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By email to: enforcementguidelines@ofgem.gov.uk
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22nd May 2013

Dear Megan

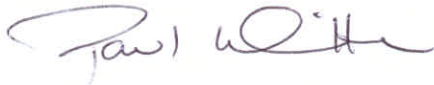
Review of Ofgem's enforcement activities – consultation dated 28 March 2013 on strategic vision, objectives and decision makers

1. Thank you for the opportunity to comment on the above consultation.
2. National Grid owns and operates the high voltage electricity transmission systems in England and Wales and operates the Scottish high voltage system. National Grid also owns and operates the gas transmission system throughout Great Britain and, through its low pressure gas distribution business, distributes gas in the heart of England to approximately eleven million businesses, schools and homes. In addition, National Grid owns and operates substantial electricity and gas assets in the US, operating in the states of New England and New York.
3. There are some overarching comments in response to the consultation which are set out below: a more detailed response is provided in Appendix 1.
4. National Grid notes that the content of this consultation is extremely high level. Whilst comments have been provided, National Grid looks forward to receiving more detail on the specific proposals over the coming months, and to providing a more complete response.
5. National Grid appreciates that this consultation is part of the wider Enforcement Review taking place over the coming months, and that some issues that have been raised in earlier stages of the Enforcement Review, such as the settlement procedure and communications with companies under investigation, will be re-reviewed at a later date, in addition to reviewing further issues, such as Ofgem's penalty policy. It is National Grid's view that, to the extent possible, all enforcement issues should be looked at together. Accordingly, National Grid requests that its responses dated 28 February 2012 to Ofgem's earlier consultation on the Draft Enforcement Guidelines, should be read in conjunction with this

6. response. Although National Grid has not sought to repeat these responses in the context of responding to this consultation (unless relevant to the current issues), National Grid notes that the majority of the comments and concerns in its responses have not yet been addressed by Ofgem and confirms that all its comments still stand. It is also National Grid's view that any changes being considered now should take into account likely future changes to Ofgem's enforcement powers, such as the introduction of Consumer Redress Orders.
7. National Grid also notes that Ofgem is working with KPMG in order to increase the efficiency of its enforcement procedures and approach to penalties and redress. National Grid welcomes any attempts to increase efficiency (whilst still ensuring a fair and transparent process). As Ofgem is aware, National Grid has been involved in previous investigations which have taken in excess of 2 years (from the first statutory request for information to the final notice) to reach a conclusion. Lengthy periods of investigation cause great uncertainty and cost for regulated entities and Ofgem and are arguably not in the interests of consumers. It follows that investigations of this length should be avoided, to the extent possible.
8. National Grid welcomes Ofgem's overall mission to make a positive difference for energy consumers. However, in line with other regulators, Ofgem's Vision should specifically refer to achieving the right culture through a transparent and proportionate approach to enforcement. Transparency and proportionality should be key elements of any regulatory vision.
9. Two of Ofgem's key Strategic Objectives are credible deterrence and having meaningful consequences for non-compliance. National Grid considers that the focus of the Strategic Objectives should be on changing behaviours and ensuring that regulated entities are acting in accordance with regulatory standards, rather than on punishment and sanctions for non-compliance.
10. National Grid is encouraged that some of the provisions in this recent consultation aim to make the enforcement process more transparent, consistent and proportionate, which accords with the principles of Better Regulation. It is hoped that the introduction of a clear Vision and Strategic Objectives may empower Ofgem to focus on investigating the most significant instances of non-compliance which have a serious and measurable impact on consumers, and to deal with less significant cases in a more streamlined and proportionate manner, whilst assuring consumers and regulated entities with its transparent approach.
11. National Grid welcomes an independent, specialist Enforcement Decision Panel to make enforcement decisions. However, the constitution of this panel must indeed be independent, and balanced.
12. Ofgem's consultation also refers to a conference being scheduled during the summer as part of its Enforcement Review. National Grid welcomes this opportunity to have a productive discussion with Ofgem and all interested parties in relation to the way forward in respect of enforcement.

