

Notice under section 27A of the Electricity Act 1989

Proposal of the Gas and Electricity Markets Authority to impose a financial penalty, following an investigation into compliance with SLC 4D and SLC 12 of the electricity distribution licence by Electricity North West Limited

7 February 2011

1. Summary

- 1.1. The Gas and Electricity Markets Authority ("the Authority") proposes to impose a financial penalty on Electricity North West Limited ("ENWL") and has considered that ENWL breached its licence obligations under its electricity distribution licence, specifically standard licence condition 4D ("SLC 4D") and standard licence condition 12 ("SLC 12").
- 1.2. Under SLC 4D (Requirement to Offer Terms for Use of System and Connection) ENWL was obliged to provide offers for connection as soon as practicable, and in any event within three months of receipt of an application which contained all such information as ENWL may have reasonably required for the purpose of formulating the terms of the offer.
- 1.3. Since 1 June 2008 the obligations in SLC 4D have been set out in SLC 12 (Requirement to Offer Terms for Use of System and Connection). SLC 12 requires ENWL to provide offers for connection as soon as reasonably practicable, and in any event within three months of receipt of an application which contains all such information as ENWL may reasonably require for the purpose of formulating the terms of the offer.
- 1.4. ENWL has entered into a settlement agreement with Ofgem by which ENWL has agreed not to contest Ofgem's findings as set out in this proposed decision.
- 1.5. Ofgem's investigation concerned applications and offers for connections made from 1 April 2007. During this time, ENWL has accepted that there were 22 breaches of SLC 4D and six breaches of SLC 12. The Authority is satisfied that ENWL contravened SLC 4D and SLC 12.
- 1.6. The Authority gives significant weight to ENWL's cooperation with Ofgem's investigation in this case, including its willingness (and agreement) to settle this investigation.
- 1.7. The Authority's view is that it is appropriate to impose a penalty on ENWL in relation to three breaches of SLC 12. The Authority considers that the overall penalty on ENWL should be £100,000.
- 1.8. The Authority hereby gives notice of its intention to impose a penalty in accordance with section 27A of the Electricity Act 1989 ("the Electricity Act"). Representations on the proposed penalty may be made by 28 February 2011 and sent by email to: Dipen.Gadhia@Ofgem.gov.uk

2. Background

- 2.1. Distribution Network Operators are natural monopolies with respect to a number of services where it is more efficient for a single company to provide the service than it would be for several competing companies. Examples of such “non-contestable” activities carried out by DNOs include deciding the point of connection to the DNO’s network; and the design, approval and connection of extension assets to the DNO distribution system and their energisation. Other “contestable” activities, such as the design and provision of equipment and construction of the contestable works, are open to other (accredited) third parties to complete the work for customers, and this has allowed competition to develop to varying degrees across the UK.
- 2.2. Even where there is a degree of competition, Ofgem considers it is important, given the significant levels of market shares that most DNOs still maintain, that where customers choose to have their connection provided by the incumbent DNO it provides offers for those services in accordance with the relevant licence condition. Ofgem’s enforcement powers serve to provide an important incentive to DNOs to comply with their obligations.
- 2.3. ENWL voluntarily reported to Ofgem a number of breaches in April 2009, and in response to an Ofgem information request sent in January 2010 ENWL informed Ofgem that it had failed to meet the three month timescale set out in SLC 4D and SLC 12 on 27 occasions.
- 2.4. In an email dated 26 May 2010, ENWL notified Ofgem that it had identified another breach of SLC 12.
- 2.5. In total, ENWL has accepted that it breached SLC 4D on 22 occasions and SLC 12 on six occasions.
- 2.6. ENWL had identified problems associated with the breaches and had taken steps to rectify the issue prior to the opening of Ofgem’s investigation, including the installation of a new workforce management system in November 2008. The installation of this system appears to have significantly improved ENWL’s ability to monitor its compliance with its obligations as set out in SLC 12.

3. The Authority’s decision on whether to impose a financial penalty

- 3.1. The Authority has carefully reviewed the relevant licence obligations, the statement of case submitted by Ofgem and ENWL’s written response.
- 3.2. The Authority is satisfied that contraventions of SLC 4D and SLC 12 have occurred on the basis of the evidence available and ENWL’s acceptance of them.
- 3.3. The Authority has considered whether the imposition of a financial penalty is reasonable in all the circumstances of this case, in accordance with the requirements of the Electricity Act 1989 and having regard to its published

statement of policy ("Policy") with respect to financial penalties. The matters detailed in this Policy are considered below.

