

THE GAS AND ELECTRICITY MARKETS AUTHORITY'S STATEMENT OF POLICY WITH RESPECT TO FINANCIAL PENALTIES AND CONSUMER REDRESS UNDER THE GAS ACT 1986 AND THE ELECTRICITY ACT 1989¹

THIS IS A DRAFT DOCUMENT FOR CONSULTATION ONLY.

1. Introduction

1.1. The Gas and Electricity Markets Authority (the Authority) regulates the gas and electricity markets in England, Scotland and Wales. Ofgem is the Office of Gas and Electricity Markets. It carries out the day-to-day work of the Authority and investigates matters on the Authority's behalf.

1.2. Where the Authority is satisfied that a regulated person² has (a) contravened or is contravening any relevant condition or requirement; or (b) has failed or is failing to achieve any standard of performance prescribed under section 30A(1) of the Gas Act 1986 (the Gas Act) or section 27A(1) of the Electricity Act 1989 (the Electricity Act) (referred to collectively as "the Acts") the Authority may impose a financial penalty.

1.3. If it is satisfied that there has been or is a contravention of any relevant condition or requirement, the Authority may also make a consumer redress order.³ It may do this where

¹ The Authority will have regard to separate penalty guidance when imposing penalties under the Security of Network & Information Systems Regulations 2018 and under the retained European Regulation (1227/2011) on wholesale energy market integrity and transparency (REMIT). Further, the Authority will have regard to the Competition and Markets Authority's penalty guidance when imposing penalties under the Competition Act 1998. See

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284393/oft423.pdf.

² The term 'regulated person' includes licence holders, storage facility owners and supply exemption holders (see section 28(8) of the Gas Act and section 25(8) of the Electricity Act).

³ Section 30G of the Gas Act and section 27G of the Electricity Act as inserted by section 144 of, and Schedule 14 to, the Energy Act 2013. However, it remains the responsibility of the Ombudsman to

one or more consumers have suffered loss, damage or inconvenience as a result of the contravention. The Authority can require the regulated person to do anything necessary to remedy the consequences of the contravention or to prevent a contravention of the same or a similar kind from being repeated.

1.4. The Authority may impose a financial penalty, a consumer redress order or both for contraventions.⁴ This Statement of Policy with respect to penalties is required by the Acts⁵ and sets out the factors that the Authority will normally consider when:

- deciding whether or not to impose a financial penalty and/or a consumer redress order;
- determining the amount of any financial penalty; and
- determining the requirements of any consumer redress order.

1.5. This Statement of Policy provides that the Authority may take account of factors which impact penalty, including but not limited to those included in this Statement of Policy, when determining the level of penalty to impose upon a regulated person where it is satisfied that that person has contravened a relevant condition or requirement.

1.6. The Acts provide that the amount of any financial penalty must be reasonable in all the circumstances of the case. When determining a reasonable penalty, regard will be had to the level of any redress ordered and/or any redress which is being or has been provided.

1.7. Where the Authority:

- imposes a financial penalty,

consider whether redress should be made to individual consumers that make a complaint about a distribution or supply licence holder.

⁴ For failures to achieve standards of performance, the Authority may only apply a penalty.

⁵ Section 27B of the Electricity Act and Section 30B of the Gas Act.

- makes a consumer redress order which requires the regulated person to pay compensation, or
- imposes a financial penalty and makes a consumer redress order which requires payment of compensation in relation to the same contravention,

the amount or combined amount must not exceed 10 per cent of the turnover of the regulated person.⁶

1.8. Consistent with the Authority's vision that businesses should put energy consumers first and act in line with their obligations, the Authority expects regulated persons will not seek to recover the costs of financial penalties or consumer redress from their customers. Evidence that regulated persons are recovering these costs from their customers may be seen as an indication that the market is insufficiently competitive.