13. If you would like to discuss any points we have raised or have any questions, please contact Charlotte Digby in the first instance on charlotte.digby@nationalgrid.com or on 01926 655229.

Yours sincerely

A handwritten signature in purple ink, appearing to read 'Paul Whittaker'.

Paul Whittaker
Director, UK Regulation

Appendix 1

Vision, Objectives and Strategic Priorities

Q.1 Do you agree that this is the right Vision for Ofgem's enforcement work? Please provide us with any comments you have on the Vision.

1. National Grid welcomes Ofgem's overall mission to make a positive difference for energy consumers and to have a more transparent framework within which it makes its decisions.
2. National Grid also welcomes a culture where businesses put energy consumers first and act in line with their obligations, and considers it to be a good starting point for a vision. One query National Grid has is why the Vision and Strategic Objectives are directed towards businesses, rather than regulated entities or licensees. We presume that, by businesses, Ofgem is referring to licencees, but clarification on this point is requested.
3. Other regulators adopt similar visions, with a focus on protecting consumers. The Office of Rail Regulation's (the "ORR's") Economic Enforcement Policy and Penalties Statement describes *"how [the ORR] use [its] licence enforcement powers to ensure that the public interest is protected, that the industry delivers a safe, high quality and efficient service to passengers and freight customers which represents value for money, and to be transparent as to the approach [the ORR is] likely to adopt in individual cases."* The Solicitors Regulatory Authority's vision is to be *"the leading regulator of legal services, protecting the public, empowering, supporting and developing our people, providing value for money, fair and transparent outcomes and service excellence in everything we do."*
4. In light of other regulatory approaches, National Grid considers that, in addition to protecting consumers, a key element of any enforcement vision must be transparency; both for consumers and regulated companies. While National Grid notes that Ofgem has provided that it proposes to achieve its Strategic Objectives under this consultation by "being transparent and fair in enforcement processes", it considers that transparency should be a cornerstone of Ofgem's regulatory approach and therefore form part of its vision. Ensuring transparent enforcement is vital to helping the industry to understand what is expected of it and what it should expect from Ofgem. Ofgem might consider adding to its proposed vision as follows to make it clear that it has an external and internal focus: "To achieve a culture where businesses put energy consumers first and act in line with their obligations supported by a transparent approach to enforcement."

Q.2 Do you agree with Ofgem's proposed Strategic Objectives, and principles for achieving them, and do you think it would be helpful to adopt annual strategic priorities? Please explain the reasons for your answer and any aspects which you think we should consider.

Strategic Objectives

5. Ofgem's proposed Strategic Objectives and principles for achieving them largely appear sensible. While we welcome Ofgem providing details of its initial thoughts on this important area, it is difficult for National Grid to provide detailed comments at this stage as the information provided is very high level. National Grid expects to have further comments once the detailed proposals for the Strategic Objectives have been considered, and looks forward to providing these as part of a more detailed consultation. For example, National Grid would like to understand more about the range of enforcement tools that Ofgem is planning to use and how and when these will be adopted.
6. Whilst National Grid accepts that enforcement activities will be carried out in a changing environment, it is not clear from Ofgem's consultation paper how these changing enforcement priorities will determine what Ofgem does in practice on a year on year, day to day basis. For example, it is likely that investigations may be commenced in one year under one set of strategic priorities but continue into the following year when the priorities may have changed. National Grid is unclear whether Ofgem would continue with such an investigation, despite the fact that it no longer represents one of Ofgem's strategic priorities. Clarity needs to be provided in this respect. Regulators such as the Office of Fair Trading ("OFT") have previously closed cases part way through an investigation on the basis that the matters under investigation no longer represented the OFT's strategic priorities. Will this be the approach taken by Ofgem? Clarity is also needed on issues such as, is it only instances of regulatory non-compliance that fit within the annual strategic priority that will be investigated, or that will be investigated in full or will other cases be investigated too? In relation to the selection of strategic priorities, National Grid requests that any changes to Ofgem's strategic priorities are consulted upon with interested stakeholders.
7. National Grid questions whether the first, primary, Strategic Objective should be to deliver credible deterrence. National Grid suggests that delivering credible deterrence sets the wrong tone for Strategic Objectives, as it draws the focus immediately on punishment and sanctions for non-compliance. National Grid considers that Ofgem's strategic priorities should focus on changing behaviours and ensuring that regulated entities are acting in accordance with the regulatory standards they are subject to through establishing a transparent, open and co-operative regulatory environment. This focus on transparency is in line with the principles of Better Regulation.
8. National Grid notes that the Financial Conduct Authority ("FCA"), to which it is understood Ofgem and KPMG may be looking as an example of best practice regulation, has credible deterrence as one of its Strategic Objectives. The financial services and energy sectors are very different and it is not the case that what may work well for the FCA will automatically work well for Ofgem. The key for Ofgem as a regulator is licence compliance, for which there

