

Approach to enforcement

Consultation on revising our enforcement procedure and financial penalties policy



About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland’s electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

Our Mission

Value and sustainability in energy and water.

Our Vision

We will make a difference for consumers by listening, innovating and leading.

Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted

Be a united team

Be collaborative and co-operative

Be professional

Listen and explain

Make a difference

Act with integrity

Abstract

This paper sets out proposals for revisions to our enforcement procedure. The objective of this document is to create a transparent process which will provide operational certainty for industry whilst at the same time providing us with the capacity to tailor the process to suit individual cases. The proposed changes make explicit provision for publication of information relating to cases under investigation, a settlement procedure, and prioritization principles. The revised **Enforcement Approach and Procedure** is attached at annex 1. A **flow chart** summarizing the new procedure is attached at annex 2.

We have also reviewed our financial penalties policy to ensure it works effectively and in tandem with the revised enforcement procedure. The revised **Financial Penalties Policy** is attached at annex 3 of this paper.

Audience

This document is likely to be of interest to regulated companies in the energy and water industry, government and other statutory bodies and consumer groups with an interest in the energy and water industries.

Consumer impact

The introduction of the amendments to our enforcement procedure will bring us in line with other sector Regulators and provide reassurance to stakeholders that we are focused on legislative and licence compliance.

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1. Introduction

Purpose of this document

1. Effective and timely enforcement is of vital importance in order to ensure customer protection in line with promoting functioning markets. We currently have a number of statutory powers to take enforcement action against a regulated company for a breach of licence or a failure to comply with specified legislation.
2. In that regard the Utility Regulator (UR) is required to have a statement of policy with respect to penalties for both energy and water.¹ The *Financial Penalties Policy* was last revised in 2016. The Orders state that when revising the policy, the UR shall undertake such consultation as it considers appropriate. The publication of this document fulfills that requirement.
3. Although not required by statute, we have also published an *Enforcement Procedure*,² the purpose of which is transparency. It lets people know what to expect if they find themselves being investigated or having enforcement action taken against them.
4. The UR's 2017/18 Forward Work Programme included a project to review our *Financial Penalties Policy* and associated guidance. In doing so we wished to ensure that it is aligned with best practice and stakeholders are aware of the financial implications associated with non-compliance with legislative or licence requirements. As the *Financial Penalties Policy* works in tandem with the *Enforcement Procedure*, we reviewed these two documents together.

¹ See Article 46 Energy (Northern Ireland) Order 2003 and Article 36 of The Water and Sewerage Services (Northern Ireland) Order 2006.

² <https://www.uregni.gov.uk/news-centre/utility-regulators-enforcement-procedure-comes-effect>

5. The purpose of this document is to set out for consultation the changes to the *Enforcement Procedure* and to the *Financial Penalties Policy* that we propose to make as a consequence of our review.

- The proposed changes to the *Enforcement Procedure* are explained in section 3 of this document. The revised procedure itself is entitled *Our Enforcement Policy Approach and Procedure* and is published alongside this document (annex 1). A revised summary flow-chart of the procedure is also published alongside this document (annex 2).
- The proposed changes to the *Financial Penalties Policy* are explained in section 4. The revised policy document is published alongside this document (annex 3).

6. We are also reviewing the UR's *Policy on the Resolution of Complaints, Disputes and Appeals*³ as this has been in place since June 2013 without change. We are minded to make only minor updates to this policy and believe this will be inconsequential. At present we do not plan to consult on these minor amendments. We will however publish the tweaked policy on our website in the Spring time.

7. Our review has not included the UR's *Competition Guidance*⁴, therefore no changes to this procedure are presently proposed.

³ [https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/Appeals Complaints and Disputes Policy - June 13.pdf](https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/Appeals%20Complaints%20and%20Disputes%20Policy%20-%20June%2013.pdf)

⁴ *Guidance on the Application of the Utility Regulator's Competition Powers.*
<https://www.uregni.gov.uk/sites/uregni.gov.uk/files/media-files/Guidance%20on%20the%20application%20of%20the%20UR%27s%20competition%20powers%20-%20September%202016.pdf>

Responding to this consultation

8. Responses to this consultation paper should be submitted no later than **12 noon on Monday 9 April 2018**. Responses should be sent to:

Roisin McLaughlin
Utility Regulator
Queens House
14 Queens Street
Belfast BT1 6ER

consultation.enforcement@uregni.gov.uk

9. It would be our preference that responses are submitted by e-mail.

10. Individual respondents may ask for their responses (in whole or in part) not to be published, or that their identity should be withheld from public disclosure. Where either of these is the case, we will ask respondents to supply the redacted version of the response that can be published.

