

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 by British Gas Trading Limited with reporting requirements under the Renewables Obligation

1 July 2011

1. Summary

- 1.1. The Gas and Electricity Markets Authority ("the Authority") proposes to impose a financial penalty on British Gas Trading Limited ("BG") following an investigation into BG's failure to report accurate supply data as required under the Renewables Obligation ("the RO") for England & Wales and Scotland, as set out by various statutory instruments¹.
- 1.2. By 1 July each year, electricity suppliers are required to inform the Authority of the amount of electricity supplied to customers in England & Wales and Scotland during the previous obligation period (financial year).
- 1.3. Ofgem's investigation concerns BG's reporting of electricity supply data from the first obligation period in 2002-03 to the seventh obligation period in 2008-09.
- 1.4. The Authority finds that:
 - BG misreported the amount of electricity supplied to customers in England & Wales and Scotland each year from the first obligation period in 2002-03 to the seventh obligation period in 2008-09. The misreporting amounted to 0.62% of electricity supplied per year on average; and
 - as a result of the misreporting other market participants suffered an aggregate loss of £2.8m over the 7 year period.
- 1.5. BG is taking appropriate action to address any market impact caused by the error.
- 1.6. The Authority considers it appropriate to impose a financial penalty on BG. In so doing the Authority gives significant weight to BG's actions in relation to redress as well as to BG's co-operation with Ofgem's investigation, including its willingness (and agreement) to settle this investigation.
- 1.7. In the circumstances, the Authority hereby gives notice under section 27A of the Electricity Act 1989 (the "Act") of its proposal to impose a penalty of £1,000,000 on BG in respect of contraventions of relevant requirements in the seventh obligation period in 2008-09.
- 1.8. Any written representations on this notice must be sent to Christoph Fütter at Ofgem (christoph.futter@ofgem.gov.uk) by 22 July 2011.

¹ These statutory instruments include all those in force at the relevant time for each of the obligation periods between April 2, 2002, and March 31, 2009, including the Renewables Obligation Order 2002, the Renewables Obligation (Scotland) Order 2002, the Renewables Obligation (Scotland) Order 2004, the Renewables Obligation Order 2005, the Renewables Obligation (Scotland) Order 2005, the Renewables Obligation Order 2006, the Renewables Obligation (Scotland) Order 2006, the Renewables Obligation (Scotland) Order 2007, the Renewables Obligation Order 2009 and the Renewables Obligation (Scotland) Order 2009.

2. Background

- 2.1. Under the RO, electricity suppliers are required to source a certain percentage of electricity supplied to customers from renewable sources. This percentage increases from year to year and reached 9.1% for the seventh obligation period in 2008-09.
- 2.2. An electricity supplier can meet its obligations under the RO by:
 - presenting Renewables Obligation Certificates ("ROCs") to the Authority for each obligation period;
 - using a buy-out clause to pay for shortfalls ("buy-out payment"); or
 - using a combination of the two methods.
- 2.3. Buy-out payments are received by Ofgem and recycled, on a pro rata basis, to those electricity suppliers who were able to meet their obligations by presenting ROCs. For example, in the 2008-09 obligation period, the total RO amounted to 28,975,678 MWh of electricity. Of that obligation, 65% was met by presenting ROCs and the rest by buy-out payments. As a result, Ofgem recycled £353m to suppliers, who received £18.61 for every ROC they had submitted ("recycle value" of a ROC).
- 2.4. The calculation of the amount of each supplier's individual RO in a yearly obligation period is made on the basis of how many MWh of electricity were supplied by that supplier. To do so the Authority relies on accurate reports of the amount of electricity supplied to customers in England & Wales and Scotland by the 1 July immediately following the end of an obligation period.
- 2.5. On 28 April 2010, BG reported to Ofgem that it had discovered errors in the historic supply data reported to the Authority. This report and subsequent correspondence² led to concerns that BG might have breached its reporting requirements under the RO.
- 2.6. During the investigation³, Ofgem found that from 2002-03 to 2008-09, BG understated the amount of electricity it supplied to customers in England & Wales and Scotland. This is estimated to be equivalent to a value of £2.8m over the 7 year period.
- 2.7. BG acknowledged that the misreporting was caused by insufficient procedures and a wrong interpretation of the reporting requirements by BG's non-domestic supply arm, British Gas Business ("BGB"). BGB's supply figures from 2002-03 to 2008-09 were based on billing data, including estimated bills, rather than actual supply data in relation to non-domestic customers. The British Gas Residential arm of the business, used actual supply data. These two figures were consolidated when BG reported its total supply data to Ofgem, which led to an underestimating of supply to Ofgem over the seven year period.
- 2.8. BG has committed to take appropriate action as soon as possible to address the harm caused by its failure to comply. BG will retire a number of ROCs (around 87,000) in relation to the current renewables obligation period, the implications of which are that it will pay an additional amount into the 2010-11 buyout fund. This will address the harm caused, including interest, to industry parties from its under

² Ofgem met BG on 11 May 2010, and investigated its compliance by means of a letter dated 26 May 2010.

