



Department
of Energy &
Climate Change

Strengthening enforcement in gas and electricity markets

A DECC consultation on amending Ofgem's
powers

URN 15D/547 December 2015



Department of Energy and Climate Change

3 Whitehall Place

London

SW1A 2AW

Telephone: 0300 068 4000

Website: www.gov.uk/government/organisations/department-of-energy-climate-change

© Crown copyright 2014

Copyright in the typographical arrangement and design rests with the Crown.

This publication (excluding logos) may be re-used free of charge in any format or medium provided that it is re-used accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the publication specified.

For further information on this consultation, contact:

Energy Markets and Consumers

Department of Energy and Climate Change

3 Whitehall Place

London

SW1A 2AW

Telephone: 0300 068 6089

Email: enforceconsult@decc.gsi.gov.uk

The consultation can be found on DECC's website:

<https://www.gov.uk/government/consultations/strengthening-enforcement-in-gas-and-electricity-markets>

Published by the Department of Energy and Climate Change

Foreword

To ensure that consumers can have trust in the energy sector, they need to be confident that they will be treated fairly by gas and electricity suppliers and, where this does not happen, tough and effective regulatory action will be taken which incentivises better behaviour across the sector.

Ofgem has a clear mandate to protect the interests of consumers and strong powers to take action against businesses which break the rules and it has demonstrated that it is prepared to use these powers when this is justified. Since 2010, it has imposed penalties and redress payments totalling over £183 million¹. Effective enforcement depends upon the regulator having a full range of effective and usable powers and in the past Ofgem's powers have been amended when this is justified, most significantly when Ofgem was given new powers to obtain redress for consumers in 2013.

Ofgem's recent enforcement activity has identified some limitations on the existing powers and this consultation contains proposals to improve or refine the tools Ofgem has available to ensure compliance and the sanctions that it can impose where the rules are broken. Taken together, these changes will strengthen Ofgem's ability to protect the interests of energy consumers.

¹ For details see: <https://www.ofgem.gov.uk/investigations/investigations-and-enforcement-data>

Contents

Foreword	4
Contents	5
General information	6
Executive Summary	8
Catalogue of Consultation Questions	9
Introduction	11
Background	12
Compliance Orders	13
Information Gathering Powers for Unlicensed Supply	16
Special Audit Reports	17
REMIT	19
Penalties for Regulatory Breaches	21
Impact Assessment	23

General information

Purpose of this consultation:

The Government is consulting on proposals to amend Ofgem's enforcement powers so it is better equipped to enforce the rules. The Government seeks views from stakeholders with interests in regulation of the gas and energy sectors.

Issued: 21 Dec 2015

Respond by: 31 January 2016

Enquiries to:

Department of Energy & Climate Change,
Area 4B 3 Whitehall Place,
London, SW1A 2AW
Tel: 0300 068 6089
Email: enforceconsult@decc.gsi.gov.uk
Consultation reference: URN 15D/547

Territorial extent:

England, Scotland and Wales.

How to respond:

Your response will most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome. Responses should be sent in hard copy or by email to the above addresses.

Additional copies:

You may make copies of this document without seeking permission. An electronic version can be found at <https://www.gov.uk/government/consultations/strengthening-enforcement-in-gas-and-electricity-markets>

Other versions of the document in Braille, large print or audio-cassette are available on request. Please contact us under the above details to request alternative versions.

Confidentiality and data protection:

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information legislation (primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

If you want information that you provide to be treated as confidential please say so clearly in writing when you send your response to the consultation. It would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded by us as a confidentiality request.

We will summarise all responses and place this summary on our website at www.decc.gov.uk/en/content/cms/consultations/. This summary will include a list of names or organisations that responded but not people's personal names, addresses or other contact details.

Quality assurance:

This consultation has been carried out in accordance with the Government's Code of Practice on consultation, which can be found here:

<http://www.bis.gov.uk/files/file47158.pdf>

If you have any complaints about the consultation process (as opposed to comments about the issues which are the subject of the consultation) please address them to:

DECC Consultation Co-ordinator

3 Whitehall Place

London SW1A 2AW

Email: consultation.coordinator@decc.gsi.gov.uk

Executive Summary

Ofgem is the independent regulator of gas and electricity markets and mainly regulates energy businesses through administering and enforcing the rules set out in licence conditions and energy regulations. Where it finds that businesses have breached these requirements, Ofgem can take action to enforce compliance and, where appropriate, impose penalties and/or obtain redress for consumers.

Experience has shown that some of the current provisions do not work as well as originally intended, restricting Ofgem's ability to regulate as effectively as it might. This paper sets out proposals to refine these powers so Ofgem is better equipped to investigate possible non-compliance and take action to protect consumers. The proposed measures are:

- New time limits for compliance orders so Ofgem has more time to complete investigations and can make better use of these orders.
- Wider powers to request information from businesses so it can establish whether they are committing an offence by supplying gas or electricity without a licence.
- A broader statutory ability for Ofgem to require licensed businesses to engage skilled persons who will investigate and report on compliance-related matters on its behalf.
- A flexible new power for Ofgem to investigate market abuse by allowing it to remove documents from premises and sift these elsewhere to establish whether they are relevant to the investigation and a new gateway for the Competition and Markets Authority to disclose relevant information to Ofgem.
- A new ability for Ofgem to impose penalties on businesses with little or no turnover so it has an effective deterrent to use in such cases.

These measures will have the most impact on businesses which breach regulatory rules and will have few implications for companies which are compliant. Primary legislation will be required for most of the measures and the Government will seek a suitable implementation vehicle at the earliest opportunity.

This consultation invites views on our proposals. Responses are required by 31 January 2016.

Catalogue of consultation questions

<u>Compliance Orders</u>	
Question 1:	Do you agree that Ofgem should have more time to confirm provisional orders or issue a penalty notice following the confirmation of a provisional order or making of the final order?
Question 2:	Do you have a view on which of the proposed options would be more effective? Could you provide a justification of your views?
Question 3:	Do consultees anticipate that these changes could increase their costs? If so, please provide estimates of these costs and explain them.
Question 4:	Do you think these changes could generate benefits for consumers? If so, what do you think these benefits may be?
Question 5:	Do you agree with the costs and benefits as presented in the impacts assessment? Can you provide any further evidence which DECC should consider?
<u>Information gathering powers for unlicensed supply</u>	
Question 6:	Do you agree that Ofgem should be able to request information from unlicensed bodies to enable it to investigate their suspected non-compliance with the prohibition on unlicensed activity and any associated consumer detriment?
Question 7:	Can consultees provide any information on the costs they typically incur in dealing with information requests relating to licenses from Ofgem and detail the extent to which you consider they are likely to be valid in this situation?
Question 8:	Do you think these changes could generate benefits for consumers? If so, what do you think these benefits may be?
Question 9:	Do you agree with the costs and benefits as presented in the impacts assessment? Can you provide any further evidence which DECC should consider?
<u>Special Audit Reports</u>	
Question 10:	Do you agree that Ofgem should have a statutory power under the Gas and Electricity Acts to require regulated businesses to pay for skilled persons to undertake audits/reports on its behalf?
Question 11:	Do licensees have any information on the potential costs of such audits? We would be grateful for estimates of auditors' fees (both maximum and minimum) and the length of investigations, based on

	your past experience?
Question 12:	Do you think these changes could generate benefits for consumers? If so, what do you think these benefits might be?
Question 13:	Do you agree with the costs and benefits as presented in the Impacts Assessment? Can you provide any further evidence which DECC should consider?
<u>REMIT</u>	
Question 14:	Should Ofgem be given a “seize and sift” power in respect of REMIT similar to that contained in the Criminal Justice and Police Act?
Question 15:	Should there be a gateway for the CMA to pass information to Ofgem?
Question 16:	Do consultees consider that they might face increased costs as a result of these proposals? If so, can you provide us with estimates of these costs and explain them?
Question 17:	What benefits do you think these changes might lead to? Please provide details.
Question 18:	Do you agree with the costs and benefits as presented in the Impacts Assessment? Can you provide any further evidence which DECC should consider?
<u>Penalties for regulatory breaches</u>	
Question 19:	Do you agree that the penalty provisions should be revised so Ofgem is able to impose an appropriate penalty on businesses with small or no turnover of its own?
Question 20:	What do you consider the maximum fine should be where a regulated body has either a low turnover or no turnover at all? Please provide your justification.
Question 21:	What benefits do you think these changes might lead to? Please provide details.
Question 22:	Do you agree with the costs and benefits as presented in the Impacts Assessment? Can you provide any further details which DECC should consider?

Introduction

Ofgem has given more priority to enforcement in recent years, reorganising and assigning significantly more resource to enforcement activity. These changes are reflected in the increased number of investigations and the total amount of fines and redress. Since 2010 it has imposed fines totalling more than £52 million and obtained over £131 million worth of redress for consumers.

Ofgem's enforcement activity has also identified some limitations within their existing powers which hamper their ability to investigate problems thoroughly and impose appropriate sanctions in all cases. These limitations undermine the potential effectiveness of the regulatory regime and we have identified a number of ways in which powers might be modified so Ofgem is better equipped to enforce the rules and ensure that consumers are protected.

This paper sets out a number of possible proposals to enhance Ofgem's enforcement powers. It focusses on Ofgem's powers under gas and electricity legislation rather than its concurrent competition powers.

While most enforcement action is taken against suppliers, networks and generators can also be subject to enforcement so it is proposed that any changes to Ofgem's powers should apply to all categories of licence holder or regulated bodies.

The Competition and Markets Authority (CMA) has also undertaken an investigation into certain aspects of gas and electricity markets and proposed a number of remedies to address the problems it identified. While none of the CMA's proposed remedies concerned Ofgem's existing sectoral enforcement powers, the proposals in this paper may support any remedies which may potentially be put in place by the CMA via new licence conditions.

Background

Ofgem is the regulator of gas and electricity markets with a principal objective to protect the interests of consumers. Its main powers and duties are set out in the Gas Act 1986 and the Electricity Act 1989. Under both these Acts, Ofgem is required to administer licensing regimes which set out detailed rules with which energy businesses must comply. All licensees are subject to standard licence conditions, which cover such matters as marketing, contractual matters, complaints handling and connection to networks, while transmission, transportation and distribution licensees are also subject to individual sets of ‘special conditions’, which cover their price controls.

Ofgem has a range of enforcement powers to address breaches of licence conditions or other regulatory requirements¹. It can impose orders on licensees requiring them to comply with the rules, and, where breaches have occurred, impose penalties or require redress to be provided to consumers, up to a combined maximum of 10% of a business’s annual turnover. It has powers to monitor, investigate and enforce against breaches of the EU Regulation on wholesale energy market and transparency (REMIT). It can also enforce consumer and competition law but these powers are not the subject of this consultation.

In recent years, there have been cases of serious and persistent non-compliance across the energy industry, especially by suppliers. Cases of misselling and poor complaints handling have been well-publicised and have contributed towards the lack of trust in energy markets which was one of the reasons Ofgem decided to refer gas and energy markets to the Competition and Markets Authority in 2014.

In response to the failures it identified, Ofgem has made vigorous use of its existing enforcement powers, adopting more robust enforcement policies and imposing stiff sanctions on companies found to have breached their regulatory obligations². Its actions reflect Ofgem’s view that it can bring about greater compliance by using its existing powers more assertively but this activity has also revealed some ways in which its powers could be strengthened and these are the subject of this consultation.

Ofgem is examining how to rely more on principles and outcomes rather than prescriptive rules in the way it regulates retail markets. This is in part aimed at putting much greater onus on suppliers, especially their senior management, to understand and deliver what’s right for consumers alongside providing more room for innovation in service offerings which are more tailored to meet the needs of consumers, including those in vulnerable situations. This approach should also offer more comprehensive protection. In the Government’s view, this change programme bolsters the argument that its powers need to be strong, flexible and agile enough to complement the new approach.

¹ These other requirements are set out in Schedule 6 of the Electricity Act 1989 and Schedule 4B of the Gas Act 1986.

² Details of Ofgem’s enforcement activity can be found at: <https://www.ofgem.gov.uk/investigations/investigations-and-enforcement-data>

Compliance Orders

Under both gas and electricity legislation³, Ofgem has powers to make orders designed to ensure that regulated bodies which are, or appear to be, in breach of regulatory requirements comply with the rules.

Provisional orders

Ofgem is able to make **provisional orders** requiring a regulated body to take specific steps to achieve compliance where it appears that a regulated body is contravening or likely to contravene a regulatory requirement. Where Ofgem is satisfied that the body is contravening, or is likely to be contravening, a regulatory requirement, it can ensure a move into compliance by confirming the provisional order or issuing a **final order** (see below) which outlines the steps that Ofgem requires the body to take. Ofgem would usually make a provisional order where it considers that urgent action is required to bring about compliance. In deciding whether the matter is urgent Ofgem will have regard to the risk and level of consumer harm. In practice, Ofgem should use a provisional order where it considers this necessary to prevent loss or damage to consumers but the investigation has not progressed sufficiently to justify a final order.

Ofgem has issued 3 provisional orders in the past, covering matters such as disconnecting customers in debt, failing to comply with energy codes, poor complaint handling and preventing customers from switching to an alternative supplier. Under these orders, Ofgem has required the licensees to comply with relevant licence conditions and regulations and it has also set out specific actions which it expected the licensee to take in order to achieve compliance. These steps included installing prepayment meters for debt recovery instead of disconnecting customers, improving complaints handling and a ban on acquiring new customers until conditions had been met. Ofgem has also used the prospect of its imposing an order to obtain voluntary commitments from licensees.

Once it has issued a provisional order, Ofgem has three months to undertake its investigation before it must either confirm or revoke the order. During this period, Ofgem must issue a notice setting out details of the alleged breach and allow a minimum period of 21 days for the licensee to make representations. If Ofgem then modifies the order, it must then allow a further period of 21 days for further representations. If Ofgem does not confirm or revoke the order before the end of a three month period, the Order will be revoked automatically.

