

ENFORCEMENT CONFERENCE

**Enforcement & Competition Policy Division
Venue: Park Plaza Hotel
Date 26th September 2013**

ofgem

9.00 to 9.10	Welcome and agenda	A Pygram
9.10 to 9.30	1. Introduction and objectives	S Harrison
9.30 to 10.30	2. Feedback and findings; Our proposals	A Pygram / A Stacey
10.30 to 11.00	Break	
11.00 to 12.15	3. Consultation exercise	J Higon
12.15 to 12.45	4. Lessons learned from past enforcement decisions	A Pygram
12.45 to 13.00	5. Next steps & close	A Stacey

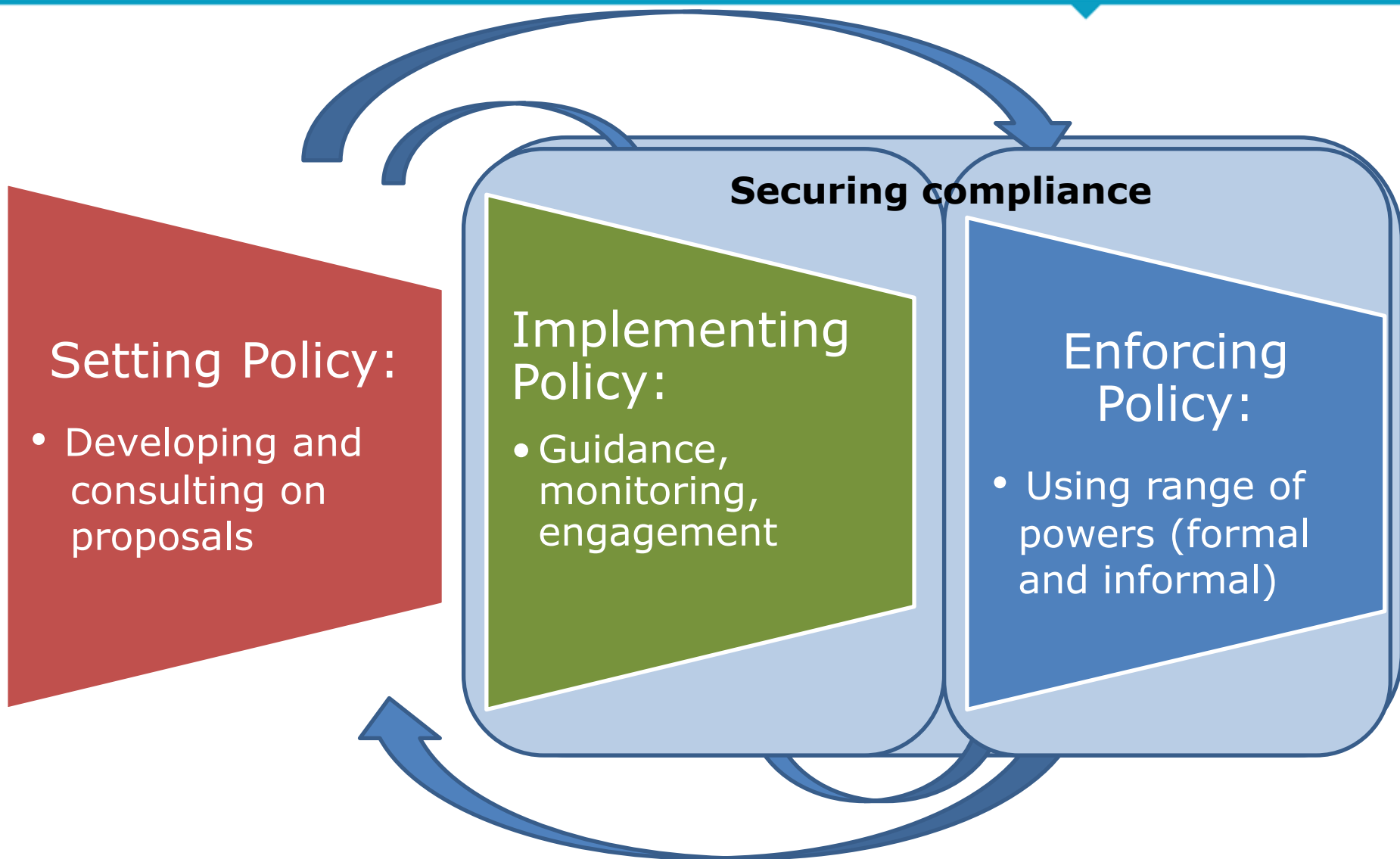
1. Introduction and objectives

Sarah Harrison,
Senior Partner, Ofgem and
Member of the
Gas and Electricity Markets Authority

Protecting consumers

- Ofgem uses a range of tools to make the market work effectively and protect consumers, for example :
 - developing policy
 - determining the content of gas and electricity licences
 - price controlling monopoly network businesses
 - monitoring market conduct and vfm for consumers
 - enforcing when things go wrong
- Today's focus is on the role of the last of these in protecting consumers

Policy lifecycle – a conceptual framework



Enforcement - a core activity

- The scope of Ofgem's enforcement activities is increasing
- Our responsibility is to carry out investigations into company behaviour when we believe they may have breached:
 - a condition of their licence
 - the requirements of consumer protection
 - the requirements of competition legislation
 - the requirements of the REMIT regulations

Enforcement – a changing landscape

- Sectoral powers
 - Standards of Conduct, RIIO framework, E-Serve schemes, further market changes eg EMR
- Competition powers
 - ERRA 2013 envisages a “step up” in application of competition policy and law including in regulated sectors
 - Ofgem is committed to working with CMA in new UKCN framework
- REMIT
 - a new regime to tackle market manipulation in traded wholesale markets
 - key interactions with ACER
- Consumer redress
 - giving statutory backing to what is being achieved voluntarily

The Enforcement review helps set the future framework

Enforcement Review: why?

- Drivers:
 - to target resources proportionately and effectively
 - to increase efficiency and speed of case completion where possible
 - to improve transparency of investigation processes and decision making