11. As a public body and non- ministerial government department, we are required to comply with the Freedom of Information Act (FOIA). The effect of the FOIA may be that certain recorded information contained in the consultation responses is required to be put in the public domain. Hence, it is now possible that all responses made to consultations will be discoverable under FOIA, even if respondents ask us to treat responses as confidential. It is therefore important that respondents take account of this and in particular, if requesting that we treat their responses as confidential.

12. This paper is available in alternative formats such as audio, Braille etc. If any alternative format is required please contact our office and we will be happy to assist.

Next steps

13. During the consultation period we are happy to engage directly with any stakeholder on the detail of the proposed changes to the Enforcement Procedure and the Financial Penalties Policy. For this purpose Roisin McLaughlin can be contacted at **consultation.enforcement@uregni.gov.uk** or on 028 9031 6350.

14. Following consideration of the responses to this consultation we will publish the revised versions of our enforcement procedure and financial penalties policy. We expect to do this no later than May 2018.

2. Approach to the review

15. In reviewing the *Enforcement Procedure* we wished to ensure that it:

- continues to be an informative and transparent procedural document which identifies a clear process so that regulated companies know what to expect of the process if they are being investigated or having enforcement action taken in respect of them;
- is aligned with best practice;
- stakeholders are incentivized to comply with their obligations and it has a deterrent effect; and
- works in tandem with the UR's *Financial Penalties Policy*.

16. To inform the review of the *Enforcement Procedure* we considered recent compliance cases where the procedure had been applied. From this experience we concluded that the overall aim of *Enforcement Procedure* should be expanded and that the procedure could benefit from clarity in the following areas:

- when the UR would publish information about issues under investigation and the importance of consistency in that regard;
- how non-statutory undertakings and other voluntary commitments by companies fit into the procedure;
- whether provision might be made for 'settlement' of cases and what this might mean.

17. We also reviewed the enforcement policies and procedures published by a number of other economic regulators to assess whether the development of our procedure and policy could be informed by their approaches. The policies and procedures of the other regulators reflect the industries they regulate and the

legislative frameworks within which they operate, therefore no two approaches are the same. Nonetheless, we identified four broad procedural practices employed by many of the other regulators which were either absent within the UR's *Enforcement Procedure* or could be further developed. These are set out below.

- **Prioritisation Principles-** First many of the other regulators employ prioritisation principles. These are used for example when deciding to open a case and to decide whether enforcement action is the correct regulatory tool for the issue under consideration;⁵
- **Publicity-** Second many regulators have an explicit position on publicising cases and view publicising information on cases as an important part of carrying out enforcement functions transparently and ensuring accountability;
- **Alternative Resolution-**Third, resolution of cases by means of voluntary commitments by companies (e.g. charitable donations, voluntary undertakings) is provided for in appropriate cases. Agreement on alternative resolution avoids the need for formal enforcement action;
- **Settlement-** Fourth, 'settlement' of cases is a feature of enforcement approaches in other regulators. Although the specifics differ it generally involves an admission of liability in relation to the contravention resulting in a legally binding formal enforcement decision. Cases settled in this way typically result in a discount from the financial penalty that would otherwise be imposed.

18. Consequently, we concluded that our approach to enforcement should be expanded to provide for:

- **Prioritisation principles** to guide us in deciding when to take enforcement action;
- **Clarity** on how alternative resolution of cases fits into the procedure;
- **Settlement** of cases;

⁵ See for example section 3 of Ofgem's 'Enforcement Guidelines', the 'Referral criteria' used by the Financial Conduct Authority, and the 'Prioritisation Principles' used by the Civil Aviation Authority.

- Publication of information on investigations and case outcomes.

19. To inform the review of the *Financial Penalties Policy* we likewise considered recent experience where the policy had been applied together with the policies of some of the other regulators. In this regard Ofgem's policy seemed most relevant given that the statutory framework for enforcement governing Ofgem's powers is similar to that governing the UR's powers.

20. We concluded that the *Financial Penalties Policy* could benefit from greater structure and detail in some areas. Also that the concept of the gain to the company and the detriment to the customer arising from the contravention should have more prominence.

