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Enforcement Guidelines – Summary of stakeholder responses to our proposed revisions and Ofgem's response

Introduction

In advance of our recent Compliance and Enforcement Annual Conference, we circulated details of proposed changes to our Enforcement Guidelines. These guidelines set out how we can use our enforcement powers to put things right when energy companies fail to comply with their obligations.

At the conference, we discussed the key changes in a presentation and follow-up roundtable session. Feedback from conference attendees suggests the session was engaging and well received. Invitees who were not able to attend the conference were given an opportunity to respond in writing and we drew industry attention to our proposed changes and the chance to respond in writing via a blog.

We have not proposed radical changes to the guidelines but there are some key areas of reform:

- streamlining and clarifying our case opening criteria
- abolishing annual enforcement priorities
- removing the bespoke approach to enforcing the Standards of Conduct
- reinforcing our expectations on companies to self-report problems
- clarifying the circumstances in which resolving issues via alternative action may be appropriate

In addition to the feedback we collected at the conference from the roundtable session, we received four written responses from energy suppliers and their representatives.

This document summarises the responses we received, sets out our response and gives details of additional changes to the Guidelines to reflect comments received. We have incorporated the changes in the Enforcement Guidelines; the revised version is now available on the Ofgem website, is effective from today and will apply to current and future matters.

SUMMARY OF COMMENTS RECEIVED AND OFGEM'S RESPONSE

General

There was a consensus amongst respondents that the timing of the changes was appropriate in light of recent market developments and Ofgem's transition towards more principles-based rules. Respondents broadly welcomed our objective of clarifying our approaches to prioritisation, self-reporting and alternative action.

Self-Reporting

While welcoming the additional detail around our expectations for self-reporting, two key feedback themes emerged. The first was around a materiality threshold for self-reporting; could we clarify when an issue was serious enough to warrant self-reporting?

The second drew attention to a potential tension between the need to self-report "promptly" and the need to do so "accurately" and "comprehensively". In other words, respondents considered self-reporting promptly might mean companies would not have time to fully understand the extent of potential non-compliance (and its impacts) or fully develop plans to put things right.

Ofgem's response:

On the first theme, we recognise it might not be appropriate for companies to self-report minor instances of non-compliance where their actions or failure to act has not caused material harm to consumers, the market or to Ofgem's ability to regulate. However, we expect companies to report non-compliance, which has caused (or has potential to cause) such harms and for which companies would need to take remedial action. Companies should therefore make an assessment and consider whether they should self-report to Ofgem. This could also include providing advance notice of plans for high-risk activities, for example software system migrations. Responsibility for compliance rests with companies and they (in conjunction with their advisors) are best placed to assess how and when compliance matters should be drawn to Ofgem's attention. We would encourage companies to err on the side of caution and to open a dialogue with us as soon as possible when they identify issues that could result in material harm. We take self-reporting into account in our enforcement and compliance engagement

On the second theme, we recognise that the need to self-report promptly might mean that companies will not necessarily have complete information or fully developed remedial plans. Initiating prompt dialogue with Ofgem (in the retail supply space this will be with contacts in the Consumers Directorate team) and fully disclosing the facts available at the time is of primary importance. We expect companies to develop remedial plans that fully address issues as quickly as possible.

In light of the comments received, we have amended paragraph 3.5 of the Guidelines to read, "We strongly encourage companies to promptly self-report potential breaches that may give rise to material harm to consumers, the market or to Ofgem's ability to regulate; our expectation is that they will do so. Companies should promptly open a dialogue with Ofgem and provide as much detail as possible about the potential breach (or breaches), what caused it, the harm that may have resulted, including to customers, and the steps that have been or will be taken (including proposed timings) to remedy the situation. We recognise that the need to self-report promptly might mean companies have not necessarily established the full extent of problems but that should not prevent prompt and accurate self-reporting of the facts as they stand and taking steps, in a timely manner, to determine the full extent of problems and to put things right."

