

Notice of intention to impose a financial penalty pursuant to section 30A(3) of the Gas Act 1986

Proposal of the Gas and Electricity Markets Authority to impose a financial penalty, following an investigation into the failure by National Grid Gas plc to comply with standard special condition D10 paragraph 2(g) of its gas transporters licence

21 December 2011

1. Summary

- 1.1 The Gas and Electricity Markets Authority ("the Authority") proposes to impose a financial penalty of £4,300,000 on National Grid Gas plc ("NGG") following an investigation into NGG's failure to comply with standard special condition ("SSC") D10 paragraph 2(g) of its gas transporters licence.
- 1.2 In accordance with SSC D10 paragraph 2(g), Gas Distribution Network operators ("GDNs") are required to attend 97 per cent of *uncontrolled* gas escapes within one hour and 97 per cent of *controlled* gas escapes within two hours ("the Gas Emergency Standards").
- 1.3 The investigation concerned NGG's compliance with the Gas Emergency Standards for the period covering 1 April 2010 to 31 March 2011 ("the Relevant Period").
- 1.4 The Authority finds that for the Relevant Period -
 - NGG failed to meet the standard for uncontrolled gas escapes during the Relevant Period in all four of its Distribution Networks (North West of England, East of England, West Midlands and London). In North West of England NGG attended, on average, 92.1% of uncontrolled gas escapes within the relevant time limit required by the Gas Emergency Standards. Similarly, in East of England, West Midlands and London, NGG reached annual performance levels of 95.2%, 95.3% and 96.1% respectively.
 - NGG failed in two of its Distribution Networks (North West of England and East of England) to meet the standard for attending controlled gas escapes within the relevant time limit required by the Gas Emergency Standards. In North West of England NGG attended, on average, 95.1% of controlled gas escapes within the relevant time limit required by the Gas Emergency Standards. Similarly, in East of England, NGG reached an annual performance level of 96.8%.
 - These failings constitute a breach of SSC D10 paragraph 2(g).
- 1.5 The Gas Emergency Standards are an extremely important part of the licence conditions, as they are related directly to public safety and unattended gas escapes have the potential to cause harm to consumers.
- 1.6 NGG has informed Ofgem that it is taking appropriate action to apply the lessons learnt from last year's performance to its plans for this year. In particular, NGG has taken considerable steps to revise its winter operation plans and increase available resources to ensure future compliance with the Gas Emergency Standards.

- 1.7 The Authority considers it appropriate to propose the imposition of a financial penalty on NGG in respect of the contraventions of its licence conditions referred to above. In deciding on the level of the penalty, the Authority has taken into account the action taken by NGG to revise its plans and increase available resources for this winter. It has also had regard to NGG's willingness to engage and co-operate with Ofgem and, in particular, its agreement to settle this investigation as quickly as possible.
- 1.8 In the circumstances, the Authority hereby gives notice under section 30A(3) of the Gas Act 1986 ("the Act") of its proposal to impose a penalty of £4,300,000 on NGG in respect of its failure to comply with SSC D10 paragraph 2(g) of its gas transporters licence during the Relevant Period. The proposed level of penalty would have been higher had NGG not admitted the breach of the licence and co-operated fully with Ofgem's investigation.
- 1.9 Any written representations on the proposed penalty must be received by Claire Dance at Ofgem (Claire.dance@ofgem.gov.uk) by 5.00pm on Monday, 23 January 2012.
- 1.10 Any representations received that are not marked as confidential may be published on the Ofgem website. Should you wish your response or part of your response to remain confidential, please indicate this clearly.

2. Background

- 2.1 SSC D10 paragraph 2(g) provides:

"2. For each relevant period, the licensee shall procure that:

g) in 97 per cent of cases, where a report of a gas emergency including a gas escape, an emission of carbon monoxide, fumes or other hazardous situation is received through the emergency telephone service, or by any other means, the licensee shall attend or procure the attendance of an emergency service provider at the site of the incident promptly and in either event:

(i) in respect of an uncontrolled gas escape or other uncontrolled gas emergency, within 1 hour of the full emergency details being received by the telephone service, or by any other means; or

(ii) in respect of a controlled gas escape or other controlled gas emergency, within 2 hours of the full emergency details being received on the telephone service, or by any other means".