are civil penalties for non-compliance. One of the key issues for the FCA as a regulator is preventing criminal activity. The FCA has powers to prosecute a number of criminal offences including, for example, the carrying out of regulated activities without being authorised, insider dealing and market abuse. This increasing focus by the FCA on using its criminal powers lends itself much more appropriately to a strategic objective of credible deterrence and simply does not read across to the energy sector. Whilst credible deterrence is not limited to the field of criminal misconduct, the regulatory agenda adopted by the FCA has been driven by factors which are, in many ways, unique to the financial services market.

9. Further clarification is required in relation to what is meant by the Strategic Objective of achieving the greatest positive impact by targeting enforcement resources and powers. It is hoped that this will ensure that Ofgem deals with cases going forward with reference to the Strategic Objectives, but also that it deals with cases proportionately with reference to the materiality of the breach and its impact on consumers. In previous investigations, our experience has been that Ofgem has not always focused primarily on the materiality of the breach or the actual impact of any breach on consumers.

Targeting enforcement resources and powers

10. As Ofgem will no doubt be aware, other regulators also adopt a targeted and proportionate approach to enforcement, this being two of the key principles of Better Regulation. The approach of the ORR, the Office of Communications ("Ofcom") and the Office of Water Services/Water Services Regulation Authority ("Ofwat") is to focus their resources and only bring formal enforcement action to deal with the more serious and/or persistent breaches or individual events of material significance. There is a bias against intervention, and a focus on pursuing constructive, less punitive action with companies where that is the most appropriate means of making sure that they meet their obligations. Similarly, the OFT targets its work at the most serious and prevalent market problems, to avoid burdening business with the costs of unnecessary intervention; the aim being to be as robust as necessary to gain compliance while allowing maximum freedom for effective competition within the law.
11. In order to ensure that resources are used to maximum effect, National Grid would encourage a more proportionate and targeted approach to instances of non-compliance by Ofgem, which may include the use of alternative sanctions, such as undertakings (formal and informal), warning letters, private notices, regular reporting mechanisms, requirements for additional investment and appropriate consumer redress orders, rather than lengthy investigations and financial penalties. The focus on enforcement has the potential to undermine the delivery of appropriate consumer outcomes.
12. An example of where a more informal, alternative sanction could have been considered by Ofgem is the recent investigation into Wales and West Utilities ("WWU"), resulting in the final notice dated 17 October 2012 and a financial penalty of £375,000. This was an investigation into mis-reporting of regulatory reporting data relating to the Mains Replacement Programme. Ofgem accepts in its final notice that WWU did not receive allowed revenue in

