



**Consumer
Focus**
Campaigning for a fair deal

Response to DECC call for evidence: review of Ofgem

September 2010

Consumer Focus

Consumer Focus is the independent champion for consumers across Britain and for postal consumers in Northern Ireland. We operate across the whole of the economy, persuading businesses and public services to put consumers at the heart of what they do.

We are a statutory organisation that works in a devolved setting, with work priorities varying across different parts of the country, by all working to common strategic goals.

Through campaigning, advocacy and research, we champion consumers' interests in private and public sectors by working to secure fairer markets, greater value for money, and improved customer service. We have a particular focus on the interests of consumers in markets that are 'designated' by Government as requiring additional consumer advocacy. Currently these include energy and postal service consumers. We also have a commitment to work on behalf of vulnerable and disadvantaged consumers, and a duty to work on issues of sustainable development.

Ofgem review: call for evidence

The environment is challenging for energy consumers. Although the performance of the regulator has improved in the last couple of years some persistent problems remain to be addressed. Fuel poverty is at record levels as policy increasingly struggles to balance affordability, security of supply and sustainability. Concerns around sales standards and the complexity (and configuration) of tariffs remain acute. Wholesale power markets are illiquid and opaque market arrangements make it hard to have confidence that significant drops in suppliers' costs have been fully passed on to bill-weary consumers.

Now more than ever consumers need an accountable, effective regulator who protects and promotes their interests.

A review of the scope and nature of regulation is timely. We are pleased to respond to DECC's call for evidence. We set out initial views against the terms of reference later in this document, but first set out the wider context in which they should be considered.

Delivery is a part of the policy process

One of the fundamental challenges for the review will be to set the boundaries for what matters should rest with Government and which should rest with the sectoral regulator.

Some may argue that there should be a clear delineation between Government and the regulator, with the former holding sole responsibility for creating policy and the latter purely responsible for implementing those policies. We doubt that such a clear division of responsibilities could ever be entirely achievable because in practice much of the benefit and cost (in all senses, social and environmental as well as financial) of any given policy is derived from how it is implemented. It is inevitable that the regulator will have a role in developing energy policy as the delivery choices it makes may facilitate, or impede, any broader strategic goals that are set by government.

A broad versus a narrow remit

There will naturally be a focus on the existing statutory duties of the regulator. Are these too wide? Is it realistic to expect it to make the trade-off between potentially conflicting duties or are these political rather than regulatory matters?

Over time there has been a significant broadening of Ofgem's statutory duties, most notably to include matters relating to the environment and sustainability; and to balance the interests of current and future consumers. This has led to tensions where trade-offs may be necessary between its different duties. For example, its work on Project Discovery highlighted a range of scenarios for the future development of the sector in which affordability, security of supply and sustainability may not go hand-in-hand. In areas such as transmission access, this conflict has resulted in a lack of clarity as to whether DECC or Ofgem is leading on policy development.

The existence of tension is not new, Ofgem has long held social as well as economic duties, but it has grown as its remit has grown.

There is a powerful case to suggest that decisions on such trade-offs are essentially political ones and should be taken by ministers to ensure democratic accountability.

We think that there are a wide range of areas where this is clearly so; for example in areas such as social price support and decisions on carbon targets. Decisions about

equity and social justice are essentially value laden judgements that should reflect the wishes of the public as expressed through the democratic process.

But we think it would be a step too far to roll-back Ofgem's duties such that it purely concentrated on economic regulation. Narrowing its considerations such that they do not reflect society's broader aspirations would increase the chances of its decisions coming in to conflict with Government, not reduce them. The regulator has a crucial role to play in helping deliver society's wider goals and it is right that its duties reflect this.

There is therefore a need to find ways to manage the tension better. We think one such way is through the construction of a clear upfront mandate for regulation.

A mandate for regulation

We explored how such a mandate might work in our publication 'Regulating in the consumer interest'¹.

Clarity over roles must start with parliament ensuring that the regulator has a clear statutory basis. This should include straightforward regulatory objectives to ensure it has a sense of purpose. Protecting consumers must take priority over objectives such as promoting competition, which is a means rather than an end – competition often benefits consumers, which is why it is important, but it is not an objective in its own right.