1.9. The Authority must not impose a financial penalty under the Acts on a regulated person, or make a consumer redress order, where it is satisfied that it would be more appropriate to proceed under the Competition Act 1998.⁷ Ofgem will take this into account when considering whether or not to open an investigation under the Acts. The Authority may impose a financial penalty or make a consumer redress order even if it has already made a provisional or final order under the Acts.⁸

2. Objectives and duties in relation to financial penalties and redress

2.1. The Authority's principal objective is to protect the interests of existing and future gas and electricity consumers.⁹ The Authority is required to carry out all of its functions under the

⁶ Section 300(4) of the Gas Act and section 270(1-4) of the Electricity Act. Relevant turnover is defined in the Electricity and Gas (Determination of Turnover for Penalties) Order 2002 (as amended).

⁷ Section 30(A)(2A) of the Gas Act and section 27A(2A) of the Electricity Act.

⁸ Section 25 of the Electricity Act and section 28 of the Gas Act provide for final and provisional orders where a regulated person is contravening or is likely to contravene a relevant condition or requirement.

⁹ Section 4AA of the Gas Act and section 3A of the Electricity Act.

Acts, including taking any decisions in relation to imposing financial penalties and consumer redress, in the manner that it considers is best calculated to further its principal objective and vision.

2.2. The Authority is clear that regulated persons should not benefit financially from any contravention or failure. Indeed, the Authority considers that non-compliance should normally cost significantly more than compliance and that financial penalties should act as a significant deterrent to future non-compliance. The Authority will, therefore, normally seek to ensure that any financial penalty, and compensation or other payment under a consumer redress order, or any combination of them, significantly exceeds, where this can reasonably be calculated or estimated,

- the gain to the regulated person; and
- the detriment caused to consumers or other market participants (whether individually or as a group, affected by the contravention or failure).

2.3. When determining the amount of a financial penalty and/or consumer redress payment, the Authority will consider any remedial measures that have been taken by a regulated person. However, the Authority may impose a financial penalty significantly in excess of the gain or detriment even where the gain or detriment has been mitigated in full. The Authority considers that this may be necessary in order to deter non-compliance and provide appropriate encouragement for all regulated persons to comply with their obligations.

2.4. The Authority is also required to take into account its other statutory duties when considering the use of its penalty and redress powers. In particular, the Authority will have regard to the principles of best regulatory practice.

3. Imposing a financial penalty and/or a consumer redress order

3.1. In deciding whether it would be appropriate to impose a financial penalty and/or make a consumer redress order, the Authority will take account of the relevant facts and circumstances of the contravention or failure under consideration.

3.2. If the Authority is satisfied that a contravention or failure has occurred or is occurring, it will consider whether it is appropriate to impose a financial penalty. The Authority will also consider whether it is appropriate to make a consumer redress order. In this context, the Authority must determine whether one or more consumers have suffered loss or damage or been caused inconvenience as a result of the contravention.

3.3. If the Authority considers it appropriate to impose a financial penalty, it must determine what level of penalty is reasonable in all the circumstances of the case. In considering whether it is appropriate to make a consumer redress order, the Authority must determine what is necessary to remedy the consequences of the contravention or prevent future contraventions and may make an order to that effect.

3.4. The Authority will consider any representations or objections that are duly made and are not withdrawn in line with statutory requirements.¹⁰ The Authority will follow the procedural requirements set out in the Acts in imposing any financial penalty or consumer redress order.¹¹

3.5. The following paragraphs set out the various criteria and factors which the Authority may consider in deciding to impose a penalty or make a consumer redress order. These criteria and factors are not exhaustive.

4. General criteria in relation to imposing a financial penalty and/or making a consumer redress order

4.1. The Authority will consider various factors in respect of (a) the imposition of a financial penalty and/or (b) the making of a consumer redress order, including, but not limited to the:

- Seriousness of the contravention or failure.

¹⁰ Sections 30A(3) and 30I(3) of the Gas Act and sections 27A(3) and 27I(3) of the Electricity Act.

¹¹ Sections 30A to F and 30I of the Gas Act and sections 27A to F and 27I of the Electricity Act.

