

Notice of intention to impose a financial penalty by the Gas and Electricity Markets Authority, following an investigation into compliance by Transco plc with its obligations under section 9(1)(a) of the Gas Act 1986 in relation to its provision of connections services

23 March 2004.

1. This document constitutes a notice, published in accordance with section 30A of the Gas Act 1986 stating that the Gas and Electricity Markets Authority (the Authority) is satisfied that Transco plc has contravened section 9(1)(a) of the Gas Act 1986 in relation to its provision of connections services 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 transportation of gas. It has a duty to keep under review activities in the areas to which gas licences apply. It also has a duty to impose an enforcement order where it is satisfied that a relevant condition or requirement is being, or is likely to be, contravened. The Authority may impose a financial penalty in respect of a past or continuing contravention. On the matter of financial penalties section 30A (3) of the Gas Act 1986 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 condition 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.

4. For the purpose of paragraph 3(a), the Authority proposes to impose a financial penalty of £1 million.
5. For the purpose of paragraph 3(b), the relevant condition or requirement or the standard of performance in question is section 9(1)(a) of the Gas Act 1986. (Full text at **annex1** to this notice).
6. 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

7. Transco plc (Transco) is a wholly owned subsidiary of National Grid Transco plc.
8. Ofgem has conducted an investigation into Transco's compliance with section 9(1)(a) of the Gas Act 1986, specifically in relation to whether its connections activities have been carried out in an economical and efficient manner.

B The Complaint

9. In April 2002 Ofgem received a number of complaints from a Utility Infrastructure Provider (UIP) in relation to the connection services provided by Transco. Ofgem's investigation of these complaints indicated there was cause for concern and a need to

investigate more widely in order to determine whether the problems were widespread.

C Investigation

10. Ofgem issued a consultation document in November 2002 seeking views on Transco's performance in relation to connections. Ofgem investigated and assessed the complaints and responses and published an update document in March 2003. In August 2003 Ofgem followed this up with detailed information requests to certain connections customers.

11. After April 2002 Ofgem continued to receive complaints from the original UIP which were individually followed up.

12. Between April 2002 and November 2003, Ofgem made enquiries of Transco, exchanged correspondence and held meetings with a view to preparing a report to the Authority.

13. Transco has reviewed the facts gathered by Ofgem which were presented to the Authority. Transco has made representations to the Authority regarding the investigation which have been reviewed by the Authority.

D Findings

14. The Authority is satisfied that, between March 2001 and December 2003, Transco contravened section 9(1)(a) of the Gas Act 1986 through failing to develop its pipe-line system in relation to connections in an economical and efficient manner.

15. In order to develop its pipe-line system in an economical and efficient manner the Authority considers it necessary that Transco provides an economical and efficient connections service.

16. While connections services account for 6% of Transco's revenues the Authority considers that it is an area which has significant direct customer impact. A failure to

provide an economical and efficient connections service is therefore material and can constitute a breach of Section 9(1)(a).

17. The Authority is satisfied that in relation to connections services there is clear evidence of serious levels of under-performance in terms of Transco's failure to:

- produce quotations in a timely or accurate manner;
- carry out siteworks efficiently or when planned; and
- resolve problems efficiently.

18. The evidence which the Authority has for these failures comes from three sources:

- the original complaints made by a UIP and other third parties (up to July 2003) which, upon investigation by Ofgem, raised significant concerns;
- a comprehensive industry consultation which indicated that these problems were not isolated instances or limited to one company and showed that problems were encountered in all aspects of Transco's connections service. Ofgem received 13 responses to its consultation in November 2002 with 8 respondents providing evidence in relation to specific cases. The responses to the August 2003 follow-up showed a continuing high level of dissatisfaction, including detailed evidence in relation to particular areas;
- statistical performance figures including the Connection Standards of Service (CSOS) figures which relate primarily to the timeliness of quotations and which show performance below the 90% planned performance level for the period from May 2003 to December 2003 with a failure rate of 24.8% in October 2003.

19. Transco accepted that its performance fell short of the service levels expected by itself or its customers although it denied this amounted to a breach of Section 9(1)(a).

20. Considering all the evidence taken together the Authority is satisfied that Transco's performance in relation to the provision of connections is a breach of Section 9(1)(a) of the Gas Act 1986.

E Enforcement

21. In correspondence and meetings with the Authority, Transco has confirmed that it has taken steps that it believes will secure compliance with section 9(1)(a) of the Gas Act and, in particular, has agreed in principle to the introduction of a new licence condition relating to connections services.
22. In the light of these actions the Authority does not consider it appropriate to make a final or provisional order. The Authority will continue to monitor Transco's compliance with section 9(1)(a) of the Gas Act 1986.

F Financial Penalties

23. Section 30A (1) of the Gas Act 1986 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.
24. Section 30A (2) of the Gas Act 1986 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 an issue of Gas Act compliance. Therefore, the Authority is not satisfied that the most appropriate way of dealing with this case would be under the Competition Act.
25. In accordance with section 30B of the Gas Act 1986 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. This policy was revised and published in October 2003. This penalty notice is issued in accordance with published policy.
26. Under section 30A(8) of the Gas 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 Transco for the financial year 2002/2003 was £3,037 million.

