

Notice under section 30A of the Gas Act 1986 and section 27A of the Electricity Act 1989.

Decision of the Gas and Electricity Markets Authority, following an investigation into compliance by companies in the Npower group with standard licence condition 25 of their gas and electricity supplier licences

30 January 2009

1. Summary

1.1. This is the decision of the Gas and Electricity Markets Authority (“the Authority”) following an investigation into compliance by companies in the Npower group with the obligations under standard licence condition 25 of their gas and electricity supplier licences (“SLC25”) relating to the marketing of contracts to domestic customers.

1.2. The relevant companies are:

- Npower Limited (Electricity supply)
- Npower Gas Limited (Gas supply)
- Npower Northern Limited (Electricity and gas supply)
- Npower Yorkshire Limited (Electricity and gas supply).

1.3. In the remainder of this Notice, the companies are referred to collectively as “Npower”.

1.4. Following media reports (in the Sunday Times) and a referral by energywatch¹ of a number of complaints regarding misselling by Npower, Ofgem initiated an investigation into Npower’s compliance with SLC25.

1.5. Npower contacted Ofgem on 8 April 2008 to draw its attention to the press articles and setting out the immediate disciplinary steps which it had taken in respect of the staff implicated in the press reports.

1.6. The investigation focused on alleged breaches of SLC25 between 1 November 2007 and 30 April 2008.

1.7. It is the Authority’s view that Npower contravened the obligations set out in SLC25.5 and SLC25.10.

1.8. The Authority announced on 22 December 2008 that it intended to impose a penalty on each licence holder and that the overall penalty on Npower should be £1,800,000. It allowed representations to be made on this intention by 21 January 2009. No such representations were received.

1.9. The Authority has decided to confirm penalties of £1,800,000 on Npower. It hereby gives notice of its intention to impose penalties in accordance with section 30A of the Gas Act 1986 (the Gas Act) and section 27A of the Electricity Act 1989 (the Electricity Act). The penalties must be paid by 16 March 2009. Payment details are being provided to Npower separately.

¹ On 1 October 2008, Energywatch merged with Postwatch and the National Consumer Council to form Consumer Focus.

2. Background and the case presented by Ofgem²

2.1. Following media reports and the referral by energywatch to Ofgem of a number of complaints alleging misselling by companies in the Npower group, Ofgem initiated an investigation into those companies' compliance with the relevant licence obligations, which are contained in SLC25 of their Gas and Electricity supply licences.

2.2. The investigation focused on alleged breaches of both licence conditions in a six month period between 1 November 2007 and 30 April 2008.

Ofgem's investigation

2.3. Ofgem considered the initial evidence presented in the press reports and energywatch complaint data, and the information set out in the letters from Npower.

2.4. On 23 April 2008, Ofgem informed Npower that it was commencing a formal investigation into the alleged non-compliance with SLC25. It indicated that it would be issuing formal information requests to the individual companies concerned in the near future.

2.5. These requests were issued on 3 June 2008, pursuant to section 38 of the Gas Act and section 28 of the Electricity Act. These sought documents or information relating to -

- The recruitment and training of staff
- The ongoing monitoring of quality of work
- Procedures and instructions relating to follow-up contacts with new customers designed to confirm their satisfaction with the sales process and willingness to become Npower customers
- Recording of telephone conversations with these customers
- Systems used to record complaints against sales agents
- Details of recruitment, training and disciplinary records for those staff who had incurred serious complaints, including those specifically referred to in press articles
- Npower's sales management, appraisal and commission structures
- Details of compensation paid to complainants during the investigation period (1 November 2007 to 30 April 2008).

2.6. Npower's response was received in two stages. The first was on 17 June 2008 with the second being on 1 July.

2.7. Following the evaluation of this first tranche of information, Ofgem issued a follow-up information request on 25 July 2008, seeking -

- Copies of management reports relating to the acquisition of prepayment customers
- Details of management reporting arrangements relating to sales complaints
- Methods used to ensure consistency of disciplinary remedies used where complaints were received against agents
- Statistics relating to the range of sanctions imposed following those complaints
- Data showing staff turnover.

² In this notice, Ofgem means the executive arm of the energy regulator and in particular the investigating team for this case. The Authority means the Board of the energy regulator. An Authority Committee, with delegated powers and independent of the investigating team, heard the case.