3. Proposed changes to UR's enforcement approach

21. This section provides an overview of the changes we propose to make the *Enforcement Procedure*. The revised procedure is published alongside this document (**Our Enforcement Policy Approach and Procedure (annex 1)**). We have also revised the flow-chart description of the procedure and this is also published alongside the document (**Revised Enforcement Procedure Flow-Chart (annex 2)**).

22. Aside from the changes outlined below we have also made minor changes to the procedure for clarity. We have also taken out many of the references to competition as we now have a separate guidance for competition matters.

Aim of the revised enforcement approach and procedure

23. The current aim of the enforcement procedure is to protect the interests of consumers and to ensure that regulated companies comply with their legislative and licence obligations.

24. However, we also see enforcement action as a key part in changing the behavior of companies by acting as a deterrent. Consequently we have added drafting in section 2.3-2.4 of the revised procedure (annex 1) highlighting our expectation that enforcement action will act as an incentive on the individual company in question to change its behavior, and in addition make it clear to other companies where their own behavior may need to change and incentivise compliance best practice more generally.

25. We would welcome views on the revised aim of the enforcement approach and procedure set out in annex 1.

Publicity

26. We consider that publishing information on the investigations we undertake and on case outcomes is important to ensure deterrence and to incentivize best practice more generally by regulated companies. It is also a means to ensure accountability and consistency in our decision making.

27. We have published information about particular cases in the past but have not set out previously our expectations as to what information about cases we consider should be published at each stage of the enforcement process.

28. Section 3 of annex 1 explains when we will publish information and what will be published at each stage of the procedure. Information will be published on a dedicated section of our website (see relevant paragraphs of 3.27-3.74).

29. We would welcome views on our proposals in relation to publishing information about investigations and case outcomes.

Prioritisation principles

30. We propose to use prioritization principles to guide us in considering whether enforcement action is an appropriate course of action to take, when considering whether a case could be resolved by means of alternative resolution or when deciding to formally open a case.

31. The UR already has a set of prioritization principles to guide its competition investigations⁶ and these are based on those applied by the CMA⁷. Also, as highlighted above, other regulators use prioritisation principles in their enforcement work. These are context specific to some extent but some examples

⁶ See section 3.10 – 3.16 of *Guidance on the Application of the Utility Regulator's Competition Powers*.

⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/299784/CMA16.pdf

include whether the regulator has the power and is best placed to act, likely impact on customers, strategic and regulatory importance, the regulator's resources and impact on other work streams.

32. Prioritization principles do not negate the importance of taking enforcement action when it is appropriate to do so. They are utilised by regulators as a means of allowing for targeted enforcement which will have the best impact for consumers.

33. We would welcome views on whether it is appropriate to use prioritization principles and on the principles which could be used. Some potential principles are set out below:

- the likely impact of the investigation in terms of the direct and indirect consumer benefit that investigation may bring;
- the significance of the case (including strategic fit, the seriousness of the contravention, the level of harm to consumers, the duration of the contravention);
- the risks involved in taking on a case (i.e. the likelihood of a successful outcome);
- whether other tools are available that would be more appropriate to achieve the same or a better outcome;
- the resources required to carry out the investigation and the availability of such resources;
- whether taking enforcement action could deter contraventions in the future, including whether the case will have a more general deterrent effect; and

- whether we are the most appropriate body to carry out a formal investigation or whether another body is better placed, is already carrying out or has already carried out such an investigation.

Alternative resolution

34. The current *Enforcement Procedure* provides for the acceptance of undertakings as a means of alternative resolution and as an alternative to formal enforcement action. Currently the company may suggest undertakings at any stage but are not incentivized to do so early in a case.
35. We propose that the revised enforcement approach and procedure will make provision for alternative resolution and settlement, distinguishing very clearly between them. This section provides an overview of alternative resolution and how it fits into the revised procedure. For more details please refer to annex 1.
36. Alternative resolution will not result in a finding that a company is contravening or has contravened or is likely to contravene a condition or requirement. Therefore it is likely to be most appropriate in cases in which it would be a more proportionate way of responding to the contravention while still effectively protecting the interests of consumers and of the market, and deterring future contraventions. Low impact, less significant cases, or cases where other tools are available that would be more appropriate to achieve the same or a better outcome, may be suitable for alternative resolution. We consider that the prioritisation principles should be used to decide if a case is suitable for alternative resolution.
37. We propose that the revised Enforcement Approach Procedure provides for more forms of alternative resolution as well as give guidance on when alternative resolution may be suitable and how it fits into the procedure. See section 3.11-3.12 of annex 1 for the forms alternative resolution may take. More than one form may be necessary to fully resolve a particular case.