 - to increase impact, and
 - to address challenges of changing landscape in a coordinated and integrated way

Enforcement vision

To achieve a culture where businesses put energy consumers first and act in line with their obligations

Three Strategic Objectives:

1. Deliver credible deterrence across the range of our functions.
2. Ensure visible and meaningful consequences for businesses who fail consumers and do not comply.
3. Achieve the greatest positive impact by targeting enforcement resources and powers.

* Subject to Authority decision

Enforcement Review: activity to date



 Conference scope

Objectives of today

1. Progress the enforcement review
 - we asked for your views (via KPMG)
 - we will update on how we are taking these forward, and
 - consult on some specific proposals

2. Give some feedback
 - share some lessons & themes from previous cases

2. Feedback and findings

Anthony Pygram

Partner, Enforcement and Competition Policy,
Ofgem

Stakeholder engagement

- Earlier this year KPMG conducted interviews and roundtable meetings with external stakeholders
- The aim was to obtain their perspectives in relation to Ofgem's enforcement activities. A range of areas were covered:
 - the outcomes enforcement is trying to achieve
 - how enforcement should be carried out in order to achieve its outcomes
 - how the Enforcement team should work
 - the key requirements for effective enforcement
- Stakeholders from seventeen organisations were interviewed: large and small licensees, industry bodies and other regulators

Regulators – key themes

“there was broad agreement among regulators that there was no quick-fix or simple solution to enhancing enforcement activity”

- **Strategic planning** - moving towards greater use of strategic planning to bring structure to enforcement activity
- **Prioritisation criteria** – defining criteria to prioritise cases, enabling a fair and consistent approach to decision-making
- **Principles-based regulation** – there is a move from rules-based to principles-based regulation (e.g. Standards of Conduct)
- **Alternatives to fines** – alternatives (e.g. redress) are being considered and used
- **Outcomes-based investigations** – closer attention to the long-term effects of actions and less focus less on immediate results

