

Decision of 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.

24 August 2004

1. This document constitutes a notice, published in accordance with section 27A (5) 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 confirms the decision to impose a financial penalty of £450,000 on Powergen Retail Limited.
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. Ofgem has investigated Powergen Retail Limited’s compliance with standard condition 20 of its electricity supply licence. At its meeting on 14 July 2004, the Authority, after consideration of written and oral representations made by Powergen Retail Limited, concluded that Powergen Retail Limited had contravened standard licence condition 20 of its electricity supply licence.

5. Section 27A (1) of the Electricity Act 1989 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 a penalty of such amount as is reasonable in all the circumstances of the case.
6. 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.
7. On 19 July 2004, in accordance with section 27A(3) of the Electricity Act 1989, the Authority gave notice that it proposed to impose a penalty of £450,000 on Powergen Retail Limited.

A Background

8. Powergen Retail Limited is a subsidiary of E.ON UK plc (formerly Powergen UK plc).
9. Ofgem analysed statistics relating to electricity transfer requests and objections submitted by all suppliers, including Powergen Retail Limited. That analysis prompted Ofgem to conduct an investigation into the company's compliance with Standard Licence Condition 20 of its electricity supply licence, specifically whether, where Powergen Retail Limited had objected to the transfer of its customers, such objections were 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

10. As a result, between 17 July 2003 and 5 March 2004 Ofgem made enquiries of Powergen Retail Limited, exchanged correspondence and held meetings to

investigate the position with regard to compliance with standard licence condition 20 of its electricity supply licence.

11. In the course of those enquiries and discussions, Powergen Retail Limited carried out its own audit of compliance and forwarded the results to Ofgem.

C Findings

12. 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.
13. 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.
14. 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.
15. 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.
16. 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.

17. 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.
18. The Authority 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

19. 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.
20. 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.
21. In the light of these actions the Authority will not make a final order or make or confirm a provisional order.

E Financial Penalties

22. 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.
23. 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.
24. 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.

Such a notice was published on 19 July 2004.

25. 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.

26. 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.

27. 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.

28. 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.

29. 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

- ◆ 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. The Authority also notes that in January 2004 Powergen Retail Limited sent a letter of apology to those of the affected customers who were still with the company.

- ◆ 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 Representations

30. The Authority has considered the single written representation it has received on the matter.

31. This representation was made by Powergen Retail Limited.

In it the company accepts its responsibility to put in place procedures which are effective in guarding against breaches of the licence conditions relating to customer transfers and confirms that it has now implemented more rigorous

processes and procedures.

Powergen Retail Limited states that it accepts the Authority's findings and does not challenge the proposed penalty.

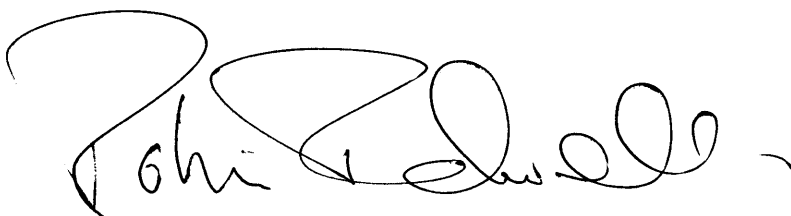
The letter will be published on the Ofgem website.

G Decision

32. After considering the responses, the Authority must confirm, vary or withdraw the penalty.
33. If the Authority decides to confirm the proposed penalty it is required by section 27A (5) of the Electricity Act 1989 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.
34. For the purpose of paragraph 33 (a), following the proposal of 19 July 2004 and after considering all the representations received, the Authority hereby imposes a penalty of £450,000 on Powergen Retail Limited.
35. For the purpose of paragraph 33(b) the relevant licence condition or requirement, or the standard of performance in question, is standard licence

condition 20 of Powergen Retail Limited's electricity supply licence.

36. For the purpose of paragraph 33(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 C, D and E of this notice, and in the Authority's notice of intention to impose a financial penalty dated 19 July 2004.
37. For the purpose of paragraph 33(d) the penalty must be paid to the Authority no later than 6 October 2004.
38. In accordance with section 27A (6) of the Electricity Act 1989 Powergen Retail Limited 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.
39. 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 27D (1) of the Electricity Act 1989, 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.
40. In accordance with section 27F of the Electricity Act 1989, 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 Powergen Retail Limited, as a civil debt due to it, any of the penalty or interest which has not been paid.



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