38. The redrafted Enforcement Approach and Procedure provides clarity on how alternative resolution fits into the procedure – proposals for alternative resolution may be brought forward during the Initial Enquiry Stage and during the Enforcement Action Stage 1 (see annex 2).
39. However, once the Summary of Initial Findings (see the flow-chart at annex 2) has been served on the company no further proposals for alternative resolution will be considered. This is a key change from the current procedure.
40. Proposals for alternative resolution put forward by a company must include steps to comprehensively address the full extent of all issues under investigation, compensate customers for any detriment suffered and rectify any gain to the company, and include steps to ensure the contravention is not repeated. In short the company must show a real commitment to resolve the issue under investigation and prevent repeat contraventions.
41. In the re-drafted procedure, decisions on alternative resolution are made by the investigation team (see the flow-chart at annex 2). Any decision will be informed by the investigation team's initial findings which will include an assessment of the gain to the company and the detriment to customers of the issue under investigation. The terms of alternative resolution must be agreed in writing by both the company and the UR.
42. A case closed by means of alternative resolution will not involve any finding of contravention by the UR and the company will not formally admit a contravention has occurred. However, we propose that the company name, details of the issue investigated, and the alternative resolution agreed will be published on our website. Before publishing anything about alternative resolution on our website we will inform the company concerned.
43. If commitments are not kept the case may be re-opened. Where a statutory undertaking is given by a water company we may be able to take enforcement

action against the company directly for the failure to comply with the terms of the undertaking.

44. Cases which are not resolved by means of alternative resolution will proceed to resolution by means of our statutory enforcement powers and a formal finding as to whether a contravention has occurred, which will be made public.

Settlement of cases

45. We propose that the revised enforcement procedure will provide for a settlement process. This section provides an overview of the proposed settlement process and how it fits into the revised procedure. Full details are set out in annex 1 (paras. 3.20 – 3.26 and 3.45-3.51). See also the flowchart at annex 2.

46. Settlement is very different from alternative resolution as to settle a case a company must admit to all the contraventions that are under investigation and agree not to challenge or appeal any finding by the UR that a company is contravening a condition or requirement, or any decision as to the amount of a financial penalty.

47. Settlement is a voluntary process. Settlement is possible only in cases where a financial penalty is in prospect. Cases where the investigation team consider that an enforcement order is required or (in water) statutory undertakings are proposed, will not be suitable for settlement.

48. In return for admitting the contravention the settlement agreement will include a discount from the amount of financial penalty that may otherwise have been imposed. The earlier the settlement agreement is signed the greater the discount will be.

49. There will be two windows wherein the company can indicate it wishes to settle - the company will have the duration of the window to sign the settlement

agreement.

50. We have considered the merits of having one or more settlement windows, but consider that for our purposes the optimal starting point is two windows. If settlement is not reached in the first window then a case is likely to be contested.

51. We propose that a case settled in the first window will result in a discount of 40% and a case settled in the second window a discount of 20%. We consider that these discounts provide incentive for a company to settle balanced against the benefits of early settlement - resources saved for both the company and the UR and ensuring that redress for customers is available earlier than would otherwise be the case.

52. The discounts are set out in the *Financial Penalties Policy* which also provides that monies to be recovered from the company (as a consequence of any gain to the company or detriment to consumer from the contravention investigated) will not be discounted.

53. The UR will convene a Settlement Committee for the purposes of deciding that settlement is appropriate and the provision of a settlement mandate.

54. If the settlement agreement is signed by the end of the first window the process moves into the final stage, Enforcement Action Stage 3 (see flowchart in annex 2). The Settlement Committee will take the final decisions in stage 3.

55. If a settlement is not agreed in the first window we will consider the case as contested and our investigation team will prepare a draft statement of case which will be issued to the company.