Stakeholder feedback

- **Clarity of enforcement priorities** – people felt uncertain about Ofgem’s enforcement priorities (and felt uncertainty could increase the cost of compliance activity in the sector)
- **Guidance and interpretation** – more guidance, advice and information was requested
- **Fairness, clarity and connection to objectives in decision making** – perception that there was inconsistent application of the rules, standards and processes in relation to enforcement activity
- **Independence and trust**
 - there was widespread recognition that an enforcement regime is in the interests of licensees and overall is welcomed and encouraged
 - enforcement activity was not always perceived as visibly independent of internal and external pressures

Stakeholder feedback

- **Matching skills to activity** – stakeholders did not always see an appropriate match of Enforcement team skills, experience and empowerment to the activity underway
- **Engagement**
 - acknowledgement that Ofgem had shown leadership on topics which the sector would probably have not moved on unprompted
 - better interaction/communication with the Enforcement team
- **Transparency**
 - competing challenges facing Ofgem were recognised (e.g. the pace of change vs. developing holistic responses within adequate timeframes)
 - more transparency in relation to investigations, the expected steps and timeframe was desired

Stakeholder feedback

- **Accountability and timeliness**
 - enforcement has forced licensees to move away from an engineering culture to one where accountability for consumers is moving higher up the organisation
 - people thought that the way in which the Enforcement team conduct investigations needed more challenge and accountability; their length was also raised
- **Pragmatism** – preference for Ofgem to make greater use of the full range of enforcement tools not just investigations
- **Understanding** – perceived lack of knowledge and understanding of the operational constraints and complexities of working in the sector

3. Our proposals

Anna Stacey

Head of Enforcement Policy, Ofgem

Our proposals

- **Clarity of enforcement priorities** – we have proposed (subject to GEMA decision) that enforcement priorities, agreed by GEMA, will be set each year, and used to prioritise our enforcement activities
- **Fairness, clarity and connection to objectives in decision making & Independence and trust** – we have proposed (subject to GEMA decision):
 - an Enforcement Decision Panel for contested cases
 - a Settlement Committee to decide cases where the penalty is above a threshold
 - formal decision-making guidance and the annual enforcement priorities to promote consistency
 - the establishment of an Enforcement Oversight Board to take strategic case-handling decisions like opening formal investigations

Our proposals

- **Matching skills to activity** – we are reviewing case resourcing and staff development processes
- **Accountability and timeliness** – we are:
 - reviewing our case management processes to ensure effective and timely planning and management of cases, empowering staff and clarifying their accountability
 - identifying opportunities to improve efficiency and generate time savings
 - formalising our knowledge management and continual improvement processes to ensure that we continue to get better at what we do