- Impact of licensees' behaviours, including whether the contravention or failure damaged the interests of consumers or other market participants.
- Deterrence, including whether a financial penalty and/or restitution payment is necessary to deter future contraventions or failures by all market participants and encourage compliance.

4.2. The Authority regularly introduces and amends relevant conditions and requirements. Conduct which the Authority may, at one point, have taken into account in deciding whether to impose a penalty or make a consumer redress order, and at what level, may, as a result of such changes, amount to a contravention in itself. Where the Authority considers that conduct may amount to a contravention in itself, it reserves the right not to take that conduct into account in deciding whether to impose a penalty or make a consumer address order and at what level. It may, instead, decide to investigate and impose a penalty or make a consumer redress order in respect of that conduct. That decision will be made in line with Ofgem's Enforcement Guidelines.¹²

4.3. The Authority cannot impose a financial penalty or consumer redress order where its principal objective and duties preclude it.

5. Process for determining the amount of a financial penalty and/or amounts payable under a consumer redress order

Introduction

5.1. This section sets out the process for determining the regulated person's overall financial liability as a result of the contravention or failure.

¹² For example, regulated suppliers are required to self-report under Standard Licence Condition 5A of the Electricity and Gas Supply Licences. Therefore, self-reporting will not be considered as an aggravating or mitigating factor in the Authority's consideration of penal element in respect of a contravention or failure by a regulated supplier. In the event that a supplier should fail to self-report, the Authority may, instead, decide to investigate and impose a penalty or make a consumer redress order in respect of that conduct.

5.2. Where consumers or other market participants have suffered loss, damage, inconvenience or other adverse consequences as a result of the contravention or failure, the Authority will normally aim to impose a financial penalty and/or ensure that consumers and/or other market participants receive appropriate redress. Further, the Authority will seek to deprive a regulated person of all the financial benefit derived from the contravention or failure where it is proportionate, reasonable and practicable to quantify it.

5.3. The Authority will seek to impose a financial penalty and/or make a consumer redress order that:

- Ensures that the regulated person does not benefit financially from the contravention or failure;
- reflects the seriousness of the contravention or failure; and
- deters future misconduct by the regulated person under investigation and other industry participants.

5.4. The total amount payable by a regulated person will normally be calculated in accordance with the following five step process.

Step 1 - Calculate the detriment and gain

5.5. The Authority will seek to calculate detriment to consumers and/or other market participants resulting from a contravention or failure where it is proportionate, reasonable and practicable to quantify it.

5.6. The Authority will seek to calculate any gain to the regulated person resulting from the contravention or failure where it is proportionate, reasonable and practicable to quantify it. Gain may come in the form of additional profits, avoided costs or some other undue advantage to the regulated person.

5.7. When calculating overall detriment and gain resulting from a contravention or failure, the Authority will consider any overlap which may exist between quantified detriment and gain.

5.8. When the Authority has not quantified detriment or gain for the purposes of Step 1, the Authority may nevertheless take account of its view that the contravention or failure may have resulted in gain and/or detriment in its assessment of seriousness at Step 2.

5.9. Where the Authority is satisfied that adequate redress has been or is being provided, the final penalty and/or final redress ordered to be paid by the regulated person will take this into consideration. In this context, the Authority will consider the interests of consumers and/or other market participants, and accordingly will:

- Consider the efforts that have been made by the regulated person to direct the redress to the affected consumers and/or other market participants and whether the redress fully reflects the loss, damage or inconvenience caused.
- Take into account any payments to the affected consumers and/or other market participants that may already have been made, for example under statutory standards of performance, other regulatory obligations or as a result of action taken by the Energy Ombudsman.

Step 2 - Assess seriousness

5.10. The Authority will assess the seriousness¹³ of the contravention or failure. This is a key factor in calculating the penal element of the final liability, irrespective of whether the Authority has identified and calculated detriment and/or gain. In assessing seriousness, the Authority will take into account various factors, including, but not limited to the:

- nature of the contravention or failure, including the frequency and/or duration of the contravention or failure;
- behaviour of the regulated person, including the regulated person's awareness of the contravention and the extent to which the regulated person and its senior management had taken steps to secure compliance;

¹³ The seriousness of a contravention or failure includes its potential seriousness.