excess of which it was entitled as a result of the misreporting and that the lengths of pipe misreported and its consequent effect on allowed revenues was small. WWU misreported in aggregate 0.1% of its mains abandoned for the relevant period. Despite this, the investigation into this misreporting took in excess of 2 years from the date on which WWU self reported the issue to the final notice issued by Ofgem, and a financial penalty was still imposed. A more proportionate response might have been to address the systems and process issues identified by Ofgem through alternative measures, such as undertakings. This would have been more efficient and proportionate and would also have had the further benefit of encouraging others to report errors, from which Ofgem and other regulated entities could learn lessons. National Grid notes that the FCA, Ofwat and Ofcom already use a range of these different measures. Ofwat publishes a pyramid in its Enforcement Guidelines, which shows the range of measures that it uses in enforcement action according to the seriousness of the breach/non compliance.

13. Issues such as proportionality and the materiality of any breach should impact on the decision to investigate and the methodology of any investigation, in addition to the level of any penalty/consumer redress order or other sanction. It is not in the interest of consumers to spend significant time and money on an investigation into a relatively trivial matter.

Q3. What obstacles do you consider that Ofgem may encounter in achieving its Vision and Strategic Objectives?

14. Some of the obstacles that we consider Ofgem may encounter in achieving its Vision and Strategic Objectives are:
 - 14.1 Being able to present them in a way that is understandable and meaningful to stakeholders;
 - 14.2 Ensuring that the Vision and Strategic Objectives are capable of being, and in fact are, applied in practice, by virtue of the enforcement tools and powers used by Ofgem;
 - 14.3 Taking into account the various stakeholder views and different interpretations of the proposed Vision and Strategic Objectives;
 - 14.4 Determining, in a clear and transparent way, the extent to which the Vision and Strategic Objectives will determine the day to day operation of the various enforcement groups within Ofgem and the Authority; and
 - 14.5 Taking into account various proposed changes, such as the proposed introduction of consumer redress orders, in the setting and interpretation of the Vision and Strategic Objectives.

Decision Making

Q4. Do you agree with the proposals for an Enforcement Decision Panel and Secretariat to take decisions in contested enforcement cases?

15. National Grid welcomes the acceptance of the need for visibly objective decision making, and the proposed introduction of an independent, specialist panel. Such decision making also needs to be transparent. The benefits of a specialist, independent panel are demonstrated by the OFT/Competition Commission.
16. Ofgem need to ensure that there is a balanced Enforcement Decision Panel. For example, if there are consumer rights representatives on the Panel, there should also be representatives from the industry to ensure a balanced viewpoint. More generally, it would be useful to have a representative from the energy industry on each panel who will understand the practical issues being investigated.
17. The members of the Enforcement Decision Panel must be sufficiently trained in order to make decisions in line with Ofgem's strategic priorities and Ofgem's Enforcement Guidelines and penalty policy. They must also be flexible and available to meet as required. Meetings of the Enforcement Committee must take place at a time that is appropriate for the overall investigation.
18. Further clarification needs to be provided in relation to how the Panel chair is selected and also how the Panel chair then selects the remainder of the Panel. In addition to being balanced, the Panel should be selected according to relevant experience of the specific issues being investigated in any one case.
19. The consultation states that the Enforcement Decision Panel will "have regard to the decision making guidance set out by the Authority". This guidance should be published in draft and consulted upon. Clarification is required in relation to the meaning of "have regard to" in this circumstance. It should not be open to the Enforcement Decision Panel to have regard to the decision making guidance set by the Authority, but then go on to make a decision that, for example, contradicts various provisions of the guidance.
20. National Grid encourages the introduction of an Enforcement Decision Secretariat if it achieves the aim of making the enforcement process more efficient. There may also be legal/public policy issues that need dealing with by a team independent of the investigation team, if questions are being raised about the actions of the investigation team. Further clarification is required on precisely what work falls within the remit of the Enforcement Decision Secretariat and what decisions the Secretariat would be making. In addition, further clarity is also required in relation to the proposed membership of the Enforcement Decision Secretariat. National Grid may have further comments on this proposed new unit once further information is available.