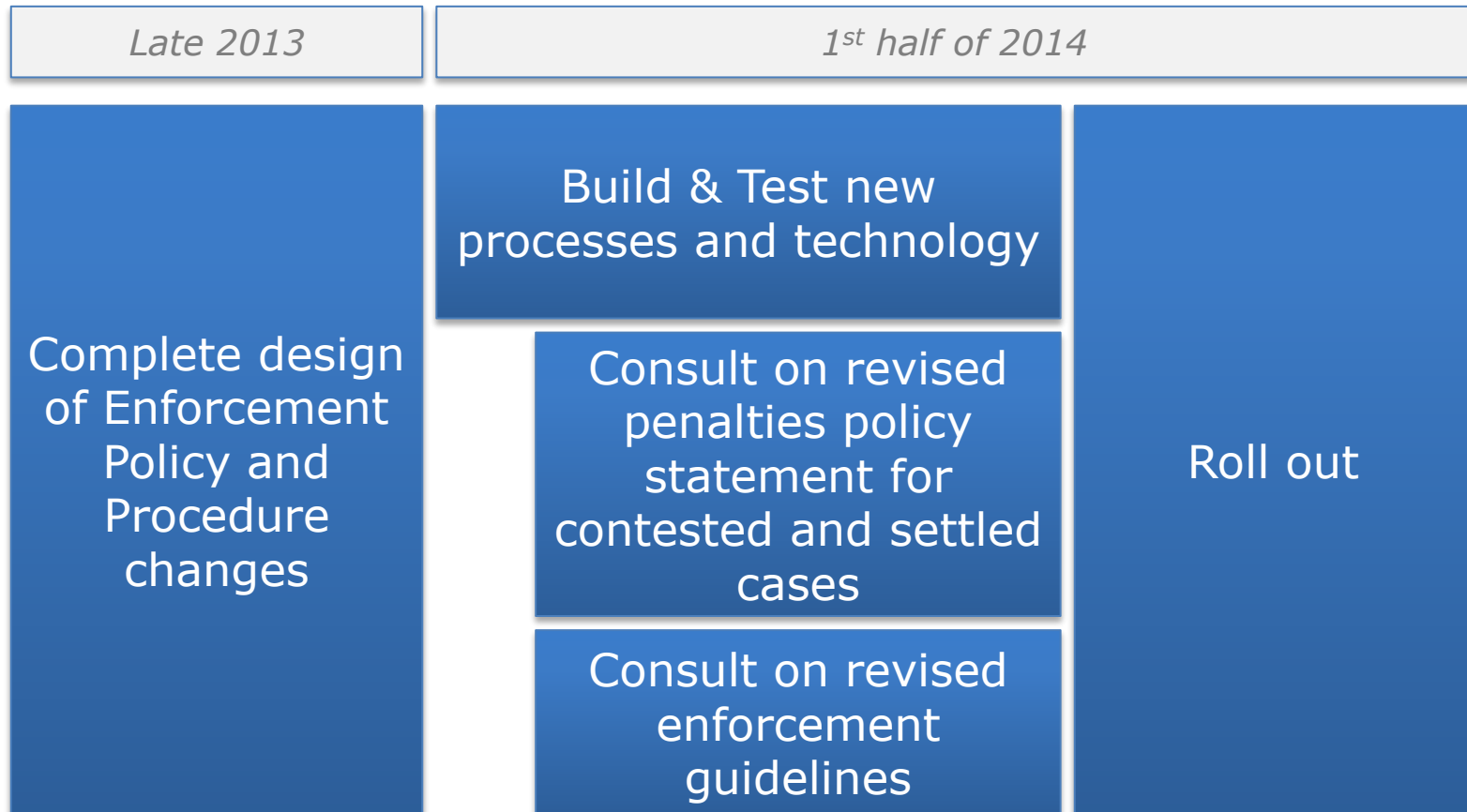
Our proposals

- **Pragmatism** – in line with other regulators we are already using a range of enforcement tools such as warning letters, reputational measures, penalties and consumer redress. Now we will be incorporating processes to formalise this in our standard procedures
- **Understanding** – we will encourage more interactions (e.g. site visits) to ensure that the Enforcement Team is more aware of the operational realities

Our proposals

- **Guidance and interpretation, Transparency & Engagement** – for enforcement we are:
 - re-formatting and updating our case management processes and the external guidelines to ensure that there is clarity and robustness in the way we conduct our enforcement activities. One process for all cases.
 - incorporating processes to ensure that we have more regular and useful communication with parties under investigation
 - considering regular events (e.g. hosting an annual conference) to present enforcement prioritisation themes and lessons learned to our stakeholders

Enforcement Review: planned activity



Questions?

Consultation

- After the break
- We will give you an opportunity to comment on the findings we have presented.
- Then, we would like to consult on aspects of our proposals. These are:
 - flexible interaction with companies
 - shared understanding of cases
 - publicity
 - guidelines

4. Consultation exercise

John Higton
Director, Prederi

Comments?

Flexible interaction with companies

Outcome Improved communication, leading to better understanding for both parties

Proposal Our ideas include:

- more site visits, meetings, informal updates and regular contact to improve communication with the company under investigation
- updates with companies could be driven primarily by milestones as well as elapsed time/fixed intervals (e.g. as particular stages of evidence-gathering or analysis are passed, rather than once every 3 months). We may be able to tailor our approach for each case – discussing with the company at the start what the schedule of communications will look like

Questions

- How do we find the balance between increased interaction to improve communication, with the burden that can be created by the company's need to prepare for visits (e.g. for smaller companies)?
- What types of interaction do companies find helpful?
- What are the right milestones for updates?

