Annex

Consultation on Statement of Policy with respect to Financial Penalties

Following the publication of the NIAUR (the Utility Regulator) *Statement of Policy with respect to Financial Penalties* on 26th October 2007, seven responses have been received. We have considered all responses, all comments and all the arguments made in detail. Because this consultation relates to such an important issue we wish to explain some of our thinking, therefore the next table shows a summary outline of the main comments and the Utility Regulator's view on them. The Utility Regulator notes that this statement and its associated consultation relate in the main to the process we will follow when considering the imposition and quantum of financial penalties. We are aware that there may be separate policy issues related, but not central, to our financial penalties consultation exercise, some of which were touched on during the consultation phase. We note here our intention to revisit these wider issues at a suitable time in future.

	SUMMARY OF COMMENT	UTILITY REGULATOR'S VIEW
1. Background and general principles. (Sections 1 and 2 of Policy).	1. In the case of a Government-owned licence holder, imposition of a penalty under a Financial Penalties Policy should only be considered in exceptional circumstances.	The relevant energy and water legislation requires us to have a Financial Policy Statement that applies to all regulated companies. The Water Order was drafted in full knowledge of the current undertaker's status.
	2. A financial penalty up to 10% of turnover is considered disproportionate for a Government-owned company established without reserves. This Policy could lead to risks to investors and extra costs to customers. It is suggested that there should be a reduction of the maximum penalty level to token amounts (Para 1.2 of Policy).	As above, our Policy applies to all regulated companies. Though each contravention will be considered on a case by case basis and bearing in mind our Policy and also our Water SORPI.
	3. The Policy should clarify the definition of "turnover" (Para 1.2).	Policy already clear in statutory rules footnote that "turnover" is for a regulated company as a whole. No drafting action required.
	4. Respondent wants clarification on the term "turnover" in terms of the regulated revenue of the licensee related to carrying on its licenced activities in accordance with its licence in Northern Ireland (Para 1.2).	The footnote to paragraph 1.2 and the related 2005 and 2007 Statutory Rules on determination of turnover set out the legal parameters that will be used in the penalty calculation. This is specific legal documentation and drafting.
	5. It is desirable that the Utility Regulator publishes a list of the "relevant	Under the Energy Order (article 41) "relevant conditions" are defined (meaning

	conditions", which will facilitate a transparent and accountable process (Para 2.2).	any condition of the relevant licensee) and the Water Order covers similar ground in the article 30, where general sign posts are given that contravention of licence conditions and certain parts of the legislation trigger use of our enforcement and penalty powers. Establishing the relevant conditions and our vires to use our Financial Penalties Policy will be a first step in each investigation.
2. Substantiating a breach (section 3 of Policy).	1. The Utility Regulator should be required to provide detailed substantiations in any investigation to justify any deviation from respondent's own records (Para 3.1 and 3.2).	The Utility Regulator would do this in any event. Paragraphs 3.1 and 3.2 redrafted to clarify that we will explain the basis for our final decisions on a case by case basis.
	2. The respondent would be interested in the methodology used by the Regulator when assuming and estimating data (Para 3.1).	The methodology used will completely depend on the issue being examined (i.e. benchmarking, use of experts, key witness interviews, mathematical analysis, etc). No further action in terms of drafting.
	3. The Policy should be amended following the Article 35 (2) of the Water and Sewerage Services (NI) Order 2006, which states that the Regulator may impose a penalty on a water/sewerage company where there is a contravention of an enforceable duty under the Order (Para 3.2).	Comment correct. We have deleted part of 3.2 and added a new sentence to reflect respondent's comment.
	4. The Policy should specify how the Utility Regulator is going to consult with interested parties and obtain their representations or objections (Para 3.2).	Articles 43 and 45 of Energy Order and article 35 of Water Order set out our legislative requirements which we will meet.
	5. Respondent noted phrase "Or other requirement", specifying if it covers all EU and local regulations. Respondent feels the Policy should not affect to license holders who are not complying with EU Regulation not yet implemented into licence provisions (Para 3.1 first sentence, and 4.1).	Where the relevant EU obligations are listed as a relevant condition or requirement under Article 45 of the Energy (NI) Order 2003 or Article 35 of the Water and Sewerage Services (NI) Order 2006, then the financial penalties policy will apply to any instances of non compliance.
	6. The Policy should include detailed procedures for dealing with potential contraventions, making representations, justification of assumptions and estimates, arbitration of disputes, etc.	The document already notes that procedures are set up in the relevant Orders (2003 Energy Order; articles 45 to 50 and 2006 Water and Sewerage Order, articles 35 to 40). We propose to follow these procedures and have confirmed that in the Policy Draft. Also we would not wish to limit our options in an individual case. As regards arbitration specifically, any