- impact of the contravention or failure, including any detrimental effect on the ability of Ofgem or the Authority to fulfil its statutory duties and whether there was any consumer or market participant detriment or gain (financial or otherwise) made by the regulated person.

Step 3 - Consider aggravating or mitigating factors

5.11. The Authority will consider aggravating and mitigating factors and adjust the penal element accordingly. Any reductions to the penal element will not affect the amount of any monies identified as detriment and/or gain.

5.12. The Authority will consider aggravating and mitigating factors related to the behaviour of the licensee, including, but not limited to:

- Its compliance history;
- actions, or lack thereof, taken after becoming aware of the contravention or failure prior to Ofgem’s investigation; and
- actions, or lack thereof, taken after becoming aware of the contravention or failure during Ofgem’s investigation.

5.13. When considering factors that may mitigate the level of a penalty, the Authority attaches significant value to the self-reporting of breaches. However, regulated persons should expect to receive less credit where self-reporting has not occurred promptly on first discovering that a breach has occurred. The Authority expects regulated persons to be prompt in reporting when a potential breach is first uncovered and to be prompt, accurate and comprehensive in reporting any further information that comes to light.¹⁴

¹⁴ Regulated suppliers are required to comply with Standard Licence Condition 5A of the Electricity and Gas Supply Licences. Therefore, self-reporting will not be considered as an aggravating or mitigating factor in the Authority’s consideration of penal element in respect of a contravention or failure by a regulated supplier.

Step 4 - Consider an adjustment for deterrence

5.14. The Authority will consider whether a further adjustment to the penal element needs to be made to ensure that it will have a sufficient deterrent effect.

5.15. The Authority may make such an adjustment if it considers that the penal element would otherwise be insufficient to deter the regulated person, or others, from committing further or similar contraventions or failures.

Step 5 – Apply a discount in settled cases

5.16. The Authority may offer the regulated person the opportunity to settle the case. Early settlement has many potential advantages. It can, for example, result in:

- consumers and/or other market participants obtaining compensation earlier than would otherwise be the case;
- the saving of Authority resources and those of the regulated person;
- messages getting out to the energy market sooner; and
- timely and effective action that improves consumer confidence.

5.17. The Authority therefore considers that in many cases it is likely to be in the interests of consumers for a regulated person to be offered the chance to resolve matters through settlement. In recognition of the benefits of such agreements, the Authority may offer to reduce the penal element of the overall financial liability to be imposed on the regulated person by 30 percent during the settlement window. Such a discount will not apply to any gain and/or detriment that has been identified by the Authority.

5.18. Further detail of the Authority's settlement framework, including the beginning and end of the settlement window, is set out in sections 6.6 through 6.34 of Ofgem's Enforcement Guidelines.

Step 6 - Establish the total financial liability

5.19. The Authority will determine the total financial liability of the regulated person by adding the final penal element (Step 4 or 5) to any gain and/or detriment that the Authority has identified as resulting from the contravention or failure (Step 1).

5.20. The Authority may adjust the total financial liability to ensure that any financial penalty and/or redress payments are reasonable in all the circumstances of the case.

5.21. The Authority may at this stage consider the effect of a proposed penalty and/or redress payment on the financial viability of a regulated person and may make adjustments accordingly in light of its principal objective.¹⁵

5.22. Having considered all of the circumstances of the case, the Authority will determine an appropriate amount for any financial penalty and/or payments required under a consumer redress order (see section 6).

6. Interaction between financial penalties and compensation and/or other redress payments

6.1. In this section we consider the interaction between financial penalties and compensation and/or other redress payments. Where the Authority requires payments under a consumer redress order, it will take this into account when determining the appropriate amount of any penalty it imposes.