Underneath the statutes, it is important to have clarity over the medium and long-term outcomes that departments and regulators are working towards, in order to fulfil the statutory objectives. This requires Government and regulators to engage at a strategic level, rather than simply on individual issues.

This could mean every Government department publishing a strategic policy document for each regulated area within its remit. This document should be applicable for a fixed term, perhaps 5-7 years, to provide continuity and stability in policy goals. It could spell out the Government's visions and objectives for the sector; what it intends to do to give effect to that vision; what it expects the regulator to do; and how it intends to ensure co-ordination of these two parallel streams of work. This would draw the Government out to say what it wants to achieve and provide an accountability framework against which the regulator's performance can be assessed.

There should also be clarity as to how the day-to-day relationship between departments and regulators operates in practice. This might take the form of a 'regulatory contract' between Government and the regulator, outlining who is doing what and what resources each will have to ensure that this work is done as efficiently and effectively as possible.

Each of these documents should be in the public domain. Select committees could question representatives from each actor to assure themselves that the work is allocated and co-ordinated appropriately.

To merge, to migrate, to marry or to maintain?

The review asks where the boundaries should lie between Ofgem and the Office of Fair Trading (OFT) implying that there may be a need for some migration of responsibilities between the two.

We hold the OFT in high regard and consider that it has won itself a well justified reputation as a credible, muscular regulator with a decent track record of promoting consumers' interests. Migrating powers between the bodies would not be without risk however; there would probably be transition inefficiencies and an inevitable loss of sectoral focus.

¹ March 2010, <http://consumerfocus.org.uk/g/4m7>

You may also wish to look at where the boundaries lie between Ofgem and the other utility regulators. Many of the challenges that they face are similar and there are areas where the current delineation between sectors is somewhat artificial. For example, in principle there is no reason why the smart meter communications infrastructure being developed in the energy sector could not also service metered water consumers, potentially reducing the cost of meter reading in that sector and increasing customers understanding of their water use. Water and energy share obvious other points of contact such as around the use of waste to create biogas and fire renewable electricity generation, and the approach taken to price-controlling monopoly network infrastructure.

This should not be interpreted as a call for merger; there are strong arguments both for and against such a step. But it is a call for these arguments to be considered in the course of the review. In areas where the interests of currently separate sectoral regulators overlap, the Government should consider how best to ensure that a joined-up approach is taken to tackling those issues going forward.

We think that the diagnosis of the problem should drive the nature of the remedies emerging from the review. If the Government considers that Ofgem has the wrong duties or scope it should seek to reform these. If however it thinks that it has the right duties or scope but is simply failing to perform adequately then it should seek to challenge the under-performance rather than reform – moving duties to the OFT or in to DECC would carry its own risks and would not tackle behavioural failure.

The coming years will see fundamental changes in the energy sector, not least through the introduction of smart metering and grids and the need to decarbonise energy production and use. Energy consumers have never needed a strong regulator more than they do now, so the review will need to be careful to ensure that any transition to new arrangements does not create a decision making vacuum, preventing or postponing necessary market reforms.

Ensuring enduring accountability

Consumer Focus, and its predecessor body energywatch, has been critical of aspects of Ofgem's work but we must give it credit for having markedly improved its performance in the last couple of years. Its energy supply probe showed a welcome willingness to challenge the preceding seemingly one-directional nature of regulation – that consumer protection would only ever be diluted and never strengthened. Its RPI-X@20 project was similarly impressive in the boldness and clarity of its thinking, although it is too early to judge the practical effectiveness of the measures it will introduce.

We think it is no coincidence that this upswing in performance has coincided with it being subject to an unprecedented degree of scrutiny by parliamentarians and other stakeholders, culminating in this review. While this improvement is welcome, we would like to see regulators being competent as a matter of course and not simply under duress.

The National Audit Office's 'Review of the UK competition landscape'² ably highlighted that there is a systemic unwillingness of British utility regulators to expose themselves to scrutiny by independent competition authorities. Ofgem, Ofwat, Ofcom and the ORR have collectively only made one market reference to the Competition Commission since 2002 while the OFT made nine during that period. The energy sector has never been subject to a market referral, despite considerable (and continuing) evidence of dysfunction. It is now a decade since a disputed energy licence condition was last referred to the Competition Commission.

