

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 Northern Gas Networks Limited 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 £900,000 on Northern Gas Networks Limited ("NGN") following an investigation into NGN's failure to comply with standard special licence 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 NGN'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:

NGN failed to comply with the Gas Emergency Standards during the Relevant Period. NGN attended, on average, 91.6% of uncontrolled and 94.3% of controlled gas escapes within the time limits. This is a breach of SSC D10 paragraph 2(g).
- 1.5 These 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 NGN 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, NGN 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 NGN 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 timely action taken by NGN to revise its plans and increase available resources for this winter. It has also had regard to NGN'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 £900,000 on NGN 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 NGN not admitted the breach of the licence and co-operated fully and promptly 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 NGN informed Ofgem in December 2010 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 December 2010. NGN had previously reported its level of performance was at 99.5 per cent for uncontrolled gas escapes at the end of September 2010, and 100 per cent for controlled escapes ahead of quarter three.

- 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"). NGN submitted its RRP in July 2011 and it was clear that NGN had failed to meet the Gas Emergency Standards during the Relevant Period. This resulted in Ofgem opening an investigation and placing this matter on a formal basis in October 2011.
- 2.7 NGN accepts that the impact of the severe weather could have been mitigated through more effective planning and resourcing ahead of winter 2010-11. NGN 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 and road closures within the Northern Gas Distribution Network during winter 2010-11 and a record number of publicly reported escapes in December 2010.
- 3.5 While the Authority accepts that these factors were, to some extent, outside the control of NGN, GDNs are funded to meet the Gas Emergency Standards in all weather conditions and NGN 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 factors referred to 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 NGN. The Authority

acknowledges the risk of harm posed to consumers by NGN's non-compliance 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, NGN's turnover was £340,045,000, therefore the maximum penalty that can be applied in this case is £34,004,500.

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

- 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 NGN's failure to meet 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, NGN on average attended 91.6% of uncontrolled and 94.3% of controlled gas escapes within the time limits, which falls short of the 97% standard. As stated above, Ofgem expects GDNs to aim for 100 per cent compliance, and the 97 per cent standard already incorporates a tolerance level.

- 4.4 However, the Authority has considered NGN's compliance over the year and notes that before the winter period, NGN were in a strong position at the end of quarter 2 of the Relevant Period. Specifically, NGN was at 99.5 per cent for uncontrolled gas escapes and 100 per cent for controlled gas escapes and only fell below the standard in the winter period in quarters 3 and 4. The failure in quarter 3 was driven by the high volume of public reported gas escapes during the month of December. Relatively low volumes of escapes in all other months then exacerbated the annual performance achieved.

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 NGN. 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 NGN's non-compliance and the charges paid by consumers through their bills for NGN'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.

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, NGN avoided expenditure that could be considered required of a GDN to achieve the 97 per cent emergency standard.
- 4.8 NGN has informed Ofgem that it spent an additional £2.5m on responding to the severe winter and attempting to meet the Gas Emergency Standards in 2010/11, when compared with winter 2009/10.

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

- 4.8 In 2006/07, NGN failed to reach the Gas Emergency Standards for uncontrolled escapes, and reached a year-long average of 96.8% (0.2% below the minimum). At that time, the Gas Emergency Standards were not part of the gas transporter licence conditions, so this was not investigated using the Authority's formal enforcement powers.
- 4.9 The next reporting period will end on 31 March 2012, and NGN'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

- 4.10 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 NGN. The Authority takes the view that poor decision making in these areas were contributing factors in NGN's non-compliance with the Gas Emergency Standards.

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

- 4.11 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

- 4.12 NGN 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.
- 4.13 During the investigation, NGN 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

- 4.14 The Authority acknowledges that NGN 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 NGN's planning was based on the previous three years work volumes, and did not necessarily consider the wider implications of a more severe winter which had not been experienced for some time.

Appropriate action by the licensee to remedy the contravention or failure

- 4.15 In an effort to secure future compliance with the standards, NGN has taken prompt and proactive steps to revise its plans and increase available resources for this winter, specifically:
- changes to workload volume triggers to allow for earlier identification and escalation of performance issues;
 - more clearly defined roles and responsibilities to address some of the data and communication issues experienced (e.g. new Winter Manager role);
 - additional 4x4 vehicles designed to operate in severe weather conditions;
 - additional contractor Front Call Operative (FCOs) resources;
 - a schedule of deviations to normal operating standards, which if triggered will enable them to focus on highest priority emergency jobs.

Evidence that the contravention or failure was genuinely accidental or inadvertent

- 4.16 While there is no evidence that the contravention was wilful, the contravention cannot be regarded as genuinely accidental or inadvertent as it was within NGN'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 and road closures within the Northern Gas Distribution Network during winter 2010-11. It has also considered the record number of publicly reported escapes in that Network in December 2010 and the impact these factors had on NGN's ability to meet the Gas Emergency Standards during the Relevant Period.

Reporting the contravention or failure to Ofgem

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

Co-operation with Ofgem's investigation

- 4.18 NGN has co-operated fully with Ofgem's investigation and has admitted the contraventions of SSC D10 paragraph 2(g). In particular, NGN has provided Ofgem with detailed information about its revised plan and lessons learnt for this winter, on a voluntary basis and in a timely manner. NGN'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 NGN'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 NGN of £900,000 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 NGN:
- had not co-operated with Ofgem's investigations and responded to requests for information in a timely manner;
 - had contested Ofgem's findings;
 - had not been in a strong position to meet the Gas Emergency Standards in the lead up to winter 2010-11, suggesting that the severe weather conditions, road closures and increased workload volumes in the Northern

Gas Distribution Network had an adverse impact on their 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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