¹⁵ This includes cases where adjustments have been made for settlement.

Consumer detriment

- 6.2. The Authority starts from the principle that redress should be provided to the consumers who have suffered detriment. This may take the form of a voluntary redress package put in place following discussions between Ofgem and the regulated person. Voluntary action can potentially bring benefits in terms of a swifter resolution for the affected consumers.
- 6.3. Indeed, the Authority expects a regulated person proactively to take adequate steps to remedy the consequences of a contravention by identifying the consumers that have been affected (for example by contacting customers it knows have been affected or by writing to consumers asking them to get in touch if they think they have been affected) and compensating them. Only if the Authority is satisfied that it is not possible or practicable to do this would the Authority expect the regulated person to direct payments elsewhere in line with paragraph 7.5.
- 6.4. The Authority may, however, make a redress order where it has identified and calculated consumer detriment. Such an order will normally require compensation to be paid to those consumers who have been directly affected as a result of noncompliance. As with voluntary redress, the Authority will only consider requiring payments to be directed elsewhere if it is not possible or practicable to compensate the consumers who were directly affected (for example, because the administration costs would be disproportionate to the benefits of the redress). Any such requirements will be in line with paragraph 7.5.
- 6.5. Where the immediate customer is a regulated person that has already passed on the costs of a contravention or failure to the end consumer, the Authority may require payment direct to the end consumer. This situation might arise where a network or generation business has contravened an obligation and its immediate customer is a supply business. However, if there is difficulty in establishing the identity of these end consumers, the Authority may in respect of this detriment impose a financial penalty or make a consumer redress order requiring a payment to be made in line with paragraph 7.5.
- 6.6. The Authority may conclude that the extent to which specific consumers are affected by some or all of the detriment from a contravention or failure is difficult to determine. If so, the Authority may require a redress payment to be made to other consumers or to a consumer fund:

- Where it is necessary to remedy the consequences of the contravention; or
- where it is necessary for the purpose of preventing a contravention of the same or similar kind from being repeated.

6.7. For example, this may be appropriate where the total size of the detriment can be estimated but not the individual loss to each consumer. This could arise where the total detriment has been estimated via statistical sampling, or where the detriment has arisen as a result of harm to the market in general.

Gain

6.8. The regulated person may derive a gain from the contravention or failure. This gain may come in the form of additional profits, avoided costs or some other undue advantage. Where the Authority has identified and calculated such a gain, the Authority may make a consumer redress order or impose a financial penalty in respect of this amount.

6.9. In making this decision, the Authority will consider whether adequate redress will be achieved by returning to consumers any amount that it has calculated as detriment (see paragraphs 6.2 to 6.7). Where the Authority is satisfied that returning the amount calculated as detriment to consumers would provide adequate redress for the consumers, the Authority will normally remove any additional gain by imposing a financial penalty.

Penal element

6.10. Normally, the Authority will also impose a penal element to be paid as a financial penalty.

7. Scope of the remedies available under consumer redress orders

7.1. The Authority may make a consumer redress order which requires the regulated person to do anything necessary for the purpose of remedying the contravention or preventing a similar contravention in future.

7.2. The Authority will seek to ensure that, where consumers have suffered loss, damage or inconvenience, every effort is made to compensate the affected consumers directly. Where it is not possible or practicable to compensate individuals who have been affected by the contravention, the Authority will seek to ensure that any such loss, damage or inconvenience is acknowledged and put right in other ways.

7.3. The Acts provide that consumer redress orders may require the regulated person to do anything necessary to remedy the consequences of the contravention or to prevent a contravention of the same or similar kind from being repeated.

7.4. A consumer redress order may in particular require the regulated person to:

- Pay compensation to each affected consumer for the loss, damage or inconvenience it has caused (either directly, or by setting up a scheme to which affected consumers can apply);
- prepare and distribute a written statement to each affected consumer explaining the contravention and its consequences; or
- terminate or vary contracts it has with affected consumers.

