

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

19 July 2004

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 Powergen 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 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 £450,000.
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 Powergen Retail Limited's electricity supply licence (full text at **annex 1** to this notice, with a copy of the relevant provisions of the Master Registration Agreement, to which it relates).

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 C, E and F.

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 9 August 2004 to:

Michael Knowles

Ofgem

9 Millbank

London

SW1P 3GE

Or by e-mail to michael.knowles@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. Powergen Retail Limited is a subsidiary of E.ON UK plc. (formerly Powergen UK plc).

11. Ofgem has conducted investigations into Powergen Retail Limited's compliance with Standard Licence Condition 20 of its electricity supply licence, specifically whether, where Powergen Retail Limited has objected to the transfer of its 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 Investigation

12. Between 17 July 2003 and 5 March 2004 Ofgem made enquiries of Powergen Retail Limited, exchanged correspondence and held meetings to establish the position with regard to compliance with standard licence condition 20 of its electricity supply licence.

13. Powergen Retail Limited reviewed the facts gathered by Ofgem.

14. Following Powergen Retail Limited's response, Ofgem submitted a report to the Authority which, having considered it, issued a letter to Powergen Retail

Limited, stating that it was “minded to” find Powergen Retail Limited in breach of its electricity supply licence and asking for comments.

15. Powergen Retail Limited provided written comments in response and attended the Authority’s meeting on 14 July 2004.

C Findings

16. The Authority is satisfied that, between 1 October 2002 and 24 July 2003, Powergen Retail Limited contravened Standard Licence Condition 20 of its electricity supply licence for the following reasons.
 17. Procedural instructions current between 1 October 2002 and 24 July 2003 as to when staff should object to a customer transfer on the grounds of outstanding debt were inadequate, in that they did not reflect the requirement for the relevant debt to have been demanded in writing. Personnel making decisions relating to objections to transfer were not adequately instructed as to how to determine whether a demand for payment had been issued.
 18. The regular statements issued to Powergen Retail Limited’s direct debit and regular cash payment customers do not contain a demand for any arrears outstanding and include the words “For information only”. The requirement set out in paragraph 16.1.2 of the MRA is not satisfied by the issue of such statements.
 19. Letters issued to prepayment customers who continued to use their former suppliers’ rechargeable cards following transfer to Powergen Retail Limited (resulting in so-called “misallocated payments”) did not ask for payments to

correct the resulting debt. Consequently that debt could not form the basis for an objection in the event of a later request for transfer to a third supplier.

20. The staff concerned were given inadequate training in the procedures to be followed in determining whether an objection was appropriate. Further, Powergen Retail Limited failed to put in place adequate supervisory measures which would have identified and remedied erroneous objection decisions.
21. Powergen Retail Limited said that it had brought some errors to the attention of its external contract service provider following an internal audit in September 2002. In addition following an energywatch complaint Powergen Retail Limited required the service provider to rebrief staff in January 2003 and implement a quality report. However, follow-up checks, including the appropriateness of the quality report, were not made by Powergen Retail Limited.
22. Ofgem has accepted an estimate provided by Powergen Retail Limited that some 12,800 customers were wrongly prevented at some time during the relevant period from transferring to another supplier.

D Enforcement

23. If the Authority is satisfied that a licence holder is contravening, or likely to contravene any relevant condition or requirement, section 25 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 or provisional order, to make such provision as appears requisite for the purpose of securing compliance with that condition or requirement.

24. In correspondence and meetings with the Authority, Powergen Retail Limited confirmed that it has taken steps that it believes will secure compliance with Standard Licence Condition 20. The company suspended objections to transfer on the grounds of debt on 24 July 2003, subsequently re-introducing them for some categories of customer following the adoption of more rigorous manual checking procedures.

25. In the light of these actions the Authority will not make a final order or make or confirm a provisional order as it has no basis to conclude that Powergen Retail Limited is contravening, or is likely to contravene, Standard Licence Condition of 20 of its electricity supply licence. Ofgem will continue to monitor Powergen Retail Limited's compliance with Standard Licence Condition 20.

E Financial Penalties

26. 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.

27. 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. The Authority is not satisfied that the most appropriate way of dealing with it would be under the Competition Act 1998.

