

Notice of intention to impose a financial penalty by the Gas and Electricity Markets Authority, following an investigation into compliance by British Gas Trading Limited with its obligations under standard licence condition 20 of its electricity supply licences.

16 April 2002

1. This document constitutes a notice, published in accordance with section 27A of the Electricity Act 1989 stating that Gas and Electricity Markets Authority (the Authority) is satisfied that British Gas Trading Limited has contravened standard licence condition 20 in its electricity supply licence and that in consideration of that contravention it proposes to impose a financial penalty.
2. The Authority has a principal objective to exercise its functions to protect the interests of gas and electricity consumers. The Authority also has general duties which apply to the performance of its functions, including a duty to have regard to the interests of:
 - (a) individuals who are disabled or who are chronically sick;
 - (b) individuals of pensionable age;
 - (c) individuals with low incomes; and
 - (d) individuals living in rural areas.
3. The Authority grants licences for the supply of electricity. It has a duty to keep under review activities in the areas to which electricity licences apply. It also

has a duty to take enforcement action where it is satisfied that a licence obligation is being, or is likely to be, contravened and may impose a financial penalty in respect of a past or continuing contravention.

4. On the matter of financial penalties section 27A (3) of the Electricity Act 1989 requires the Authority before imposing a penalty on a licence holder to give notice:
 - (a) stating that it is proposing to impose a penalty and the amount of the penalty proposed to be imposed;
 - (b) setting out the relevant conditions or requirement or standard of performance in question;
 - (c) specifying the acts or submissions which, in the opinion of the Authority, constitute the contravention or failure in question and the other facts which, in the opinion of the Authority, justify the imposition of a penalty and the amount of the penalty proposed; and,
 - (d) specifying the period (not being less than 21 days from the date of publication of the notice) within which representations or objections with respect to the proposed penalty may be made.
5. For the purpose of paragraph 4(a), the Authority proposes to impose a financial penalty of £150,000.
6. For the purpose of paragraph 4(b), the relevant condition or requirement or the standard of performance in question is standard licence condition 20 of British Gas Trading Ltd's electricity supply licence (full text at **annex 1** to this notice).

7. For the purpose of paragraph 4(c), the acts or omissions which, in the opinion of the Authority, constitute the contravention or failure in question and the other facts which, in the opinion of the Authority, justify the imposition of a penalty and the amount of the penalty proposed are set out in sections D, F and G.

8. The Authority will consider any representations or objections with respect to this proposed financial penalty. All such comments should be sent by 5pm on 16 May 2003 to:

Annette Lovell

Ofgem

9 Millbank

London

SW1P 3GE

Or by e-mail to annette.lovell@ofgem.gov.uk

Where paper copies of a response are sent, it would be helpful if responses could also be sent electronically. It is open to respondents to mark all or part of their responses as confidential. However, the Authority would prefer it if, as far as possible, responses were provided in a form that can be placed in the Ofgem library and on the Ofgem website.

9. If the Authority proposes to vary the amount of the financial penalty the Authority will give notice as required under section 27A (4) of the Electricity Act 1989 in which it shall state the proposed variation and the reasons for it and

stating the period within which representations or objections to the proposed variation can be made.

A Background

10. British Gas Trading Ltd is a wholly owned subsidiary of Centrica plc.

11. Ofgem has conducted investigations into British Gas Trading Ltd's compliance with Standard Licence Condition 20 of its electricity supply licence, specifically whether, when British Gas Trading Ltd has objected to the transfer of its direct debit customers, such objections have been consistent with the requirements of clause 16.1 of the Master Registration Agreement compliance with which is a requirement of Standard Licence Condition 20.

B Information provided to Ofgem

12. On 1 May 2002 Ofgem received a complaint alleging that British Gas Trading Ltd had objected incorrectly to the transfer of a direct debit electricity customer on the grounds of outstanding debt and, in doing so, had contravened the relevant paragraphs of the Master Registration Agreement, and, thus, the requirements of the relevant electricity supply licence condition.

13. Specifically, the complaint alleged that, before making the objection, British Gas Trading Ltd had failed:

- to make a written demand for the outstanding sum; and
- to allow the consumer 28 days in which to make payment before making the objection.

14. Ofgem analysed statistics relating to electricity transfer requests and objections submitted by all suppliers, including British Gas Trading Ltd, and as a result decided to investigate British Gas Trading Ltd's compliance position.