7.5. The Authority may also require the regulated person to make payments to consumers including those not directly affected by the contravention. Such payments may be directed to:

- A specified category of consumers (such as consumers in vulnerable situations or, in appropriate cases, all those consumers served by a particular company); or

- an appropriate charity, trust or organisation.

7.6. The Authority may, for example, require this where it is satisfied that:

- It is not possible to quantify the loss, damage or inconvenience suffered by consumers on an individual basis;
- it is not possible or practicable to identify or trace the individual consumers that have been harmed; or
- payment to each affected consumer would be in such small amounts that requiring it would create a disproportionate administrative burden.

7.7. The Authority may require the regulated person to publish an apology for the contravention or write to consumers with accurate information about their rights.

7.8. The list above is not exhaustive. The Authority will consider the particular circumstances of each case in determining which things would be most effective in remedying the consequences of the contravention or in preventing a contravention of the same or a similar kind from being repeated (see section 8 for further detail).

8. Determining the requirements of a consumer redress order

8.1. In determining the types of redress that are reasonable for the purposes of remedying the consequences of the contravention or preventing a contravention of the same or a similar kind from being repeated, the Authority will have regard to a range of factors including, but not limited to, those outlined in paragraph 5.3 and may also consider:

- The nature of the harm suffered, having regard to factors such as the characteristics of the affected consumers and the interests of those consumers; and

- the impact that the redress order is likely to have, including whether it will remedy the harm suffered including and / or will bring the regulated person back into compliance through remedial action, taking account of any relevant action already taken by the regulated person.

8.2. The Authority will take into account any compensation already paid by the regulated person in determining any compensation to be paid under a consumer redress order. The Authority does not intend to require regulated persons to compensate individual consumers twice in relation to the same contravention. However, where the Authority is not satisfied that a regulated person has already provided or is taking steps to provide full compensation to consumers, the Authority will expect to require further compensation payments to be made.

8.3. The Authority will normally include a provision in each consumer redress order that requires the regulated person to demonstrate or confirm compliance with the order. The Authority may, in the consumer redress order, require the regulated person to engage a third party to provide independent verification that the regulated person has complied with the order.¹⁶

8.4. The Authority considers that the costs associated with administering the requirements set out in a consumer redress order should be borne by the regulated person. The Authority will, in determining the requirements of a consumer redress order, have regard to better regulation principles, including considering whether the likely administration costs are disproportionate to the benefits of the redress that is required.

¹⁶ The Authority can enforce a final order, provisional order or consumer redress order by civil proceedings. See sections 30(8) and 30L of the Gas Act and sections 27(7) and 27L of the Electricity Act.

9. Application, adoption and revision of the Statement of Policy

9.1. The Authority, having undertaken such consultation as it considers appropriate, has prepared and published this Statement of Policy.¹⁷ The Authority will have regard to this statement in respect of any contravention which occurred on or after XX-XX-2021¹⁸:

- i. in deciding whether to impose a financial penalty;
- ii. in determining the amount of any financial penalty;
- iii. in deciding whether to make a consumer redress order; and
- iv. in determining the requirements to be imposed by any such order.

9.2. The Authority may refer to further policies or statements as are relevant to the contraventions or failures at issue and as the Authority may publish from time to time.

9.3. This statement has been adopted by the Authority. The Authority has not delegated to the Enforcement Decision Panel, or to any member or employee of the Authority, the power to vary this statement. The Authority may, from time to time, revise this statement, in accordance with the Acts.¹⁹ Any revised statement will be issued for consultation and published.

Gas and Electricity Markets Authority

XX-XX-2021²⁰

¹⁷ Section 30B and 30J of the Gas Act and sections 27B and 27J of the Electricity Act.

¹⁸ To be updated when the updated Statement of Policy is published following consultation.

¹⁹ Section 30B(3) and 27J(3) of the Gas Act and sections 27B(3) and 27J(3) of the Electricity Act.

²⁰ To be updated when the updated Statement of Policy is published following consultation.