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Dear Sarah,

Consultation on Ofgem's financial penalties and consumer redress policy statement

This is the British Gas response to the above consultation, dated 31 March.

One of British Gas' core values is "do what's right". This means taking the time to understand our customers' needs and treating them fairly. Even though we don't always get it right, we strive to ensure that there is a good and fair intent at the heart of every decision we make. This is essential for us to build strong relationships with our customers and, more generally, to restore consumer trust in the market.

The objectives set out in Ofgem's new financial penalties and consumer redress policy statement are aligned to this value and make it clear that there are real and meaningful consequences for suppliers who fail to do what's right for customers.

It is right that Ofgem should act decisively to put things right where companies breach their obligations. However, financial penalties and consumer redress orders should be fair for all parties, including suppliers. Key to achieving this is to make the process as collaborative as possible, including giving suppliers the opportunity to challenge the levels of financial penalties and consumer redress payments, where it is reasonable to do so.

British Gas has engaged actively in discussions about the changes to Ofgem's ability to impose financial penalties and award consumer redress, including responding to previous consultations held by both the Department for Business, Innovation and Skills (BIS) and the Department for Energy and Climate Change (DECC).

One of the features of these previous consultations was that the introduction of a power to mandate energy companies to pay redress would have the effect of reducing fines. For example, the Impact Assessment[1] published by DECC alongside its consultation assumed the new power to order redress would lead to increased redress and a ***reduction*** in the level of fines. It went on to state that, overall, no increase in the aggregate level of payments resulting from enforcement action is anticipated.

The proposals put forward by Ofgem in its draft financial penalties and redress policy statement would appear to go far beyond this policy intention and are therefore a cause for concern. We request that Ofgem reviews this aspect of its proposed guidelines to ensure they remain properly aligned to Government objectives.

In our response to Ofgem's consultation on revised enforcement guidelines dated 23 May, we suggested a list of principles for Ofgem to take account of, all of which apply equally to setting the levels of financial penalties and to consumer redress orders. The full list is in Annex 1 but it is useful to draw out the key themes underpinning the principles:

- Penalties should be reasonable and proportionate to the circumstances of the case, including the detriment or harm caused by the compliance breach;

[1] Impact Assessment: Ofgem Consumer Redress consultation - IA No: DECC0074, April 2012, DECC, p.10

- Transparency and clarity are needed around the settlement window, particularly the factors that are necessary for the window to open;
- Genuine mistakes must be distinguished from systemic failings. From time to time all organisations, especially those reliant on data, computer systems and complex industry processes, make mistakes: suppliers should not be unduly punished for these, particularly when it is clear the offending party is genuinely and proactively taking steps to do the right thing for affected customers and to fix the issue;
- Detriment and levels of penalty should be calculated by reference to clear, proportionate and consistently applied principles; and
- Consideration must be given to the impact of the size of any penalty and the approach to media communications on wider market participants whether through consumer trust, brand impact, investor relations or operational impacts.

I have responded to your questions separately in Annex 2 of this letter. Given the close link between compliance and redress, it would also be helpful for this work on redress and penalties to be considered in conjunction with the request from industry and consumer groups for Ofgem to establish a compliance function. As a minimum, we believe Ofgem should take steps to review how it currently assists suppliers' understanding of certain complex or ambiguous licence conditions, and how further improvements might be made to deliver benefits to customers, suppliers and indeed Ofgem itself.

I hope this response is useful to Ofgem in finalising its policy statement on financial penalties and consumer redress. We would be very pleased to discuss it further and look forward to a constructive dialogue with Ofgem as this initiative progresses.

Yours sincerely,

Lex Keel
Head of Energy Compliance
British Gas

Annex 1: Financial Penalties and Consumer Redress – Important principles

We set out the following principles for Ofgem to take account of in our response to Ofgem's consultation on revised enforcement guidelines dated 23 May.

Since these principles apply equally to setting the levels of financial penalties and consumer redress orders, we include these detailed principles below before we go on in Annex 2 to answer the specific questions posed in the Ofgem consultation document on financial penalties and consumer redress.