Opportunities for shared understanding of cases

Outcome Companies feel that they have regular opportunity to understand Ofgem's thinking on a case, and to challenge

Proposal Our ideas include:

- a kick off meeting, at the outset of the investigation, to initiate dialogue with the company, set out our concerns (the potential breaches) and where appropriate, identify opportunities for remedial action
- setting out our views of breaches and our findings to the company, giving companies the chance to comment before the evidence is written up for a Statement of Case, or settlement negotiation
- holding a state of play meeting with companies to enable Ofgem to decide whether to focus on a settlement route, or move to issue a Statement of Case. The aim would be to enable the parameters for settlement negotiations to be established, and avoid spending time on negotiations when the parties' positions are too far apart

Questions

- What are the stages where companies most feel the need for comment?
- What is the right starting point for a meeting to enable Ofgem and the company to be clear about whether the settlement route is viable?
- What do you need to agree the settlement route at senior management / Board level?

Publicity

Outcome

- Fulfil Better Regulation objective of transparency
- Deter those who might commit similar transgressions
- Provide information about the sort of behaviours which concern Ofgem
- Encourage third parties to come forward with evidence
- Incentivise faster informal resolution of cases

Proposal

- We will be developing our policy for when and how cases should be publicised in future, and will consult on this next year
- Cases will not be publicised where it is not in the public interest or it will be detrimental to the investigation

Question

How can we strike the right balance between transparency on the one hand, and confidentiality / consumer confidence on the other?

Enforcement Guidelines

Outcome Guidance is another key component of transparency. It must meet better regulation principles and:

- be accessible to stakeholders, avoiding unnecessary duplication of text
- clearly describe how we take decisions to open and close cases
- explain the case-handling processes we would normally expect to follow
- show how decisions will be taken and publicised

Proposal

Changes to case-handling and decision-making processes will be set out in revised guidelines. We want your views on how this could best be laid out.

Bearing in mind the needs of stakeholders, we propose, for example, to split out the part of the Guidelines aimed at consumers into a separate document.

Question

How can we improve on what we currently do?

What are the needs for the Guidelines within your organisations?

5. Lessons learned from past cases

Anthony Pygram

Partner, Enforcement and Competition Policy,
Ofgem

Lessons from recent cases: monitoring and auditing

- Sufficient Board-level attention needs to be paid to compliance, and senior management need to give compliance a sufficiently high priority. Responsibility for having appropriate systems rests with senior management, and so their decisions can contribute to a failure to comply¹
- Absence of appropriate monitoring and compliance arrangements is clearly serious²
- Audit criteria should include ascertaining whether all things that are required under licence conditions have been done³
- Need to be able to show that you are gathering evidence that allows you to monitor compliance with obligations⁴
- Auditing should not be done by someone who has a financial interest in the outcome of the audit⁵

¹ See for example <https://www.ofgem.gov.uk/sites/default/files/sse-penalty-notice.pdf> para 133 and <https://www.ofgem.gov.uk/sites/default/files/final-edf-energy-penalty-notice-failure-comply-standard-licence-conditions-23-25-and-27.pdf> para 5.18 and <https://www.ofgem.gov.uk/sites/default/files/final-wales-and-west-utilities-ltd-penalty-notice-failure-comply-conditions-its-gas-transporter-licence.pdf> para 6.10 and https://www.ofgem.gov.uk/sites/default/files/final_penalty_notice_for_e.on_energy_solutions_limited_-_1_august_2013_0.pdf para 4.9

² See <https://www.ofgem.gov.uk/sites/default/files/sse-penalty-notice.pdf> paras 130 and 149

³ See <https://www.ofgem.gov.uk/sites/default/files/sse-penalty-notice.pdf> para 32.

⁴ See <https://www.ofgem.gov.uk/sites/default/files/sse-penalty-notice.pdf> para 81.