² March 2010, <http://bit.ly/aVPL2P>

As Peter Freeman, Chairman of the Competition Commission, has highlighted, ‘all the regulators need to be able credibly to threaten a CC reference if they are to achieve any sort of settlement which is worth having. The longer a sector goes without a reference, the less credible that threat becomes, and the more the regulatory system as a whole comes under scrutiny and pressure’³. Sector regulators have made little use of powers under the Competition Act 1998 to the extent that the NAO recommends that ‘the Government should evaluate whether the incentives within the system for Regulators to use their competition powers are appropriate to establish the body of case law required for an effective competition system’.

We think it is time to look again at the nature of market referral powers to see if they should be changed. We recommend that there should be periodic independent review of the state of competition in the energy sector to ensure that accountability remains after the spotlight brought by this review has moved on.

³ <http://bit.ly/aYAzD9>

Terms of reference: initial views

First term of reference: ‘the Government’s objectives for independent regulation of the energy sector, taking account both of the Government’s broader principles for economic regulation and its energy and climate change objectives’

Second term of reference: ‘the boundary of responsibility between Ofgem and Government, reflecting the need for clarity, accountability for strategic choices, and for Ofgem’s regulatory decisions to remain independent of Government so as to provide a stable and predictable regulatory regime’

We provide a combined view on these terms of reference as we consider these matters are difficult to separate; boundaries should be driven by objectives.

Independent regulation is an essential, for the reasons identified; to provide a stable and predictable investment environment. Regulatory mechanisms like price controls straddle parliamentary terms and the sector needs to have confidence that there will not be political interference in to rules and processes if it is to invest.

But there is a risk that unchecked independence can lead to a lack of accountability. There has never been an independent market review of competition in the energy sector and it is now a decade since the last referral of a disputed licence condition to the Competition Commission. This lack of systemic scrutiny is a problem and the review needs to tackle this issue of ‘who polices the police’.

An entirely clear delineation of boundaries between Government and the regulator is likely to be difficult. The suggestion that the boundary falls along the lines that Government is wholly responsible for energy policy and that the regulator simply implements it sounds superficially attractive but in practice much of the benefit and cost (in all senses) of policy depends on the implementation approach adopted.

A much clearer delineation of roles than currently exists should be possible though. It is important to have clarity over the medium and long-term outcomes that departments and regulators are working towards, in order to fulfil the statutory objectives. This requires Government and Ofgem to engage at a strategic level, rather than simply on individual issues.

This could mean DECC publishing a strategic policy document for energy regulation. This document should be applicable for a fixed term, perhaps 5-7 years, to provide continuity and stability in policy goals. It could spell out the Government’s visions and objectives for the sector; what it intends to do to give effect to that vision; what it expects the regulator to do; and how it intends to ensure co-ordination of these two parallel streams of work. This would draw the Government out to say what it wants to achieve and provide an accountability framework against which the regulator’s performance can be assessed.

There should also be clarity as to how the day-to-day relationship between DECC and Ofgem operates in practice. This might take the form of a ‘regulatory contract’ between Government and the regulator, outlining who is doing what and what resources each will have to ensure that this work is done as efficiently and effectively as possible.

Each of these documents should be in the public domain. Select committees could question representatives from each actor to assure themselves that the work is allocated and co-ordinated appropriately.

An approach along these lines may have helped to mitigate some of the difficulties in areas where it has not been clear who has held responsibility for policy development; transmission access reform being a good recent example of this.

Third term of reference: 'the boundary of responsibility between Ofgem and OFT'

In its election manifesto the Conservative Party stated that it would reform Ofgem so that 'its competition policy and consumer protection powers pass to the Office of Fair Trading'⁴.

It would be useful if the review can bring forward more clarity on how 'competition policy and consumer protection powers' should be interpreted.

A narrow interpretation could simply be that its statutory market oversight powers, such as under the Competition Act 1998 and Enterprise Act 2002 were moved to the OFT. This would mean that the latter held responsibility for investigating allegations of anti-competitive activity; for undertaking enforcement activity where legislation had not been complied with; and for making any market investigation references to the Competition Commission. This might also mean that the OFT considered any energy super-complaints.