Final Orders

Ofgem can make final orders requiring a regulated body to take specified steps to effect compliance where it is satisfied that a regulated body is contravening or likely to contravene a regulated requirement. The difference between a provisional order and a final order is evidential. In practice, final orders are usually made after the investigation has ended and Ofgem is satisfied that there is a continuing breach or likely continuing breach which means that such an order is requisite. Once Ofgem has issued a final order, it can only impose a penalty if it does so within three months of this order being issued. This means that Ofgem currently has three months to confirm whether the terms of a final order have been met and, if they have not, still impose a penalty

³ Electricity Act: <http://www.legislation.gov.uk/ukpga/1989/29/part/I/crossheading/enforcement-of-preceding-provisions>
Gas Act: <http://www.legislation.gov.uk/ukpga/1986/44/part/I/crossheading/public-gas-suppliers-enforcement>

Providing a final order is complied with and the penalty paid, Ofgem will take no further action at that time. If the order is not complied with or the penalty not paid, then ultimately Ofgem could revoke the body's licence.

Limitations on the current powers

Although Ofgem has been responsible for regulation of gas and electricity markets since 2000, it has not made frequent use of these order-making powers, despite the history of compliance problems over the years. In those cases where provisional orders were made, only one was subsequently confirmed and Ofgem either revoked the other orders or they were revoked automatically. None of Ofgem's cases to date have resulted in final orders being made.

Ofgem have told us that their infrequent use of these powers is in part due to the statutory time limits. The current three month time limit leaves Ofgem with insufficient time in which to gather adequate evidence to confirm that a company is contravening or likely to be contravening a regulatory requirement, particularly as they must give licensees the opportunity to consider the terms of the provisional order and make representations, and must issue a revised order if it accepts those representations.

The evidence gathering phase of an investigation is usually the most time consuming, especially in complex cases. Ofgem will often send information requests to the body in question and will have to allow them sufficient time to respond. These time constraints appear to have made Ofgem reluctant to use these powers unless there is clear evidence of consumer harm which can best be addressed by a provisional order. In the cases where Ofgem has issued provisional orders, the issues at stake were relatively clear-cut and easy to identify because the evidence showed that there may have been significant consumer harm. Similarly, once a final order has been issued, three months may not be enough time for Ofgem to confirm whether the terms of the order have been met and, if not, issue a penalty notice. Ofgem has never issued a penalty for suspected breaches addressed by a provisional order, even when the order has been confirmed.

The Government believes that provisional and final orders should be important tools for Ofgem to address non-compliance, particularly as they formally require regulated bodies to change their practices with immediate effect. We believe that such orders could play a greater role in addressing issues such as misselling where, although Ofgem has previously undertaken investigations that later led it to impose penalties, the evidence shows that, on occasion, regulatory breaches persisted beyond the date when the underlying problems were identified and that these might have been prevented to some extent if Ofgem's order making powers were more flexible and made more allowance for the actual time it takes to investigate such breaches in practice.

The current provisions on final orders and penalties also weaken Ofgem's ability to secure compliance with regulatory requirements. In practice, Ofgem might order substantial changes to a licensee's operations and it could take Ofgem more than 3 months to allow for these changes to happen and establish that the licensee has moved to compliance. Under the current time limits, Ofgem may be faced with an unpalatable choice between setting a company a timetable which may lead to actions being rushed or setting a timetable which will leave it unable to impose a penalty even where it considers this appropriate.

We therefore propose to amend the current time limits so Ofgem will have more time to investigate and can consider more comprehensive remedial actions to be imposed on non-compliant companies. This change should enhance Ofgem's ability to make more use of these powers to address breaches and secure compliance across a range of issues, such as inappropriate marketing and poor service.

We have identified two main options for change:

- 1) Increase the current statutory time limits as follows:
 - Ofgem will have six months (rather than three) to confirm a provisional order;

- Where a provisional order is not confirmed, Ofgem will have 18 months to issue a penalty notice from the time the order was issued;
- Where a provisional order is confirmed, Ofgem will have 12 months to issue a penalty notice from the last date stated within the order by which compliance is stipulated to be achieved, or from the date the order is revoked (whichever is soonest);
- For Final Orders, increase the statutory time limit so Ofgem has 6 months to issue a penalty notice from the last date stated within the order by which compliance is stipulated to be achieved, or from the date the order is revoked (whichever is soonest).

2) Remove the time limits altogether and require Ofgem to confirm provisional orders and issue penalty notices “as soon as is practicable”.

While removing the time limits altogether would offer maximum flexibility to Ofgem, it would also mean greater uncertainty for business. Ofgem have told us that they think they could undertake adequate investigations within the proposed new time limits without compromising the regulated body’s right to consider the terms of any provisional orders and make representations. We therefore propose to amend the time limits as set out in option 1 above so Ofgem has more time to confirm provisional orders and consider whether or not it is appropriate to issue a penalty notice. We do not anticipate that these changes will increase the compliance costs of regulated businesses but would welcome information from consultees on this issue.

Question 1: Do you agree that Ofgem should have more time to confirm provisional orders or issue a penalty notice following the confirmation of a provisional order or making of the final order?

Question 2: Do you have a view on which of the proposed options would be more effective? Could you provide a justification of your views?

Question 3: Do consultees anticipate that these changes could increase their costs? If so, please provide estimates of these costs and explain them.

Question 4: Do you think these changes could generate benefits for consumers? If so, what do you think these benefits may be?

Question 5: Do you agree with the costs and benefits as presented in the impacts assessment? Can you provide any further evidence which DECC should consider?

Information gathering powers for unlicensed supply.

Under the Electricity Act 1989, it is an offence to generate, transmit, operate an interconnector, distribute or supply electricity without a licence unless a statutory exemption applies and similar provisions cover the gas sector. Persons who are convicted of acting without a licence can be liable to a fine in the courts⁴. It is for Ofgem to investigate cases of unauthorised activity and, if necessary, instigate criminal proceedings.

Ofgem has powers⁵ to require specified documents or information to be provided by licensees and other regulated persons. There are some limitations on the information that must be provided and the provisions do not cover information which the courts could not compel to be produced during civil proceedings. A person who fails unreasonably to comply with a request or who intentionally alters, suppresses or destroys documents or records which Ofgem has required to be produced can also be fined by the courts.

The current provisions do not apply to bodies which are not regulated persons and this makes it difficult for Ofgem to establish whether there has been unauthorised activity, such as electricity supply, and an offence has been committed. Currently Ofgem has to rely on the body in question being willing to provide information on a voluntary basis and this is unsatisfactory as potential offenders can frustrate Ofgem by ignoring its requests. It is clearly in the public interest that Ofgem should be able to gather the information it needs to decide whether it should proceed with a prosecution. We therefore propose to legislate to enable Ofgem to require information from unlicensed bodies where it appears to them that an offence may have been committed and Ofgem needs to verify whether this is the case.

As with licensees, the proposed sanction for failing to comply with a request from Ofgem would be a fine. We propose this so that there is a serious sanction and deterrent available to prevent potential offenders from frustrating Ofgem's investigations by disregarding its requests for information. We do not anticipate that the proposed new powers will have any adverse impact on compliant businesses as it should be a simple matter for them to establish that they are authorised by providing Ofgem with details of any relevant licence or exemption that they consider covers their activity.

Question 6: Do you agree that Ofgem should be able to request information from unlicensed bodies to enable it to investigate their suspected non-compliance with the prohibition on unlicensed activity and any associated consumer detriment?

Question 7: Can consultees provide any information on the costs they typically incur in dealing with information requests relating to licenses from Ofgem and detail the extent to which you consider they are likely to be valid in this situation?

Question 8: Do you think these changes could generate benefits for consumers? If so, what do you think these benefits may be?

Question 9: Do you agree with the costs and benefits as presented in the impacts assessment? Can you provide any further evidence which DECC should consider?

⁴⁴ Section 4 of the Electricity Act and Section 6 of the Gas Act.

⁵ Section 28 of the Electricity Act and section 38 of the Gas Act.

Special Audit Reports

In the course of its investigations into compliance issues under the Gas and Electricity Acts, Ofgem quite often has to examine complex matters where it would help if it was able to require regulated energy businesses to appoint skilled persons, such as auditors, accountants and IT experts, to examine elements of the business's internal processes on Ofgem's behalf and report back to Ofgem. This would speed up and where necessary increase the depth of investigations and would allow Ofgem to deploy expertise that it does not necessarily possess within the organisation (and which it would be inefficient to provide for permanently). In some instances, Ofgem can currently require some businesses to undertake routine audits, and ensure that the report is addressed to them but this power does not extend to all licensees. Currently, Ofgem can request businesses to undertake audits, and to pay for these, but it does not have a statutory power to compel them to do so as part of an investigation under the Gas and Electricity Acts. Consequently, where such audits are conducted by agreement as part of an investigation there is a question of whom the skilled persons are acting for and what information they might be willing to pass to Ofgem.

Under financial services legislation⁶, the Financial Conduct Authority (FCA) can require authorised persons to appoint a skilled person who can look in-depth at a particular issue on the FCA's behalf within the firm and provide the FCA with a report. The FCA is able to nominate an expert to make the report and while authorised persons are required to bear the costs and co-operate with the appointee, the latter's responsibility is towards the regulator.

Since 2012, Ofgem has on average opened around 8 investigations a year. Given the potential costs of audits, we would not expect Ofgem to routinely require these for all investigations but only to do this when they consider it justified. This power would not be unlimited in scope but would tie in with Ofgem's existing information gathering powers in relation to enforcement, i.e. Ofgem would be able to require a skilled person report where it appears to them that the licence holder may not be compliant with regulatory requirements or performance standards. Ofgem would therefore use the power in circumstances where it is already able to require information to be provided by the licensee. Businesses may themselves derive some benefit from reviews.

Although there would be some additional costs to be borne by the licence holder, the Government's view is that these costs are justified in the energy sector because it would help Ofgem examine issues in more depth and, by transferring some of the costs of investigation from the regulator to the regulated, should incentivise businesses to address compliance issues. It should also contribute towards increasing consumer trust in energy businesses.

The use of experts should result in quicker, more focussed investigations. We would expect Ofgem to require such a report when it has concerns about whether a business's internal systems, IT capability, service quality and management control are resulting in non-compliance with regulatory requirements. The report would be expected to cover matters relating to a suspected breach such as the identification of and assessment of risks, monitoring of practices and identify preventative or remedial action that might be taken to address issues relating to a suspected breach.

Question 10: Do you agree that Ofgem should have a statutory power under the Gas and Electricity Acts to require regulated businesses to pay for skilled persons to undertake audits/reports on its behalf?

⁶ <http://www.fca.org.uk/about/what/regulating/how-we-supervise-firms/reports-by-skilled-persons>

Question 11: Do licensees have any information on the potential costs of such audits? We would be grateful for estimates of auditors' fees (both maximum and minimum) and the length of investigations, based on your past experience?

Question 12: Do you think these changes could generate benefits for consumers? If so, what do you think these benefits might be?

Question 13: Do you agree with the costs and benefits as presented in the Impacts Assessment? Can you provide any further evidence which DECC should consider?

REMIT

The EU REMIT regulation, which has been in force since 28 December 2011, prohibits insider trading and market manipulation in wholesale energy markets across the EU. There need to be tough sanctions for those who break the rules which is why the UK was the first to implement civil sanctions under European REMIT legislation enabling Ofgem to deal with market manipulation and insider dealing in wholesale gas and electricity. The REMIT Enforcement Regulations gave Ofgem the ability to impose unlimited financial penalties, access information and enter premises. To strengthen this regime and make it consistent with that for financial services, the Government created new criminal offences of insider dealing in and the manipulation of wholesale energy markets in March 2015.

The regulations went some way to aligning the regulation of energy market abuse with the regulation of financial market crimes but the Government committed to keep the relationship between the regimes under review.

One aspect in which the regimes differ is in respect of the powers (under warrant) to inspect premises. Under regulation 16(4) of the REMIT Enforcement Regulations⁷, Ofgem has the power to remove documents appearing to be of the relevant kind when undertaking a search of premises under warrant. In many cases, it should be possible for Ofgem to establish whether or not documents are of the “relevant kind”. However, there may be instances where the investigating officers are presented with a large volume of documents which may include documents of the relevant kind but it is impractical or even impossible to separate relevant from irrelevant on the premises. Documents stored electronically may present a particular problem in this regard. Under regulation 16 as it exists currently, Ofgem has no power to take away an entire body of documents in order to sift them off the premises.

In such circumstances, the availability of the power in section 50 of the Criminal Justice and Police Act 2001⁸ would be helpful. In summary, this provides that if it is not “reasonably practicable” to undertake the separation of relevant from irrelevant documents on the premises, the material can be seized in order to carry out the examination and separation (or “sifting”) of the material elsewhere. The Government is seeking views on whether Ofgem powers should be strengthened to bring them into line with this provision. The 2001 Act contains safeguards in relation to the power in section 50, including a right for a person whose property has been seized under that section to apply to the court for its return.

It would also help Ofgem enforce the REMIT regulations if the Competition and Markets Authority were able to disclose information to it about potential breaches and other information that will support the enforcement of REMIT. We therefore propose to provide for a suitable gateway between the CMA and Ofgem.

Question 14: Should Ofgem be given a “seize and sift” power in respect of REMIT similar to that contained in the Criminal Justice and Police Act?

Question 15: Should there be a gateway for the CMA to pass information to Ofgem?

⁷ The Electricity and Gas (Market Integrity and Transparency) (Enforcement etc) Regulations 2013

⁸ <http://www.legislation.gov.uk/ukpga/2001/16/notes/division/3/2>

Question 16: Do consultees consider that they might face increased costs as a result of these proposals? If so, can you provide us with estimates of these costs and explain them?

Question 17: What benefits do you think these changes might lead to? Please provide details.

Question 18: Do you agree with the costs and benefits as presented in the Impacts Assessment? Can you provide any further evidence which DECC should consider?

Penalties for regulatory breaches

Ofgem is currently able to impose a penalty and/or consumer redress of up to 10% of a regulated business's applicable turnover where it finds that business to have breached its regulatory obligations. As some energy businesses have turnover that can be measured in the billions, these penalties are potentially significant, although in practice, no penalty has approached this ceiling – the biggest penalty Ofgem has imposed under its sectoral powers is £10.5m⁹ for misselling in 2013, while the highest amount of redress it has obtained for consumers is £23m (£28m when including the penalty) for non-delivery of energy efficiency obligations.