³ Ofgem sought documents and information by means of information requests dated 21 June 2010 and 24 August 2010, as well as letters dated 13 October 2010, 22 November 2010, and 11 January 2011.

reporting in previous years. It has also revised its reporting procedures to ensure future compliance. Since the 2009-10 obligation period, BG has been reporting the actual amount of electricity supplied to its non-domestic customers. BG has ensured that BGB data, like BGR data, are formally approved by senior managers before their submission to the Authority. It also introduced regular refresher training for staff undertaking the reports. Finally, BG has committed to include compliance with its regulatory requirements in its annual internal audit programme.

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

General background to the Authority's decision to impose a financial penalty

- 3.1. The Authority has considered whether a financial penalty is appropriate in accordance with the requirements of the Electricity Act 1989 and with its published Statement of Policy ("Policy") with respect to Financial Penalties (October 2003). The Authority may impose a penalty in respect of the seventh obligation period in 2008-09.
- 3.2. The Authority is required to carry out all its functions, including the taking of any decision as to penalty, in the manner which it considers is best calculated to further its principal objective, having regard to its other duties. The Authority is not, under its own Policy, limited to consideration of matters specifically mentioned in the Policy, and will consider all the circumstances. The matters detailed in this Policy are considered below.

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

Whether the contravention or the failure has damaged the interests of consumers or other market participants

- 3.3. The Authority finds that the interests of other market participants have been damaged, but that BG is taking action that will address this in full.

Whether imposing a financial penalty is likely to create an incentive to compliance and deter future breaches

- 3.4. Misreporting of regulatory information, including of information used for the administration of the RO, by any regulated company is difficult for Ofgem to detect and may lead to significant detriment to other market participants and to consumers should it go undetected for significant amounts of time. It is therefore necessary that regulated entities are deterred from misreporting and are incentivised to put adequate systems, processes and procedures in place to ensure accurate reporting of regulatory information, including information that Ofgem uses for the administration of environmental programmes. The Authority considers that the imposition of penalties where misreporting comes to light, as in this case, is likely to have this effect.

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

If the contravention is trivial in nature

- 3.5. The Authority considers that the infringements of BG's relative requirements are not trivial due to the Authority's reliance on the accuracy of regulatory information, including information used for the administration of the RO, in order to carry out its functions.

That the principal objective and duties of the Authority preclude the imposition of a penalty

- 3.6. There is nothing in the Authority's principal objective and duties to preclude the imposition of a penalty in this case.

That the breach or possibility of a breach would not have been apparent to a diligent licensee

- 3.7. The Authority considers that a diligent licensee would have put appropriate procedures in place in order to avoid misreporting to this extent and over a period of seven years.
- 3.8. In light of the above, the Authority considers it appropriate to impose a financial penalty in this case.

4. Criteria relevant to the level of financial penalty

- 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 State⁴. The Regulations allow the inclusion of all revenue from the activities of the licence holder, whether regulated or not. In the year ended 31 December 2010, BG had a turnover of £12.7bn, according to the annual report by BG's parent company, Centrica plc. Revenues from business energy supply and services during that year amounted to £2.9bn.
- 4.2. In arriving at the quantum of the penalty in this case, the Authority has considered all the circumstances in the case including the following factors in accordance with its Policy.

Factors which are first considered when determining the level of penalty

The seriousness of the contravention and failure

- 4.3. The Authority considers that BG's breach of relevant requirements under secondary renewables legislation can be qualified as a serious breach, because Ofgem relies on accurate information being submitted by licence holders to carry out its statutory functions and administer environmental programmes, including the RO.
- 4.4. If Ofgem were unable to rely on the accuracy of information submitted by licence holders, it would need to spend more resources on monitoring work. This would lead to an increased burden on both Ofgem and licence holders, increased overall cost of gas and electricity, and an increased likelihood of inaccuracy in regulatory decision-making and administration of environmental programmes such as the RO.