A broader interpretation could be that the OFT would also take on responsibility for those consumer protections that are governed by licence conditions and industry codes rather than legislation; for example around doorstep selling and marketing rules. Under such a model, it is not entirely clear what the rump Ofgem would have left to do; especially given that many of its administrative/delivery functions have already been separated out in to Ofgem E-Serve.

The OFT currently has little involvement in the energy sector, although many of the disciplines it applies in other sectors – competition policy, consumer empowerment etc – are directly relevant to the energy sector.

We have a broadly positive view of the OFT but any shift in organisational responsibilities brings with it risks as well as opportunities.

One would expect a whole economy regulator to be able to provide greater consistency in its application of consumer protections, tackling thematic issues in the same way regardless of sector and able to run cross-sectoral projects. It should be able to exercise economies of scale and flexibility, with a greater ability to divert resources in to, or away from, sectoral work depending on demand. Behaviourally the OFT appears to have a much more muscular consumer protection culture than has tended to be the case with the sectoral utility regulators, with a seemingly much greater willingness to refer or enforce⁵. A whole economy regulator with little previous history in this sector may also be able to bring fresh thinking to areas of consumer detriment that have become seemingly intractable, such as doorstep sales practices and the simplicity and fairness of tariffs. It may also be able to inject contestability in to areas where at least superficially there appears to be scope for more efficiency or cross-industry work such as meter reading and installation across all utilities (the so-called Multi-Utility or MUSCO model).

⁴ Page 103, <http://bit.ly/9U1tS5> (PDF)

⁵ See the March 2010 'Review of the UK's Competition Landscape' by the National Audit Office (ibid)

But there would be material transition risks with any migration of powers. Any new or merged organisation takes time to find its feet and there is a risk of loss of continuity on projects, duplicated overheads and higher staff churn rate during this period; in the short term value for money from energy regulation may decrease rather than increase. There may also be blurred lines of accountability with the introduction of an additional actor in energy policy and a loss of sectoral focus and expertise. There may also be an increase in investment uncertainty if OFT's priorities and approach differs greater from Ofgem. With fuel poverty increasing and the energy sector in transition, consumers will need strong competent regulation more than ever in the coming years. Whatever new arrangements are alighted upon it is crucial that any transition risks are fully mitigated.

The review may wish to look at how the Consumer Protection from Unfair Trading regulations ('CPRs') can best be implemented in the energy sector. Ofgem has enforcement powers under the CPRs, but the process for taking action against licensees is more complex and time consuming, and its powers to fine are weaker, when compared to the powers of the OFT or Trading Standards.

The review should be conscious that the nature of consumer protection may need to change with the impending roll-out of the Green Deal. Increasingly customers may find themselves purchasing energy services as well as energy itself. Green Deal purchases may be from existing energy suppliers but they could just as easily come from other companies who have not historically operated in the sector. Energy and energy services may well be cross-sold. It may be undesirable to leave consumers in a situation where one part of a transaction or contractual relationship is regulated by one body while another part of the same transaction or contractual relationship is regulated by a different body. This could cause confusion for consumers seeking redress and result in a lack of clear ownership of the problem in any areas where market performance issues emerge.

Fourth term of reference: 'Ofgem's statutory duties, whether they are fit for purpose and how they are reflected through industry governance processes, particularly within the context of the Government's energy and climate change objectives'

Ofgem has many statutory duties but they can be grouped into four types of outcomes that it is being tasked to deliver:

- Consumer protection
- Efficiency and economy, both in networks and in the competitive market
- Sustainability
- Health and safety

This leaves it with an extremely ambitious and broad ranging remit.

While it is clear that its principal statutory duty to protect the interests of current and future consumers takes precedence over its secondary duties, its many secondary duties have equal status.

This leads to considerable scope for tension and conflict. For example, the most economic route to deliver a goal may not be the most sustainable. Given these tensions a need to make trade offs between different duties when reaching decisions is inevitable.

This makes it absolutely necessary to ensure that there is clarity on how it should, and does, make such trade offs. This clarity is currently lacking and the vehicle intended to deliver it, the social and environmental guidance issued by the Secretary of State, is not

working particularly well (we set out more detailed views on this matter against the next term of reference).