27. 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.

Transco's failure to provide connection services in an economical and efficient manner had adverse effects for both end customers and industry organisations, such as UIPs and shippers/suppliers. Adverse effects included:

- *customers being incorrectly charged;*
 - *customers incurring expense due to Transco's failure to carry out siteworks as planned;*
 - *a negative impact on the reputation for UIP and shipper competence which may result in customers being deterred from taking advantage of the competitive market.*
- 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 licensee and its customers that the Authority will not allow transporters to avoid their responsibilities under the Gas Act 1986 in relation to connections.

(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 Gas Act obligations.

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

29. In its initial assessment of the level of a financial penalty the Authority considered the following factors:

- Seriousness of the breach

In relation to connections the Gas Act imposes duties on Gas Transporters in order to provide protection to their customers. It is essential that these duties are fulfilled appropriately to ensure that customers and industry participants are not disadvantaged. This breach was considered in the context of the full range of possible breaches of section 9(1)(a). It was noted that the breach related only to Transco's connections business (which accounts for 6% of total revenue) and no safety issues were involved.

- Degree of harm or increased cost incurred by consumers or other market participants after taking account of any compensation paid

The Authority considers that the delayed quotations, delayed siteworks and difficulties in resolving problems may have been financially disadvantageous and inconvenient to customers. Competitors to Transco have stated that they incurred additional administrative and operational costs and suffered reputational damage and may have lost future customers. However, in some cases they have already received financial compensation for failures in certain elements of the work

investigated. In total approximately £2.6 million in compensation was paid by Transco between March and December 2003.

- Duration of the licence breach

The Authority considers that from March 2001 to December 2003 Transco was in breach. However, the Authority may only impose a penalty in respect of the period March 2003 to December 2003.

- Any gain (financial or other) by Transco.

The licensee may have made a gain through retaining connections business which may otherwise have been won by its competitors. However, after allowing for the compensation paid, Transco is unlikely to have financially gained from the breach.

30. 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

The Gas Act breach took place from March 2001 to December 2003.

- Continuation of contravention or failure after becoming aware of the contravention or failure, or becoming aware of the start of Ofgem's investigation
Even when the company had become aware of the investigation it continued to perform poorly.

- Involvement of senior management in any contravention or failure
It appears that senior management failed to manage effectively the way in which its connection service provider carried out its connections activities, rather than managing its business with the intention of deliberately breaching its obligations under the Act.

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

Transco has in place procedures to audit and check compliance. However, this failed to prevent the problems in Transco's performance.

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

Transco co-operated with the investigation.

31. 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

Over the past year Transco has made significant efforts to address the problems in its connections business. For example, Transco has provided information regarding a new Fulcrum management team being introduced in early 2003. However, these initiatives had limited effect in the short term and performance continued to deteriorate until the end of 2003 after which performance has improved.

- Appropriate action by the licence holder to remedy the contravention or failure
Transco has attempted to remedy the situation and agreed on the need for a new licence condition.

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

Transco is responsible for ensuring its procedures are discharged in a reasonable manner. The breach may have been inadvertent, but Transco should have had in place an effective management procedure for detecting such failures on the part of its service provider and have taken appropriate remedial action.

- Reporting the failure to Ofgem

This did not happen before the start of the investigation.

- Co-operation with Ofgem investigations

Transco has co-operated with the investigation.

G Conclusion

32. The Authority has considered all of these factors and is proposing to impose a financial penalty in the amount of £1 million. In reaching this figure the Authority had regard to section 4AA (2) (b) of the Gas Act 1986. The provision of connections is an important aspect of developing an economic and efficient pipe-line system. However, the Authority recognises that their connections business accounts for 6% (£195 million) of Transco's total turnover. The penalty has been set taking this into account. Moreover, the amount of the penalty would have been higher had Transco not already paid approximately £2.6 million in compensation. The Authority acknowledges the steps that Transco is now taking to improve its performance in this area and in particular its agreement to the need for a new licence condition.

33. The Authority will consider any representations or objections with respect to this proposed financial penalty. All such comments should be made no later than 5pm on 27 April 2004 to:

Maxine Frerk

Ofgem

9 Millbank

London

SW1P 3GE

Or by e-mail to maxine.frerk@ofgem.gov.uk

34. 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 that, as far as possible, responses were provided in a form that can be placed in the Ofgem library and on the Ofgem website.

35. 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 30A (4) of the Gas Act 1986 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 30A (5) of the Gas Act 1986 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.

Sir John Mogg

For and on behalf of the Gas and Electricity Markets Authority

Annex 1

Section 9(1)(a) Of the Gas Act 1986

General powers and duties

9. – (1) It shall be the duty of a gas transporter as respects each authorised area of his-

(a) to develop and maintain an efficient and economical pie-line system for the conveyance of gas;