

Approach to enforcement: Annex 3

Our Policy with respect to Financial Penalties

BACKGROUND

- 1.1. The Energy (Northern Ireland) Order 2003, as amended (“the Energy Order”) provides that in certain circumstances we may impose a financial penalty on any electricity or gas regulated person¹. The Water & Sewerage Services (Northern Ireland) Order 2006 (“the Water Order”) provides that in certain circumstances we may impose a financial penalty on any relevant undertaker (i.e. a company appointed as a licence holder for the provision of water or sewerage services). The term ‘regulated company’ is used in this document to encompass both any electricity or gas regulated person and any relevant undertaker under the Water Order.
- 1.2. Both Orders provide that the amount of a penalty must be reasonable in all the circumstances of the case and that it must not exceed 10% of the turnover of the regulated person/licence holder.² In the alternative, as per Article 45(9)(b) of the Energy Order, where the regulated person is or is part of a vertically integrated undertaking and the relevant condition or requirement to which the contravention³ relates is imposed on a vertically integrated undertaking pursuant to the Electricity Directive (2009/72/EC) or the Gas Directive (2009/73/EC), a penalty imposed shall not exceed 10% of the turnover of the vertically integrated undertaking.
- 1.3. The Orders require us to prepare and publish an up to date statement of policy with respect to both imposition of financial penalties and determination of their amounts. This statement has been prepared to revise the original statement which applied only to the imposition of penalties under the Energy Order. This statement now therefore adopts a cross-utility approach to in addition make provision for the Utility Regulator’s role and responsibilities in respect of the imposition of financial penalties and the determination of their amount as regards any holder of a licence for water or sewerage services in Northern Ireland.
- 1.4. We cannot impose a penalty on a regulated person/licence holder under the Orders where we are satisfied that the most appropriate way of proceeding is under the Competition Act 1998. We have powers to investigate and fine a company under the Competition Act 1998. If our investigation proves to be one

¹ Regulated person’ means both licence holders and exemption holders.

² Meaning 10% of *applicable* turnover in the preceding business year as supplemented and determined in accordance with the Electricity and Gas (Determination of Turnover for Penalties) Order (Northern Ireland) 2005 in the case of electricity and gas licence holders and the Water Industry (Determination of Turnover for Penalties) Order (Northern Ireland) 2007 in the case of penalties imposed on a water or sewerage service licence holder.

³ Contravention includes for example a failure to comply.

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that should be investigated under Competition Act powers then that route will be chosen. We will take this into account throughout our procedures and deliberations. If we become aware that a company has engaged in market manipulation practices we will consider whether it is more appropriate to proceed under REMIT enforcement powers.⁴

- 1.5. The Orders lay out procedural requirements which will be followed by us in relation to the imposition of penalties. We will also follow the procedure set out in our Enforcement Procedure which supplements these statutory requirements.
- 1.6. We will make any decision in relation to the imposition of a penalty in line with the legal framework provided by the principal objective and general duties in relation to gas, electricity (including the single wholesale market for electricity) and water as relevant. We shall also have regard to the policy set out below which has been framed in light of those principal objectives and general duties.

FINANCIAL PENALTIES – GENERAL PRINCIPLES

- 2.1. If we are satisfied that there has been or is a contravention of any relevant condition or requirement⁵, the Utility Regulator may impose a financial penalty. The policy and procedure we will follow in order to establish whether a contravention has or is occurring is set out in the Enforcement Procedure published on our website.
- 2.2. Penalties must be reasonable in the circumstances of the case and the UR also considers that they should also be such as to provide an adequate incentive both to the company in question and to other companies in the sectors we regulate to comply.
- 2.3. With respect to gas and electricity the power to impose effective, proportionate and dissuasive penalties is an important means of ensuring national compliance with the duties of a regulator under EU law and, in particular, of ensuring that consumer protection measures are effective and enforced.⁶
- 2.4. Dependent upon whether a proposed financial penalty is intended to be imposed upon a gas or electricity regulated person, or a water or sewerage services licence holder, we will need to consider the relevant legislative

⁴ The Electricity and Gas (Market Integrity and Transparency)(Enforcement etc) Regulations (Northern Ireland) 2013.

⁵ See Art. 41, 41A, and 41B of the Energy (Northern Ireland Order 2003 and Art. 30 The Water and Sewerage services (Northern Ireland) Order 2006.

⁶ Articles 41(1)(d) of the Gas Directive (2009/73/EC); Articles 37(1)(n) and 37(4)(d) of the Electricity Directive (2009/72/EC)

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provisions as set out in either the Energy Order or Water Order as the case may be.