		disagreements about penalties (imposition of penalties or amount of penalty) can be challenged in the High Court under the Orders. No action required.
3. Whether to impose a penalty or not. (Section 4 of Policy).	1. One respondent made the point that actions themselves taken by licensees in circumstances out of their control should be assessed when considering imposing a penalty (Para 4.2).	We understand the point that is made but feel the Policy does not need to be redrafted. We can deal with the issue as a normal investigation of a suspected contravention.
	2. The Utility Regulator should publish guidance on measuring whether the contravention or failure is of a trivial matter (Para 4.4).	We feel this would be difficult to define ex-ante and prefer a case by case approach.
	3. It is desirable to include clarification regarding the circumstances whether "the principal objective and duties of the Utility Regulator preclude the imposition of a penalty" (Para 4.4).	We have looked at this again and redrafted this part of the Policy to remove the term "preclude" but maintain the idea that we should consider our duties and objectives when deciding on penalties.
	4. The Utility Regulator should clarify when a penalty or the application of its value to the benefit of consumers is the most appropriate course of action. Regarding the second mentioned course of action, the Utility Regulator should explain how the compliance would be monitored (Para 4.4).	The Utility Regulator has a duty to enforce where a regulated company is failing to comply with its licence conditions or other statutory requirements. This duty is supplemented by the Utility Regulator's ability to accept undertakings from companies in lieu of enforcement action. Undertakings from a regulated company, if presented to us, will be considered carefully. The Utility Regulator intends to consider each undertaking on its merits. We will look at all contraventions on a case by case basis. In addition, we will apply our SORPI principles to water and sewerage contraventions where necessary. We will only pursue the "undertakings" route where we are sure we can monitor and enforce it through our regulatory team and price control.
	5. Contraventions or failures committed by Northern Ireland Water may be the subject of enforcement or fines by the Environment and Heritage Service or have generated payments under a future Guaranteed Standards Scheme. By punishing the same infringement the Policy could incur "double jeopardy".	We have considered all the comments made and potential resultant consequences for licence holders. We have included a bullet under 4.4 to help clarify our approach. However, to be clear, where a licensee has contravened different obligations regulated by different regulatory authorities (all be it such contraventions may emanate from the same set of circumstances), then penalties may well be imposed by each authority under the respective jurisdiction of each authority. Also, Article 35 (1) (b) of the Water Order specifically empowers the regulator to

		impose a penalty which is reasonable in all the circumstances of the case for failures to achieve guaranteed standards of performance. Thus an undertaker may pay out on guaranteed standards payments under the relevant regulations (yet to be developed) and can also be subject to financial penalties for the same category of contravention.
	6. Under the Water and Sewerage Services (NI) Order 2006, fines can not be applied later than 12 months after a contravention or failure has occurred. The Policy should clarify how the Utility Regulator intends to treat failures associated with the legacy of under-investment.	Our Financial Penalties Policy will be applied as the case merits and in accordance with the relevant orders and our Statutory Duties. Article 37 (1) allows us to issue notice of our intention to impose a penalty prior to the expiry of 12 months from "contravention or failure" thereby allowing imposition of penalties at some later date. Our SORPI does note that "we will recognize the transitional challenges facing NIW, while expecting a rapid transition to the highest standards of performance" We would take into account any relevant time-banded assents.
4. Fixing the banding (section 5 and 7.3 of Policy).	1. It would be desirable to see the publication of the broad banding of the amount of the penalties (Para 5.1).	We feel this would be difficult to define ex-ante, and is better assessed on a case by case basis.
	2. The maximum penalty should only be applied when a contravention is "beyond reasonable doubt" (Section 5, and Para 7.3).	We are not minded to insert this as the legal hurdle of beyond reasonable doubt may prove too high in an individual case. The Utility Regulator will look at the case on the balance of probabilities and decide on the level of a penalty. Companies can challenge our findings in Court if they wish.
	3. A contravention should be considered in mitigation when it is a "first offence".	We disagree. Level of penalty will need to reflect the seriousness of contravention and we will decide that case by case. First offence may not be a mitigating factor.
5. Other general comments.	1. The Utility Regulator should set out the next stage of this consultation process.	Policy is being published after Board approval along with summary of consultation issues raised.
	2. The Policy should include an explanation about how the money received by the Utility Regulator from penalties is passed onto consumers.	Any financial penalty collected is not returned to customers but is paid into the Consolidated Fund. However, as noted earlier, our penalties policy is supplemented by the Utility Regulator's ability in certain circumstances to accept remedial steps or undertakings in lieu of enforcement action.

	3. The Policy should avoid licence holders seeking to recoup financial penalties levied on them from customers of the relevant service.	This question was not part of our Policy and not part of our consultation either – hence it forms no part of our finalised Statement of Policy. However, we agree that in principle, shareholders should bear the cost of penalties and such costs should not be passed onto customers. We will consider how best to operationalise this in, for example, price control processes and OFWAT specifically note that investors bear the full cost of the penalty as such cost are not allowed in their price controls. In competitive markets where there are no price controls OFWAT take the view that companies will not pass the cost of the fines onto customers as they will wish to remain competitive. As mentioned in our opening paragraph to this Annex, We are aware that there may be separate policy issues related, but not central, to our financial penalties consultation exercise, some of which were touched on during the consultation phase. We note here our intention to revisit these wider issues at a suitable time in future.