

**Decision of 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.**

**19 May 2004**

1. This document constitutes a notice, published in accordance with section 30A (5) 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 and that in consideration of that contravention it confirms the decision to impose a financial penalty of £1 million on Transco plc.
  
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 take enforcement action where it is satisfied that any relevant condition or requirement as defined in the Gas Act 1986 is being, or is likely to be, contravened and 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. Section 30A (1) of the Gas Act 1986 states that where the Authority is satisfied that a licence holder has contravened or is continuing to contravene 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.

5 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 plc for the financial year 2002/2003 was £3,037 million.

6 On 23 March 2004, in accordance with section 30A (3) of the Gas Act 1986 the Authority issued a 'Notice of intention to impose a penalty' of £1 million on Transco plc.

## **A Background**

7 Transco plc is a wholly owned subsidiary of National Grid Transco plc.

8 Ofgem has conducted an investigation into Transco plc'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 Investigation**

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 plc. 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.

- 10 Ofgem issued a consultation document in November 2002 seeking views on Transco plc's performance in relation to connections. Ofgem investigated and assessed the complaints and responses and, in August 2003, followed these up with detailed information requests to certain connections customers.
- 11 After April 2002 Ofgem continued to receive complaints from the original UIP which were followed up individually.
- 12 Between April 2002 and November 2003, Ofgem made enquiries of Transco plc, exchanged correspondence and held meetings with a view to preparing a report to the Authority.
- 13 Transco plc reviewed the facts gathered by Ofgem which were presented to the Authority. Transco plc made representations regarding the investigation which were reviewed by the Authority.

**C 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 The Authority's findings were set out in the 'Notice of intention to impose a financial penalty' dated 23 March 2004.

**D Enforcement**

- 16 In correspondence and meetings with the Authority, Transco plc has confirmed that it has taken steps that it believes will secure compliance with section 9(1)(a) of the Gas Act 1986 and, in particular, has agreed in principle to the introduction of a new licence condition relating to connections services.
- 17 As set out in the 'Notice of intention to impose a financial penalty' dated 23 March 2004, the Authority does not consider, in the light of these actions, that it is appropriate to make a final or provisional order. The Authority will continue to

monitor Transco's compliance.

## **E Financial Penalties**

- 18 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.
  
- 19 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 clearly an issue of compliance with the Gas Act 1986 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.
  
- 20 In accordance with section 30B of the Gas Act 1986 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.
  
- 21 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 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.

Such a notice was published in this case on 23 March 2004 (see paragraph 7).

22 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 plc's failure to carry out siteworks as planned; and*
- *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 contraventions.

*The imposition of a financial penalty would send a firm signal to the licence holder 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 contravention 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 contravention 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 obligations under the Gas Act.*

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

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

◆ Seriousness of the contravention

*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 contravention was considered in the context of the full range of possible contraventions of section 9(1)(a). It was noted that the contravention related only to Transco's connections business (which accounts for 6% of total revenue). Issues regarding safety were forwarded to HSE for their consideration and were not considered in relation to the penalty.*

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

*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 statutory compensation was paid by Transco between March and December 2003.*

◆ Duration of the licence contravention

*The Authority considers that from March 2001 to December 2003 Transco was in contravention. 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 plc.

*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 contravention.*

24 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 contravention took place from March 2001 to December 2003, although the Authority may only impose a penalty in respect of the period March 2003 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 contravening its obligations under the Act.*

- ◆ Absence of any 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 identify and, thus, 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*

25 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  
*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 genuinely accidental or inadvertent  
*Transco is responsible for ensuring its procedures are discharged in a reasonable manner. The contravention 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 plc has co-operated with the investigation.*

## **F Representations**

26 Six representations were received in response to the Authority's 'Notice of intention to impose a financial penalty' dated 23 March 2004:



#### Avon Lippiatt Hobbs (Contracting) Ltd – (ALHCO)

- ALHCO considered the Authority's statement in paragraph 29 of the notice proposing the penalty, that 'no safety issues were involved' to be incorrect;
- It stated that the accurate and timely recording of live gas mains was critical to the Health and Safety process;
- It asked the Authority to reconsider its position in respect of the statement that 'no safety issues were involved'; but
- made no direct representations about the imposition or level of the proposed penalty.

#### Exoteric Gas Solutions Ltd (EGS)

- EGS suggested that the level of penalty proposed, £1 million (0.1% of Transco's annual profits), was inadequate for the purpose of securing Transco's compliance with its statutory duties in respect of connections services;
- It considered that the quantum of any penalty should be material to the shareholders of National Grid Transco plc and recommended a figure of £100 million;
- It cited duration of the contravention (prior to the period for which the Authority can impose a penalty in this case), board level awareness of the contravention and the failure to prevent its continuation and Transco's refusal to accept that it has contravened its statutory duties in support of this;
- It also noted that the compensation of £2.6 million paid by Transco in the period March to December 2003 was not made voluntarily (it was a statutory requirement) and that, since those payments did not elicit a change in Transco's behaviour, it was unlikely that the requirement to pay a further £1 million would do so;
- It stated that safety issues were involved.

