

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

4 December 2003.

1. This document constitutes a notice, published in accordance with section 27A of the Electricity Act 1989 stating that the Gas and Electricity Markets Authority (the Authority) is satisfied that Scottish Power Energy Retail Limited has contravened Standard Licence Condition 20 of 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 impose an enforcement order 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 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.
5. For the purpose of paragraph 3(a), the Authority proposes to impose a financial penalty of £125,000.
6. For the purpose of paragraph 3(b), the relevant condition or requirement or the standard of performance in question is Standard Licence Condition 20 of Scottish Power Energy Retail Limited's electricity supply licence, which requires the supplier to comply with the terms of the Master Registration Agreement. The

full text of the licence condition, and the text of the relevant clause of the Master Registration Agreement, are attached at **annex 1** to this notice.

7. For the purpose of paragraph 3(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.

A Background

8. Scottish Power Energy Retail Limited is a wholly owned subsidiary of Scottish Power plc.
9. Ofgem has conducted an investigation into Scottish Power Energy Retail Limited's compliance with Standard Licence Condition 20 of its electricity supply licence, specifically whether, when Scottish Power Energy Retail Limited has objected to the transfer of its direct debit customers, such objections have been consistent with the requirements of the Master Registration Agreement, and whether it has therefore complied with that Standard Licence Condition.

B Information provided to Ofgem

10. Ofgem analysed statistics relating to electricity transfer requests and objections submitted by all suppliers, including those submitted on behalf of Scottish Power Energy Retail Limited.

The analysis indicated that the level of objections lodged by Scottish Power Energy Retail Limited was above the industry average. As a result Ofgem decided to investigate the company's compliance position. Scottish Power Energy Retail subsequently told Ofgem that it had erroneously over-reported the level of its objections.

C Investigation

11. Ofgem gathered evidence of non-compliance at a visit to the Scottish Power Energy Retail Limited's premises on 22 November 2002, at which it evaluated a sample of customer account records, and from a scrutiny of documents submitted by the Company after the visit.

12. In a letter dated 24 October 2003, Scottish Power Energy Retail Limited conceded that it had breached the relevant condition of its electricity supply licence.

13. Following Scottish Power Energy Retail Limited's letter, Ofgem submitted a report to the Authority which, having considered the matter, now issues this Notice.

D Findings

14. The Authority is satisfied that, between 5 May 2002 and 22 November 2002, Scottish Power Energy Retail Limited contravened the relevant provisions of the

Master Registration Agreement, and consequently, Standard Licence Condition 20 of its electricity supply licence.

15. In particular, Scottish Power Energy Retail Limited failed to demonstrate that, where it had lodged objections to the transfer of direct debit customers on the grounds of debt, payment of the debt had been demanded in writing.

16. Scottish Power Energy Retail Limited has provided an estimate that, as a result, some 3,112 customers were wrongly prevented from transferring to another supplier during the relevant period. Ofgem has accepted this estimate.

17. The Authority noted that Scottish Power Energy Retail Limited had not compensated those customers who had been subject to an inappropriate objection to transfer.

E Enforcement

18. In correspondence and meetings with the Authority Scottish Power Energy Retail Limited has confirmed that it has taken steps that it believes will secure compliance with Standard Licence Condition 20. It has now ceased debt objections in direct debit cases.

19. In the light of these actions the Authority will not make a final order or make or confirm a provisional order as it is not satisfied that Scottish Power Energy Retail Limited is contravening, or is likely to contravene, Standard Licence Condition of 30 of the licence. The Authority will continue to monitor Scottish Power

Energy Retail Limited's compliance with Standard Licence Condition 20 of the electricity supply licence.

F Financial Penalties

20. 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 in all the circumstances of the case.
21. 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.
22. In accordance with section 27B of the Electricity Act 1989 the Authority prepared and published in April 2001 a statement of policy with respect to the imposition of penalties and the determination of the amount. For the purposes of section 27 B(2) this is the version of the policy most recently published at the time when the contravention occurred.
23. Under section 27A (8) of the Electricity Act 1986 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 Scottish Power Energy Retail Limited for the financial year ending 31 March 2002 was £952,100,000.

24. 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 to ensure that the facility to object is used to retain customers correctly.

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

- ◆ If the contravention were of a trivial nature.

The Authority does not consider the contraventions trivial.

- ◆ 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.

The Authority considers that a diligent licence holder would have established procedures for ensuring compliance with its licence obligations.

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

25. 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 provides protection to suppliers in circumstances that are strictly limited, since it 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. Scottish Power Energy Retail Limited has not compensated 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 5 May 2002 to 22 November 2002.

- ◆ Any gain (financial or other) by Scottish Power Energy Retail Limited.

The Authority has considered potential benefits to Scottish Power Energy Retail Limited from objecting incorrectly, i.e. benefits arising from the

prevention of transfer of customers and the potential value of those customers. Some customers will have successfully transferred subsequently.

26. 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 Standard Licence Condition 20. The failures identified by the Authority were repeated over the relevant period, and continued into the period of investigation.

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

Scottish Power Energy Retail Limited ceased debt objection activity in direct debit cases from the end of September 2003.

- ◆ Involvement of senior management in any contravention or failure

It appears that senior management failed to ensure compliance with the relevant licence obligations, rather than designing systems 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 Scottish Power Energy Retail Limited should have been in no doubt as to 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

Scottish Power Energy Retail Limited co-operated with the investigation.

27. 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

Scottish Power Energy Retail Limited ceased objection to the transfer of direct debit customers on the grounds of outstanding debt.

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

The licensee has not offered compensation to the customers affected.

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

Scottish Power Energy Retail Limited is responsible for ensuring its procedures are adequate to secure compliance. The breach may have been

inadvertent, but Scottish Power Energy Retail Limited 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

Scottish Power Energy Retail Limited has co-operated with the investigation.

G Conclusion

28. The Authority has considered all of these factors and is proposing to impose a financial penalty in the amount of £125,000. 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 restricts competition and adherence to the relevant rules is therefore important. The amount of the penalty would have been higher had not Scottish Power Energy Retail Limited co-operated with Ofgem in the investigation and taken action to prevent continuing breaches. The amount of the penalty would have been lower if Scottish Power Energy retail Limited had compensated those consumers affected by the breach.

29. 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**

January 2004 to:

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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.

30. 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.

For and on behalf of the Gas and Electricity Markets Authority

Standard Licence Condition 20

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."

Clause 16.1.2 of the Master Registration Agreement (MRA) provides that

"16.1 An old supplier may issue an objection ("Notice of Objection") to the Service Provider in relation to an Application for Registration of which it has been notifiedwhere:

16.1.2 subject to Clause 16.2, the Application for Registration is in relation to a Metering Point which is associated with Domestic Premises where charges for electricity supplied to the Customer (at any such Domestic Premises) having been demanded in writing from the old supplier, prior to the notice of termination being given remain owing to the Old Supplier more than 28 days after that demand was made...."