Enforcement Procedure – explanation of stages

56. Each stage of the Enforcement Approach and Procedure is explained in annex 1 (see sections 3.27- 3.74).

57. A summary overview of the procedure can be seen in the flowchart in annex 2.

4. Proposed changes to UR's financial penalties policy

58. The *Financial Penalties Policy* covers both whether to impose a financial penalty and a process for determining the amount of the penalty. This section outlines the changes we wish to make to the UR's current *Financial Penalties Policy*.
59. In proposing changes to our current policy our aim is to provide for a more detailed and structured policy where appropriate. We believe that this will make the policy clearer for regulated companies and easier for the UR to apply.
60. In broad terms we propose to dispense with the current approach of fixing the broad banding of the penalty and then fixing the specific banding by means of aggravating and mitigating factors. Instead, we propose to adopt a more structured process involving a series of steps which build on each other. This is more akin to the approach used by Ofgem. We also propose to give more prominence to the assessment of gain to the regulated company and detriment to customers arising from the contravention. We wish to ensure that the regulated company does not benefit financially from the contravention or failure and that any detriment to customers is remedied.
61. The first stage of the current Financial Penalties Policy involves substantiating a breach and the second stage involves consideration as to whether a financial penalty should be imposed. We propose that as the Enforcement Procedure will be applied to determine whether a contravention has or is occurring, the first stage of the revised Financial Penalties Policy should be the consideration of whether to impose a penalty or not.
62. To inform consideration of whether to impose a penalty or not, we have retained the approach in the current policy of considering the factors which may make a penalty more likely to be imposed or less likely to be imposed. We propose to

consider factors such as whether the contravention damaged the interests of customers or damaged confidence in the market, and to consider the actions of the regulated company and its management. In line with the current policy, a financial penalty will be more likely where it would be likely to create an incentive to comply and deter future contraventions or failures. See annex 3 paras. 3.4-3.5.

63. Reflecting the fact that we wish to depart from establishing the broad banding for a proposed financial penalty and then fixing a specific banding, we propose to redraft the Financial Penalties Policy to include a more detailed four step process which results in the overall financial penalty. Therefore stage 2 (annex 3 para. 3.5-3.24) has been designed to ensure that the regulated company does not benefit financially from the contravention or failure, that any detriment to customers is remedied, and that the overall financial penalty has a deterrent effect.
64. An overview of the four steps is provided below. In each step we have proposed factors to consider. We would welcome views on the steps proposed and the factors proposed for each step.
65. The factors set out in the revised policy (both stage 1 and stage 2) are those the UR may take into account and are not exhaustive. They will be applied on a case by case basis taking into consideration the facts of the case and the evidence presented.
66. The current policy considers the gain to the regulated company and the detriment to consumers are two factors the UR may consider but we believe that how this assessment impacts on the overall level of the penalty should be clearer. Our intention is that where customers have suffered loss, damage, inconvenience, or any other negative consequences that the regulated company makes appropriate redress. Therefore in step one the gain to the regulated company and the detriment to consumers is explicitly quantified (annex 3 para. 3.9-3.12). The UR will wish to deprive the regulated company of all the financial benefit they have

derived from the contravention. We propose that the amount derived in this step cannot be changed by the outcome of any of the subsequent steps.

67. Step two calculates a 'penal element' which is representative of the seriousness of the contravention (see annex 3 para. 3.13 – 3.18). The factors are designed to assess the nature and impact of the contravention and the extent to which the regulated company fell short of the standards expected of it. In this step we also propose to consider whether an adjustment to the penal element is necessary to ensure that the overall penalty will have sufficient deterrent effect.

68. With the penal element established step three will then consider aggravating and mitigating factors (see annex 3 3.19-3.21). However, any reduction will only affect the penal element and not the amount of gain or detriment identified in step one. The aggravating and mitigating factors proposed are based on those in our current policy.

69. Step four incorporates the concept of settlement and provides for a discount to the penal element of the overall financial penalty where a settlement agreement has been reached (annex 3 para. 3.22-3.24).

5. Consultation questions

70. We would welcome views on any aspect of the revised *Enforcement Policy Approach and Procedure* and revised *Financial Penalties Policy*.

71. In particular we would welcome views on:

- a. The clarity of the annexed documents
- b. The aim of the revised enforcement procedure;
- c. The concept of alternative resolution and how it fits into the procedure
- d. The concept of settlement and how it fits into the procedure
- e. The proposed settlement windows and discounts
- f. Our proposals with respect to publication.

Annex 1 Revised enforcement approach and procedure

Published alongside this document.

Annex 2 Revised enforcement procedure flowchart

Published alongside this document.

Annex 3 Revised Financial penalties policy

Published alongside this document.