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2.8. Ofgem also sought transcripts of the conversations upon which the press reports were based. In these conversations, the agent (who was an undercover reporter) is encouraged to give misleading information to vulnerable customers regarding the savings available after signing contracts with Npower, and to mislead customers as to Npower's identity and the purpose of the agent's visit.

2.9. In addition to the information detailed in the preceding paragraphs, Npower submitted a copy of a report produced by the auditor of the Board of the Association of Energy Suppliers.

Ofgem's statement of case

2.10. Ofgem produced a statement of its case against Npower, setting out the alleged licence breaches and its reasons. This was sent both to Npower, who responded on 18 November 2008, and to the Authority Committee before the oral hearing on 25 November. Ofgem's case is summarised below.

SLC25.5

2.11. Having reviewed the information provided by Npower, Ofgem considered that whilst Npower had procedures in place to follow up complaints, it had not pursued the potential issues rigorously, allowing incidents of mis-selling to proceed unchecked. This led Ofgem to the conclusion that Npower had failed in its duty to ensure that it had taken all reasonable steps to remedy the matter.

2.12. In reaching that conclusion, Ofgem considered representations by Npower that in order for it to have been in breach of SLC25.5, any weaknesses had to be identified as a result of customers responding to the contacts required under SLC25.3. Ofgem accepted Npower's interpretation of the licence obligation.

2.13. Ofgem established however that Npower did not, during the period of the investigation, operate a dedicated telephone number for receipt of these responses, relying instead on its general customer service number. In consequence, it had no reliable method of establishing which contacts resulted from the follow-up contact and which did not. Npower stated that, "it would be inappropriate for us, from a customer service perspective, to limit our response here to replies that either directly refer to the verification letter or the questions within it".

2.14. Ofgem concluded that Npower could not avoid its duty under SLC25.5 by failing to put in place an adequate means of distinguishing complaints arising from the SLC25.3 process from those which did not. Ofgem further concluded therefore that it had no alternative but to consider the wider complaint data provided by Npower.

2.15. The information submitted by Npower showed that it was a signatory to the Energysure Code of Practice, which provided that complaints against individual sales agents are categorised according to 3 levels of seriousness. After investigation, and if upheld, complaints attracted "penalty points", 5 points being awarded for the most serious, 1 for the remainder.

2.16. In the event that a 5 point penalty was incurred, the agent would be suspended from duty and would be subject to a disciplinary hearing.

2.17. Ofgem reviewed a sample of the records of such hearings. It found that, where in some serious cases the sanctions available to the hearing included dismissal, there was insufficient objective justification for imposing a lesser sanction, notwithstanding the

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discretion which ought properly to be applied to the consideration of sanctions against the personnel concerned and the need to take due account of employment law. This conflicted with Npower's duty under SLC25.5.

2.18. These cases were identified to Npower in the statement of case.

2.19. Ofgem also found that the decision on sanctions rested with the agent's line manager. This gave rise to concerns that the necessary standards of objectivity were not being met. As a result, messages sent to the sales force as a whole regarding the seriousness of misselling lacked the robustness necessary in the circumstances.

2.20. In response to Ofgem's information requests, Npower was able to provide detailed analysis of the reasons for the cancellation of contracts. The data submitted validated the fact that during the period of the investigation, some 6,283 cancellations had resulted from various forms of misselling.

2.21. Npower commented that in its view the statistics did not reveal any evidence of systemic problems with its sales process. However, Ofgem's analysis of the data suggested that it should have given clear signals to management that mis-selling was occurring.

SLC25.10

2.22. In the statement of case, Ofgem expressed the view that the obligation required a proactive approach from the licence holder. It considered that Npower did not use the considerable amount of information available to it effectively in establishing management arrangements that facilitated compliance.

2.23. This management information included the cancellation data referred to above, statistics relating to the number of prepayment meter customers switching to Npower despite its comparatively high tariffs in this area, and statistics compiled by energywatch which showed that during the period of the investigation, Npower's total contact rates (i.e. complaints, empowerments and enquiries) had been the highest across all suppliers.

2.24. Ofgem considered that Npower had taken a narrow view of the energywatch statistics, limiting itself to, and taking comfort from, consideration of complaint levels alone when it might more properly have considered its total contact performance.

2.25. Ofgem considered that the steps taken by Npower following the opening of the investigation and most recently set out in Npower's letter of 18 November should reduce the risk of further breach.