#### Scottish and Southern Energy plc (SSE)

- SSE stated that it was aware of shortcomings in the connections services provided by Transco;

- It noted that Transco was unlikely to have benefited from the contravention, has paid compensation, its performance has begun to improve and it has agreed a new licence condition relating to connection services; and
- that, in the light of the above factors, it did not believe Ofgem would be justified in imposing a £1 million penalty on Transco.

#### Mr Y

- Mr Y (a Transco shareholder) stated that National Grid Transco was an efficient utility;
- He considered that Ofgem persistently bullied the company and did not recognise its work and achievements; and
- He did not consider that a financial penalty should be imposed.

#### energywatch

- energywatch welcomed Ofgem's intention to impose a financial penalty on Transco for this contravention, although it expressed concern that market forces had not been strong enough to improve service delivery;
- Expressed the expectation that the financial penalty would be paid from profits rather than being passed on to consumers; and
- Believed that Ofgem's investigation and financial penalty would bring about 'real behavioural change within Transco'.

#### Transco plc

- Transco considered the Authority's finding that it contravened section 9(1)(a) of the Gas Act 1986 and the proposed financial penalty 'inappropriate and disproportionate';
- It maintained that the Authority's interpretation of section 9(1)(a) of the Gas Act 1986 was wrong and that its 'underperformance' did not amount to a contravention of the Act;
- It maintained that the evidence relied on by the Authority in its findings was unreliable and did not support the Authority's conclusions;

- It maintained that the various standards of service regimes to which it is subject (GSOS, OSOS and CSOS) provide the appropriate means of dealing with any underperformance;
- Transco stated in its letter that it did not consider that the imposition of a financial penalty would create a further incentive to comply with its obligations under section 9(1)(a) of the Gas Act;
- Since Transco plc did not accept that it contravened the requirements of the Act, Transco plc did not consider that contravention could have been apparent to it as a 'diligent licensee';
- Transco plc considered the 'seriousness of the contravention' should be taken against its entire connections and network operations, rather than just its connections business, and that this was therefore smaller than the Authority considered; and
- Transco plc considered compensation that it had paid more than offset any costs and damage experienced by its customers;

27 The Authority has considered fully all of the responses. The Authority has noted that the safety issues raised had been passed to the Health and Safety Executive (HSE) which was considering them. This was in accordance with the Authority's Memorandum of Understanding with the HSE.

## **G Decision**

28 The Authority wishes to make clear that, in reaching its decision, it has considered very carefully the question of whether the penalty should be increased or reduced. It noted the representation arguing for a very considerable increase in the level of the penalty, but did not consider that this was appropriate in the circumstances. Transco has been working to improve its performance in matters covered by the investigation and has agreed, in principle, to an additional licence condition providing further regulation in that aspect of its work. The Authority noted also that Transco plc did not consider that the imposition of a financial penalty would create a further incentive to it to comply with its obligations. The Authority believes that the penalty, publicity and the new licence condition (which the Authority wishes to see finalised as quickly

as possible) will all provide incentives to Transco plc's future improvement and compliance.

- 29 After considering all of the responses, the Authority must confirm, vary or withdraw the proposed penalty.
- 30 If the Authority decides to confirm the proposed penalty it is required by section 30A (5) of the Gas Act 1986 to issue a notice:
- (a) stating the imposition of the penalty and its amount;
  - (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, constitutes the contravention or failure in question and the other facts which, in the opinion of the Authority, justify the imposition of the penalty and the amount; and
  - (d) specifying a date, no earlier than the end of 42 days from the date of service of the notice on the licence holder, by which the penalty is required to be paid.
- 31 For the purpose of paragraph 28 (a) and after considering all the representations received, the Authority hereby confirms the decision of 17 March 2004 to impose a penalty of £1 million on Transco plc for contravening section 9(1)(a) of the Gas Act 1986 as set out in the findings above and in the Authority's 'Notice of intention to impose a financial penalty' dated 23 March 2004.
- 32 For the purpose of paragraph 28 (b) the relevant licence condition or requirement, or the standard of performance in question, is section 9(1)(a) of the Gas Act 1986.
- 33 For the purpose of paragraph 28 (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 that penalty are set out in sections B, C and E of this notice and in the 'Notice of intention to impose a financial penalty' dated 23 March 2004.

- 34 For the purpose of paragraph 28 (d) the penalty must be paid to the Authority no later than 2 July 2004.
- 35 In accordance with section 30A (6) of the Gas Act 1986 Transco plc may, within 21 days of the date of service of this notice, make an application to the Authority for it to specify different dates by which different portions of the penalty are to be paid.
- 36 If the whole or any part of the penalty is not paid by the date it is required to be paid, then in accordance with section 30D (1) of the Gas Act 1986, the unpaid balance from time to time shall carry interest at the rate for the time being specified in section 17 of the Judgements Act 1838.
- 37 In accordance with section 30 F of the Gas Act 1986, where a penalty imposed, or any portion of it, has not been paid by the date on which it is required to be paid, the Authority may recover from Transco plc, as a civil debt due to it, any of the penalty or interest which has not been paid.

A handwritten signature in black ink, appearing to read 'John Mogg', with a stylized flourish at the end.

SIR JOHN MOGG

Chairman, Gas and Electricity Markets Authority

For and on behalf of the Gas and Electricity Markets Authority