, networks and suppliers. The rationale is that consumers are less likely to have the same resources as larger businesses to pursue redress on an individual basis. Small businesses, to the extent they are consumers, would be within scope for redress.

Question 4. Do you agree that Ofgem should have discretion to decide what form of redress is appropriate to address the detriment caused by regulatory breaches?

Although there was wide-spread support for this proposal, particularly from consumer groups, some industry respondents (one network company and two suppliers) thought Ofgem should not have unfettered discretion. Others thought redress should be based on actual financial loss and that this was for Ofgem to prove. There was one suggestion that the company concerned should be given discretion not to pay compensation if the cost of identifying affected customers outweighed the level of compensation. There were several calls for guidance to be introduced for the use of this power. Some respondents said that this was not an appropriate role for Ofgem, suggesting that this role should lie with the Ombudsman or a consumer body.

Government Response

Given the support for this proposal in the responses to the consultation, the Government has decided to make legislation providing Ofgem with the discretion to decide what form of redress is appropriate to address the detriment caused by the contravention committed by an energy business. The legislation will require Ofgem to publish a statement of policy setting out how they will decide how to apply consumer redress orders and how they will determine the particular requirements which might be imposed within an order.

Question 5. Can energy businesses provide Government with any information about administration or other costs they anticipate they might face should Ofgem require them to provide redress to consumers?

Very few energy businesses were able to provide quantified information about administration or other costs related to providing redress.

Government Response

The Government believes that there will be no new costs to compliant businesses from this proposal. The impact assessment presents estimates of the administrative costs to non-compliant businesses of around £0.6m a year. These would primarily be concerned with identifying precisely which customers were affected and measuring individual losses and making the payments.

These may be mitigated because Ofgem follows a proportionality principle and may permit less burdensome forms of redress in cases where it would be disproportionate to provide individual redress. However only costs on compliant businesses are considered in cost benefit analysis and so these administrative costs on non-compliant businesses are not counted in the impact assessment.

Annex

List of respondents

Age UK
British Gas
Citizens Advice Bureau
Citizens Advice Bureau - Coventry
Consumer Focus
Ecotricity
EDF Energy
Energy Networks Association
Energy UK
First Utility
Forth Ports Limited
Gazprom Energy
Good Energy
GTC
National Grid
Northern Gas Networks
Northern Powergrid
Ombudsman Services
Rwe npower
SP Energy Networks
Scottish Water
SSE
Trading Standards Institute
UK Major Ports Group
Wales and West Utilities Company
Western Power Distribution

Summary of meetings with stakeholders

DECC also met with the following bodies:

Centrica
Consumer Focus
EDF Energy
Energy Networks Association
Energy UK
National Grid
NPower
Scottish Power
SSE

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