⁵ See <https://www.ofgem.gov.uk/sites/default/files/sse-penalty-notice.pdf> para 39.

Lessons from recent cases: misreporting

- The 'regulatory contract' depends on us receiving information that we can rely on
- Misreporting leads to bad decisions
- Even small absolute levels of misreporting are not trivial but can be serious because their underlying cause could allow more significant misreporting, and because Ofgem relies on accurate information being reported for carrying out its functions¹
- Licensees are on notice of the importance of providing accurate information and have been for some time²

¹ See for example <https://www.ofgem.gov.uk/sites/default/files/final-wales-and-west-utilities-ltd-penalty-notice-failure-comply-conditions-its-gas-transporter-licence.pdf> para 5.5. and https://www.ofgem.gov.uk/sites/default/files/final_penalty_notice_for_e.on_energy_solutions_limited_-_1_august_2013_0.pdf paras 3.6 and 4.3.

² See <https://www.ofgem.gov.uk/sites/default/files/final-wales-and-west-utilities-ltd-penalty-notice-failure-comply-conditions-its-gas-transporter-licence.pdf> para 5.10.

Lessons from recent cases: achieve statutory targets on time

- The 'regulatory contract' also depends on companies delivering on statutory targets
- Meeting deadlines is essential for the credibility of government schemes (we have recently opened several CERT/CESP cases)
- Also important where targets prevent consumers losing out
- This will be important for the roll out of smart meters
- Progress towards meeting targets can be noted in determining penalty.¹

¹ See https://www.ofgem.gov.uk/sites/default/files/ngg_penalty_decision_final_for_pub.pdf para 4.4

Lessons from recent cases: after a breach

- Reacting swiftly to breaches identified is good¹
- Compensation to affected customers is welcome - but is no more than should be expected from any conscientious licensee²
- The Authority can accept assurances, based on proper investigation by the licensee, that that all breaches have been identified – but would take a very serious view of evidence that the assurances were not valid³
- The Authority welcomes a licensee using an independent external auditor where the auditor has duty of care to Ofgem and an agreed mandate⁴

¹ See for example <https://www.ofgem.gov.uk/sites/default/files/final-edf-energy-penalty-notice-failure-comply-standard-licence-conditions-23-25-and-27.pdf> para 5.19.

² See <https://www.ofgem.gov.uk/sites/default/files/sse-penalty-notice.pdf> para 136.

³ See <https://www.ofgem.gov.uk/sites/default/files/final-wales-and-west-utilities-ltd-penalty-notice-failure-comply-conditions-its-gas-transporter-licence.pdf> para 3.6.

⁴ See https://www.ofgem.gov.uk/sites/default/files/final_penalty_notice_for_e.on_energy_solutions_limited_-_1_august_2013_0.pdf para 1.9

Lessons from recent cases: principal terms

- Principal terms include:
 - Unit rates
 - Standing charges
 - Amount and type of any discounts

(see: <https://www.ofgem.gov.uk/sites/default/files/sse-penalty-notice.pdf> para 23 and <https://www.ofgem.gov.uk/sites/default/files/final-edf-energy-penalty-notice-failure-comply-standard-licence-conditions-23-25-and-27.pdf> para 3.5)

6. Next steps

Anna Stacey
Head of Enforcement Policy, Ofgem

Next steps

- The presentations and minutes from today's conference will be posted on the Ofgem website
- Authority decisions on the Vision, Strategic Objectives and decision-making processes (autumn 2013)
- Finalised REMIT penalty and procedural guidance (autumn 2013)
- Further consultations on consumer redress, penalties and revised Enforcement Guidelines

Any further comments on today's consultation:

- Please send to enforcementguidelines@ofgem.gov.uk by Friday 25 October

Ofgem is the Office of Gas and Electricity Markets.

Our priority is to protect and to make a positive difference for all energy consumers. We work to promote value for money, security of supply and sustainability for present and future generations. We do this through the supervision and development of markets, regulation and the delivery of government schemes.

We work effectively with, but independently of, government, the energy industry and other stakeholders. We do so within a legal framework determined by the UK government and the European Union.