

To all stakeholders

31 March 2014

Dear stakeholder

Consultation on our financial penalties and consumer redress policy statement

Customers of energy companies rightly expect to be treated fairly and to be confident that companies¹ will meet their obligations and provide good services. It is important that, where companies breach their obligations, we act decisively to put things right. We have been reviewing our approach to enforcement. Now that we are at the end of our review, we are consulting on a new policy statement on imposing financial penalties and making consumer redress orders.²

The new policy statement emphasises the central role of penalties and redress in securing fair outcomes for consumers and deterring non-compliance. It also explains how we intend to use the new powers under the Energy Act 2013 to require companies to provide redress to consumers, compensating them directly where possible or putting them back into the position they were in before the breach.

Comments are welcome on the questions in the attachment to this letter and indeed on any aspect of the policy statement. Please send your responses by 23 June. Further details of how to do this are set out at the end of the attachment.

This work complements our recently published enforcement guidelines consultation and our open letter setting out our position on regulatory compliance, the roles and responsibilities of different parties, and how our approaches to compliance and enforcement activities interact with one another.

Yours faithfully

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Senior Partner, Sustainable Development

¹ The Gas Act 1986 and the Electricity Act 1989 impose obligations on 'regulated persons'. For simplicity we refer to 'companies' throughout this letter.

² In November 2013 we published separate guidance on REMIT [penalties](#) and [procedures](#). We expect to consult on proposed revisions to these documents later this year.

Consultation questions

The consultation has two sections. Section 1 outlines the key features of the penalties and redress policy statement and specifically seeks views on

- the objectives that we should promote when imposing financial penalties and making consumer redress orders
- the process that we propose to follow in calculating the amount of a financial penalty or consumer redress payment
- the factors that may aggravate or mitigate the amount of a financial penalty or consumer redress payment.

Section 2 summarises our proposed approach on key aspects of consumer redress and seeks views on

- the requirements that may be included in a consumer redress order
- the treatment of consumer detriment
- whether companies should bear the costs of administering the requirements of a consumer redress order.

We welcome comments on the questions and on any aspects of the policy statement.

Section 1: Financial penalties and consumer redress policy statement

We have reviewed our approach to imposing financial penalties taking into account our experience to date and the approaches of other regulators.

Objectives and duties in relation to penalties and redress

The proposed policy statement describes our central objectives in imposing penalties and/or making consumer redress orders. Consistent with our overall vision for enforcement, the objectives seek fair outcomes for consumers and aim to deter non-compliance by companies (see paragraph 2.3 of the policy statement).

The Authority is clear that companies should not benefit financially from any contravention or failure. Indeed, the Authority considers that non-compliance should normally cost significantly more than compliance (see paragraph 2.4). 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 the gain to the company and the detriment caused to consumers whether individually or as a group (see paragraph 2.5). We will also consider best regulatory practice to ensure that penalties and redress are targeted and proportionate (see paragraph 2.7).

Q.1 Are these objectives appropriate?

Determining the amounts payable under penalties and redress orders

The policy statement says the amount payable by a company will normally be made up of two elements: an amount to recover the detriment suffered by consumers and any gain made by the company as a result of the contravention or failure, and an amount that reflects the seriousness of the contravention or failure and the need for deterrence (see paragraph 5.3). This second category is the penal element.

The document then describes the process we will normally follow to determine the amount payable (see paragraphs 5.4 to 5.30). In summary, we will:

- seek to calculate the detriment and/or gain
- consider whether it is appropriate to make a consumer redress order and the scope of the remedies available under an order
- determine the penal element by looking at the seriousness of the breach, aggravating and mitigating factors
- consider deterrence and the overall reasonableness of the penal element, including the principle that the total amount paid by the regulated person should exceed the benefit that it gained from failing to comply with its obligations
- where a case is settled, apply a discount to the penal element
- make a consumer redress order and/or impose a financial penalty.

Q.2 Is the proposed process for determining the amount of penalties and/or redress appropriate?

This section of the policy statement also emphasises the importance of companies acting diligently and proactively in order to minimise the risks of non-compliance. We expect the processes and procedures employed by companies to guard against this risk to be more robust than in the past. For this reason, in calculating penalties, we are placing particular emphasis on the role that senior management play in maintaining an effective culture of full compliance in companies. Additionally, this section of the policy statement emphasises the importance of:

- reporting breaches to us promptly
- taking prompt and effective remedial action
- cooperating fully with us during an investigation.

Q.3 Do you agree with the proposed factors that may aggravate or mitigate the amount of a penalty or redress payment?

Settlement discounts

Our recently published consultation on the revised enforcement guidelines set out and sought views on our proposed new settlement procedures. It also noted that we were proposing to introduce a system of fixed percentage settlement discounts for reaching agreement with the Authority in cases under the Gas Act or Electricity Act. These discounts will be applied only to the penal element and not to any gain and/or detriment that have been identified by the Authority. We propose:

- a 30 per cent discount for early settlement
- a 20 per cent discount for middle settlement
- a 10 per cent discount for late settlement.

Q.4 Do you agree with the proposed settlement percentage discounts in cases under the Gas Act or Electricity Act?

Section 3: Consumer Redress Powers

In recent years, we have secured voluntary redress through our settlement process. Our new powers under the Energy Act 2013 mean we now have the power to compel companies to provide redress to consumers for the harm they have caused. When consumers suffer loss, damage or inconvenience as the result of a company

contravening an obligation, we can make a redress order to restore the losses suffered by consumers.