Alternative Action

Respondents broadly welcomed the additional information in the Guidelines on alternative action. One asked whether we could provide further clarification on the distinction between alternative action and enforcement cases. Most respondents drew our attention to the first bullet point in paragraph 3.33; they pointed out that it could imply alternative action was reserved solely for resolving issues that had been self-reported.

One respondent believed that all cases, even competition ones, should be considered on their own merits and that alternative action should not be ruled out.

Another respondent queried situations in which Ofgem was already aware of problems which energy companies had intended to self-report; they believed options such as resolving via alternative action should not be ruled out in such circumstances.

Ofgem's response:

On the potential ambiguity of the first bullet point in paragraph 3.33, we agree with respondents and have therefore changed the relevant bulleted text to read "where issues have been self-reported, we are satisfied the full extent of the potential breach has been self-reported promptly, accurately and comprehensively by the company". We have also added an additional bullet immediately beneath it to clarify that when issues come to light by means other than self-reporting we will also need to be content that the extent of the potential breach has been established.

On the issue of whether alternative action is appropriate for resolving competition issues we would point out that paragraph 3.8 of the revised Guidelines states "Given that potential breaches of competition law are by their nature serious, alternative action is unlikely to be appropriate" and paragraph 3.29 states "we do not normally consider alternative action to be appropriate when addressing potential breaches of competition law". While the Guidelines do not, therefore, preclude alternative action for competition issues, by their nature, potential competition breaches tend to be serious and most appropriately dealt with via enforcement action. We also aim to ensure that our application of competition law is consistent with that of other UK competition regulators.

Regarding the point about companies who intended to self-report, the amendment of paragraph 3.33 clarifies that alternative action will be considered for issues that have not been self-reported. However, we cannot give credit to companies who intended to self-report when Ofgem is already aware of a problem. When, however, Ofgem becomes aware of a problem because it was self-reported, this will normally count in a company's favour as paragraph 3.7 of the Guidelines makes clear.

With reference to the comment on providing additional clarification or criteria we would point out that the prioritisation criteria outlined in paragraphs 3.36 – 3.49 describe how we will determine whether enforcement case opening (versus, say, resolution via alternative action) is warranted.

Prioritisation criteria for deciding whether or not to open (or continue) a case

The revised approach and criteria for prioritisation described in paragraphs 3.36-3.49 received broad support. Some respondents pointed out that the criteria retained a high degree of flexibility and that Ofgem should continue to ensure its decisions are consistent and proportionate. On that point, one respondent supported the inclusion of the additional information provided in paragraphs 1.11-1.12 setting out how better regulation principles (including consistency and proportionality) guide our enforcement activity.

Bespoke approach for enforcing the Standards of Conduct (SoC)

Two respondents referred explicitly to our proposal to remove the bespoke approach to enforcing the SoC. Both referred to Ofgem's recent consultations on removing the "all reasonable steps" test from the SoC and believed part of Ofgem's rationale for doing so relied on our existing version of the Enforcement Guidelines including the bespoke approach for enforcing the SoC. One respondent went further by disagreeing with the proposal to remove the bespoke approach; they noted that in paragraph 3.47 we had retained a key element of the bespoke approach in stating "For principles-based rules, it will include considering whether a company intent on complying might have acted in the

way it did". They argued that retaining that key element suggested a bespoke approach was necessary and that it should therefore remain in its entirety.

Ofgem's response:

Because the SoC is now established and because we are transitioning towards a greater reliance on principles-based rules, a bespoke approach for the SoC is no longer appropriate in our view. In addition, our assessment concluded that the bespoke approach was broadly aligned with the general enforcement approaches set out in our revised Guidelines. We considered, however, that the important concept of "assessing whether a company intent on complying would have acted in the way that it did" should be retained, principally because it provides reassurance that Ofgem will consider this in relevant decision-making. Furthermore, we considered that the concept could usefully be applied more widely (than to the SoC alone) to cover all principles-based rules, no matter where they occurred in licences. The level of reassurance provided by broadening the application of this concept has therefore increased. We do not agree that capturing this important concept, and then applying it more widely, provides a basis for retaining the bespoke approach in its entirety.