2.5. Once we are satisfied that the regulated company has contravened or is contravening any relevant condition or requirement, or has failed to achieve any standard of performance set in accordance with the relevant provisions of the Orders⁷, there are two questions which we are required to address prior to imposing a financial penalty on each type of regulated company which it regulates. These are:

- Is it appropriate to impose a financial penalty?
- If so, what amount is reasonable in all the circumstances of the case?

2.6. We adhere to the principles of best regulatory practice as set out by the Better Regulation Executive – namely those principles which state that regulatory action should be transparent, consistent, accountable, targeted and proportionate.

⁷ Standards of Performance are set in accordance with specified provisions of the Water Order and the Energy Order and prescribed in separate regulations.

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PROCEDURAL GUIDANCE AND FACTORS RELEVANT TO THE IMPOSITION OF A PENALTY

Stage 1: Whether to impose a penalty or not

- 3.1. Once satisfied that a contravention of any relevant condition or requirement or any provision of a Community Regulation as defined by Article 45(11) of the Energy Order) has occurred or is occurring we will consider whether a financial penalty should be imposed and at what level.
- 3.2. The Utility Regulator will take full account of the particular facts and circumstances of the contravention under consideration. It will also take full account of any representations or objections made to it by interested parties by seeking either written or oral submissions as necessary in the case. Any contravention that may arise from circumstances or events outside the control of the regulated company will not incur any penalty, provided the Utility Regulator is of the opinion that the regulated company is not, in any way, to blame or contributed in any way to any such contravention or failure.
- 3.3. The factors listed below (both for stage 1 and stage 2) are those the Utility Regulator may take into account and are not exhaustive.
- 3.4. When considering whether to impose a penalty, a penalty is more likely where:
- the contravention damaged or could have damaged, the interests of customers or other market participants or damaged the environment; or
 - the contravention damaged or could have damaged, the confidence that customers and/or other market participants have in the market;
 - its imposition would be likely to create an incentive to comply and deter future contraventions or failures;
 - the circumstances from which the contravention arose were or should have been substantially within the control of the regulated company;
 - the contravention or possibility of contravention would have been apparent to a diligent regulated company;
 - the lack of effective remedial action after the contravention becomes apparent to the regulated company;
 - whether or not the regulated company has committed similar contraventions in the past.

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3.5. A financial penalty may be less likely to be imposed where:

- the contravention was or is of a very minor or trivial nature; or,
- the contravention or possibility of contravention would not have been apparent to a diligent regulated company;
- the relevant principal objective and duties of the Utility Regulator or general duties (in water) would weigh against the imposition of a penalty;
- the circumstances from which the contravention arose were outside the control of the regulated company;

Stage 2: Process for determining the amount of a financial penalty

3.5. Once it has been decided that a financial penalty should be imposed we must consider the appropriate level. Any penalty must be reasonable in the circumstances of the case.

3.6. The Utility Regulator will seek to impose a financial penalty that:

- Reflects the seriousness of the contravention
- Ensures that the regulated company does not benefit financially from the contravention;
- Deters future misconduct by the regulated company or other regulated companies.

3.7. The total amount of any penalty will normally be made up of a number of cumulative elements:

- STEP 1 A calculation of the detriment to customers and the gain to the regulated company resulting from the contravention. Where these can reasonably be calculated or estimated they will be removed from the company;
- STEP 2 A 'penal element' which reflects the seriousness of the contravention and the need for future deterrence. This will include any adjustment considered necessary to deter the regulated company or any other market participant from committing the same contravention in the future;
- STEP 3 Any aggravating or mitigating factors that may increase or decrease the penal element
- STEP 4 Where a case is settled under the enforcement procedure, apply the relevant discount to the penal element.

3.8. However, it should be noted that the outcome of steps 2-4 will not affect the amount identified as detriment and/or gain.

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Step 1: Calculation of the detriment and the gain

- 3.9. The Utility Regulator will wish to ensure that customers receive appropriate redress where they have suffered loss, damage, inconvenience, or any other adverse impact as a consequence of the contravention. We will therefore attempt to quantify the level of customer detriment where it is possible to do so.
- 3.10. Where the regulated company has taken or is taking steps to compensate affected customers we will consider the evidence of efforts made in this regard before finalising the amount of customer detriment.
- 3.11. In addition the Utility Regulator will wish to deprive the regulated company of all the financial benefit they have derived from the contravention. There are many ways a company may benefit from a contravention, therefore in calculating the gain to the regulated company we will consider both direct financial benefits and indirect benefits such as avoided costs.
- 3.12. Where the regulated company has not made any gain or customers have not suffered any detriment a financial penalty may still be appropriate and in such cases the Utility Regulator will consider the seriousness of the contravention in accordance with step 2 below.