Recent enforcement cases have highlighted a potential loophole in the penalty provisions. In some of these cases, breaches of the Capacity Market rules were committed by companies which effectively had zero turnover. Although, under the Capacity Market rules, the generating units concerned were excluded from participating in the capacity auctions for two years, where this was considered an appropriate sanction Ofgem was unable to impose financial penalties.

DECC has already consulted upon amending the capacity market rules and has proposed a CM-specific solution but these cases have demonstrated that the 10% of turnover ceiling may not be appropriate in all cases. Companies/entities operating in the capacity market are examples of a type of entity with low/no turnover and the same problem could arise more widely within sectors regulated by Ofgem now or in the future. Applying the 10% of turnover threshold in such cases could mean in some instances that Ofgem would only be able to impose very small, or no, penalties which would have limited effect as either sanctions or deterrents.

The Government considers that gas and electricity legislation would benefit from providing for an appropriate sanction in cases where the regulated body has little or no turnover. There are three main options for doing this:

- 1) Remove the 10% ceiling and replace it with a requirement for Ofgem to impose a penalty which is reasonable to all the circumstances of the case. This would resemble the case in financial services where the 10% ceiling does not apply.
- 2) Retain the 10% ceiling for businesses where this formula remains applicable but make special provision for cases where the business's turnover is below a specified threshold; in the latter cases, Ofgem would be able to impose a penalty which is reasonable to all the circumstances of the case but is capped at a specified limit.
- 3) This is the same as Option 2 but there would be an additional special provision for businesses which, although they had little or no applicable turnover themselves, had a parent company or belonged to a group; in these cases, Ofgem would be able to take the parent's or group's turnover into account when calculating the applicable turnover.

Option 1) would be simpler but it might increase the regulatory risk for current industry players whose liabilities are limited under the 10% ceiling. As we and Ofgem believe the current arrangements already adequately provide for these larger businesses, our preference is to keep the 10% ceiling but to make special provision for instances where the ceiling prevents Ofgem from imposing a meaningful penalty by implementing Option 2) or Option 3). Ofgem would still have to have regard to the fact that the amount of any financial penalty must be reasonable in all the circumstances of the case.

We invite views on what a sensible figure for the maximum penalty under options 2) and 3) might be. We think a turnover threshold of £10m and a maximum penalty of £1m might cater for most circumstances but this could mean that in some cases the fine would not be in line with

⁹ Ofgem has imposed a penalty of £15m using its concurrent powers under competition law but these powers are out of scope of this consultation.

the potential gains for the regulatory breach and could mean that some fines for similar breaches could be very different according to which ceiling applied.

Question 19: Do you agree that the penalty provisions should be revised so Ofgem is able to impose an appropriate penalty on businesses with small or no turnover of its own?

Question 20: What do you consider the maximum fine should be where a regulated body has either a low turnover or no turnover at all? Please provide your justification.

Question 21: What benefits do you think these changes might lead to? Please provide details.

Question 22: Do you agree with the costs and benefits as presented in the Impacts Assessment? Can you provide any further evidence which DECC should consider?

Title: Impact Assessment on Measures to Strengthen Ofgem's enforcement powers IA No: RPC-3133-DECC Lead department or agency: Department for Energy and Climate Change Other departments or agencies: Ofgem	Impact Assessment (IA)		
	Date: 04/11/2015		
	Stage: Consultation		
	Source of intervention: Domestic		
	Type of measure: Primary legislation for all options apart from Option 8 that can be implemented via statutory instruments.		
Contact for enquiries: Isabella.righi@decc.gsi.gov.uk			
Summary: Intervention and Options			RPC rating: fit for purpose

Cost of Preferred (or more likely) Option				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out?	Measure qualifies as
£m	£m	£m	Yes/No	NA

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

In recent years, there have been several examples of non-compliance with licence conditions and other regulatory requirements mandated by Ofgem, the gas and electricity markets regulator. At times, this has tested current powers and procedures and Ofgem has identified a number of ways in which the existing powers might be modified and augmented in order to deliver better consumer outcomes through more effective regulation. In some cases these address specific concerns that the powers are not operating as originally intended.

What are the policy objectives and the intended effects?

Ofgem's primary duty is to protect the interests of energy consumers both now and in the future. It is important, therefore, that it is able to act quickly and appropriately where it identifies non-compliant behaviour in the market. Failure to do so can result in significant costs and other negative outcomes both for domestic and non-domestic consumers. It can also undermine competition in the energy market. Therefore, we are consulting on measures to strengthen Ofgem's enforcement powers to ensure that the regulator is able to ensure better outcomes for consumers and better functioning markets for companies of all sizes within the sector.

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

A number of measures have been identified during Ofgem internal reviews, which would be introduced as a package aimed at targeting non-compliance behaviours by firms operating in the sector. The measures would address two areas of Ofgem activity: a set of measures is about improving Ofgem's ability to conduct investigation when there is a suspicion of non-compliance with regulatory framework (Options 1, 2, 3, 4, and 8) and the second set of measures is about ensuring that Ofgem is able to apply penalties when non-compliance has been established (Option 5, 6, 7). The measures include:

- Option 0: Do nothing
- Option 1 and Option 2: increasing length or removing limits of investigation periods for compliance orders
- Option 3: allowing information gathering from unlicensed suppliers
- Option 4: introducing special audit requirements
- Option 5, Option 6 and Option 7: improving applications of penalties for regulator breaches
- Option 8: improving Ofgem's ability to gather evidence in respect to REMIT and creation of an information gateway with the CMA.
- Option 9 (preferred option): package of measures including Options 1, 3, 4, [6 or 7] and 8.

Option 9 is the preferred option because it delivers the largest amount of benefits to competition and consumers.

Option 9 is the most comprehensive solution to all issues identified by Ofgem.

Will the policy be reviewed? DECC will review the impact of these changes after 5 years. If applicable, set review date:

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.	Micro Yes	< 20 Yes	Small Yes	Medium Yes	Large Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded:		Non-traded:

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
SELECT SIGNATORY:**

..... **Date:**

Summary: Analysis & Evidence

Policy Option 0

Description: Do nothing: we assume that a degree of non-compliance would happen in the market in line with what is currently observed by Ofgem, imposing a cost on society.

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate:
COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant)		Total Cost (Present Value)
Low					
High					
Best Estimate					
Description and scale of key monetised costs by 'main affected groups'					
We have not monetised costs of the do nothing option.					
Other key non-monetised costs by 'main affected groups'					
This option is the status quo; as we assume non-compliance would continue in line with the current levels, we do not expect additional costs from this option. However, non-compliance represents a cost to society in the form of the foregone benefits from compliance. Non-compliance by industry can also be detrimental to competition, leading to a market failure and harm to consumers. In the absence of intervention, industry may face lower costs because they do not comply with regulation. However, this would be at the expense of larger costs to society as it could result in a lower quality service for consumers, and harm competition by creating incentives for compliant firms to become non-compliant.					
BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant)		Total Benefit (Present Value)
Low					
High					
Best Estimate					
Description and scale of key monetised benefits by 'main affected groups'					
We do not anticipate any additional benefits from the do nothing option.					
Other key non-monetised benefits by 'main affected groups'					
We do not anticipate any additional benefit from the do nothing.					
Key assumptions/sensitivities/risks					Discount rate (%)
For the do nothing option, we assume levels of non-compliance would continue in line with levels currently observed by Ofgem.					
There is a risk that the existence of gaps in the system identified by Ofgem might lead more firms to avoid compliance with current regulations, which might generate further costs to society.					

BUSINESS ASSESSMENT (Option 0)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs:	Benefits:	Net:	No	OUT

Summary: Analysis & Evidence

Policy Option 1

Description: Compliance Orders: Review the period of time Ofgem has to do investigative work on Provisional and Final Orders to ensure proper consideration of evidence is possible before procedural and penalty time limits are exceeded. Under this proposal the time limits that apply to provisional and final orders would be extended to give Ofgem more time to gather evidence to the standard required in order to impose a penalty where appropriate to do so. Further details on how times would be extended are provided in the Evidence base section under “options under consideration”.

FULL ECONOMIC ASSESSMENT

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

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

Description and scale of key monetised costs by ‘main affected groups’

We have not been able to monetise costs at this stage and are seeking information as part of consultation.

Other key non-monetised costs by ‘main affected groups.’

The main parties affected by this option are regulated parties licenced by Ofgem, primarily energy market participants suspected of non-compliance with their licence conditions, or other relevant requirements. Extending investigation periods is likely to encourage increased usage of Orders as an enforcement tool. However, as these orders are a mechanism for securing compliance, we do not anticipate an increased cost to compliant businesses. We do not have data on the cost of investigations for industry participants and intend to gather this information during the course of the consultation. However, Ofgem already carries out investigations under the current framework, time extensions would allow Ofgem to put binding obligations on businesses to take steps and become compliant, without losing the opportunity also to apply a penalty. Therefore we do not expect an increase to Ofgem’s business as usual costs and therefore the fees levied on industry as we do not expect an increase in Ofgem’s overall enforcement activity as a result of this measure.

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

Description and scale of key monetised benefits by ‘main affected groups’

We have conducted qualitative analysis at this stage. DECC intends to gather further information at consultation.

Other key non-monetised benefits by ‘main affected groups’

The main parties affected by this option are energy firms regulated by Ofgem and consumers in the energy sector. We expect that lengthening the investigation period for provisional and final orders would allow Ofgem to use Orders as an enforcement tool more frequently whilst still conducting in depth and effective investigations. The extension of investigation periods could also benefit involved firms as they would have more time to respond to Ofgem requests and comply with requirements.

Key assumptions/sensitivities/risks

As conservative estimates, we assume that Ofgem might issue 1-2 provisional orders and 1 final order in total per year. However, as the current limitations of orders would be addressed, we anticipate that there could be a small increase in the number of investigations, as provisional and final orders will be used more often as an enforcement tool. As there is a large amount of uncertainty, we would welcome views on these assumptions during the consultation.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs:	Benefits:	Net:		

Summary: Analysis & Evidence

Policy Option 2

Description: Compliance Orders. Review the period of time Ofgem has to do investigative work on Provisional and Final Orders to ensure proper consideration of evidence is possible before procedural and penalty time limits are exceeded. Under this proposal the time limits of the investigation period would be removed.

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate:
COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Cost (Present Value)
Low					
High					
Best Estimate					
Description and scale of key monetised costs by 'main affected groups'					
We have not been able to monetise costs at this stage and are seeking information as part of consultation.					
Other key non-monetised benefits by 'main affected groups.'					
Removing a time limit is likely to lead to a considerable increase in uncertainty for industry participants compared to Option 1 where Order investigation periods are extended to an appropriate fixed period.					
The removal of a time limit could lead to increases in the length of the investigation where Orders are used, therefore potentially increasing costs both for energy markets participants and for Ofgem, whereas under Option 2 we do not expect considerable increases in costs for compliant firms or for the regulator.					
BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Benefit (Present Value)
Low	Optional		Optional		Optional
High	Optional		Optional		Optional
Best Estimate					
Description and scale of key monetised benefits by 'main affected groups'					
We have conducted qualitative analysis at this stage.					
Other key non-monetised benefits by 'main affected groups'					
Similarly to Option 1, this option would allow Ofgem to conduct more in-depth and effective investigations, leading to better outcomes for consumers and better functioning markets for companies of all sizes within the sector. However, as Ofgem has suggested that an extension in time limits would be sufficient to improve the quality of investigation; we do not consider that Option 2 would generate any additional benefit on top of those generated by Option 1.					
Key assumptions/sensitivities/risks					Discount rate (%)
As a conservative estimate, we assume that Ofgem might issue 1-2 provisional orders and 1 final order in total per year. However, as the current limitations of orders would be addressed, we anticipate that there could be a small increase in the number of investigations, as provisional and final orders will be used more often as an enforcement tool. As there is a large amount of uncertainty, we would welcome views on these assumptions during the consultation.					

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs:	Benefits:	Net:	No	OUT

Summary: Analysis & Evidence

Policy Option 3

Description: Information gathering for unlicensed supply. Under the proposal, powers would be clarified to enable Ofgem to compel the provision of information from organisations that appear to be operating in the market without the appropriate licence.

FULL ECONOMIC ASSESSMENT

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

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

Description and scale of key monetised costs by ‘main affected groups’

We have not been able to monetise costs at this stage and are seeking information as part of consultation.

Other key non-monetised costs by ‘main affected groups’

The main parties affected by this option are energy market participants suspected of operating in the market without a licence. This provision will not place any additional burden on licensed suppliers, given that it is very easy for a business to demonstrate compliance by producing its licence and that they are already required under legislation to provide information to Ofgem on request. This power would be directed mainly at companies whose activities give rise to suspicions that they may be operating in the energy market without an appropriate licence. Based on Ofgem’s experience to date, this is only ever likely to be a small number. It should be noted that if companies were in full compliance this proposal would have no net costs or benefits. Additional information requests are likely to be subsumed into Ofgem’s business as usual costs and we do not see an increase in fees as a result of this measure.

In addition, there might be impacts to the Criminal Justice System (CJS) in terms of costs on courts and possibly to legal aid as a consequence of introducing new sanctions for businesses who fail to provide the requested information. There may also be further costs to the CJS if these changes lead to additional prosecutions for energy market participants operating in the market without a license.

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

Description and scale of key monetised benefits by ‘main affected groups’

We have conducted qualitative analysis at this stage.

Other key non-monetised benefits by ‘main affected groups’

The main benefit of this power is to enable Ofgem to identify and control unlicensed supply. This would ensure that the regulator is able to ensure better outcomes for consumers and better functioning markets, contributing to a safer, fairer competitive environment, for all companies in the industry.

There is a secondary benefit in that this might increase a greater deterrence to those considering supplying energy without the required licence, thereby reducing the resulting harm to domestic and non-domestic customers.

Key assumptions/sensitivities/risks

Discount rate (%)

We have not quantified any additional costs or benefits for this option, so we have not made any assumption or conducted sensitivity analysis.

There is a small risk of costs arising from information requests directed at companies which appeared to be non-compliant but are eventually found not to be operating in the market. This should be rare. We would welcome evidence on this risk as part of the Consultation.