C Investigation

15. Between May 2002 and March 2003 Ofgem made enquiries of British Gas Trading Ltd, exchanged correspondence and held meetings to establish the position with regard to compliance.

16. British Gas Trading Ltd reviewed the facts gathered by Ofgem.

17. Following British Gas Trading Limited's response, Ofgem submitted a report to the Authority which, having considered it, issued a letter to British Gas Trading Ltd advising that it was 'minded to' find British Gas Trading Ltd in breach of its Electricity Supply Licence and asking for British Gas Trading Ltd's comments.

18. British Gas Trading Ltd provided written comments and attended the Authority's meeting on 15th April 2003.

D Findings

19. The Authority is satisfied that between 1 January 2002 and 31 July 2002, British Gas Trading Ltd contravened Standard Licence Condition 20 of its electricity supply licence for the following reasons.

20. A procedural instruction current between 1 January 2002 and 4 August 2002 as to when British Gas Trading Ltd staff should object to a transfer was incomplete. It did not reflect the fact that the regular statements issued to British Gas Trading Ltd's direct debit customers do not contain a demand for any arrears outstanding and are worded "This is for information only". The requirement set out in paragraph 16.1.2 of the MRA cannot be satisfied by the issue of such a statement.
21. British Gas Trading Ltd failed to identify this problem through its own supervisory processes, and did not amend the instructions until 5 August 2002, after Ofgem had raised this matter.
22. British Gas Trading Ltd has accepted the estimate of 2,900 customers that were prevented at some time during the relevant period from transferring to another supplier.

E Enforcement

23. If the Authority is satisfied that a licence holder is contravening, or likely to contravene any relevant condition requirement, section 25 (1) of the Electricity Act 1989 requires the Authority, subject to subsections (2), (5) and (5A) of section 25 of the Electricity Act 1989, by final order, to make such provision as is requisite for the purpose of securing compliance with that condition or requirement.

24. Section 25 (2) of the Electricity Act 1989 state that, subject to subsections (5) and (5A) of section 25 of the Electricity Act 1989, where it appears to the Authority that a licence holder is contravening or is likely to contravene any relevant condition or requirement and that it is requisite that a provisional order be made the Authority shall (instead of taking steps towards the making of a final order) by a provisional order make such provisions as appears to the Authority requisite for the purpose of securing compliance with that condition or requirement.

25. Section 25 (5A) of the Electricity Act 1989 states that the Authority is not required to make a final order or make or confirm a provisional order if it is satisfied:

- a) that the licence holder has agreed to take and is taking all such steps as it appears to the Authority for the time being to be appropriate for the licence holder to take for the purpose of securing or facilitating compliance with the condition or requirement in question; or
- b) that the contraventions were or the apprehended contraventions are of a trivial nature.

26. In correspondence and meetings with the Authority British Gas Trading Ltd has confirmed that it has taken steps that it believes will secure compliance with Standard Licence Condition 20. It is now checking all transfer requests.

27. In the light of these actions the Authority is unable to make a final order or make or confirm a provisional order as it is not satisfied that British Gas Trading Ltd is contravening, or is likely to contravene, Standard Licence Condition of 20 of its

electricity supply licence. The Authority will continue to monitor British Gas Trading Ltd's compliance with Standard Licence Condition 20.

F Financial Penalties

28. Section 27A (1) of the Electricity Act 1989 states that where the Authority is satisfied that a licence holder has contravened or is contravening any relevant condition or requirement, the Authority may impose on the licence holder a penalty of such amount as is reasonable as in all the circumstances of the case.

29. Section 27A (2) of the Electricity Act 1989 states that the Authority shall not impose a penalty on a licence holder where it is satisfied that the most appropriate way of proceeding is under the Competition Act 1998. The Authority considers that this matter is clearly an issue of licence compliance which may be dealt with most appropriately as such. The Authority is not satisfied that the most appropriate way of dealing with it would be under the Competition Act.

30. In accordance with section 27B of the Electricity Act 1989 the Authority has prepared and published in April 2001 a statement of policy with respect to the imposition of penalties and the determination of the amount.