Factors tending to make the imposition of a financial penalty more likely than not

- 3.4. Whether the contravention or failure has damaged the interests of consumers or other market participants. The Authority finds that the general interests of consumers are likely to have been damaged by the contravention. Compliance with the provision to provide offers as soon as reasonably practicable, and in any event within three months, is an important service for customers, such as developers of housing estates or wind farms, who require certainty over the time of connection offers in order to manage their project schedules. ENWL has failed to provide this service to the required standard as stipulated in its electricity licence, even though it was paid for it under the price control.
- 3.5. Whether imposing a financial penalty is likely to create an incentive to compliance and deter future breaches. The Authority considers that imposing a financial penalty on ENWL is likely to incentivise compliance and help deter future breaches, by sending a message to the company, its shareholders and the industry at large that a failure to deliver services under the licence obligations will not be tolerated.

Factors tending to make the imposition of a financial penalty less likely than not

- 3.6. If the contravention is trivial in nature. The Authority does not consider that the infringements of ENWL's licence conditions are trivial. While the number of contraventions is numerically small, the Authority's view is that breaches of the "as soon as reasonably practicable" obligation with a three month backstop are serious. Further, there is an expectation on licence holders that in return for funding under the price control they will meet their obligations under the licence.
- 3.7. The principal objectives and duties of the Authority preclude the imposition of a penalty. There is nothing in the Authority's principal objective and duties to preclude the imposition of a financial penalty in this case.
- 3.8. The breach or possibility of a breach would not have been apparent to a diligent licensee. The Authority considers that the contraventions are not of the type that could have been considered to be outside ENWL's control, or would not have been apparent to a diligent licensee. The systems ENWL now has in place suggest that it is now able to monitor the progress of connection applications against the three month timescales.

4. Quantum of the penalty – general level

- 4.1. Under the Electricity Act 1989 the Authority may impose a financial penalty of up to 10 per cent of the annual turnover of the relevant licence holder. Annual turnover is defined in Regulations issued by the Secretary of State¹. The Regulations allow the inclusion of all revenue from the activities of the licence

¹ The Electricity and Gas (Determination of Turnover for Penalties) Order 2002

holder, whether regulated or not. In the year ended 31 March 2010 ENWL had a turnover of £323.4m according to regulatory accounts. On this basis, the maximum fine that could be levied is £32.3m.

Factors which are first considered when determining the level of penalty

- 4.2. Seriousness of the infringements. It is the Authority's view that this type of contravention is of a serious nature. Whilst the Authority acknowledges that the proportion of connections in ENWL's distribution service area that are conducted by independent connection providers is higher than most other DNO areas, ENWL still account for the majority of all connections work in its area. ENWL is funded under the existing price control to deliver good customer service and this is reinforced by its licence obligations. Enforcing such compliance is an important part of the integrity of monopoly network regulation.
- 4.3. The degree of harm or increased cost incurred by consumers or other market participants. The Authority believes that while there was no clear evidence of harm in this case there is potential for significant consumer detriment arising from failure to provide connection offers in accordance with the time limit.
- 4.4. The duration of the contravention or failure. There have been a number of breaches of the backstop three month timeframe between July 2007 and November 2009. In total the Authority has found 22 instances of breach of SLC 4D for the period 17 July 2007 to 31 May 2008² and six instances of breach of SLC 12 for the period 1 June 2008 to November 2009. For the purpose of imposing a penalty, the specific breaches which are relevant are those where the time of contravention was on or after 22 January 2009, where three instances of breach have been identified. However, the fact that there have been multiple breaches and that this was not an isolated incident are aggravating factors in relation to the level of any such penalty.
- 4.5. The gain (financial or otherwise) made by the licensee. It is clear that, although there may not be a precise quantification, ENWL may have avoided costs from not expending resources on appropriate systems to identify and prevent breaches of these licence obligations. Investment into systems was only undertaken from Q1 2007/08. There is however no evidence that ENWL deliberately sought to breach the condition for financial gain.