BUSINESS ASSESSMENT (Option 3)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs:	Benefits:	Net:	No	OUT

Summary: Analysis & Evidence

Policy Option 4

Description: Special Audit Arrangements. Under this proposal, Ofgem would be granted statutory powers to enable it to commission third parties to prepare a report on its behalf as part of its investigations into allegations of non-compliance, and for the cost of that work to be borne by the firm under investigation.

FULL ECONOMIC ASSESSMENT

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

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

Description and scale of key monetised costs by ‘main affected groups’

We have not been able to monetise costs at this stage and are seeking information as part of consultation.

Other key non-monetised costs by ‘main affected groups’

The proposal would generate additional costs to industry participants as the cost of special audits will be borne by the firm under investigation. We do not have firm estimates on the number of times this power might be used. It is also not possible to give a single indicative cost for these audits at this stage, as the cost will vary greatly depending on a number of factors. We are seeking evidence from industry on this as part of this consultation. However we note that in cases where companies are found to be non-compliant they are imposing additional costs on consumers and businesses and there should be an offsetting benefit in bringing them in compliance. Regarding costs to Ofgem, the cost of operating this power would be subsumed into Ofgem’s business as usual costs. We do not see an increase in fees on industry as a result of this measure.

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

Description and scale of key monetised benefits by ‘main affected groups’

We have conducted qualitative analysis at this stage.

Other key non-monetised benefits by ‘main affected groups’

We anticipate benefits to industry and society as a result of this proposal. Benefits to society accrue from improving the efficiency of investigations and the skills available to the regulator Ofgem. Independent audits of this type can be already carried out by third parties but, under the current framework the accountability of the auditor to the company and/or to Ofgem can be unclear. The statutory power would help to clarify that the auditor’s primary duty is to Ofgem. Ofgem believes this proposal will result in more targeted investigations which will reduce the amount of time a company being investigated will experience disruption and uncertainty. This would happen, alongside other reasons explained in the evidence section, thanks to more focussed and shorter investigations that produce better insight into the root causes of compliance problems along with potential remedies, reducing disruption and uncertainty for the licensee and increasing certainty that the problem has been dealt with effectively and wouldn’t recur (also benefit to the consumer).

Key assumptions/sensitivities/risks

Discount rate (%)

We have not quantified any additional costs or benefits for this option, so we have not made any assumption or conducted sensitivity analysis.

We would welcome evidence on the risks that companies are asked to bear the cost of a special audit, but eventually found compliant, as part of the Consultation.

BUSINESS ASSESSMENT (Option 4)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs:	Benefits:	Net:		

Summary: Analysis & Evidence

Policy Option 5

Description: Penalties for Regulatory Breaches. Ofgem can currently impose a fine or order compensation of up to 10% of turnover, when a licensee is found to be non-compliant with requirements. However, recent enforcement experience has thrown up cases where non-compliant companies have zero turn-over which has the effect of making it impossible to issue a penalty or order compensation.

Under Option 5 the current 10% formula for calculating the maximum penalty would be removed and Ofgem would be allowed to impose a penalty reasonable to all the circumstances of the case.

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate:
COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant		Total Cost (Present Value)
Low					
High					
Best Estimate					
Description and scale of key monetised costs by ‘main affected groups’					
We have not been able to monetise costs at this stage and are seeking information as part of consultation.					
Other key non-monetised costs by ‘main affected groups’					
Depending on the design of the option, it is very likely that the proposal would increase uncertainty for the firms involved as it would become more difficult for firms in the industry to anticipate the impact of a penalty, if issued.					
BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant		Total Benefit (Present Value)
Low					
High					
Best Estimate					
Description and scale of key monetised benefits by ‘main affected groups’					
We have conducted qualitative analysis at this stage. DECC intends to gather further information at consultation.					
Other key non-monetised benefits by ‘main affected groups’					
This proposal would allow Ofgem to consider each regulatory breach on a case by case basis, and all types of firms in the industry would be subject to the regulation.					
Key assumptions/sensitivities/risks					Discount rate (%)
Based on experience to date, Ofgem estimates that this issue is unlikely to arise more than two or three times per year. This measure is therefore expected to improve Ofgem’s ability to collect fines from parties in breach of regulatory requirements. This is a transfer from industry to society. However, it is anticipated that any impact on the overall level of fines imposed by Ofgem will not be large. We are unable to quantify this amount at this stage and would welcome views in the consultation. Ofgem have not issued a fine close to 10% of turnover previously.					

BUSINESS ASSESSMENT (Option 5)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs:	Benefits:	Net:	No	OUT

Description: Penalties for Regulatory Breaches Ofgem can currently impose a penalty or order compensation of up to 10% of the licensee’s applicable annual turnover when a licensee is found to be non-compliant with requirements. However, recent enforcement experience has thrown up cases where non-compliant companies have zero turnovers which have the effect of making it impossible to issue a financial penalty or order compensation. Under Option 6 when the non-compliant firm has little or no turnover we propose that Ofgem should be able to impose a financial penalty or order compensation of up to a specified amount.

FULL ECONOMIC ASSESSMENT

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

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

Description and scale of key monetised costs by ‘main affected groups’
 We have not been able to monetise costs at this stage and are seeking information as part of consultation.

Other key non-monetised costs by ‘main affected groups’
 There are no direct costs associated with this proposal. Under a central scenario we would assume that industry is in full compliance and this proposal results in no change. If more companies come under scope this measure is expected to increase the fine revenue collected by Ofgem on non-compliant firms. This is a transfer from industry to society. We are unable to quantify this amount at this stage.
 We have considered whether this could have an impact on the incentive to set up subsidiaries. We note that there are benefits associated with subsidiaries from a company point of view, and would not want to alter these.

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

Description and scale of key monetised benefits by ‘main affected groups’
 We have conducted qualitative analysis at this stage.

Other key non-monetised benefits by ‘main affected groups’
 The proposal would close a gap in the system that has the potential to undermine the integrity of the enforcement regime, by ensuring a level playing field in the market as all firms that breach regulation would face penalties, rather than a situation where some firms can be fined and others cannot. This would be beneficial for competition. We are unable to quantify these benefits at this stage.

Key assumptions/sensitivities/risks **Discount rate (%)**
 Based on experience to date, Ofgem estimate this that this issue is unlikely to arise more than two or three times per year. This measure is therefore expected to improve Ofgem’s ability to collect penalties from firms in breach of regulation. This is a transfer from industry to society. However, it is anticipated that any impact on the overall level of fines imposed by Ofgem will not be large. We are unable to quantify this amount at this stage and would welcome views in the consultation.

BUSINESS ASSESSMENT (Option 6)

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

Summary: Analysis & Evidence

Policy Option 7

Description: Penalties for Regulatory Breaches Ofgem can currently impose a penalty or order compensation of up to 10% of the licensee’s applicable annual turnover when a licensee is found to be non-compliant with requirements. However, recent enforcement experience has thrown up cases where non-compliant companies have zero turnovers which have the effect of making it impossible to issue a financial penalty.

Under Option 7 when the non-compliant firm has little or no turnover but has a parent or is part of a larger group, Ofgem would be able to take account of the parent or group’s turnover in calculating the applicable turnover. Where the non-compliant firm is not part of a group, we propose that, as per Option 6, Ofgem should be able to impose a financial penalty or order compensation of up to a specified amount.

FULL ECONOMIC ASSESSMENT

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

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

Description and scale of key monetised costs by ‘main affected groups’

We have not been able to monetise costs at this stage and are seeking information as part of consultation.

Other key non-monetised costs by ‘main affected groups’

There are no direct costs associated with this proposal. Under a central scenario we would assume that industry is in full compliance and this proposal results in no change. If more companies come under scope this measure is expected to increase the fine revenue collected by Ofgem on non-compliant firms. This is a transfer from industry to society. We are unable to quantify this amount at this stage.

We have considered whether this could have an impact on the incentive to set up subsidiaries. We note that there are benefits associated with subsidiaries from a company point of view, and would not want to alter these.

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

Description and scale of key monetised benefits by ‘main affected groups’

We have conducted qualitative analysis at this stage.

Other key non-monetised benefits by ‘main affected groups’

The proposal would close a gap in the system that has the potential to undermine the integrity of the enforcement regime, by ensuring a level playing field in the market as all firms that breach regulation would face penalties, rather than a situation where some firms can be fined and others cannot. This would be beneficial for competition. We are unable to quantify these benefits at this stage.

Key assumptions/sensitivities/risks

Discount rate (%)

Based on experience to date, Ofgem estimate this that this issue is unlikely to arise more than two or three times per year. This measure is therefore expected to increase Ofgem’s ability to collect penalties or order compensation from subsidiary companies. This is a transfer from industry to society. However, it is anticipated that any impact on the overall level of fines imposed by Ofgem will not be large. We are unable to quantify this amount at this stage and would welcome views in the consultation.

BUSINESS ASSESSMENT (Option 7)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs:	Benefits:	Net:		

Description: Change REMIT information gathering and the CMA gateway: Amend Ofgem’s information gathering powers in respect of REMIT so they are better able to gather evidence. Under this proposal, if it is not “reasonably practicable” to undertake the separation of relevant from irrelevant documents on firms’ premises, Ofgem should have a power to seize materials in order to carry out the examination and separation (or “sifting”) of the material elsewhere, which is currently not possible. The CMA gateway would allow the CMA to pass Ofgem information about potential breaches of the REMIT regulations or other information that might be relevant to an investigation.

FULL ECONOMIC ASSESSMENT

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

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

Description and scale of key monetised costs by ‘main affected groups’

The main parties affected by this option are REMIT market participants. These include generators, persons professionally arranging transactions and traders. There might be some costs for Ofgem. However, for the most part this is expected to be subsumed into Ofgem’s business as usual costs and we do not see an increase in fees as a result of this measure.

We have not been able to monetise costs at this stage and are seeking information as part of consultation.

Other key non-monetised costs by ‘main affected groups’

We do not expect there to be any extra costs to industry as a result of these measures as this does not increase the level of requirements on the companies.

Ofgem are likely to spend more time examining documentation as part of their investigations. This is expected to be subsumed into Ofgem’s business as usual costs and we do not see an increase in fees as a result of this measure. Similarly, we would not expect the CMA’s costs to increase unduly.

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

Description and scale of key monetised benefits by ‘main affected groups’

The main parties affected by this option are REMIT market participants.

We have conducted qualitative analysis at this stage.

Other key non-monetised benefits by ‘main affected groups’

Ofgem are already able to remove relevant documentation to investigate allegations under the current regulations but, under this proposal, they would be able to seize and sift physical and electronic files offsite in order to identify relevant documents which would enhance their ability to establish whether an offence has occurred. Similar benefits would accrue if the CMA was able to pass information to Ofgem. This would ensure that Ofgem is able to ensure better outcomes for consumers and better functioning markets for companies of all sizes within the sector. Regarding the seize and sift power, there is also a further potential benefit in that Ofgem could spend less time on firms’ premises.

Key assumptions/sensitivities/risks

Discount rate (%)

We have not quantified any additional costs or benefits for this option, so we have not made any assumption or conducted sensitivity analysis. We have not identified any major risk, but we would welcome views during the Consultation.

BUSINESS ASSESSMENT (Option 8)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs:	Benefits:	Net:		

Description: Option 9: Implement Options 1, 3, 4, [6 or 7], and 8 as a “Package of Options” (the preferred option).

FULL ECONOMIC ASSESSMENT

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

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

Description and scale of key monetised costs by ‘main affected groups’
 We have not been able to monetise costs at this stage and are seeking information as part of consultation.

Other key non-monetised costs by ‘main affected groups’
 As a package of options, this option would have all the additional costs identified for the single options it includes. Where applicable, additional costs might arise for industry participants and for Ofgem.

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

Description and scale of key monetised benefits by ‘main affected groups’
 We have conducted qualitative analysis at this stage.

Other key non-monetised benefits by ‘main affected groups’
 As a package of options, this option would have all the additional benefits identified for the single options it includes. Where applicable, additional benefits might arise for industry participants and for consumers.
 A further benefit of this option is that, as all measures identified in the package are intended to address separate and independent issues, it would allow a comprehensive improvement of Ofgem enforcement powers that tackles all issues recently identified by Ofgem. Introducing only some of the proposals would only address some of the issues identified, but not all, leaving unsolved problems ultimately to the detriment of the market and consumer benefits.

Key assumptions/sensitivities/risks	Discount rate (%)
For all options part of this package, no quantitative analysis has been conducted. Therefore we are not presenting any analysis or sensitivity. The risks of this option are the same as those of the individual options it includes.	

BUSINESS ASSESSMENT (Option 9)

Direct impact on business (Equivalent Annual) £m:			In scope of	Measure qualifies as
Costs:	Benefits:	Net:		
			Yes	IN (because of option 4)

Evidence Base (for summary sheets)

Problem under consideration

The Office of Gas and Electricity Markets (aka “Ofgem”) is the regulator of GB gas and electricity markets. Ofgem’s primary duty is to protect the interests of energy consumers both now and in the future. Ofgem mainly does this by administering a licensing regime which sets out detailed rules for energy businesses and it has a broad range of enforcement powers to address breaches of these licence conditions and other regulatory requirements.

It is important that Ofgem has access to a wide range of effective enforcement tools, capable of meeting the challenges of regulating a sector experiencing rapid change, driven by the adoption of new technology, the entry of new market players and at times a raised political profile.

In recent years, there have been numerous examples of serious and persistent non-compliance with Ofgem’s licence conditions and other regulatory requirements by the energy industry, and especially by energy suppliers. The Ofgem website¹¹ currently lists 61 open and closed investigations since 2009 and it has issued a total of approximately £175m in fines and redress payments as a result of these to date¹².

Some of these cases have been high-profile. In 2010 Ofgem launched investigations into marketing failures by Npower, Scottish Power, SSE and EDF. In all these cases, Ofgem eventually imposed fines or agreed redress payments for breaches that lasted from 2009 to 2012 (until 2011 in the case of EDF). A fine of £10.5m was imposed on SSE while the other suppliers made redress payments of between £3.5m-£8.5m. In some cases Ofgem has opened investigations against the same company concerning issues it has previously investigated suggesting that previous enforcement action had not been fully successful in preventing future problems.