31. Section 27A (3) of the Electricity Act 1989 requires the Authority before imposing a penalty on a licence holder to give notice:

- a) stating that it proposes to impose a penalty and the amount of the penalty proposed to be imposed;
- b) setting out the relevant condition or requirement or the standard of performance in question;
- c) specifying the acts or omissions which, in the opinion of the Authority, constitute the contravention or failure in question and the other facts which, in the opinion of the Authority, justify the imposition of a penalty and the amount of the penalty proposed; and
- d) specifying the period (not being less than 21 days from the date of publication of the notice) within which representations or objections with respect to the proposed penalty may be made.

32. Under section 27A (8) of the Electricity Acts 1989 no penalty imposed by the Authority under this section may exceed 10% of the turnover of the licence holder as ascertained in accordance with The Electricity and Gas (Determination of Turnover for Penalties) Order 2002 (SI 2002/1111). The turnover of British Gas Trading Ltd for the financial year ending 31 December 2001 was £7,391,657,000.

33. In deciding whether or not to impose a financial penalty, the Authority considered:

- i. Factors tending to make the imposition of a penalty more likely:
 - ◆ The contravention has damaged the interests of consumers or other market participants.

An erroneous objection may be financially disadvantageous and is likely to be inconvenient for consumers. Customers of a supplier have a right to expect that switching supplier should be a straightforward process with little inconvenience. When that is not the case their perceptions of the competitive market may be damaged. Competitors will have incurred costs through their sales and marketing activity and their attempts to process transfers which subsequently failed. Competitors will have lost the margin that they would otherwise have gained.

- ◆ To do so would be likely to create an incentive to compliance and deter further breaches.

The imposition of a financial penalty would send a firm signal to the licence holder that the Authority will not allow suppliers to avoid their responsibility for ensuring that the facility to object is not used to retain customers outside of the permitted circumstances.

ii. Factors tending to make the imposition of a financial penalty less likely:

- ◆ If the contravention were of a trivial nature.

British Gas Trading Ltd has accepted that the contravention was not of a trivial nature and the Authority agrees.

- ◆ That the principal objectives and duties of the Authority preclude the imposition of a penalty.

The principal objectives and duties of the Authority do not preclude the imposition of a penalty in this case. The Authority sees no reason to believe that a penalty would be against consumers' interests or would hinder competition.

- ◆ That the possibility of a breach would not have been apparent to a diligent licence holder.

A diligent licence holder would have established procedures for ensuring compliance with its licence obligations. After Ofgem raised this matter with British Gas Trading Ltd, the company carried out its own compliance audit and instituted quality checks on all objections.

Taking these factors into consideration the Authority considers that the imposition of a penalty is appropriate in this case.

34. In its initial calculation of the level of a financial penalty the Authority considered the following factors:

◆ Seriousness of the breach

The facility to object to a customer transfer is an uncommon provision found within the gas and electricity supply markets. It provides protection to suppliers in prescribed circumstances and restricts the free movement of consumers between suppliers. The ability to switch is at the heart of competition. It is essential that the facility is used appropriately, to ensure that consumers are not disadvantaged. The Authority considers that erroneous objections interfere with the effective working of the electricity supply market, that they have the potential to damage customers' willingness to engage with the market and have an adverse impact on the way in which the market and the benefits of competition are perceived by consumers. However, this breach should be considered in the context of the full range of possible licence breaches. There has been no threat to safety, and no competitors have been driven from the market. In determining the seriousness of the breach the Authority took account of the

extent of the breach, the number of customers affected and that it is not likely to have caused widespread damage to consumer confidence.

- ◆ Degree of harm or increased cost incurred by consumers or other market players

The Authority considers that erroneous objections may be financially disadvantageous and inconvenient to consumers. British Gas Trading Ltd declined on the grounds of cost to identify and contact those consumers who had been affected by an incorrect objection. British Gas Trading Ltd also declined to compensate these consumers. Competitors have incurred costs that are probably unrecoverable in practice, through wasted sales activity and attempts to process transfers which subsequently failed. They also lost the margin that they might otherwise have gained.

- ◆ Duration of the licence breach

The evidence presented as a result of this investigation covers the period from 1 January 2002 to 31 July 2002. Secondary legislation essential to the financial penalty process came into force on 12 April 2002. The Authority therefore in this matter cannot impose a financial penalty for a breach before that date, nor for a breach which took place more than one year before the date of service of this notice.

- ◆ Any gain (financial or other) by British Gas Trading Ltd.

The Authority has considered potential benefits to British Gas Trading Ltd from objecting incorrectly, ie. from customers prevented from transferring

and the potential value of those customers. Some of these customers will have since successfully transferred.