The review should consider how to make these trade-offs clearer.

More broadly, we have a longstanding concern that Ofgem has tended to consider competition as the only tool in its locker, rather than one of many tools, to deliver consumer protections. We do not dispute that competition is often an extremely powerful tool for the public good but there are occasions where it is not the right one. Energy is an essential service and even commercially unattractive consumers have a right to light and heat on reasonable terms.

We believe this historical over-concentration on competition has been a behavioural deficiency rather than a statutory deficiency. In fairness, Ofgem has become much better at using a balanced range of tools during the last couple of years and its retail energy supply probe showed a welcome willingness to use intelligent combinations of competitive and non-competitive tools to try and sharpen competition while protecting the vulnerable.

Its statutory duties are only partially reflected through industry governance processes.

The majority of industry rules and processes are set out in a variety of multilateral codes that network owners and users must adhere to. These will soon additionally incorporate the network charging methodologies.

Each of these codes has its own objectives which are used for assessing its success and the business case for any changes to the rules or processes that may be proposed by the industry. These objectives form a recognisable subset of Ofgem's statutory duties and typically include the promotion of competition and efficient and economic network operation.

But none of the codes has any objective that makes direct reference to consumers. The impact of any proposal to modify the codes on consumers is therefore ignored in industry's consideration of the business case for that change.

It seems hugely inadvisable to us that Ofgem should seek to embed secondary duties in industry governance processes while omitting any objectives directly relating to its principal statutory duty. This concentration on industry process rather than consumer outcome is particularly inappropriate in a sector so persistently notorious for poor consumer outcomes⁶. Indeed, it may have contributed to this outcome because it encourages the sector to consider that consumer impacts are not relevant to the business cases it puts to the regulator.

Ofgem has recently given consumer representatives voting rights on one on the industry code panels⁷. This is a welcome change but it is not a substitute for requiring the industry to adequately assess the impact of proposals on consumers.

In other areas it has been working to better reflect its statutory duties in industry governance processes and a number of major improvements are currently in the process of being implemented as a result of its recent Code Governance Review⁸. These include the streaming of industry change proposals such that it will have more direct involvement in strategic decisions that could have a major impact on its delivery of statutory duties

⁶ A total of 5,862 telephone interviews were conducted across the UK in March and April 2009 by Ipsos MORI on behalf of Consumer Focus looking at consumers' perception of 45 markets for products or services. Energy scored worse than any other market. See our December 2009 Consumer Conditions Survey for more details: <http://consumerfocus.org.uk/g/4m8>

⁷ The Uniform Network Code in gas. Consumer representative had pre-existing voting rights on the Balancing and Settlement Code and Connection and Use of System Code panels in electricity.

⁸ Further details on the Code Governance Review are available here: <http://bit.ly/dcQZ0I>

(‘significant code reviews’), and much less involvement in straightforward changes that are capable of self governance by the sector.

This strikes us as a good example of better regulation, as it should deliver a more proportionate, targeted and transparent regulatory regime.

The Code Governance Review has also required code panels to (where relevant) deliver an environmental assessment of the impact of proposed changes, including their impact on climate change through greenhouse gas emissions. This seems like a sensible improvement that should result in industry governance better reflecting the regulator’s statutory duties.

Fifth term of reference: ‘The effectiveness of Government’s social and environmental guidance to Ofgem and how it is translated through Ofgem’s decision making’

An assessment on this matter is rather difficult, for while the majority of the areas of Ofgem’s work are, or could be argued to be, consistent with this guidance it is extremely unusual to see any meaningful reference to it in its decisions or consultations.

It is therefore difficult to tell how actively Ofgem has considered the guidance in its decision making or whether it would have pursued similar aims anyway, given that its statutory duties and the guidance are broadly aligned.

In general terms Ofgem appears most comfortable when it is acting in those areas of the guidance that could be seen as economic regulation (for example, in delivering offshore transmission networks) and least comfortable when it is acting in those areas that could be seen as social regulation (for example, in eliminating fuel poverty). Its resource accounts suggest that in 2009/10 it spent less than 4 per cent of its budget on tackling fuel poverty work compared to about 30 per cent each on competition, network regulation and sustainability⁹.