- 2.2 A controlled gas escape is defined in SSC D10 paragraph 11 as "a gas escape or other gas emergency where the person reporting the escape or other emergency, after carrying out (or causing to be carried out) the actions advised [by] the telephone service, advises the operator that the escape of gas or other emergency appears to have ceased". An uncontrolled gas escape is not defined in the licence but occurs where the person reporting it is unable to bring the situation under control after following the advice given by the telephone service.
- 2.3 SSC D10 paragraph 2(g) is an absolute standard. There are no exceptions in this standard, including no exception for severe weather conditions. Ofgem expects GDNs to aim for 100 per cent compliance, but accepts that there may be circumstances where this is not possible. The 97 per cent standard therefore reflects the need for a tolerance level.

- 2.4 As part of the price control settlement Ofgem looks to assess the efficient funding required by the GDN to undertake its network activities. In accepting the price control settlement, the GDNs are agreeing to meet all their licence obligations, including SSC D10 paragraph 2(g). Consumers are charged through their bills for the cost of managing the network and the standard required in respect of the Gas Emergency Standards is 97 per cent.
- 2.5 NGG informed Ofgem in December 2010 and January 2011 that it did not expect to meet the Gas Emergency Standards during the Relevant Period, due to the impact of severe weather conditions and increased workload volumes during November and December 2010.
- 2.6 All GDNs are required to report their performance against the Gas Emergency Standards to Ofgem each year in their annual regulatory reporting packs ("RRPs"). NGG submitted its RRP in July 2011 and it was clear that its GDNs had, to varying degrees, failed to meet the Gas Emergency Standards during the Relevant Period. In addition to the RRP, NGG formally submitted its 2010/11 performance against SSC D10 paragraph 2(g) to Ofgem on 3 May 2011. This resulted in Ofgem opening an investigation and placing this matter on a formal basis in October 2011.
- 2.7 NGG accepts that the impact of the severe weather could have been mitigated through more effective planning and resourcing ahead of winter 2010-11. NGG has informed Ofgem that it has taken action to identify the issues and incorporate the lessons learnt into its winter operation plans for this year, so as to seek to ensure future compliance with the Gas Emergency Standards.

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 this case, taking into account the requirements of the Act and its published Statement of Policy with respect to Financial Penalties (October 2003) ("the Policy").
- 3.2 The Authority is required to carry out all of its functions, including the taking of any decision as to financial penalty, in the manner which it considers is best calculated to further its principal objective and having regard to its other duties.
- 3.3 In deciding whether it is appropriate to impose a financial penalty, the Authority has considered all the circumstances of the case including, but not limited to, the specific matters set out in the Policy. These matters are examined in detail below.

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

The extent to which the circumstances from which the contravention or failure arose were outside the control of the licensee

- 3.4 The Authority acknowledges that there were severe weather conditions within NGG's Gas Distribution Networks, resulting in high volumes of publicly reported escapes during winter 2010-11.
- 3.5 While the Authority accepts that these factors were, to some extent, outside the control of NGG, GDNs are funded to meet the Gas Emergency Standards in all

weather conditions and NGG should have had arrangements in place to meet the Gas Emergency Standards, even in a particularly harsh winter. SSC D10 paragraph 2(g) is an absolute standard and one with which other GDNs also affected by bad weather were able to comply during the Relevant Period. Accordingly, the Authority considers that the impact of the severe weather could have been mitigated by more effective planning and resourcing ahead of winter 2010-11 and the circumstances of the breach were in part, therefore within the control of the licensee.

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

- 3.6 The Authority does not consider that the interests of other market participants have been damaged as a result of the contraventions by NGG. The Authority acknowledges the risk of harm posed to consumers by NGG's non-compliance with the Gas Emergency Standards set out in SSC D10 paragraph 2(g) and the fact that the bills charged to consumers assumed compliance with the tolerance standard of 97 per cent during the Relevant Period. It also recognises the importance of the obligation in ensuring that the potential for harm is mitigated as far as possible. However, the Authority is not aware that the contraventions resulted in any actual physical harm to consumers in this case.

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

- 3.7 The Gas Emergency Standards set out in SSC D10 paragraph 2(g) are important. Failure to meet the standards has the potential to cause serious physical harm to the public, given the generally high risk and hazardous nature of gas escapes. Therefore, it is important that all GDNs understand the importance of compliance and that non-compliance will have consequences. GDNs should have robust winter plans in place (including effective contingency measures) and devote sufficient resources to ensuring compliance with the Gas Emergency Standards. The Authority considers that the imposition of a penalty in this case is likely to create an incentive to compliance for the industry and deter future breaches.