At times, this has tested current powers and procedures and Ofgem have found instances where they have either been unable to produce sufficient deterrence (for example, no ability to fine a company that has zero turnover) or has had to adapt their procedures in unhelpful ways (for example, due to overly tight time limits on orders). In order to strengthen Ofgem’s ability to carry out its duties to protect consumers, Ofgem has identified a number of ways in which the existing powers might be modified and augmented in order to deliver better consumer outcomes through more effective regulatory tools.

All proposals considered are aimed at strengthening Ofgem’s ability to identify and take action against non-compliant firms. Therefore the proposals are not intended to have negative consequences on firms that comply with Ofgem regulations.

The proposals also aim at improving the effectiveness of Ofgem work, but, in most cases, not at increasing time and resource costs required to conduct its activities. For example, the introduction of the proposals is not intended or expected to lead to a considerable increase in the number of investigations conducted by Ofgem, but rather to make the investigation process more efficient, for example by allowing Ofgem to secure outcomes which prevent recidivism.

¹¹ <https://www.ofgem.gov.uk/investigations>

¹² August 2015

Rationale for intervention

Ofgem's primary duty is to protect the interests of energy consumers both now and in the future. At the same time, Ofgem has a duty to have regard to best regulatory practice and to exercise its regulatory activities in a transparent, accountable, proportionate, consistent manner, targeting only cases in which action is needed.

Ofgem have stated that "Our vision for our enforcement work is to achieve a culture where businesses put energy consumers first and act in line with their obligations." When considering enforcement action Ofgem will consider whether that is a proportionate and effective response, in line with their published guidance (see in particular para 3.25-3.30)¹³ if no other response will adequately address the issue, it is important that Ofgem has adequate powers to act quickly and appropriately to prevent consumer harm arising from non-compliant behaviour. Failure to do so can result in significant costs and other negative outcomes both for domestic consumers and for SMEs and other non-domestic energy users, and for competition in the energy market.

Strengthening Ofgem's enforcement powers in the ways proposed would ensure that the regulator is able to ensure better outcomes for consumers and better functioning markets for companies of all sizes within the sector.

Non-compliance by industry can also be detrimental to competition. In the absence of intervention, industry may face lower costs because they do not comply with regulation. However, this would be at the expense of larger costs to society due to the harm to consumers and competition resulting from non-compliance of some firms. This could lead to a non-optimal equilibrium where non-compliance occurs more frequently than the socially optimal level, which in this case is zero.

In theory this would result in a lower quality service for consumers, and harm competition by creating incentives for compliant firms to become non-compliant. The rationale for strengthening Ofgem's enforcement powers is to ensure that the regulator has the powers required to undertake its regulatory duties effectively.

It should be noted that this is a Consultation Stage Impact Assessment. We are seeking evidence to inform the proposals within this Impact Assessment and the evidence base to support this Impact Assessment as part of the Consultation.

Policy objective

Ofgem takes the view that it is for regulated companies to ensure they meet all regulatory obligations at all times. When a breach is identified, Ofgem will enforce a return to compliance and may issue financial and other penalties.

The package of changes proposed in this impact assessment seek to strengthen Ofgem's capacity to improve levels of compliance across the energy sector, reducing negative consumer outcomes caused by non-compliance and helping to build public trust in the sector.

The package of changes seeks to strengthen or alter existing powers, and create new powers where needed to achieve these objectives. We have considered five areas of intervention and these are summarised briefly in the Table 1 below.

13

https://www.ofgem.gov.uk/sites/default/files/docs/2014/09/enforcement_guidelines_12_september_2014_published_version_1.pdf

The measures would address two areas of Ofgem activity: a set of measures is about improving Ofgem's ability to conduct investigation when there is a suspicion of non-compliance with regulatory framework (Compliance Orders, Information Gathering, Special Audit Arrangements, Changes in REMIT Information Gathering and CMA Gateway) and the second set of measures is about ensuring that Ofgem is able to apply penalties when non-compliance has been proven (Penalties for regulatory breaches).

Table 1: Summary of proposed changes to enforcement powers

	Change	Strengthen/New
a)	Compliance Orders: Review the period of time Ofgem has to do investigative work on Provisional and Final Orders to ensure proper consideration of evidence. Two options are considered concerning compliance orders.	Strengthens existing powers
b)	Information gathering for unlicensed supply: Strengthen Ofgem's information gathering powers. One option is considered here.	Strengthens existing powers
c)	Special Audit Arrangements: Grant Ofgem a statutory power to commission third parties to prepare a report as part of its investigations into allegations of non-compliance, and for the cost of that work to be borne by the firm under investigation. One option is considered here.	New powers
d)	Penalties for Regulatory Breaches: Extending the scope to fine to enable Ofgem to take parent company turnover into account, when a non-compliant subsidiary firm has no turnover or, where there is no parent, impose a fine which is not dependent upon turnover. Three options are considered concerning penalties for regulatory breaches.	Strengthens existing powers
e)	Change REMIT information gathering, and CMA information gateway: Amend Ofgem's information gathering powers in respect of REMIT ¹⁴ and create gateways with the CMA, so they are better able to gather evidence. One option is considered here.	Strengthens existing powers

We are consulting on a package of proposals that would include 5 of the options considered in this paper and seeking evidence on the impact of these. We have highlighted the costs and benefits of individual proposals below.

Taken together the proposed measures will improve Ofgem's ability to detect breaches of regulatory obligations, understand the root causes of those breaches, assess the level of associated risk, prescribe appropriate remedies, ensure they are implemented, and create a credible deterrence for those tempted to take non-compliant action in future. Overall, this will have beneficial effects for regulation of gas and electricity markets and improve the treatment of consumers in these markets.

A number of measures have been identified during Ofgem internal reviews, which would be introduced as a package of measures aimed at targeting non-compliance behaviours, therefore enhancing the efficiency and effectiveness of Ofgem regulatory activity. We are consulting on these measures in the Consultation Document accompanying this Impact Assessment.

¹⁴ The EU Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency

Options under consideration

Nine options are considered in this Impact Assessment (these are summarised in the Table 2 below).

For compliance orders we are considering two options and propose to implement one of them. Similarly, we are proposing two three options regarding penalties of regulatory breaches and intend to propose to introduce one of them.

All the five areas we are considering (compliance orders, information gathering, special audit, penalties for regulatory breaches, changing REMIT information gathering) address separate issues recently identified by Ofgem without overlaps between one another. Our preferred solution would therefore be to implement a package that includes an option for each area considered, as per Option 9.

Table 2: Summary of Options

Option 0	Do nothing	Status quo
Option 1	Compliance	Extend investigation time limit.
Option 2	Orders	Remove investigation time limit.
Option 3	Information gathering	Information gathering for unlicensed supply
Option 4	Special Audit	Special Audit Arrangements
Option 5	Penalties for Regulatory Breaches	Remove 10% turnover formula.
Option 6		Retain 10% turnover formula with special provisions for firms with little or no turnover
Option 7		Retain 10% turnover formula with special provisions for firms with little or no turnover that belong to a parent company/group, and for firms with little or no turnover that are independent.
Option 8	REMIT information gathering	Change REMIT information gathering (Seize and sift power, and information gateway with CMA)
Option 9	Package	“Package of Options” (the preferred option). Implement: Option 1 Option 3 Option 4 Option 6 or 7 Option 8

These are explained in more detail in this section.

Option 0: Do Nothing

This option is to do nothing and maintain the status quo. Under this option we assume that non-compliance would continue in line with current levels observed by Ofgem.

We do not consider this a viable option as some firms could continue avoiding compliance, and compliant firms could have incentives to become non-compliant. Therefore, failing to intervene would undermine competition within the energy market and could lead to further costs to domestic and non-domestic consumers

Option 1 and Option 2: Compliance Orders

Provisional Orders are a key tool available to the Enforcement Team. They are used to require a regulated entity to do (or not do) something that is apparently non-compliant and causing damage to consumer interests.

They have been used, for example, to:

- Prevent serious harm to one group of customers in danger of having their supply cut off during cold weather
- Require an energy company not to disconnect customers and to provide the option of prepayment meters for customers in difficulty with payments
- Require an energy company to lodge sufficient credit, pay any outstanding debts, and send Ofgem a business plan, updated monthly, on the measures it has taken to comply with industry code payment and credit requirements

Further, Ofgem has threatened their use in order to obtain voluntary commitments to achieve significant improvements in customer service.

There are time limits attached to the use of a Provisional Order:

1. Ofgem issues a Provisional Order if it appears there is a contravention causing immediate harm which needs to be addressed promptly (e.g. *at the outset* of an investigation, where requisite only). Ofgem then has three months from the date of issue to satisfy itself that the body is contravening or likely to be contravening a licence condition or relevant statutory requirement and either confirm the Order or the Order will lapse.
2. If Ofgem is satisfied that contravention is ongoing, Ofgem can confirm the provisional order. Ofgem then has a further three months to complete the investigation and determine and impose an appropriate penalty. In total, Ofgem has six months from issuing a provisional order to investigate the case and serve notice of penalty.

There are also time limits attached to use of Final Orders. A final order can be issued where Ofgem is satisfied that the body is contravening or is likely to contravene a licence condition or relevant requirement (i.e. *after* it has investigated a potential non-compliance). Ofgem then has 3 months to determine and issue penalty. A Final Order is used to instruct the non-compliant body to take certain necessary steps to achieve compliance but sometimes these steps may take longer than 3 months to achieve. This can mean that if a penalty is to be ordered it must be ordered before the outcome is known. Furthermore, a penalty cannot be ordered unless it has been ordered within 3 months of the issue a Final Order, meaning that issuing a Final Order may have the unintended consequence of relieving a business from any obligation to pay a penalty should the Final Order not be complied with and a penalty has not been imposed within the short timescale for doing so.

The evidence suggests that Ofgem has only used these order making powers on an occasional basis and that this in part is due to the current statutory time limits which do not give the regulator sufficient time to investigate a potential contravention adequately, particularly as they must give licensees the opportunity to consider the terms of the provisional order and make representations and Ofgem must revise the order if it accepts those representations. The information gathering stage of an investigation is usually the most lengthy, especially in complex cases and Ofgem may

have to send several information requests and allow time for the response. These constraints have made it hard for Ofgem to use these powers.

Recent experience shows that meeting this second deadline also presents a particular challenge. Three months may not be a reasonable time for the company to deliver changes, or for Ofgem to verify that the changes will be sustained and have the desired effect. In certain circumstances this creates a tension with the full and rigorous investigative work that should always be done to deliver comprehensive outcomes for consumers, and creates a barrier to the use of a valuable and effective enforcement tool.

Ofgem has calculated that it has 6 weeks to conduct the investigation, as the 3 month time period must build in time for two consultation periods of 21 days each. On several occasions, Ofgem has decided not to use this particular tool because it believed the matter being investigated was not capable of being fully covered within the actual available time.

In order to allow Ofgem to make use of this tool while conducting investigations, we are considering two options to address issues caused by the limited investigation time periods. Under **Option 1** the time limits for each of the investigation periods would be extended in the following way:

Provisional Orders:

- i) Confirmation: Increase the current statutory time limit of 3 months so that Ofgem has 6 months to confirm a provisional order.
- ii) Not-Confirmed Provisional Orders: Increase the current statutory time limit of 6 months so that Ofgem has 18 months to issue a penalty notice from the date the PO is issued (linking to (i) above - this equates to 12 months from the date it would lapse if not confirmed).
- iii) Confirmed Provisional Orders: Increase the current statutory time limit of 3 months so that Ofgem has 12 months to issue a penalty notice from the last date stated within the provisional order by which compliance is stipulated to be achieved, or from the date the order is revoked (whichever is the soonest).

Final Orders: Increase the current statutory time limit so that Ofgem has 6 months to issue a penalty notice from the last date stated within the final order by which compliance is stipulated to be achieved, or from the date the order is revoked if no date is stipulated.

Under **Option 2** the limits to each of the investigation periods would be removed.

Option 3: Information Gathering for Unlicensed Supply

Currently, Ofgem has powers to compel licensees to provide information relevant to a regulatory investigation. However, those powers do not extend to unlicensed entities and that hinders effective investigation where a company or individual is suspected of supplying energy without a licence.

There have been some instances in the past where Ofgem has considered possible instances of supplying without the necessary licence.

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. As with licensees, the proposed sanction for failing to comply with an information request from Ofgem would be a fine.

Option 4: Special Audit Requirements

Under this proposal, DECC 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, and for the cost of that work to be borne by the firm under investigation.

This power would be particularly useful, for example, in looking at a licensee's IT systems where Ofgem could rely on the analysis and advice of an independent IT specialist to identify failures and suggest remedies, people with expertise required too infrequently to warrant its permanent retention within Ofgem.

Such a power would increase the capacity of the enforcement team to target investigations and identify root causes of non-compliance and would provide a means of engaging specialist skills needed too infrequently to justify the recruitment of suitably qualified permanent staff¹⁵.

Such a power already exists in the banking and finance sector and is used frequently and successfully by the Financial Conduct Authority (FCA). We have considered whether a similar power exists for regulators in the water and telecommunication sectors. However, while Ofgem, Ofcom and Ofwat are based on similar regulatory models, the FCA tends to have a more modern regulatory regime where improvements on the regulatory framework have been implemented to better suit current business models or practices. Hence a comparison the FCA is considered more appropriate in this instance.

Option 5, Option 6 and Option 7: 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 and Electricity Act¹⁶. However during a 2014 capacity auction there was an issue with a company submitting misinformation. Ofgem were able to use enforcement powers and disqualify the relevant units from

¹⁵ An example might be staff with ICT or management consultancy skills required to assess the reasonableness of actions taken by an energy firm to confirm the functionality of a new billing system prior to launch, or auditing skills required to assess whether a target was met or how many items were delivered

¹⁶ The 10% turnover cap does not apply to REMIT cases.

the auction and, in addition, bar them from participating in the next two auctions. In terms of financial penalties, while Ofgem are in principle able to impose a fine of up to 10 per cent of turnover, in this instance as the company was new and effectively had zero turnover, it was not practically possible to impose a fine. This may represent a potential loophole as certain types of company (for example start-ups or certain types of subsidiary, such as Special Purpose Vehicles) may be able to escape the penalties that other companies would face¹⁷.

In order to address the issue, two options are considered regarding penalties for regulatory breaches.