A consumer redress order may require the company to do anything necessary to remedy the contravention or to prevent a similar one in future. The powers are broad and flexible, reflecting the government's position that we should be able to decide the appropriate form of redress in each case.³

Requirements that may be set out in a consumer redress order

Section 7 of the policy statement contains a non-exhaustive list of items that we might include in a redress order. For example, we might require a company to

- pay compensation to each affected consumer for the loss, damage or inconvenience caused (either directly, or by setting up a scheme to which affected consumers can apply)
- undo the harm caused, for example by terminating or varying contracts
- reassure consumers, for example by providing them with
 - a written statement explaining and if necessary apologising for the contravention and its consequences
 - accurate information about their rights.

When using these powers we will choose the most suitable method of redress in each individual case. Where consumers have suffered losses, we will seek to ensure that the companies make every effort to compensate the affected consumers.

We could also require a company to make payments to consumers, including those not directly affected by the contravention, where this is necessary to remedy the contravention or prevent a similar one in future. 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)
- an appropriate charity, trust or organisation whose objectives make it a suitable proxy for the consumers who might have been directly affected.

We may require these payments to be made where we are satisfied that

- it is not possible to quantify consumer loss on an individual basis
- it is not possible or it is wholly impracticable to identify or trace the individuals
- individual payments would be so small that requiring them would be inefficient or create a disproportionate administrative burden.

We expect companies proactively to take effective steps to remedy the consequences of a contravention or failure by identifying which consumers have been affected (for example by writing to consumers asking them to get in touch if they think they have been affected) and compensating them. Only if it is not possible or it is wholly impracticable to do this would the Authority expect the company to direct payments elsewhere.

We could also require a company to remedy deficiencies in its operations, for example by ordering it to take action to improve aspects of its training, monitoring, complaint-handling or IT systems.

³ In 2012 DECC consulted on and published conclusions about consumer redress powers for Ofgem. Page 6 of [DECC's conclusions document](#) states that Ofgem should have "the discretion to decide what form of redress is appropriate" and notes the support from consultation respondents for this approach.

Q.5 Do you agree with the proposed policy on determining who receives payments where consumer redress powers are used?

Q.6 Are there any other potential consumer redress requirements that we should specifically refer to in section 7 of the policy statement?

Treatment of consumer detriment

Where consumers have suffered detriment as a result of a contravention we will aim to ensure that the company provides redress to them. We consider that, wherever possible, compensation should be directed to the consumers who have suffered the detriment. If this is not possible or it is wholly impracticable, we may require sums to be paid to a specified category of consumers or to a consumer fund where these act as a reasonable proxy. For example, in some past cases settled by agreement with the company under investigation, payments to groups of vulnerable customers have been made. In those cases, the group of customers who would have been eligible for *Warm Home Discount* payments was identified as a reasonable proxy for consumers in vulnerable situations. Other settlements⁴ have included payments to a fund that can help consumers, such as *Energy Best Deal*. This initiative helps consumers engage with the energy market and, among other things, provides advice to help consumers in vulnerable situations to switch supplier.

Payments to funds can assist both in remedying the consequences of a contravention and in preventing the same or a similar contravention from happening in future. A potential example of the latter could occur if a company has breached the licence condition requiring consideration of consumers' ability to pay when they are in debt. Payment to an organisation that provides assistance to consumers in debt could help prevent future contraventions of this kind. This is because an organisation of this kind can not only improve consumers' awareness of their rights but may act on their behalf and ensure the supplier has all the information that it needs to assess ability to pay.

There will be occasions where we can estimate the total loss suffered by consumers as a whole but we cannot determine precisely the loss suffered by specific individuals. This may occur where

- the total size of the loss can be estimated (for example via statistical sampling) but the individual loss to each consumer cannot be easily established
- detriment has arisen as a result of harm to the market in general, for example, where consumers have been deterred from switching because of mis-selling, or transfer blocking. Again, the total size of the loss may be estimated, but not the specific loss to each consumer who has suffered detriment.

In cases where this occurs, the Authority may require payments to be made to consumer groups acting as a reasonable proxy, or to a fund which can help consumers, as outlined above. The Authority may only do these things where it is satisfied that they are necessary to remedy the consequences of a contravention or to prevent the same or a similar contravention in future.

Q.7 Do you agree with the proposed approach to the treatment of detriment?

⁴ For example the settlement in 2012 in the case of EDF Energy <https://www.ofgem.gov.uk/ofgem-publications/76275/edf-press-notice-march-9-2012.pdf>.

Administering consumer redress orders and bearing administrative costs

For a redress scheme to operate properly, it may be necessary to identify affected customers or those who are to receive additional payments, calculate the amounts to be paid, contact customers and make payments to them. We think the company should meet the administrative costs involved. Where necessary we may also ask the company to create arrangements to confirm that it has fully complied with the requirements of the order.

Q.8 Should administrative costs be borne by the company in addition to any compensation or other payments that may be required?

How to respond

We welcome views on these questions and any other comments or observations that you might have. Wherever possible, please supplement your views with reasoning and examples. We prefer to receive responses electronically but hard copies by post can also be sent. **The deadline for responding to this consultation is 23 June.**

Electronic responses should be emailed to enforcementguidelines@ofgem.gov.uk and postal responses should be addressed to:

Andy MacFaul
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE.

Consultation responses will be published unless marked confidential. We plan to finalise the policy statement by the end of 2014. If you have any comments or questions about this letter or the associated documents, please contact Anna Stacey on 020 7901 7000 or by email at anna.stacey@ofgem.gov.uk.