Fairness and proportionality

- Penalties and redress should be fair and proportionate, and targeted only at cases in which action is needed. There should be no overlap or double-counting between the penal and redress elements.
- Relatively speaking, the levels of financial penalty should be significantly more for suppliers who deliberately fail to do what's right for customers, e.g. for commercial gain. Suppliers who are genuinely trying to do the right thing should not be unnecessarily penalised for accidental or inadvertent breaches in order to create a deterrent effect.
- We believe it is entirely reasonable that, in certain situations where consumer redress paid, a penalty may not be appropriate, e.g. where the supplier acted diligently, resolved the issues in an exemplary way and didn't gain.
- Materiality of a contravention or failure, and therefore the penalty amount, should be directly reflective of the impacts on customers. We would expect the financial penalty for a "technical breach" (e.g. failure to achieve standard of performance) to be considerably reduced, or not pursued at all if it is disproportionate to do so or not in the interests of customers.
- More generally, there needs to be a balance between credible deterrent and wider market impacts. The Authority should fully consider the impacts to the market overall, for example consumer perceptions and trust, when setting the level of financial penalty. This is even more vital with Ofgem increasing the level of penalties imposed from 1 June 2014.
- We agree that the costs of financial penalties or consumer redress should not be recovered from customers. However, the costs incurred by the supplier in administering the consumer redress (e.g. finding customers) should be taken into account by the Authority when setting the level of financial penalty, particularly if these costs have been incurred voluntarily.
- There must be a clearer distinction between isolated issues, including unforeseen operational issues, and systemic failings. From time to time, all organisations make mistakes and, in these situations, they should be encouraged to discuss them openly with Ofgem without the fear that enforcement action is the inevitable conclusion. This is particularly important if the supplier is already proactively taking steps to do the right thing for affected customers and fix the issue.

Structure and Certainty

- Levels of financial penalty and consumer redress should be calculated using transparent and consistent principles, particularly when based on estimates. Suppliers need to understand both the factors that will be taken into account by the Authority, and their overall impact on the level of penalty and consumer redress.
- Any scope for subjectivity and/or assumed detriment should be minimised. Whilst each case is unique, we believe that Ofgem could do more to help suppliers with this by, for example, providing a more detailed breakdown of the penalty and consumer redress calculations in penalty notices and sharing lessons learned from relevant cases as to what the Authority views to be relevant or significant.
- We support the introduction of published "penalty bands" (similar to FCA model) to help introduce more certainty over the levels of penalties suppliers can expect to see for different types of breach. This will help suppliers to better understand what the Authority considers to be a priority issue - based on consumer impact - and allocate resources appropriately.
- The process for setting the levels of financial penalties and consumer redress should be open and transparent, and based on consistently applied principles. Discussions in respect of the "size" of the problem and levels of financial penalty must be two-way, with suppliers having the ability to challenge these elements, particularly the calculations, if it is appropriate to do so.
- Gain and loss calculations should be based on clear and consistently-applied principles in all cases. Other important factors (e.g. whether the supplier acted diligently) must be considered using evidence collected as part of the two-way dialogue with the supplier.

- The Authority should only make a consumer redress order if/when arrangements cannot be reached voluntarily through discussions with the supplier. Furthermore, suppliers should be permitted to pay the penal element in the form of additional consumer redress if it is in the interests of consumers to do so – e.g. additional payments to an appropriate charity, trust or organisation, goodwill gesture payments or the provision of relevant information to the affected customers. In such cases, the additional costs of these activities should be removed from the financial penalty amount.
- The total compensation or other payment under a consumer redress order should not exceed the detriment suffered, unless the supplier willingly wishes to pay more in consumer redress measures.
- A proxy linking consumer redress payments to the nature of the contravention is important. However, where this cannot be found, other payments benefitting consumers should be considered before the full payment is made in the form of a penalty, i.e. the Authority should consider a "sliding scale" of relevant consumer redress options, preferably discussed with the supplier. Consumer redress payments benefit customers directly, and are generally preferable to all parties.
- Suppliers still require clarity over early, middle and late settlement. In particular, when the settlement windows open, what will have been agreed at this point and how long they run for.
- There should be appropriate incentives on both parties – both the company and Ofgem – to bring matters to a sensible conclusion, including payment of the appropriate level of redress to affected customers (or a suitable proxy).