Step 2: Calculate the penal element

- 3.13. The next step is to calculate a penal element which is representative of the seriousness of the contravention. In considering the seriousness of the contravention the Utility Regulator will normally consider a range of factors 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. The factors listed below are indicative and not meant to be exhaustive.
- 3.14. Factors relating to the nature of the contravention may include:
- The frequency and duration of the contravention
 - Whether senior management was aware or should have been aware of the contravention
 - Whether the contravention revealed serious or systemic weaknesses in the regulated company's management or compliance procedures
 - Whether the contravention could give rise to a criminal offence or individuals involved could face sanction from a professional body

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3.15. Factors relating to the impact of a contravention may include:

- The financial harm caused to other market participants
- The extent of any effects of customers in vulnerable situations
- Whether customers affected were deprived of the ability to exercise their rights including the right to switch supplier or were otherwise misinformed at any stage
- Whether overcharging of customers occurred, to what extent and over what period
- Adverse effects on the market and the seriousness of those effects, including whether market confidence was put at risk
- The extent of any detrimental effect on the ability of the Utility Regulator to regulate or fulfil its statutory duties.

3.16. Factors relating to the extent to which the regulated company fell short of the standards expected of it may include:

- The contravention was intentional, in that it was intended or foreseen that the action or inaction would cause or be likely to cause the contravention
- It was known that the action or inaction was not in accordance with the regulated company internal procedures
- The contravention was committed in such a way as to avoid the likelihood of detection
- Those responsible were influenced to commit the contravention because they thought it might not be detected
- A lack of understanding that an individual's action or inaction might result in a contravention
- The contravention suggests poor culture and governance within the regulated company, for example a lack of management oversight and/or policy and procedures designed to ensure adherence to licence or other obligations.

3.17. In addition the Utility Regulator will consider whether an adjustment to the penal element is necessary to ensure that the overall penalty will have sufficient deterrent effect for the regulated company's senior management and other regulated companies operating in the same market.

3.18. The Utility Regulator may be more likely to do this where previous action in respect of similar contraventions in the past has failed to improve compliance across those operating in the market.

Step 3: Consider aggravating and mitigating factors

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3.19. The Utility Regulator will next consider the aggravating and mitigating factors and adjust the penal element accordingly. However, any reductions will only affect the penal element and will not affect the amount identified as detriment and/or gain.

3.20. Aggravating factors tending to lead to an increase in the level of any penalty may include (but not be limited to):

- repeated or continued contravention, including failure to comply with previous undertakings or any other agreed form of redress
- continuation of the contravention after becoming aware of it
- continuation of the contravention after becoming aware of our investigation,
- the involvement of senior management in any contravention,
- failure to cooperate fully with reasonable requests from the investigation team (for example, any failure to comply, without proper justification, with information requests)
- withholding relevant evidence and/or submitting it in a manner that hinders the investigation (whether, for example, it is late, incomplete and/or inaccurate).
- any attempt to conceal all or part of the contravention from us,

3.21. Mitigating factors tending to decrease the level of any penalty would include (but not be limited to):

- the extent to which the regulated company in question had taken steps to avoid contraventions, either specifically or by maintaining an appropriate compliance policy with suitable management supervision,
- appropriate action to remedy the contravention,
- evidence that the contravention was genuinely accidental or inadvertent or outside management control,
- evidence that compliance activities have been reviewed and changed appropriately in light of the events that led to the investigation and that the effectiveness of these changes are being monitored
- prompt and proactive reporting (accurately and comprehensively) of potential contravention or failure to us as soon as they come to light,
- providing co-operation with our investigation which goes beyond what would be expected of a regulated company facing enforcement action.

Step 4: Apply settlement discount (where relevant)

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3.22. The Utility Regulator will reduce the penal element of the overall financial penalty in cases where the regulated company has agreed to settle the case in accordance with the Enforcement Procedure. See section 3 of the Enforcement Procedure for an explanation of the settlement process.

3.23. The size of the discount will be fixed and depend on the settlement window during which agreement on settlement is reached. The discounts are:

- 40 percent in the first settlement window
- 20 percent in the second settlement window

3.24. Having considered, to the extent appropriate, the factors listed in each step above and all of the circumstances of the matter under consideration, we will determine an appropriate amount for a financial penalty. We will ensure that the amount we determine is not more than 10% of the turnover (as determined in accordance with established rules and accounting practice set down in the relevant secondary legislation) of the regulated company in question.

REVISION OF THE STATEMENT OF POLICY

4.1. We will from time to time revise our policy in accordance with the Orders as the case may be. Any revised policy will be published.