The degree of harm or increased cost incurred by customers or other market participants after taking into account any compensation paid

- 4.5. Other market participants have been harmed as a consequence of BG's misreporting. However, BG is taking action that will address this in full.

The duration of the contravention or failure

- 4.6. The Authority considers that electricity supply data for the purpose of calculating BG's obligations under the RO were misreported over a period of seven years, from the first obligation period in 2002-03 to the seventh in 2008-09.

⁴ The Electricity and Gas (Determination of Turnover for Penalties) Order 2002.

The gain (financial or otherwise) made by the licensee

- 4.7. It is apparent from BG's responses to Ofgem's questions that the company was unable to meet its reporting requirements, because it had insufficient procedures in one part of its business, BGB, to ensure and monitor compliance with the reporting requirements under the RO. In addition to the gain, BG received in not buying additional ROCs or making appropriate payments to the buyout fund, there is an element of avoided cost associated with BG's failure to allocate company resources to appropriate reporting and monitoring procedures.

Factors tending to increase the level of penalty

Repeated contravention or failure or a continuation of failure after being aware of the contravention

- 4.8. As stated above, the contravention was repeated for seven yearly reporting periods between 2002 and 2009, before BG detected the failure. While the Authority is only able to impose a financial penalty in respect of the seventh obligation period, the Authority considers that BG's repeated contravention of the order over seven obligation periods is an aggravating factor which has compounded the level of damage caused by contravention of the orders and which emphasises the lack of adequate systems in place to ensure compliance with the order. However, the Authority is satisfied that there was no continuation of the contravention after it was detected by BG.

The involvement of senior management in any contravention or failure

- 4.9. The Authority considers that senior management was not involved in any deliberate actions in relation to the contravention.

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

- 4.10. Internal mechanisms to prevent contravention or failure were not absent, but the Authority considers that these mechanisms were insufficient, because they relied on a misinterpretation of the reporting requirements and involved only informal checks before data was submitted under the RO.

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

- 4.11. BG did not attempt to conceal the contravention and self-reported the breach to Ofgem. However, eight months passed from BG's detection of the failure in September 2009 to its report to Ofgem in April 2010. BG acknowledged that its internal investigation into the contravention took too long and delayed the escalation to Ofgem.

Factors tending to decrease the level of penalty

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

- 4.12. BG has taken steps to secure compliance with its reporting requirements under the RO by: clarifying the reporting requirements to its staff; updating its process manuals; introducing yearly refresher training; strengthening and formalising the sign-off procedure for reports to Ofgem; and including regulatory reporting under the RO in its annual audit.

Appropriate action by the licensee to remedy the contravention or failure

- 4.13. BG has committed to making appropriate redress to other market participants by retiring around 87,000 ROCs in the current reporting obligation year.

Evidence that the contravention or failure was genuinely accidental or inadvertent

- 4.14. While there is no evidence that the contravention was wilful, the contravention or failure cannot be regarded as genuinely accidental or inadvertent. The Authority considers that the duration of the breach over seven years and the use of insufficient reporting and monitoring procedures during that time demonstrate a failure to apply sufficient attention to BG's non-domestic supply business.

Reporting the contravention or failure to Ofgem

- 4.15. BG self-reported the contravention to Ofgem.

Co-operation with Ofgem's investigation

- 4.16. BG co-operated fully with Ofgem's investigation and provided detailed information, both on a voluntary basis and in response to formal information requests. Because BG decided not to contest Ofgem's findings, Ofgem did not have to spend additional resources on issuing a statement of case and preparing for an oral hearing. The Authority also gives weight to BG's willingness (and agreement) to settle this investigation on the basis of this decision.

5. The Authority's decision

- 5.1. The Authority proposes to impose a financial penalty on BG of £1,000,000 which it considers is reasonable in all the particular circumstances of this case. This represents 0.01% of the company's total turnover and 0.03% of the revenues of BGB. The penalty is a much lower figure than would have been imposed if BG:
- had not been cooperative in providing Ofgem with full and accurate information about its contraventions across all seven obligation periods;
 - had contested Ofgem's findings; and
 - had not committed to action to address the harm suffered by other market participants as soon as possible.
- 5.2. Any representations or objections with respect of the Authority's proposal must be made, preferably by email, before 22 July 2011, to: christoph.futter@ofgem.gov.uk (postal address: Ofgem, 9 Millbank, London SW1P 3GE).
- 5.3. 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.