Factors tending to increase the level of penalty

- 4.6. Repeated contravention or failure. Ofgem first wrote to ENWL in April 2009 to assist Ofgem with its ongoing investigation against EDFE. It was in response to this letter that ENWL first voluntarily notified Ofgem that it had breached its obligations set out in SLC 12. We understand that there has been a further instance of breach, in November 2009, after Ofgem first wrote to ENWL. We are not aware of any breaches since that time. We had not previously specifically written to ENWL in relation to its compliance with these obligations. We do not consider the singular instance of breach after we first wrote to ENWL (to assist

² SLC 4D became SLC 12 on 1 June 2008

with our ongoing investigation against EDFE) amounts to a repeated contravention or failure.

- 4.7. Continuation of the contravention or failure after either becoming aware of the contravention or failure or becoming aware of the start of Ofgem's investigation. Ofgem's enquiries commenced in April 2009 and its investigation in January 2010. ENWL have confirmed that its last contravention took place in November 2009.
- 4.8. Absence of any evidence of internal mechanisms or procedures intended to prevent contravention or failure. We note that, pre-April 2007, ENWL informed Ofgem that it was unlikely to be able to conclusively determine if there had been any failures to meet the three month deadline prior to 1 April 2007. After this time period ENWL initiated a number of initiatives culminating with the installation of its WFM system in November 2008, which appears to have put it in a better position to monitor and so prevent contraventions. The Authority notes that these remedial measures were started and completed before Ofgem began its enquiries.
- 4.9. The involvement of senior management in any contravention or failure. So far as we are aware senior management were not involved in any deliberate actions in relation to the contraventions or failures.
- 4.10. The extent of any attempt to conceal the contravention or failure from Ofgem. Once ENWL became aware of the breaches (from its own review) it did not attempt to conceal the contravention from Ofgem.

Factors tending to decrease the level of penalty

- 4.11. Co-operation with Ofgem's investigation. ENWL has co-operated with Ofgem over the course of the investigation providing Ofgem with detailed information, both on a voluntary basis and in response to formal information requests. Because ENWL accepted the breaches, Ofgem did not have to expend additional resources on a detailed analysis of the relevant cases.
- 4.12. Appropriate action by the licensee to remedy the contravention or failure. ENWL has spent a considerable amount of time and money on upgrading its systems, which appears to have put it in a position where it can adequately monitor its compliance with its obligations.
- 4.13. The extent to which the licensee had taken steps to secure compliance either specifically or by maintaining an appropriate compliance policy, with suitable management supervision. ENWL started taking steps to secure compliance from April 2007. It appears that it was not in a position to prevent contraventions until November 2008, following the installation of its WFM management system and possibly slightly later than that, as a result of the need for a bedding in period for using this system, which may explain why there were 4 breaches after this time.
- 4.14. Evidence that the contravention or failure was genuinely accidental or inadvertent. The Authority recognises the fact that ENWL's breach was not wilful.

However, it should have taken adequate steps to ensure compliance and to ensure that the licence breaches were not accidental or inadvertent.

- 4.15. Reporting the contravention or failure to Ofgem. When Ofgem requested information from DNOs to assist with its ongoing investigation against EDFE, ENWL voluntarily reported its breaches to Ofgem at that time.

5. The Authority's decision on financial penalty

5.1. The Authority considers that there are a number of mitigating factors in this case which it has taken into account in determining the level of financial penalty. In particular:

- There are only three breaches in the period during which the Authority can impose a financial penalty;
- ENWL's co-operation with Ofgem's investigation;
- Action taken by ENWL, prior to Ofgem opening its enquiries;
- Voluntarily reporting its contraventions to Ofgem and admitting the extent of its breaches; and
- ENWL's agreement to settle this investigation.

5.2. Given the above the Authority intends to impose a financial penalty of £100,000 on ENWL, which it considers is reasonable in all the particular circumstances of the case. This penalty represents 0.03% of the company's licensed turnover and 0.3% of its connections revenue.³

5.3. Representations on this decision should be sent, preferably by email, by 28 February 2011 to: Dipen.Gadhia@ofgem.gov.uk (postal address, Ofgem, 9 Millbank, London SW1P 3GE).

5.4. The Authority would prefer it if, as far as possible, responses were provided in a form that can be placed on the Ofgem website. Should you wish your response or part of your response to remain confidential, please indicate this clearly.

Gas and Electricity Markets Authority

7 February 2011

³ Based on the regulatory accounts year ended 31 March 2010