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

Whether the contravention is of a trivial nature

- 3.8 The Authority does not consider that the contraventions of the Gas Emergency Standards are trivial in nature. The standards set in SSC D10 paragraph 2(g) are essential requirements due to the potential for serious consumer harm.

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

- 3.9 There is nothing in the Authority's principal objective and duties that precludes the imposition of a penalty in this case.

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

- 3.10 The Authority considers that a diligent licensee would have taken steps to ensure that it had robust winter plans in place, including effective contingency measures, and devoted sufficient resources to meeting the Gas Emergency Standards, ahead of the Relevant Period.
- 3.11 After consideration of the above, the Authority concludes that it is appropriate to impose a financial penalty in this case.

4. Criteria relevant to the level of financial penalty

- 4.1 In accordance with section 30A(8) of the Act, 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 an Order issued by the Secretary of State¹ as the applicable turnover for the business year preceding the date of this notice. In the business year ending on 31 March 2011 NGG's turnover was £2,747,000,000 therefore the maximum penalty that can be applied in this case is £274,700,000. However, the Authority have also considered the fact that the breach occurred only in the Gas Distribution part of NGG's business, which has a turnover of £1,524,000,000.
- 4.2 In deciding the appropriate level of financial penalty, the Authority has considered all the circumstances of the case, including the following specific matters set out in the Policy.

Factors which are first considered when determining the level of financial penalty

The seriousness of the contravention and failure

- 4.3 The Authority considers that NGG's failure to fully comply with the Gas Emergency Standards is a serious breach, due to their importance and the potential for consumer harm resulting from non-compliance. These are very important obligations with which we expect all GDNs to comply. During the Relevant Period, NGG fell short of the 97 per cent standard for uncontrolled gas escapes in all four of its GDNs and in two of its GDNs (North West of England and East of England) NGG also failed to meet the standard for controlled gas escapes. Compliance levels amongst the GDNs varied from 92.1% to 96.1% for uncontrolled gas escapes. For controlled gas escapes, North West of England attended, on average, 95.1% of controlled gas escapes within the relevant time limit required by the Gas Emergency Standards. Similarly, East of England reached an annual performance level of 96.8%. As stated above, Ofgem expects GDNs to strive for 100 per cent compliance, and in our view the 97 per cent standard already incorporates a tolerance level.
- 4.4 The Authority has also considered NGG's compliance over the year and notes that before the winter period, NGG failed to meet the standard for uncontrolled escapes in one of its GDNs (London) in quarter 2 of the Relevant Period.

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

- 4.5 The Authority does not consider that the interests of other market participants have been damaged as a result of the contraventions by NGG. Furthermore, the Authority is not aware that the contraventions resulted in any actual physical harm to consumers. However, the Authority has had regard to the serious risk posed to consumers by NGG's non-compliance and the charges paid by consumers through their bills for NGG's service at the required standard, which they did not receive during the Relevant Period.

The duration of the contravention or failure

- 4.6 The duration of the contravention is limited to the period 1 April 2010 to 31 March 2011. The breach is not ongoing.

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

The gain (financial or otherwise) made by the licensee

- 4.7 GDNs are funded as part of their regulated revenue to reach the Gas Emergency Standards in each year as a minimum. By failing to put in place adequate contingency procedures for bad weather, NGG avoided expenditure that could be considered required of a GDN to achieve the 97 per cent emergency standard.
- 4.8 NGG has informed Ofgem that it spent an additional £6m on responding to the severe winter and attempting to meet the Gas Emergency Standards in 2010/11.

Factors tending to increase the level of financial penalty

Repeated contravention or failure or continuation of a contravention or failure after either becoming aware of the contravention or failure or becoming aware of the start of Ofgem's investigation

- 4.9 There has been no previous breach of the Gas Emergency Standards by NGG.
- 4.10 The next reporting period will end on 31 March 2012, and NGG's compliance with the Gas Emergency Standards will be monitored as part of Ofgem's ongoing monitoring work.

The involvement of senior management in any contravention or failure

- 4.11 The Authority does not consider that senior management was involved in any deliberate actions in relation to the contravention. However, the Authority considers that planning and resourcing for its winter operations and the implementation of contingency plans were the responsibility of senior management at NGG. The Authority takes the view that poor decision making in these areas were contributing factors in NGG's non-compliance with the Gas Emergency Standards.