Consistency across suppliers, irrespective of size

- The level of the financial penalty should not necessarily be higher for bigger suppliers simply because of their size, i.e. "brand" should not be a factor in the setting the level of the financial penalty simply to maximise the deterrent effect. Decisions should be based on the nature and severity of the breach rather than on the size of the supplier. The same “facts” and “circumstances” need to be consistently applied across all suppliers irrespective of size. This includes ensuring there is consistency as to how “loss, damage or inconvenience” is defined and measured.
- The Authority must consider impacts to other market participants, i.e. diligent suppliers’ brand damage and lost revenue from actions of less diligent suppliers. Operational impacts of consumer redress measures on other suppliers must also be considered – for example, npower paid consumer redress to its customers who were mis-sold to by re-calculating their quote using information relating to the supply with their previous supplier (i.e. tariff, energy used and type of meter) which resulted in us receiving a significant uplift in calls from npower’s customers requesting this information to claim their compensation which impacted the service we were able to offer our own customers.
- Impact of the contravention or failure, and whether it was deliberate and/or reckless, should be considered by issue rather than by supplier. A small supplier’s deliberate contravention of the rules, to the detriment of customers should be no less material because of the supplier’s smaller market share.

Constructive engagement with suppliers

- Self reporting and cooperation throughout the investigative process of issue can play more of a role in the current regime; it needs to be more of factor with clear benefits to suppliers to encourage an open and transparent culture.
- It is important that suppliers have the option to voluntarily undertake consumer redress actions before the Authority makes an order. Suppliers understand their customers' needs and wants, and are best placed to develop to the most appropriate remedial actions.
- Suppliers should be permitted to undertake this proactive consumer redress activity, and this should be reflected in a reduction in the overall level of financial penalty (including any administration costs).

Annex 2: Detailed response to consultation questions

Q.1 Are the Objectives in relation to penalties and redress appropriate?

Yes, the objectives of the proposed penalty statement are appropriate and rightly focus on seeking fair outcomes for consumers and deterring non-compliance.

However, we consider that it is important that any penalty should be reasonable and proportionate. Ofgem should make this clear in the policy statement, and similarly reflect this within the 'penalty bands' that may be published.

In addition, the process of setting the level of financial penalties and consumer redress must be:

- **fair for all parties**, including suppliers, with deterrent effect calculated to be appropriate to the circumstances of the case and consistently applied.
- **targeted and proportionate**, for example, we would expect the financial penalty for a "technical breach" to be considerably reduced, or not pursued at all if disproportionate to do so or not in the interests of customers.

As we make clear in our covering letter to this response, we also consider that Ofgem's objectives and duties in relation to penalties and redress should be better aligned to the original Government intention. Specifically, Ofgem should seek to reflect the stated intent of Government that any new power to order redress would lead to increased redress and a ***reduction*** in the level of fines. In our opinion, the proposals put forward by Ofgem in its draft financial penalties and redress policy statement appear to go far beyond this policy intention and are therefore a cause for concern. We request that Ofgem reviews this aspect of its proposed guidelines to ensure they remain properly aligned to Government objectives.

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

Yes, the proposed process for determining the amount of penalties and/or redress is appropriate.

In general, it will be appropriate for the amount payable to 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.

We believe that in certain situations the second element (the penal element) may not be appropriate, e.g. where the supplier acted diligently, resolved the issues in an exemplary way and didn't gain from its actions.

The process followed to determine the amount payable is broadly appropriate. Gain and detriment, as well as the seriousness of the breach, aggravating and mitigating factors, need to be calculated and applied fairly and consistently. Suppliers should be given sufficient time to be able to challenge these calculations, including within the settlement window, particularly where assumptions and estimates have been used to determine the overall impacts.