Under **Option 5** the current 10% formula would be removed and Ofgem would be allowed to impose a penalty reasonable to all circumstances of the case. This would be similar to current procedure adopted by the FCA. We think it is unlikely that this would result in higher fines or orders for compensation for licence holders where the 10% of turnover formula is appropriate but it would create uncertainty for them in that the ceiling would no longer apply and so their liability for regulatory breaches would be potentially unlimited. In practice, the penalties imposed by Ofgem have not approached the ceiling but we believe it would increase regulatory risk for some licensees if it were to be removed entirely.

Under **Option 6** the 10% formula would be retained but special arrangements would be made for firms with little or no turnover. Under the special provisions Ofgem would be able to impose a penalty which is reasonable to all the circumstances of the case but is capped at a specified limit.

Under **Option 7** the same provisions as per Option 6 would be introduced, i.e. the 10% formula would be retained and Ofgem would be allowed to impose a penalty or impose an order for compensation up to a fixed amount for firms with little or no turnover. However, if a firm with little or no turnover has a parent company or belongs to a group, Ofgem would be able to take the parent's or group's turnover into account when calculating the applicable turnover. i.e. Ofgem would apply the 10% formula to the parent or group turnover. .

Option 8: Change REMIT information gathering and provide for information gateway with CMA.

The EU REMIT regulation prohibits insider trading and market manipulation in wholesale energy markets across the EU and the Enforcement Regulations¹⁸ gave Ofgem the ability to impose unlimited financial penalties, access to information and the power to enter premises.

Under the regulations, Ofgem has the power to remove documents appearing to be of the relevant kind when undertaking a search of premises under warrant.

However, there may be some instances where the investigating officers are presented with a large volume of documents which are likely to contain documents of the relevant kind but in the circumstances it is impractical or even impossible to separate

¹⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/468173/Autumn_Consultation_Document.pdf

¹⁸ The Electricity and Gas (Market Integrity and Transparency) (Enforcement etc) Regulations 2013 (SI 2013/1389, as amended by SI 2015/862).

relevant from irrelevant on the premises. Documents stored electronically may present a particular problem in this regard.

Ofgem has no current power to take away an entire body of documents in order to sift them off the premises. We are proposing that if it is not “reasonably practicable” to undertake the separation of relevant from irrelevant documents on the premises, Ofgem should have a power to seize all of the material in order to carry out the examination and separation (or “sifting”) of the material elsewhere. This will improve Ofgem’s ability to investigate allegations.

We are also proposing that the Competition and Markets Authority (CMA), should be able to pass relevant information to Ofgem where they comes across a potential REMIT breach or where it might hold information that is relevant to an investigation. This would also enhance Ofgem’s ability to investigate allegations.

Costs and Benefits

We have presented a summary table with the main cost and benefits of each option considered.

Options	Topic area	Description	Additional Costs to Industry	Additional Costs to Ofgem	Additional Benefits from more efficient regulatory processes
0	Do nothing	Status quo	None	None	No additional benefits, but rather additional costs to society due to forgone benefits from compliance
1	Compliance Orders	Extend investigation time limit.	Expected to be low but not quantified (seeking data during consultation).	Expected to be subsumed in BAU costs	Expected to enhance Ofgem's ability to use Orders to protect consumers
2		Remove investigation time limit.	Expected to be low, with however higher levels of uncertainty, but not quantified (seeking data during consultation).	Expected to be subsumed in BAU costs	Expected to enhance Ofgem's ability to use Orders to protect consumers
3	Information gathering	Information gathering for unlicensed supply	No additional costs expected for licenced businesses.	Expected to be subsumed in BAU costs	No additional benefits for licenced businesses. Benefits to society from detecting unlicensed businesses operating in the market.
4	Special Audit	Special Audit Arrangements	Expected to have some costs but not quantified (seeking data with the consultation)	Expected to be subsumed in BAU costs	Expected to improve efficiency of Ofgem investigations
5	Penalties for Regulatory Breaches	Remove 10% turnover formula.	No additional costs expected assuming full compliance, however, higher uncertainty depending on design of alternative system to calculate penalties.	No additional costs expected assuming full compliance	Additional benefits from fairer competition in the markets as all firms can be subject to penalties.
6		Retain 10% turnover formula with fine up to a fixed amount for firms with little or no turnover.	No additional costs expected assuming full compliance	No additional costs expected assuming full compliance	Additional benefits from fairer competition in the markets as all firms can be subject to penalties.
7		Same as Option 6 plus	No additional costs expected	No additional costs	Additional

		take parent firm or group turnover into account when a firm with little or no turnover has a parent company or belongs to a group.	assuming full compliance	expected assuming full compliance	benefits from fairer competition in the markets as all firms can be subject to penalties.
8	REMIT	Change REMIT information gathering	No additional costs expected for licenced businesses.	Expected to be subsumed in BAU costs	Expected Ofgem's enhanced ability to establish if an offence has occurred. Businesses could benefit from Ofgem spending less time on premises.
9	Package	Implement Options 1,3, 4, 6 or 7, and 8 as a "Package of Options" (the preferred option)	As per Option 1, 3, 4, [6 or 7], and 8	As per Option 1, 3, 4, [6 or 7], and 8	As per Option 1, 3, 4, [6 or 7], and 8

Option 0: Do Nothing

The do nothing option is the status quo – ie. We would not introduce any new powers or strengthen Ofgem's existing powers. We have not attempted to assess the costs and benefits of these, but costs and benefits of each option considered have been assessed against the do nothing option, which acts as our counterfactual.

Under the do nothing option, we assume non-compliance would continue in line with the current levels observed by Ofgem. Therefore we do not expect additional costs from this option. However, non-compliance represents a cost to society in the form of the foregone benefits from compliance. This is harmful to fair competition in the market and ultimately to consumers' outcomes.

Compliance orders

We have considered two options to address issues related to the length of investigation periods when compliance orders are issued. For the reasons outlined below, Option 1 is the preferred option against Option 2.

Option 1: Extend the investigation time limit

Provisional Orders are a key tool available to the Enforcement Team. They are used to require a regulated entity to do (or not do) something that is apparently non-compliant and causing damage to consumer interests.

Under this proposal, the investigation periods (after a provisional order and after a final order) would be extended in a number of ways, in order to allow sufficient evidence of breach to be gathered before procedural and penalty time limits expire, and to provide Ofgem with more time to check that firms have implemented Ofgem's requirements.

There is some uncertainty about the right length of time required as the complexity of investigations varies, and there is a balance between giving Ofgem enough time to

conduct a robust investigation, but without creating too much uncertainty for the companies involved. Ofgem considers that the suggested changes to the current statutory deadlines¹⁹ will be sufficient.

a) Benefits

Lengthening the investigation period would enable Ofgem to conduct more in-depth and effective investigations. This provision is aimed at removing the tension between the benefits of imposing an order to secure compliance, and potentially losing the opportunity to apply an appropriate deterrent penalty due to procedural time constraints. This should allow Ofgem to make better use of the order-making powers. Assuming companies continue to breach regulations at rates seen in recent years, we anticipate that Ofgem will make more orders in the future.

Ofgem has completed 84 investigations since 2002, an average of 6 a year, but has only issued 3 provisional orders and no final orders during this period.

It is difficult to know to what extent Ofgem will use the revised power. Although difficult to predict with a high degree of certainty, as a conservative estimate based on past experience, we estimate it might issue 1-2 provisional orders a year under the new provisions and 1 final order every year. This is a total number, not in addition to current levels. It should be noted that we do not anticipate an increase in the number of investigations as a result of this measure, more that provisional and final orders will be used more as an enforcement tool.

Where these investigations identify and substantiate breaches, these changes should result in better outcomes for consumers and better functioning markets for companies of all sizes within the sector. However we are unable to quantify the benefits of an extended investigative period as it will depend on the nature of the cases which we are unable to predict.

Better understanding of the causes of regulatory breaches and more comprehensive remedies will lead to more robust industry practices and reduced likelihood that breaches will be repeated. We are unable to quantify this effect.

Costs

There are two main parties that might experience additional costs as a result of these powers – Ofgem and companies under investigation. As noted above, we have assumed that Ofgem might issue 1-2 provisional orders a year under the new provisions and 1 final order every year. These should be however considered as conservative estimates. As the current limitations of orders would be removed, it is possible that there might be an increase in use of orders.

¹⁹ **Provisional Orders:**

i) Confirmation: Increase the current statutory time limit of 3 months so that Ofgem has 6 months to confirm a provisional order.
ii) Provisional Orders which are not confirmed: Increase the current statutory time limit of 6 months so that Ofgem has 18 months to issue a penalty notice from the date the PO is issued (linking to (i) above - this equates to 12 months from the date it would lapse if not confirmed).

iii) Confirmed Provisional Orders: Increase the current statutory time limit of 6 months so that Ofgem has 12 months to issue a penalty notice from the last date stated within the provisional order by which compliance is stipulated to be achieved, or from the date the order is revoked (whichever is the soonest).

Final Orders: Increase the current statutory time limit so that Ofgem has 6 months to issue a penalty notice from the last date stated within the final order by which compliance is stipulated to be achieved, or from the date the order is revoked if no date is stipulated.

i. Costs on Industry

Provisional and Final Orders may be made in relation to enforcement investigations of any licensed company, large or small. The nature and cost of each investigation varies greatly, dependent on the facts of the case. As mentioned above, we do not anticipate an increase in the number of Ofgem Investigations as a result of this measure, more that provisional and final orders will be used more as an enforcement tool and the investigative time associated with these Orders will increase. Increasing order time limits might increase uncertainty; we welcome views on this as part of the consultation.

Ofgem does not separately record the cost on industry of issuing an Order. We do not have any estimate of the cost that extended investigations might have on industry (extended investigation may benefit Industry through giving them more time to respond and comply) and are gathering this evidence as part of the consultation. We do not expect costs to be significant as Ofgem exercise proportionality with respect to investigations.

We note that in cases where Orders are substantiated with evidence supply companies are imposing additional costs on consumers and businesses and there should be an offsetting benefit in bringing them in compliance.

ii. Costs on Ofgem

Extended investigations are likely to be subsumed into Ofgem’s business as usual costs and we do not expect to see an increase in fees as a result of this measure largely because it is likely these matters would be investigated anyway, regardless of whether Ofgem is able to issue orders. This suggests that there is no opportunity cost in terms of work Ofgem does not pursue as a result of this power.

Overall Initial Assessment	<p>Overall all we expect this proposal to be generate a net benefit against the do nothing option.</p> <p>This provision is aimed at improving the quality of Ofgem’s investigations in more complex cases and should allow Ofgem to make better use of the order-making powers to bring licensees back into compliance more quickly. Where these investigations identify and substantiate breaches this should result in better outcomes for consumers and better functioning markets for companies of all sizes within the sector. Better understanding of the causes of regulatory breaches and more comprehensive remedies will lead to more robust industry practices and reduced likelihood that breaches will be repeated.</p> <p>Ofgem is required to exercise its regulatory activities in a transparent, accountable, proportionate, consistent manner, targeting only cases in which action is needed. Increased use of Provisional and Final Orders (and the extended investigative time) associated with them would help them meet this requirement.</p>
----------------------------	---

Option 2: Remove investigation time limit

An alternative to Option 1, which will be considered in the consultation, would be to remove the time limit set on each investigation period. While this proposal would give Ofgem as much time as needed to conduct each investigation on a case by case basis,

this proposal would have implications for firms involved as it would increase considerably the level of uncertainty around the length of the investigations.

a) *Benefits*

Similarly to Option 1, this option would allow Ofgem to conduct more in-depth and effective investigations, leading to better outcomes for consumers and better functioning markets for companies of all sizes within the sector, where these investigations identify and substantiate breaches.

Ofgem has suggested that an extension as set out in Option 1 would be sufficient to improve the quality of investigation; therefore we do not consider that Option 2 would generate any additional benefit on top of those generated by Option 1. For the same reasons as above, we are not able to quantify and monetize the benefits of increasing the length of the investigations and we aim to seek comments through the consultation

b) *Costs*

Similarly to Option 1, additional costs might be experienced by Ofgem and by companies under investigation, as a result of these powers. We have assumed that Ofgem might issue 1-2 provisional orders a year under the new provisions and 1 final order every two years. These should be however considered as conservative estimates. As the current limitations of orders would be removed, it is possible that there might be an increase in use of orders.

i. Costs on industry

The proposal might lead to a possibly considerable increase in uncertainty for businesses around the length of an order. Besides the risk of increases time and resource costs, should order length increase as a consequence of the proposals, the proposal would also increase the perceived risks of the regulatory burden. However, Ofgem’s view is that length of investigations in general would not increase as a consequence of this option.

ii. Costs on Ofgem

Under Option 2, there is a risk that the removal of time limits might create an incentive for Ofgem to increase the length of investigations, leading to increased costs for Ofgem and for industry, and potentially to lengthy and inefficient investigations.

We are not able to quantify and monetise the costs of this proposal, and we intend to seek views during the consultation.

Overall Initial Assessment	Overall all we expect this proposal to generate a net benefit against the do nothing, however, this options wold bear more risks than its alternative Option 1. . This is mainly due to the increased uncertainty around the length of investigations and potentially costs to businesses due to increased time and resources spent on the investigation. Similarly, Ofgem might face an
----------------------------	--

	increase in the time and resource spent on investigations, which would increase the opportunity cost of the proposal.
--	---

Option 3: Information Gathering for Unlicensed Supply

Currently, Ofgem has powers to compel licensed companies to provide information relevant to a regulatory investigation. However, those powers do not extend to unlicensed companies and that hinders effective investigation where a company is suspected of supplying energy without a licence.

Under the proposal, Ofgem would be given powers to enable it to compel the provision of information from organisations that appear to be operating in the market without the appropriate licence. Failure to comply with an information request would be an offence and subject to a sanction.

a) Benefits

The main benefit of this power is to enable Ofgem to identify and control unlicensed supply. Strengthening Ofgem's enforcement powers in this way would ensure that the regulator is able to ensure better outcomes for consumers and better functioning markets for companies of all sizes within the sector.

The proposal would contribute to ensuring competition in the market is fair, by stopping or preventing potential unlicensed suppliers from operating in the market to the detriment of existing market participants. The proposal would ensure all suppliers in the market are subject to the same monitoring and scrutiny by the market regulator and ensure all firms operating in the market comply with the regulatory standards.