Other

Some respondents commented on wider enforcement-related issues. Some believed Ofgem's approach to enforcement would need to adapt as the retail supply industry began to work with a more principles-based regime; they believed a greater emphasis on open dialogue and transparency in the engagement and compliance space should be our preference. On transparency, one respondent called for Ofgem to share lessons learned from enforcement investigations externally (as well as within Ofgem) and felt that more feedback throughout the investigatory process would facilitate transparency and accountability.

One respondent believed there was a need for more opportunities to discuss the settlement part of the enforcement process, particularly around the calculation of penalties. Another contended that Ofgem generally made the rules, investigated breaches, made judgments and enforced suspected breaches resulting in no effective separation of powers and an absence of a means of appeal to an independent body. Other respondents also called for merits based appeals.

One respondent queried the role of the EOB set out in paragraphs 6.4 – 6.6; they thought the EOB could have a greater degree of independence, particularly because it oversees alternative action decisions, which are likely to feature more prominently in future.

Ofgem's response:

In the retail space, we have recognised the increased need for dialogue, which is reflected in our enhanced approaches to engagement, monitoring and compliance (working alongside enforcement). We set out at the recent compliance and enforcement conference (and via our recent blog) how our system will incorporate engagement, monitoring and compliance.

In this exercise, we have addressed a limited number of proposed changes to our current enforcement policies and processes. Details of relevant appeal routes are set out in our governing legislation and are summarised in Chapter 6 of the Enforcement Guidelines. Our internal system under the Enforcement Guidelines sets out how we will apply our powers within the parameters of our governing legislation. Our system incorporates a number of safeguards to ensure companies are treated fairly. Companies

have the option of contesting our investigation findings should they wish to do so. Our Enforcement Decision Panel (EDP) hears contested decisions; it is independent from the case team.

The EOB is an internal Board comprising senior civil servants from across Ofgem; one of its key functions is to determine whether to open (or not) an investigation into a potential breach, taking account of the prioritisation criteria. The EOB also makes determinations about some alternative action cases. In reaching its decisions the EOB will assess the seriousness of potential breaches and look at the company's willingness and ability to put things right. It will also consider Ofgem's resources (see paragraph 3.48 of the Guidelines). Because a consideration of Ofgem resources is a key element of the process, we consider that the EOB being a board comprised of senior civil servants is appropriate.

We considered the matter of negotiations around penalties and settlement when we consulted on the Enforcement Guidelines in 2014. Our view has not changed. Our system provides companies with clarity on our process and helps us achieve our aims in respect of efficiency and impact. The purpose of the settlement process is to allow issues to be resolved quickly and efficiently; the discounts available reflect efficiency savings. Allowing negotiations to re-enter the settlement process would cause it to become more protracted and less efficient. Companies are not obliged to settle and can choose to continue discussions after closure of the early settlement window or take the contested route if they disagree with our findings.

On greater transparency around penalty calculations, our approach to their calculation is set out in our penalty and redress policy. We updated the policy in November 2014 to provide more transparent information about how we calculate penalties, particularly with regard to detriment and gain.

With regard to sharing lessons learned more widely and seeking more feedback, we note that paragraph 7.11 of the Guidelines makes clear that Ofgem may seek feedback from, for example, companies under investigation. However, we agree that there is an opportunity to do this more systematically and then use feedback constructively to inform improvements to our enforcement work. Information about that process could then be shared (taking account of any confidentiality concerns) more widely as appropriate. We have therefore revised the second sentence of paragraph 7.11 to read, "In most cases we will also request feedback from others involved in the case (for example, companies under investigation) and use it to inform our future enforcement work."