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

Broadly yes, the proposed factors that may aggravate or mitigate the amount of a penalty or redress payment is appropriate.

We strongly believe that, in order to rebuild consumer trust, the right values must be embedded into all suppliers' policies and practices. The levels of financial penalty should therefore be significantly more for suppliers who deliberately fail to do what's right for customers.

We also believe that self-reporting and cooperation throughout the investigative process is underplayed in the current regime; it needs to be more of a factor with clear and tangible benefits being provided to suppliers in order to encourage an open and transparent culture.

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

Yes, in principle we agree with Ofgem's proposal to introduce a system of fixed percentage settlement discounts for reaching agreement with the Authority in cases under the Gas Act or Electricity Act.

However, suppliers still require clarity over early, middle and late settlement. Particular issues where greater transparency would be welcome include when the settlement windows open, what will have been agreed at this point, and how long they run for.

It is important that the implementation of this principle places the right incentives upon suppliers to conclude negotiations quickly and upon Ofgem to reach a settlement figure that is appropriate to the nature of the infringement.

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

Yes. The proposed policy on determining who receives payments where consumer redress powers are used is broadly correct. It is clearly right and appropriate that, in the first instance, Ofgem seeks to ensure that companies make every effort to compensate the affected customers. In circumstances where this is not possible, we are broadly content with the suggested proxies. However, it may not always be possible to identify an obvious suitable proxy.

For instance, in the case of non-domestic consumers, identifying a suitable proxy may not always be possible given the diversity of entities in the market and inability/inappropriateness of targeting certain target groups (e.g. concepts of 'vulnerability' and 'fuel poverty' are not transferable to non-domestic consumers). Where this is the case, and all possibilities have been considered, we believe it is not unreasonable to provide redress for non-domestic issues to domestic consumers. In this situation, we would expect Ofgem to be open to the company making suggestions as to where such consumer redress may best be directed.

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

Yes. Firstly, and most importantly, suppliers should have the option to voluntarily undertake consumer redress actions before the Authority makes an order. This should include compensating for any loss, damage or inconvenience caused (either directly, or by setting up a scheme to which affected consumers can apply). Where an appropriate set of measures cannot be agreed, the Authority should be able to make an order to ensure all consumers suffering a loss are compensated.

Importantly, where an order is made, the total compensation (or other payment) should not exceed the detriment suffered, unless the supplier elects to pay more by way of a goodwill gesture payment or other additional payments in the interests of consumers. This does not preclude the payment of the fine/penalty as consumer redress rather than a penalty paid to Treasury.

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

Yes, with the following observations; where consumers have suffered detriment as a result of a contravention, it is right that the supplier provides redress to them.

Wherever possible, this should be directed to the consumers who have suffered the detriment; however, donations to consumer funds can act as a reasonable proxy. Where such a proxy cannot be found, other mechanisms to benefit consumers should be considered before the full payment is made in the form of a penalty.

The levels of consumer redress must be calculated using clear and consistent principles, particularly when based on estimates. Suppliers need to understand both the factors that will be taken into account by the Authority and their overall impact in order to eradicate any scope for subjectivity and/or assumed detriment.

Finally, suppliers should be able to pay any penal element in the form of additional consumer redress if it would be in the interests of consumers. Where this happens, these costs should be removed from the financial penalty amount.

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

Up to a point, the administrative costs incurred by the company involved in identifying affected customers or those who are to receive additional payments, calculating the amounts to be paid, contacting customers and making payments to them should be borne by the supplier. These costs should be factored in by Ofgem when it is considering the size of any penalty to be imposed.

However, these costs need to be reasonable, and not unduly onerous, e.g. if the costs to locate and compensate individual customers significantly exceeds the amount of compensation due. This could occur when customer data has been archived and/or the affected customers are no longer on supply. In these situations, it is reasonable for the payments to be returned to consumers in the form of a charitable donation or similar.

Suppliers should be permitted to undertake additional consumer redress activity if they wish, and this should be reflected in a reduction in the overall level of financial penalty (including any administration costs).