There is a secondary benefit in that this might increase a greater deterrence to those considering supplying energy without the required license, thereby reducing the resulting harm to domestic and non-domestic customers. We are unable to quantify either of these benefits.

b) Costs

There are two main parties that might experience additional costs as a result of these powers – Ofgem and companies under investigation.

i. Costs on Industry

This provision will not place any additional burden on licenced suppliers, given that it is very easy for a business to demonstrate compliance by producing its licence. Assuming that complying with an information request will cost a fixed amount, small businesses might be affected more than larger firms as a proportion of their net worth. However, we do not expect the requests to be onerous in the majority of cases, and therefore the impact on small businesses should not be significant, but we welcome views on this as part of the consultation. This power would be directed only at companies whose activities give rise to suspicions that they may be supplying energy without an appropriate licence. Based on Ofgem's experience to date, this is only ever likely to be a small number.

We are unable to estimate the costs of these requests (and it should be noted that this information may be viewed as commercially sensitive by companies) and their number. We welcome evidence on this as part of the Consultation. However we note that in cases where companies are found to be supplying without a licenses they are imposing additional costs on consumers and businesses and there should be an offsetting benefit in bringing them in compliance.

It should be noted that if companies were in full compliance this proposal would have no net costs or benefits.

There is a low risk of costs arising from information requests directed at companies which appeared to be, but are eventually found not to be operating in the market. This should be rare. We would welcome evidence on this risk, as well as possible other risks, as part of the Consultation.

ii. *Costs on Ofgem*

Additional information requests are likely to be subsumed into Ofgem's business as usual costs and we do not see an increase in fees as a result of this measure. This is because, while unlicensed suppliers have the potential to undermine Ofgem's enforcement regime, Ofgem has rarely detected evidence of firms operating without an appropriate licence to date. Therefore, the expected volume of new work that would result from exercising this power is expected to displace a negligible amount of the overall workload of the Enforcement Team. Therefore, Ofgem's view is that there is unlikely to be a measureable opportunity cost in terms of work Ofgem does not pursue as a result of this power.

iii. *Costs to the Criminal Justice System*

The introduction of sanctions could generate a cost for the Criminal Justice System (CJS). The overall impact would depend on whether the sanction is a criminal or a civil offence and the number of cases taken to court. Given past experience, we do not anticipate the number of cases to increase significantly and therefore have a considerable impact on the CJS. For criminal sanctions, we would expect costs to arise from court costs, and possibly legal aid, but not from prison and probation costs as the sanction would not include a custodial sentence. These costs have not yet been monetised but we intend to work with the Ministry of Justice going forward to obtain estimates of the costs of additional prosecutions (both for the new offences and also for those energy market participants operating in the market without a license). For civil sanctions, there could be an impact on the civil court system. Court costs would be recovered from fees charged to applicants.

Initial Overall Assessment	<p>Overall all we expect this proposal to generate a net benefit against the do nothing option.</p> <p>The purpose of this proposal is to enable Ofgem to identify cases where companies are acting illegally. Full compliance would have no costs on Ofgem, industry or society.</p> <p>Ofgem is required to exercises its regulatory activities in a transparent, accountable, proportionate, consistent manner, targeting only cases in which action is needed.</p>
----------------------------	--

Option 4: Special Audit Requirements

Under this proposal, we would give Ofgem the statutory powers to compel parties to appoint suitably qualified third parties to carry out audits as part of Ofgem's investigations into allegations of non-compliance, and for the cost of that work to be borne by the firm under investigation.

Such a power would increase the capacity of the enforcement team to carry out more targeted enforcement and would provide a means of engaging specialist skills needed too infrequently to justify the recruitment of suitably qualified permanent staff²⁰. Such a power already exists in the banking and finance sector and is used frequently and successfully by the FCA²¹.

The use of specialist external expertise will allow Ofgem to conduct investigations faster and in a more focussed way responding to variable workloads.

a) Benefits

We anticipate benefits to society as a result of this proposal. Strengthening Ofgem's enforcement powers in this way would ensure that the regulator is able to ensure better outcomes for consumers and better functioning markets for companies of all sizes within the sector.

In addition Ofgem believe this will result in speedier investigations which will reduce the amount of time a company being investigated will experience disruption and uncertainty. This will have a positive benefit for companies being investigated through three ways:

- Using specialist external expertise could lead to more focussed and shorter investigations that produce better insight into a compliance problem or remedy, reducing disruption and uncertainty for the licensee during the investigation and increasing certainty that the problem had been dealt with effectively and wouldn't recur (a benefit to the consumer). .
- More focussed enquiries will ensure the resources required to respond to information requests will be optimised, this may also lower information requests to industry as a whole. We are unable to quantify this benefit at this stage.

b) Costs

Companies under investigation might experience additional costs as a result of these powers. We do not expect this option to generate additional costs for Ofgem.

i. Costs on Industry

The cost of special audits will be borne by the firm under investigation. In order to estimate these costs on industry we need to know:

- a) The cost of an special audit

²⁰ An example might be staff with ICT or management consultancy skills required to assess the reasonableness of actions taken by an energy firm to confirm the functionality of a new billing system prior to launch, or auditing skills required to assess whether a target was met or how many items were delivered

²¹ Financial Conduct Authority, Skilled Persons Reviews (s166 and s166A)

- b) How often they will be used
- c) How often compliant firms might be captured

Evidence about these is explored in more detail, in order, below.

d) The cost of an special audit

It is not possible to give a single indicative cost for these investigations at this stage. The cost will vary greatly depending on a number of factors. The following scenarios will illustrate.

- At one end of the spectrum, Ofgem might commission a forensic accountant to audit the accounts of a small organisation. Given the third-party's expertise and the high degree of organisation required in relation to financial accounts, we might expect this task to be straightforward, swift and not overly costly.
- At the other end of the spectrum, Ofgem might wish to commission a team with specialist expertise in the implementation of enterprise IT systems. The size of such projects, the lack of a completely standard approach to programme implementation, and inherent organisational differences are factors likely to result in a less straightforward, longer and more costly exercise.
- Between these two examples, Ofgem could envisage a range of scenarios with variables such as the size of organisation; whether they are seeking structured or unstructured data; whether the licensee has the required information in a readily accessible form or needs to process pre-cursor data or derive it from email threads; the levels of authorisation required within the licensee company before it is released (some of Ofgem's information requests are processed by a company's compliance staff, some needs to be signed-off by the Finance Director or even CEO).

Based on experience of using audits in the enforcement context, Ofgem estimates that special audits at the high end of the spectrum might cost in the tens of thousands of pounds. We also note that some firms have voluntarily done special audits in the past, suggesting that they see the benefit of the exercise.

e) How often they will be used

Ofgem intends to issue guidance setting out the circumstances in which the special audit requirements would be used, as a safeguard against indiscriminate use. The number of times the powers will need to be used will depend on the nature of the cases that have to be investigated.

We currently do not have any estimates on the number of times this power might be used and the cost of these special audits. We welcome evidence on this as part of the consultation.

f) How often compliant firms might be captured

There may be circumstances in which Ofgem commissions an audit and it finds that the company is in fact compliant. Ofgem intends to use this power only in cases with sufficient prima facie indications of wrongdoing, so that the possibility of cases that ultimately result in a finding of compliance are minimised. However, this possibility cannot be eliminated completely. This could generate some additional costs to firms that are audited and then found compliant.

We would welcome evidence on the risk that companies are asked to bear the cost of a special audit, but eventually found compliant as part of the Consultation. Costs to compliant firms will be considered in scope of OITO (see more in later section). We are planning to calculate this cost to businesses for the final Impact Assessment supporting of these proposals.

Overall, we are seeking evidence from industry on special audits as part of this consultation. However we note that in cases where companies are found to be non-compliant they are imposing additional costs on consumers and businesses and there should be an offsetting benefit in bringing them into compliance.

As mentioned before, the practice of special audit has already been adopted by the FCA. While evidence is available on the impact of special audit in the financial sector, we do not consider it appropriate to draw comparisons between the financial and the energy industries. This is because the FCA regulates a far wider range of products than Ofgem and financial products can be far more bespoke than gas and electricity contracts. Examples of products traded in the financial sectors are prudential products and investment products such as securities and futures. Issues related to activities in the financial sector are therefore more complex and bear higher risks than those likely to be considered in the energy sectors, such as mis-selling and complaints handling. We therefore consider that the auditing process in the financial sector would be more complex, and more expensive, than in the energy sector.

ii. *Costs on Ofgem*

Operating this power would be associated with periodic costs due to the tendering for places on any framework which might be introduced, however these costs are likely to be minimal and likely to be subsumed into Ofgem’s business as usual costs. The use of special audits might also reduce costs of enforcement work that Ofgem has to do itself. We do not foresee an increase in fees and a measureable opportunity cost, in terms of work Ofgem does not pursue, as a result of this power.

Initial Overall Assessment	<p>Overall all we expect this proposal to generate a net benefit against the do nothing option.</p> <p>Strengthening Ofgem’s enforcement powers in this way would ensure that the regulator is able to ensure better outcomes for consumers and better functioning markets for companies of all sizes within the sector. In addition Ofgem believe this will result in speedier investigations which will reduce the amount of time a company being investigated will experience disruption and uncertainty.</p> <p>Ofgem is required to exercise its regulatory activities in a transparent, accountable, proportionate, consistent manner, targeting only cases in which action is needed.</p>
----------------------------	--

Penalties for Regulatory Breaches

We have considered three options to address issues related to penalties of regulatory breaches when firms have no turnover. For the reasons outlined below, Option 7 is the preferred option against Option 6 and Option 5.

Option 5: Remove 10% turnover cap on Gas and Electricity Act penalties

As an alternative to Options 6 and 7 we consider a change to the penalty provision whereby Ofgem would be allowed to impose a penalty reasonable to all the circumstances of the

case. Under this proposal, the 10% of turnover limit would be removed. The financial services sector does not apply the 10% ceiling but the regulator, the FCA, can impose a reasonable penalty which seeks to ensure that the regulated firm does not benefit from the breach, that wrongdoing is penalised and that there is a deterrent effect on the firm in question as well as other market participants. We would anticipate similar factors applying if the 10% ceiling were removed in gas and electricity markets (although it should be noted that current penalty provisions already provide for reasonable penalties that can take account of these factors).

a) Benefits

This proposal would allow Ofgem to consider each regulatory breach on a case by case basis, so that all types of firms in the industry would be subject to penalty. The proposal would close a gap in the system that has the potential to undermine the integrity of the enforcement regime, by ensuring a level playing field in the market as all firms that breach regulation would face fine penalties, rather than a situation where some firms can be fined and others cannot. This would be beneficial for competition. We are unable to quantify these benefits at this stage.

b) Costs

Depending on the design of the option, the proposal might increase uncertainty for the firms involved. Ofgem’s principal objective is to protect the interests of existing and future gas and electricity consumers²². It is required to carry out all of its functions under the Acts, including taking any decisions in relation to financial penalties and consumer redress, in the manner that it considers is best calculated to further its principal objective.

Initial Overall Assessment	<p>Overall all we expect this proposal to generate limited net benefits against the do nothing option. This option could result in higher uncertainty for industry participants than its alternative Option 5. The proposal would ensure a level playing field in the market as all firms that breach regulation would face fine penalties, rather than a situation where some firms can be fined and others cannot; this could be beneficial for competition.</p> <p>However, the lack of clear criteria on the upper limit of penalties would risk increasing uncertainty and the perceived regulatory burden in the industry.</p>
----------------------------	--

Option 6: Retain 10% turnover formula but for firms with little or no turnover allow Ofgem to impose a fine up to a fixed amount.

Ofgem can currently impose a fine of up to 10% of turnover, when a licensee is found to be not compliant with requirements. However, recent experience²³ has shown that subsidiaries with no turnover can fall non-compliant with regulatory requirements, and Ofgem is not able to impose fines on parent companies. Under this proposal, if a firm has

²² Section 4AA of the Gas Act and section 3A of the Electricity Act

²³ <https://www.ofgem.gov.uk/publications-and-updates/investigation-uk-capacity-reserve-limited-s-compliance-rule-5-13-1b-capacity-market-rules>

no or low turnover, Ofgem would be allowed to be able to impose a penalty which is reasonable to all the circumstances of the case but is capped at a specified limit.

Based on experience to date, Ofgem estimate this issue might arise two or three times per year

This measure is therefore expected to increase the fine revenue collected by Ofgem. This is a transfer from industry to society (via HMT).

a) Benefits

The proposal would close a gap in the system that has the potential to undermine the integrity of the enforcement regime, by ensuring a level playing field in the market as all firms that breach regulation would face fine penalties, rather than a situation where some firms can be fined and others cannot. This would be beneficial for competition.

We are unable to quantify these benefits at this stage. We are seeking evidence through the consultation on what the maximum penalty amount should be.

b) Costs

There are no direct costs associated with this proposal. Under a central scenario we would assume that industry is in full compliance and this proposal results in no change. If more companies come under scope this measure is expected to increase the fine revenue collected by Ofgem on non-compliant firms. This is a transfer from industry to society. While transfers might give rise to distributional impacts, they are not a source of direct economic costs. Hence we have not quantified this amount.

The policy design is currently not clear on what is meant by “little turnover”. This should be further specified during the course of the consultation as there might be risks in terms of increases uncertainty for small business if clear guidance is not provide, should the provisions be introduced.

Initial Overall Assessment	<p>Overall all we expect this proposal to have limited net benefit against the do nothing option.</p> <p>The proposal would ensure a level playing field in the market as all firms that breach regulation would face financial penalties, rather than a situation where some firms can be fined and others cannot; this could be beneficial for competition.</p> <p>There are no direct costs associated with this proposal. Under a central scenario we would assume that industry is in full compliance and this proposal results in no change.</p>
----------------------------	--

Option 7: Retain 10% turnover cap but for firms with little or no turnover, which have a parent company, allow Ofgem to impose the 10% rule to the parent company.

Under this proposal, as per Option 6, the 10% formula would be retained and Ofgem would be able to impose a fine up to a capped fixed amount for firms with no turnover. In addition, where firms with little or no turnover have a parent company or belong to a group, Ofgem would be able to take the parent company or group turnover into account when applying the 10% rule.