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

- 4.12 Internal mechanisms to prevent contravention or failure were not absent but the Authority considers that the mechanisms in place during the Relevant Period were insufficient to ensure compliance with the Gas Emergency Standards.

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

- 4.13 NGG did not attempt to conceal the contravention. It first reported the likelihood of its failure to reach the Gas Emergency Standards in the Relevant Period to Ofgem in December 2010 and then reported the failure to meet the Gas Emergency Standards at the end of July 2011, as part of its RRP.
- 4.14 During the investigation, NGG has been open with Ofgem on the circumstances of the breach and the reasons behind its failure to reach the standards and has fully cooperated with Ofgem during this investigation.

Factors tending to decrease the level of financial 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

- 4.15 The Authority acknowledges that NGG had taken steps and made contingency plans in relation to the Gas Emergency Standards for the Relevant Period. However, it is the Authority's opinion that its plans for winter 2010 were not appropriate for ensuring the standard was reached. In particular, NGG's planning was based on the previous three years' work volumes as a base resource with contingency resources and escalation processes designed to cope with a severe winter. The plan failed to deliver against the severity of the 2010-11 winter and NGG has subsequently altered the balance of base, contingency resources and escalation processes for the current winter.

Appropriate action by the licensee to remedy the contravention or failure

- 4.16 In an effort to secure future compliance with the standards, NGG has taken the following steps to revise its plans and increase available resources for this winter:
- increased governance and oversight of the winter operations plan by the NGG Distribution Executive team;
 - introduction of a winter steering group to co-ordinate the development and implementation of the winter operations plan;
 - increased resources within the base level plan using experience of winter 2010-11 in terms of weather and workload patterns;
 - improved resilience of contingency plans, for instance by increasing the number of available contractors;
 - improved workload/manpower planning process including developing and introducing a predictive model to forecast future gas escapes volumes based on leading indicators such as temperature and gas demand volumes. Further, revision of the Alert Trigger process by which emerging workload and resource risks are monitored and contingency plans are triggered;
 - review of escalation processes to ensure more effective communication;
 - implemented a dry run in October 2011 to enable all relevant management teams to experience and test the Alert Trigger and escalation Processes.

Evidence that the contravention or failure was genuinely accidental or inadvertent

- 4.17 While there is no evidence that the contravention was wilful, the contravention cannot be regarded as genuinely accidental or inadvertent as it was within NGG's control to allocate resources appropriately to respond to gas escapes within the Relevant Period. The Authority has, however, taken into account the severe weather conditions within NGG's Gas Distribution Networks, resulting in high volumes of publicly reported escapes during winter 2010-11 and the impact these factors had on NGG's ability to meet the Gas Emergency Standards during the Relevant Period.

Reporting the contravention or failure to Ofgem

- 4.18 NGG reported the relevant details to Ofgem in December 2010, January 2011 and subsequently at the end of July 2011, as part of its RRP.

Co-operation with Ofgem's investigation

- 4.19 NGG has co-operated fully with Ofgem's investigation and has admitted the contraventions of SSLC D10 paragraph 2(g). In particular, NGG has provided Ofgem with detailed information about its revised plan and lessons learnt for this winter, on a voluntary basis. NGG's agreement to settle the investigation and decision not to contest Ofgem's findings has resulted in a saving of time and

resources for Ofgem. The Authority has given weight to NGG's willingness to engage with Ofgem and its agreement to settle the investigation.

5. The Authority's decision

- 5.1 The Authority hereby proposes to impose a financial penalty on NGG of £4,300,000 which it considers is reasonable in all the circumstances of the case.
- 5.2 The penalty is a lower figure than would have been imposed if NGG:
- had not fully co-operated with Ofgem's investigation;
 - had contested Ofgem's findings;
 - had not experienced severe weather conditions and increased workload volumes in its Gas Distribution Networks during winter 2010-11, having an adverse impact on overall performance;
 - had not taken steps to revise its plans and increase available resources in time for this winter;
 - had, through its failure to comply with the Gas Emergency Standards during the Relevant Period, caused actual physical harm to consumers.
- 5.3 Any written representations on the proposed penalty must be received by Claire Dance at Ofgem (Claire.dance@ofgem.gov.uk) by 5.00pm on Monday, 23 January 2012.
- 5.4 Any representations received that are not marked as confidential may be published on the Ofgem website. Should you wish your response or part of your response to remain confidential, please indicate this clearly.

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