35. In its published guidance the Authority stated that it would look at factors that could lead to an increase in the level of the penalty. These include, but are not limited to:

- ◆ Repeated contravention or failure

Each incorrect objection was a failure to comply with the MRA and, thus, Standard Licence Condition 20. The failures identified by the Authority were repeated over the relevant period, and had continued through the period of investigation, though when British Gas Trading Ltd became aware of the issue it took rapid action to prevent recurrence.

- ◆ Continuation of contravention or failure after becoming aware of the contravention or failure, or becoming aware of the start of Ofgem's investigation

Once the company became aware of the investigation, it moved quickly to assess its own compliance and change its processes.

- ◆ Involvement of senior management in any contravention or failure

It appears that senior management failed to control the way in which objections policy was applied, rather than designing it with the intention of wrongly retaining customers.

- ◆ Absence of any evidence of internal mechanisms or procedures intended to prevent contravention or failure

The facility to object is not new to the market, and there can be no doubt that British Gas Trading Ltd will have been aware of its obligations – which have been the subject of a number of industry and Ofgem meetings.

- ◆ The extent of any attempt to conceal the contravention or failure from Ofgem

British Gas Trading Ltd co-operated with the investigation.

36. Under the Authority's published guidance it will consider a number of factors that could tend to decrease the level of any penalty. These factors may include, but are not limited to;

- ◆ the extent to which the licence holder has been taking steps to secure compliance, either specifically or by maintaining an appropriate compliance policy, with suitable management supervision

British Gas Trading Ltd's policy was appropriate but that it was not properly implemented in respect of direct debit customers.

- ◆ Appropriate action by the licence holder to remedy the contravention or failure

The Authority has noted that, from 5 August 2002, British Gas Trading Ltd has had in place revised procedures which it believes will secure compliance with the relevant licence condition.

- ◆ Evidence that the contravention or failure was generally accidental or inadvertent

British Gas Trading Ltd is responsible for ensuring its procedures are adequate to secure compliance. The breach may have been inadvertent,

but British Gas Trading Ltd did not have in place at the time effective procedures for detecting such errors.

- ◆ Reporting the failure to Ofgem

This did not happen before the start of the investigation.

- ◆ Co-operation with Ofgem investigations

British Gas Trading Ltd has co-operated with the investigation.

G Conclusion

37. The Authority has considered all of these factors and is proposing to impose a financial penalty in the amount of £150,000. In reaching this figure the Authority had regard to section 3A (2) (b) of the Electricity Act 1989. The facility to object to the transfer of a customer to another supplier is an uncommon measure and adherence to the relevant rules is therefore important. The amount would have been higher had not British Gas Trading Ltd co-operated fully with Ofgem in the investigation and taken rapid action to address the breach when it became aware of the issue.

38. The Authority will consider any representations or objections with respect to this proposed financial penalty. All such comments should be sent by 5pm on **16**

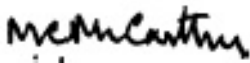
May 2003 to:

Annette Lovell
Ofgem
9 Millbank
London
SW1P 3GE

Or by e-mail to annette.lovell@ofgem.gov.uk

Where paper copies of a response are sent, it would be helpful if responses could also be sent electronically. It is open to respondents to mark all or part of their responses as confidential. However, the Authority would prefer it if, as far as possible, responses were provided in a form that can be placed in the Ofgem library and on the Ofgem website.

39. After considering all responses, the Authority will confirm, vary or withdraw the proposed penalty. If the Authority proposes to vary the amount of the financial penalty it will give notice as required under section 27A (4) of the Electricity Act 1989 in which it will state the proposed variation and the reasons for it and state the period within which representations or objections to the proposed variation can be made. If the Authority decides to confirm the proposed penalty it will in accordance with section 27A (5) of the Electricity Act 1989 issue a notice stating the imposition of the penalty, the relevant condition or requirement to which it applies, the acts or omissions which constitute the contravention of failure in question, and specifying a date by which the penalty is required to be paid.



CALLUM McCARTHY
Chairman, Gas and Electricity Markets Authority
Chief Executive, Office of Gas and Electricity Markets
For and on behalf of the Gas and Electricity Markets Authority

16th April 2003

Annex 1

Condition 20. The Master Registration Agreement

1. The licensee shall become a party to and thereafter comply with the provisions of the Master Registration Agreement.