21. In relation to both the Enforcement Decision Panel and the Enforcement Decision Secretariat, in order to ensure the transparency of the process, the terms of reference from the Authority/Oversight Board should be available to the regulated entity being investigated, as should the identity and background of those on the Panel. The Panel should also be requested to complete and disclose a register of interests. Each set of terms of reference must have a requirement on the Panel members/Secretariat to act independently and impartially.
22. With the introduction of an Enforcement Decision Panel, Enforcement Decision Secretariat, Settlement Committee, Enforcement Oversight Board and the general work of the Authority, the terms of reference for each of these bodies must be clear and mutually consistent in order to avoid any confusion and overlap. The roles, responsibilities and reporting lines for these different groups must be clear and transparent to all involved in enforcement.
23. National Grid notes that other regulators, such as the FCA, have a further independent body (the Upper Tribunal in the case of the FCA) to which final decisions can be referred for a re-hearing when one party is not satisfied with that decision. As noted in previous consultation responses, regulated entities in the energy sector have extremely limited rights of appeal and currently have no rights in respect of merits based appeals or a re-hearing of the issues.

Q5. Do you agree with the proposal for settlement decisions?

24. National Grid has previously provided comments on Ofgem's proposed settlement procedure, as set out in its response to Ofgem's consultation on its Draft Enforcement Guidelines dated 28 February 2012. Some of the key points have been repeated below, but please refer to National Grid's previous comments in full for further detail.
- 24.1 The settlement procedure does not take into account section 30A(3) and section 30A(4) of the Gas Act 1986 and section 27A(3) and section 27A(4) of the Electricity Act 1989, which require notices to be published of the intention to impose a financial penalty before it is finally confirmed. It is National Grid's experience that in enforcement cases where there has been an agreed settlement position between Ofgem and the regulated entity, Ofgem has required such a notice to be published in advance of any formal confirmation of the settlement terms, and that no guarantee could be provided by the Authority that the terms of settlement would not be amended to take into account third party representations made during the notification period. This is unworkable for regulated entities. The suggestion that the enforcement procedure would be truncated in the event that the Authority considered the settlement offer needed to be amended is a serious barrier to settlement. Absent a change in the primary legislation, Ofgem could take the view that an agreement to pay a penalty as part of a settlement agreement does not constitute the "imposition" of a financial penalty for the purposes of section 30A of the Gas Act 1986 or section 27A of the Electricity Act 1989, or alternatively extend the system of undertakings to encompass the payment of a financial penalty by agreement. The Financial Conduct Authority ("FCA"), which also has a formal settlement process, has no requirement to publically consult on the terms of any settlement, proposed penalty or other form of sanction.

- 24.2 There is no detail in the settlement section of the Enforcement Guidelines regarding final steps once the settlement terms are approved following the period of consultation and how they are recorded in a final order. A guideline as to the time to be taken by Ofgem to confirm the terms of settlement or the terms of the Penalty Notice should be included in the Enforcement Guidelines.
- 24.3 In addition to ensuring separation of decision making between the Settlement Committee and the Enforcement Committee/Enforcement Decision Panel, it should also be made clear that: (i) neither party can rely on statements during the settlement discussions in subsequent Enforcement Committee/Enforcement Decision Panel hearings; (ii) in the interest of fairness and transparency, the investigation team cannot rely on information received during settlement discussions in making recommendations to the Enforcement Committee/Enforcement Decision Panel; (iii) all communications between the investigation team and the Enforcement/Settlement Committees should be copied to the regulated entity under investigation; and (iv) the investigation team should not make a recommendation to the Enforcement Committee/Enforcement Decision Panel as to the appropriate outcome of the enforcement proceedings. Within the FCA, any instances of non-compliance that cannot be settled within its enforcement division are referred to the Regulatory Decisions Committee (the "RDC") with a recommendation for regulatory action. The RDC is a committee of the FCA board, but it is completely separate from the FCA's executive management structure. Apart from its chairman, none of the members of the RDC are FCA employees. The RDC has its own legal advisors and support staff. This level of independence and separation is seen as key to the fair and transparent treatment of enforcement matters within the Financial Services sector. Such independence and separation is equally required in the Energy sector.
25. In addition to the comments made above and with specific reference to the current consultation, Ofgem needs to clarify the extent to which the annual strategic priorities will influence which cases are deemed appropriate for settlement. Ofgem also needs to provide greater clarity on the wider factors that may influence a decision as to whether a particular case is suitable for settlement.
26. As the Settlement Committee is a non standing committee, members of the committee should be available as and when required. In previous cases, National Grid has had to work to unrealistic deadlines because a non standing committee is already meeting on a particular date.
27. National Grid agrees in principle that settlement decisions can be made by a Senior Partner in charge of enforcement where the proposed penalty is less than £100,000. This should help to ensure that cases are dealt with efficiently and proportionately. However, such a decision must still be fair, transparent and independent, and be seen to be such.
28. Further clarity is required on the role and constitution of the Enforcement Oversight Board. From the consultation document, it appears that the Enforcement Oversight Board only has responsibility for providing advice to Senior Partners who make settlement decisions where