It is natural for any person or body to play to their strengths but this does not make it desirable. The review should consider how to tackle this. The absence of clear weighting for different priorities within the guidance may well be a contributory factor, as may be the absence of any clear direction as to whether Ofgem should be leading, or supporting, in each of the policy areas. As set out earlier in this submission, we think a much clearer upfront mandate for regulatory work could help to provide this clarity.

The review should seek evidence from Ofgem on how it has systematised its use of the guidance from the Secretary of State.

We suggest that the review could also usefully clarify how binding the guidance will be going forward, noting that the introduction of the EU 3rd package for energy includes some constraints on the extent to which Governments can direct the work of regulators.

Sixth term of reference: ‘The value for money Ofgem provides.’

For many years Ofgem has voluntarily committed itself to an RPI-3 per cent price control which has meant that its costs in real terms have improved year on year¹⁰. This is a welcome and appropriate commitment.

It is hard to assess the value that consumers gain from these costs however. Its pre-implementation impact assessment of policy is generally conducted to a decent standard and has been steadily improving over time. But post-implementation review is rare and it is not clear to us that it looks backward to see whether post-decision reality matches pre-decision expectation in any coherent fashion.

⁹ Page 33, ‘Resource Accounts 2009-10’ <http://bit.ly/ar9k0L>

¹⁰ <http://bit.ly/clReG7>

This deprives it of a tool to learn from experience and to prioritise future work; it also has a dilatory effect on its accountability and makes it harder to gauge whether its effectiveness is improving or deteriorating over time.

It could usefully learn from other regulators in this area. For example, the Office of Fair Trading has agreed with HM Treasury to deliver measurable benefits at least five times its budget each year and has a formalised process for evaluating and reporting on its performance in doing so¹¹. Although the subjectivities involved in assessment mean that no evaluation process will ever be beyond dispute, we think this formalised discipline of making sure that the regulator is adding real value is an inherently sensible one and would like to see this principle adopted in energy.

Seventh term of reference: ‘Ofgem’s approach to minimising the burdens from its regulatory activity.’

No one wants to see unnecessary regulation; it impedes the efficiency of the wider economy and is ultimately paid for by consumers.

But we urge some caution in this area of the review – some regulations are necessary and there is a very real risk of unintended consequences if an excessively gung ho approach to removing consumer protections is adopted.

This is not simply a theoretical risk either; an over-confidence in the competitive health of the energy market and its ability to self-police has blighted consumer experience in the past. To use just two examples of this:

- In 2000 Ofgem scrapped licence conditions banning undue discrimination between consumers ‘in a bid to minimise regulatory burdens’¹². Very similar licence conditions had to be re-introduced in 2009 after Ofgem found that there were persistent unjustified differentials between the prices suppliers charged customers depending on their payment method or region
- In 2004 Ofgem scrapped ‘self-supply’ licence conditions preventing the large vertically integrated energy companies from selling the output from their generation arms directly to their supply arms, arguing that this protection was not necessary in spite of evidence that wholesale market liquidity was deteriorating¹³. In its March 2010 joint Energy Market Assessment, HM Treasury and DECC suggested that the biggest impediment to retail market entry is the illiquidity of wholesale markets and that this is driven by the Big 6 self-supplying¹⁴. Ofgem has been consulting on proposals to remedy this situation – included within which are options to reintroduce some form of self-supply licence condition

On balance we consider that Ofgem has a mixed scorecard in its approach to minimising regulatory burdens.

There have been some major areas where it has consolidated or simplified the requirements on industry, for example through its supplier licence review and the consolidation of hundreds of separate distribution connection agreements in to a single common code. As previously mentioned, its Code Governance Review conclusions will reduce its involvement in ‘business as usual’ changes to industry processes where it may be adding little value.

¹¹ <http://bit.ly/d6Y8Gx>

¹² 25 July 2000 Ofgem press release, ‘Improving consumer protection by reducing the regulatory burden’

¹³ <http://bit.ly/cCqmSV>

¹⁴ Para 2.22 <http://bit.ly/dsHAfh>

We also consider that it has also been finding a markedly better balance between burdens and protections in the last couple of years. For example its 2009 energy supply probe was a welcome intervention that showed willingness to challenge the preceding seemingly one-directional nature of regulation – that consumer protections would only ever be removed, and not introduced.