28. 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. This is the version of the policy that was in force at the time of the breach.

29. Under section 27A (8) of the Electricity Act 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 Powergen Retail Limited for the financial year ending 31 December 2002 was £1,138,400,000.

30. 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. It is reasonable for customers of a supplier 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.

The Authority believes that a licence breach affecting 12,800 customers cannot be considered to be trivial, especially when considered in the context of the number of objections made, rather than the total number of transfers or customers.

- ◆ 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. Although it had identified shortcomings in September 2002, Powergen Retail Limited failed to put in place supervisory procedures which were adequate to detect and prevent further non-compliance, which was not tackled until after Ofgem began its investigation.

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

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

- ◆ Seriousness of the breach

The ability to switch supplier is at the heart of competition. 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. 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. However, Powergen Retail Limited said that a large percentage of customers subsequently succeeded in transferring, on average within two months of the initial erroneous objection. Notwithstanding this, competitors will 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 October 2002 to 24 July 2003.

- ◆ Any gain (financial or other) by Powergen Retail Limited.

The Authority has considered potential benefits to Powergen Retail Limited from objecting incorrectly, i.e. from customers prevented from transferring and the potential value of those customers. Some of these customers will have since successfully transferred. Powergen Retail Limited stated that it had incurred significant costs in addressing the problem.

32. 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 scale of the breach by Powergen Retail Limited was far in excess of that seen in earlier cases. Each incorrect objection was a failure to comply with the MRA and, thus, a breach of Standard Licence Condition 20. The failures identified by Ofgem were repeated over the relevant period.

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

Powergen Retail Limited had become aware of the contravention during an internal audit in September 2002 but effective remedial action was not taken until July 2003, after Ofgem had raised the issue. This was despite publicity in April 2003 regarding a similar contravention by one of its competitors. Once the issue was raised by Ofgem, Powergen Retail Limited responded swiftly to prevent further breaches by stopping all objections.

- ◆ Involvement of senior management in any contravention or failure

Although there is no evidence that procedures were intended to retain customers wrongly, senior management failed to control the way in which the objections policy was applied

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

Powergen Retail Limited was aware of its obligations. Having identified apparent breaches of these obligations it failed to manage intended remedial action effectively. Procedural instructions given to staff were deficient, as were supervisory measures which would otherwise have detected continuing errors.

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

Powergen Retail Limited has co-operated fully with the investigation, and has not denied non-compliance.

33. 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

Powergen Retail Limited established that there were deficiencies in operation of its debt blocking procedures. However, it failed to ensure proper implementation and control of revisions to those procedures. It has now put in place a revised compliance accountability structure.

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

The Authority has noted that Powergen Retail Limited suspended objections to transfer on the grounds of debt on 24 July 2003, subsequently re-

introducing them for some categories of customer following the introduction of more rigorous manual checking procedures.

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

Powergen Retail Limited is responsible for ensuring that its procedures are adequate to secure compliance. The breach may have been inadvertent, but the company should have had in place arrangements for detecting errors, and for correcting any procedural deficiencies which caused them.

- ◆ Reporting the failure to Ofgem

This did not happen before the start of the investigation.

- ◆ Co-operation with Ofgem investigations

Powergen Retail Limited has fully co-operated with the investigation. Much of the evidence considered by Ofgem was provided voluntarily by the company.

F Conclusion

34. The Authority has considered all of these factors and is proposing to impose a financial penalty in the amount of £450,000. In reaching this figure the Authority took into account the fact that a relatively large number of customers across all payment types were affected and whilst Powergen Retail Limited moved swiftly to address the problem once it was identified by Ofgem it had failed to address the issues effectively when the problems came to its attention. 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 penalty would have been higher had Powergen Retail Limited not co-operated fully with Ofgem in the investigation.

35. The Authority will consider any representations or objections with respect to this proposed financial penalty. All such comments should be sent by 5pm on 9 August 2004 to:

Michael Knowles
Ofgem
9 Millbank
London
SW1P 3GE

Or by e-mail to michael.knowles@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.

36. 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.

Dr Robin Bidwell

For and on behalf of the Gas and Electricity Markets Authority

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 of the Master Registration agreement (MRA) provides that (*inter alia*)

"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 notified where:

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"