the proposed penalty is less than £100,000. There is a reference to the Enforcement Oversight Board taking strategic decisions on enforcement cases throughout their duration, but this comment is made in reference to lower level settlement decisions. It is not clear whether the Enforcement Oversight Board has a wider role, beyond these limited settlement decisions. As with the Enforcement Decision Panel, Enforcement Decision Secretariat, and Settlement Committee, the terms of reference for the Enforcement Oversight Board should be available for all interested parties to review.

Q6. Do you agree with the proposed arrangements for the Authority's oversight of the Panel's work?

29. National Grid welcomes one body having oversight of the various activities being undertaken by Ofgem in relation to enforcement, as it should help to ensure a consistent and fair approach in respect of all regulated entities. National Grid is likely to have more comments on the specific guidance provided by the Authority when it is published. As mentioned at paragraph 19, such guidance (and any subsequent updates) should be subject to the consultation of interested stakeholders.
30. Further clarity is required in relation to any actions that may be taken by the Authority in its oversight function. The consultation paper states that the Authority will review all decisions, and decision making functions and case progress on an annual basis, but it also says that the Authority will not seek to influence "live" cases. It would be useful, for example, if the Authority (or another body) regularly reviewed the status and progress of cases, with a view to the strategic priorities and to ensure that cases are being dealt with proportionately, given the nature of the matters being investigated. The FCA guidance provides that there will be ongoing dialogue throughout the investigative process, and where the FCA's concerns change significantly from that notified to the company at the outset, the FCA will reconsider the case and ensure that it is satisfied that the investigation should continue.

Q7. Do you have any additional comments on the matter covered in this Letter?

31. National Grid appreciates that this consultation is part of the wider Enforcement Review over the coming months, and that some issues that have been raised in earlier stages of the Enforcement Review, such as the settlement procedure and communications with companies under investigation, will be re-reviewed at a later date. It is National Grid's view that, to the extent possible, all enforcement issues should be looked at together and that National Grid's responses dated 28 February 2012 to Ofgem's earlier consultation on the Draft Enforcement Guidelines, should be read in conjunction with this response. It is also National Grid's view that any changes being considered now should take into account likely future changes to Ofgem's enforcement powers, such as the introduction of consumer redress orders.
32. National Grid is encouraged that some of the provisions in this recent consultation aim to make the enforcement process more transparent, consistent and proportionate, which accords with the principles of Better Regulation. It is hoped that the introduction of a clear Vision and Strategic Objectives may empower Ofgem to focus on investigating the most

significant instances of non-compliance which have a serious and measurable impact on consumers, and to deal with less significant cases in a more streamlined and proportionate manner, whilst assuring consumers and regulated entities with its transparent approach.