Its successes in these areas are rather undermined by failures in other areas. Most notably its conduct of consultation falls far short of best practice and its prioritisation of projects can be irrational. Both have an adverse effect on regulatory burdens.

Back in 2007 the House of Lords Select Committee on regulators concluded ‘that wherever possible regulators allow for at least a 12 week consultation period in their forward planning to give industry a reasonable amount of time to respond to their papers¹⁵’. This recommendation has never been adopted by Ofgem – we would struggle to identify any instance where it has allowed for a 12 week consultation period. Four to six weeks is the norm, regardless of how material an issue is and any other consultations that are live.

We consider that there may be benefit in Ofgem and DECC working together to co-ordinate the issue date, length and deadlines of energy policy consultations to try and smooth out peaks and troughs. This would help reduce the burden of regulation and may improve the accessibility of consultation processes.

Away from process and looking at policy, Ofgem’s current proposal to look again at strengthening electricity imbalance price signals appears irrational given the continuing illiquidity in wholesale power markets. Strengthening signals to ‘go to market’ when there is no market to go to is likely to further exacerbate an already tough trading environment for smaller market participants, increasing regulatory burdens without delivering consumer benefits.

Eighth term of reference: ‘The scope for learning lessons from other regulatory models and examples of good regulatory practice’.

In February 2009 we published a study, ‘Rating regulators’, a consumer assessment of the performance of six regulators (Ofgem, Ofcom, Ofwat, Postcomm, the Foods Standard Agency and the Financial Services Authority) against a series of indicators that together form the essential building blocks of a consumer-focused regulator¹⁶. That report included a wide range of examples of good regulatory practice and a comparative assessment of Ofgem against the other regulators. We recommend that our Rating Regulators report is considered alongside this submission and that you consider developing a similar assessment framework for analysing Ofgem’s performance.

As previously highlighted, we think that the review could learn from the OFT’s practices in evaluating and reporting its own value. We suggest that in addition to trying to formalise how it measures and reports the aggregate level of value that it delivers Ofgem should also be tasked with considering and reporting on the distributional impact of its work, ie the effect on different income groups and regions (including the devolved nations). It should not be assumed that energy policies have a ‘flat’ impact on different geographic areas and income groups and the regulator should be working to understand any variations in outcomes.

¹⁵ <http://bit.ly/cqFAh5>. Although the reference is to industry, we consider that the need for other stakeholders such as consumer groups to have adequate time to respond is equally great.

¹⁶ The main report is here <http://consumerfocus.org.uk/g/4m9>, an executive summary is here <http://consumerfocus.org.uk/g/4ma> and an extended report on Ofgem is here <http://consumerfocus.org.uk/g/4mb>. We include the key performance indicators as the Appendix to this document.

We think it is no coincidence that the recent improvement in Ofgem's performance has coincided with a period where it has been subject to an unprecedented degree of external scrutiny.

A challenge for the review will be to establish measures that will ensure that it remains accountable when the spotlight eventually turns from this sector to another part of the economy.

In principle, it should be under ongoing constructive challenge through the periodic referral of matters to the Competition Commission. The Competition Commission would act as the statutory referral body for any disputed licence condition or for a wider market investigation. In practice, this safeguard appears to us to have been circumvented by the systemic unwillingness of British utility regulators to make any use of its expertise. The National Audit Office's March 2010 'Review of the UK's competition landscape' highlighted that Ofgem, Ofwat, Ofcom and the ORR had collectively only made one market investigation reference to the Competition Commission since 2002 while the OFT had made nine in that period¹⁷.