Based on experience to date, Ofgem estimate this issue might arise two or three times per year

This measure is therefore expected to increase the fine revenue collected by Ofgem. This is a transfer from industry to society.

a) Benefits

As per Option 6, this option should introduce a level playing field where all firms are treated fairly and face fine penalties, if found in breach of regulation.

We have considered whether this could have an impact on the incentive to set up subsidiaries. We note that there are benefits associated with subsidiaries from a company point of view, and would not want to alter these. If a company is setting up a subsidiary which is intended to be in full compliance, it should have no impact as there should be no change in the compliance risk faced by the subsidiary. However, if a company is setting up a subsidiary where they think they might be in high risk of non-compliance, this proposal should act to remove the incentive to do this, which would represent a potential benefit to the market. If companies were in full compliance this proposal would have no changes to the incentives or net costs or benefits.

b) Costs

As per Option 6, we assume that in a central scenario firms should be fully compliant and therefore face no additional costs from this option.

As per Option 6, the policy design is currently not clear on what is meant by “little turnover”. This should be further specified during the course of the consultation as there might be risks in terms of increases uncertainty for small business if clear guidance is not provided, should the provisions be introduced.

Initial Overall Assessment	<p>Overall all we expect this proposal to have limited net benefit against the do nothing option.</p> <p>The proposal would ensure a level playing field in the market as all firms that breach regulation would face similar penalties, rather than a situation where some firms can be fined and others cannot; this could be beneficial for competition.</p> <p>There are no direct costs associated with this proposal. Under a central scenario we would assume that industry is in full compliance and this proposal results in no change.</p>
----------------------------	--

Option 8: Change REMIT information gathering and create information gateways with the CMA.

The EU REMIT regulation prohibits insider trading and market manipulation in wholesale energy markets across the EU and the Enforcement Regulations gave Ofgem the ability to impose unlimited financial penalties, access to information and the power to enter premises. Under the regulations, Ofgem has the power to remove documents appearing to be of the relevant kind when undertaking a search of premises under warrant.

However, Ofgem has no current power to take away an entire body of documents in order to sift them off the premises. We are proposing that if it is not “reasonably practicable” to undertake the separation of relevant from irrelevant documents on the premises, Ofgem should have a power to seize all of the material in order to carry out the examination and separation (or “sifting”) of the material elsewhere. This will improve Ofgem’s ability to investigate allegations.

The purpose of this proposal is therefore to reduce the risk that evidence of significant wrongdoing is not brought to light because it is hidden within a larger body of information.

The information gateway between Ofgem and the Competition and Markets Authority (CMA) would enable the CMA to pass on to Ofgem information about potential breaches of the REMIT regulations or other information that might be relevant to monitoring and investigation under these regulations.

Taken together, these proposals would mean that Ofgem would be better able to obtain information and evidence that will enable it to enforce the REMIT regulations, and facilitate efficient performance of its other statutory functions.

a) Benefits

Ofgem are already able to remove relevant documentation to investigate allegations under the current regulations but, under this proposal, they would be able to seize and sift physical and electronic files off site in order to identify relevant documents which would enhance their ability to establish whether an offence has occurred, and prevent Ofgem from missing critical evidence.

It is possible that this will result in an increase in breaches found by Ofgem. This could encourage greater compliance, which could lead to a decrease in breaches in the long term.

We were unable to quantify the benefits to the market. However, strengthening Ofgem’s enforcement powers in this way would ensure that the regulator is able to ensure better outcomes for consumers and better functioning markets for companies of all sizes within the sector.

In addition, regarding the power to seize and sift information, there may be a small benefit to business under investigation in that there may be a reduction in time Ofgem spends at their offices. We have not quantified this benefit.

The benefits would be further strengthened by allowing the CMA to share relevant information for an investigation with Ofgem.

b) Costs

The main parties that might experience additional costs as a result of these powers are Ofgem, the CMA and companies under investigation.

i. Costs on Ofgem

Ofgem are likely to spend more time examining documentation as part of their investigations. This is expected to be subsumed into Ofgem’s business as usual costs and we do not see an increase in fees as a result of this measure. This is because the

time required to sift is not significant in relation to the time that would have to be spent at the premises to retrieve the information, so that the introduction of this measure is not expected to add significantly to the REMIT investigation team’s overall workload. Therefore, it is unlikely for a measureable opportunity cost to arise in terms of work Ofgem does not pursue as a result of this power. In addition, any additional cost resulting from this measure is likely to be offset by corresponding reductions in work associated with pursuing cases with a better evidence base.

ii. Costs on CMA

The CMA will face some costs in passing on information to Ofgem, but we do not expect this to be significant.

We do not expect there to be any extra costs to industry as a result of these measures as this does not increase the level of requirements on the companies.

As per Option 5 and Option 6, the policy design is currently not clear on what is meant by “little turnover”. This should be further specified during the course of the consultation as there might be risks in terms of increases uncertainty for small business if clear guidance is not provide, should the provisions be introduced.

Initial Overall Assessment	<p>Overall all we expect this proposal to have a net benefit against the do nothing option.</p> <p>Ofgem are already able to remove relevant documentation to investigate allegations under the current regulations but, under this proposal, they would be able to seize and sift physical and electronic files off site in order to identify relevant documents which would enhance their ability to establish whether an offence has occurred. This effect would be further strengthened by allowing the CMA to share relevant information for an investigation with Ofgem.</p> <p>Strengthening Ofgem’s enforcement powers in this way would ensure that the regulator is able to ensure better outcomes for consumers and better functioning markets for companies of all sizes within the sector. There may be a small benefit to business under investigation in that there may be a reduction in time Ofgem spends at their offices. We do not expect there to be any extra costs to industry as a result of these measures as this does not increase the level of requirements on the companies.</p>
----------------------------	---

Option 9: “Package of Options”

Under this option, DECC/SoS would provide Ofgem with a number of powers including:

Option 1: Compliance Orders – Extend Investigation period.
Option 3: Information gathering for unlicensed supply
Option 4: Special Audit Arrangements
Option 6 or 7: Penalties for Regulatory Breaches – Retain 10% formula with special provisions for firms with little or no turnover.
Option 8: Change REMIT information gathering, and CMA information gateway

We have described the costs and benefits of the individual options above. Regarding compliance orders, between Option 1 (extend investigation period) and Option 2 (remove investigation period), we have suggested that Option 1 would be the preferred option. Regarding penalties for regulatory breaches, between Option 5 (remove 10% formula) Option 6 (retain 10% formula and introduce special provisions for firms with no turnover) and Option 7 (remove 10% formula and take group turnover into account where applicable) we have suggested that Option 6 or Option 7 would be the preferred option.

As all options identified in the package are intended to address separate and independent issues, we consider that a package implementing several proposals would be the most beneficial solution for the consumer. This would allow a comprehensive improvement of Ofgem enforcement powers that tackles all issues recently identified by Ofgem. Introducing only some of the proposals would only address some of the issues identified, but not all, leaving unsolved problems ultimately to the detriment of consumer benefits.

a) Benefits

Benefits to Ofgem include:

- Extending procedural time limits enabling Ofgem's to conduct more in-depth and effective investigations while retaining the ability to impose penalty thereby allowing Ofgem to make better use of the order-making powers.
- Enable Ofgem to identify and control unlicensed supply.
- Seize and sift physical and electronic files off site in order to identify relevant documents which would enhance their ability to establish whether an offence has occurred.

Benefits to society include:

- Ensuring competition in the market is fairer, by stopping or preventing potential unlicensed suppliers from operating in the market to the detriment of existing market participants. The proposal would ensure all suppliers in the market are subject to the same monitoring and scrutiny by the market regulator and ensure all firms operating in the market comply with the regulatory standards.
- There is a secondary benefit from creating greater deterrence to those considering supplying energy without the required license, thereby reducing the resulting harm to domestic and non-domestic customers.
- Better understanding of the causes of regulatory breaches and more comprehensive remedies will lead to more robust industry practices and reduced likelihood that breaches will be repeated.
- Benefits to society also accrue from improving the efficiency and skills of the regulator Ofgem.

Benefits to Companies include:

- The introduction of special audit would result in speedier investigations which will reduce the amount of time a company being investigated will experience disruption and uncertainty.
- More focussed enquiries will ensure the resources required to respond to information requests will be optimised, this may also lower information requests to industry as a whole.
- Ensure a level playing field in the market as all firms that breach regulation would face financial penalties, rather than a situation where some firms can be fined and others cannot; this could be beneficial for competition.
- Increased skills available to Ofgem.

b) Costs

i. Costs on Industry

An increase in the costs experienced by firms suspected of being non-compliant associated with longer investigations associated with compliance orders, special audits and information requests. We have been unable to cost these at this stage.

We are seeking evidence from industry on this as part of this consultation. However we note that in cases where companies are found to be non-compliant they are imposing additional costs on consumers and businesses and there should be an offsetting benefit in bringing them in compliance.

It should be noted that if companies were in full compliance these proposals would have no net costs or benefits.

ii. Costs on Ofgem

As explained in the individual options, additional administrative and enforcement work is likely to be subsumed into Ofgem’s business as usual costs and we do not see an increase in fees as a result of this measure. Similarly, Ofgem’s view is that there is unlikely to be a measureable opportunity cost in terms of work Ofgem does not pursue as a result of this power.

Initial Overall Assessment	<p>Overall all we expect this proposal to be generate a net benefit against the do nothing option.</p> <p>These provisions are intended to improve the quality of Ofgem’s investigations and enable them to have tools to deal with breaches more effectively.</p> <p>Where these investigations identify and substantiate breaches should result in better outcomes for consumers and better functioning markets for companies of all sizes within the sector. Better understanding of the causes of regulatory breaches and more comprehensive remedies will lead to more robust industry practices and reduced likelihood that breaches will be repeated.</p> <p>Ofgem is required to exercises its regulatory activities in a transparent, accountable, proportionate, consistent manner, targeting only cases in which action is needed.</p>
----------------------------	---

Risks and Assumptions

DECC intends to gather further information on costs and benefits, including risks, associated with each proposal from market participants during the course of the Consultation accompanying this Impact Assessment.

Business Impacts and One in Two Out (OITO)

Activities of independent regulators are not in scope of the business impact target, therefore policies relating to specific enforcement actions are out of scope of OITO. However costs arising from the enforcement that falls on compliant firms are in scope of OITO.

Therefore, we consider that the only Option proposed that falls in scope of OITO is Option 4 on Special Audit, as it could have an impact on compliant firms. Table 3 summarises the Options and whether they are in or out of scope of OITO.

Table 3: In or Out of Scope Options

	Option	In or out of scope of OITO
1	Option 1: Compliance Orders – extend investigation time limit.	OUT
2	Option 2: Compliance Orders – remove investigation time limit.	OUT
3	Option 3: Information gathering for unlicensed supply	OUT
4	Option 4: Special Audit Arrangements	IN
5	Option 5: Penalties for Regulatory Breaches – remove 10% turnover formula.	OUT
6	Option 6: Retain 10% turnover formula but for firms with no turnover allow Ofgem to impose a fine up to a fixed amount	OUT
7	Option 7: Retain 10% turnover formula but for firms with little or no turnover, which have a parent company, allow Ofgem to impose the 10% rule to the parent company.	OUT
8	Option 7: Change REMIT information gathering	OUT
9	Option 8: Package of options. Includes: <ul style="list-style-type: none"> • Option 1 • Option 3 • Option 4 • Option 6 or 7 • Option 8. 	IN (Because it includes Option 4 on Special Audit Arrangements)

In order to understand the impact on businesses of special audit, we would need information on:

- a) **The cost of special audit:** ideally we would want to estimate a range of minimum and maximum cost of a special audit. This could be done in two ways: we could use an auditor's average daily fee and multiply by a minimum and a maximum length of auditing period. Alternatively, we could use a high and a low estimate of an auditor's daily fee and multiply the high fee times the longest auditing period as upper estimate, and multiply the low estimate times the shortest auditing period. This second approach would give a wider range. Which approach to take depends on what terms will be used to set the auditor's fees.
- b) **The number of special audits issued:** this is going to be difficult to anticipate. As an approximation, we could ask firms how often, on an annual average, they have engaged a 3rd party to provide information to Ofgem. This would be compared to Ofgem records.
- c) **The proportion of audited firms that are found compliant:** this is also going to be difficult to anticipate. As an approximation, we could ask firms how often, on an annual average, they are subject to an investigation by Ofgem and eventually found compliant to regulations. This would be compared to Ofgem records.

Small and Micro Business Assessment (SaMBA)

Smaller suppliers do fall within scope of these proposals and Ofgem has taken enforcement action against them in the past, although most action has been taken against breaches of larger suppliers and network operators. In general, our proposals would benefit non-domestic consumers as well as domestic ones. The impacts on licensees who are compliant with regulatory requirements should be minimal but we should accept that there is possibly a higher risk that smaller businesses or new entrants with relatively smaller resource or expertise will be subject to enforcement action as a result of the market diversifying and more new entrants appearing.

With the consultation, we are seeking feedback from businesses of all sizes, including small and micro businesses. As part of the responses review process, we intend to capture the impacts of the proposals on small scale businesses and we will provide details of this in a final stage IA.

Wider impacts

We have considered wider impacts relevant for the impact on competition and consumer confidence in the market, as we consider these to be the most relevant ones in this context. We have not identified main effects in terms of social and environmental impacts; however, we will review these in light of the consultation responses and incorporate changes to the final Impact Assessment supporting legislation on these measures.

The wider impacts we have considered are:

- **Barriers to entry/exit in the market:**
As the proposals aim at ensuring a level playing field for all market participants, they would lead to an improvement in competition, including benefits to market entry and exit. For example, a potential new entrant prone to compliance would not feel threatened by

the possibility of other firms not complying with industry requirements while not being caught and punished by the market regulator.

This should not increase the costs to compliant businesses and therefore have no impact on barriers to entry or exit. In particular, the options have not been designed to disadvantage firms of any particular size compared to others (e.g. smaller versus larger suppliers). We therefore do not expect different impact on firms of different size.

- **Consumer confidence:**

As the proposals are aimed at improving competition and further ensuring consumers' protection, consumer confidence should increase as a consequence of the introduction of the proposals. However, the extent to which consumers' confidence might increase depends on the scale of non-compliance cases prevented, and whether improvements in the market are perceived and recognised by consumers.