Peter Freeman of the Competition Commission provided an excellent summary of this problem in his speech¹⁸ to Kings College on 28 May 2008:

'A more fundamental issue is whether the regulatory system, taken as a whole, has a built-in tendency to avoid references. It is worth noting that our current regulatory references are either mandatory (airports) or are under very specific regimes (mobile phones, code modifications). I can see that from the perspective of an economic regulator, there are some good reasons not to have cases referred to us. CC investigations take time, cost money and risk reputational damage if a regulator is perceived to have 'lost', in the sense of not having achieved their desired outcome. These considerations apply as much to regulated companies as to the regulators. But all the regulators need to be able credibly to threaten a CC reference if they are to achieve any sort of settlement which is worth having. The longer a sector goes without a reference, the less credible that threat becomes, and the more the regulatory system as a whole comes under scrutiny and pressure. I can do no better than cite the recent recommendation of the House of Lords Select Committee on Regulators '...where possible, utility regulators should work to bring more cases to the competition authorities and that the regulators should work to ensure that the case most likely to establish useful precedents are brought to the CC' and the Government's response '... the Government agrees with the Committee that regulators should be encouraged to think about whether they can be more proactive in using competition law, including market investigation references to the Competition Commission'.'

There has never been an independent market investigation in to the energy sector and it is now approximately a decade since a disputed energy licence condition was last referred to the Competition Commission. It must be called in to question whether the statutory referral process is providing the safeguard it was intended to. In the absence of any credible likelihood that such a referral will ever take place the regulator is insulated from scrutiny and this absence of credible challenge impedes its accountability. It also has a dilatory effect on its bargaining position with the industry, which is all too aware that it can call its bluff on any threat to refer. This is a recipe for anaemic regulation.

We think the main problem preventing the safeguard from working is that there are inherent conflicts of interest surrounding the current statutory trigger for a market referral

¹⁷ <http://bit.ly/bpHZpl>

¹⁸ Ibid.

to the Competition Commission. Such a referral can only be initiated by the regulator itself or by the Secretary of State. The former will always be associated with the design of the arrangements under investigation and the latter may well also be depending on when such calls come in the lifespan of a parliament.

A solution to this problem may come in the form of changing the nature of market referrals such that these operate on an opt-out, rather than an opt-in basis. A sector such as energy is so integral to the public interest that we think it should be subject to periodic independent review. This periodicity could be set in statute.

To mitigate the risk of unnecessary review we think the independent review body should be given the option of truncating the review at its initial findings stage if these suggest that the sector has a clean bill of health (or does not, but that the nature of detriment and ongoing work of the sectoral regulator provide it with adequate comfort that these problems can be, and are being, addressed by the sectoral regulator). This would constitute the opt-out decision point; which crucially would not be a decision made by a party with a conflict of interest. As a further mitigation against the risk of unnecessary review the scheme design could allow the clock time before the next mandatory review to be reset if the sectoral regulator made a voluntary referral.

It may be that there are better alternative approaches to improving the accountability of Ofgem, but we think it is clear that the current referral processes are ineffective and provide consumers with little protection. The review needs to tackle this accountability deficit.

Appendix – an assessment framework for rating regulators

Last year we published an analysis of six key regulators, including Ofgem, in our report *Rating Regulators*¹⁹. Our assessment framework consisted of twenty indicators which together form the essential building blocks of a consumer focused regulator. These are:

Legal framework

- statutory objectives and duties enable the regulator to adequately promote the interests of all consumers
- responsibilities between different actors are clearly defined, without gaps or overlaps
- structures are sensitive to devolved contexts
- the right tools for the job

Culture and accountability

- translates statutory objectives into consumer-focused priorities and values
- embeds a consumer focus across all levels of the organisation
- transparent about its activities
- accessible to the general public, including disabled users
- works effectively in a devolved setting

State of readiness

- identifies likely sources of consumer detriment, both now and in the future, which shapes work priorities
- uses effective mechanisms to understand the consumer perspective and translate this insight into sound decisions
- works effectively with others, including with consumer organisations
- influences the wider regulatory agenda

State of action

- empowers consumers to help achieve regulatory outcomes
- has effective incentives to encourage compliance with its rules
- chooses the appropriate regulatory approach in the circumstances, and intervenes in a timely fashion when needed
- gives priority to, and intervenes effectively on behalf of, consumers who are vulnerable

¹⁹ Consumer Focus, *Rating Regulators*, February 2009.

- uses enforcement tools when appropriate to protect consumers

Impact and learning

- defines and measures its impact on consumers in terms of outcomes
- evaluates its work and embeds learning



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