2.26. Ofgem had seen no evidence to suggest a continuing or future breach.

Npower response to the statement of case

2.27. Npower explained that it had introduced 13 additional measures designed to improve both the sales process and the follow up contact procedures, at an estimated annual cost of some £4.8m.

2.28. Npower challenged Ofgem's view that these new measures could be taken as evidence that during the period of the investigation Npower was not taking all reasonable steps to address weaknesses in its processes, and this amounted to a failure in management arrangements.

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2.29. Npower clarified the internal target times which it sets for the investigation of post-sale complaints. It has explained that the 10 day target time set for the investigation of complaints in its Contract Investigations Handbook relates to the time taken to resolve a complaint with the customer – where complaints are complex, and cannot be resolved within 10 days, the customer is given an explanation and a revised response target date.

2.30. In view of this, Npower argued that, in citing data relating to timescales, Ofgem was not correct in asserting that it did not take the complaint investigations seriously. Npower pointed out that in all but one of the 38 cases cited in Ofgem's statement, the adviser concerned had been suspended pending the outcome of the complaint investigation. Npower acknowledged that in that one exception the adviser should have been suspended.

The Authority's decision

3. The relevant licence obligations

The relevant licence obligations are in standard licence condition 25 of gas and electricity supply licences. The obligations are in 25.5 and 25.10.

25.3 Where a Domestic Supply Contract is entered into as a result of a visit or conversation of the kind mentioned in paragraph 25.2, the licensee must within a period of between 24 hours and 14 days after entering into the Domestic Supply Contract take all reasonable steps to contact the Domestic Customer, through a Representative of the licensee who is not engaged in activities leading to the making of Domestic Supply Contracts between the licensee and Domestic Customers, by telephone or in Writing to seek confirmation that the Domestic Customer:

(a) understands that he has entered into a Domestic Supply Contract;

(b) is content to have entered into that contract; and

(c) is content with the way in which the Marketing Activities of the licensee were conducted.

25.5 Where the response of a Domestic Customer, or the response of Domestic Customers generally, to contact as required by paragraph 25.3 suggests weaknesses in the methods, systems or personnel employed or engaged by the licensee or its agents or sub-contractors for the purpose of its Marketing Activities, the licensee must ensure that all reasonable steps to remedy the matter are taken.

25.10 The licensee must take all reasonable steps:

(a) to establish management arrangements that facilitate the licensee's compliance with its obligations under paragraphs 25.2 to 25.6; and

(b) to ensure that any agents and sub-contractors of the licensee take steps to establish equivalent arrangements.

4. The contravention

4.1 The Authority carefully reviewed the relevant licence obligations, the statement of case submitted by Ofgem, Npower's written response, and information put to it at the oral

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hearing on 25 November 2008. The Authority found that contraventions of SLC25.5 and SLC25.10 occurred for the reasons outlined below.

4.2 The Authority found that suppliers in the Npower group failed to satisfy their duties under both SLC25.5 and SLC25.10 of their respective licences in that they failed:

- to take all reasonable steps to identify, from the information available to them from follow-on contacts, weaknesses in the systems and some of the personnel employed in the marketing of supply contracts; and
- to take action to remedy those weaknesses; and
- to establish management arrangements that facilitate compliance with these obligations.

4.3 In reaching this conclusion, the Authority considers that it is not sufficient for suppliers simply to put in place administrative arrangements to deal with misselling. Licence Condition 25 requires proactive management. This should include ensuring that there is continuous improvement in arrangements designed to identify, prevent and discourage misselling to customers. The concept of "management" in this context includes the use of systems and processes which enable a clear understanding to be achieved on an ongoing and timely basis of the effect of the administrative and operational processes established to enable compliance.

4.4 The Authority notes that SLC25.5 places obligations on suppliers to take **all** reasonable steps and implicitly requires suppliers to have a system in place to address any weaknesses revealed as a result of the follow up contacts with customers required by SLC25.3. Within the scope of these obligations are the disciplinary arrangements employed by suppliers to address non-compliance and to incentivise future compliance by staff. The obligations also extend to the need to remedy weaknesses in systems and processes proactively.

4.5 The Authority considers that in SLC25.5 the hurdle for triggering management action is relatively low and that the requirement to act is a demanding one and has to be to an objective standard. It agrees with Ofgem's overall conclusion, put to Npower in the statement of case, that in failing to ensure consistency in its disciplinary process, and to react promptly and proactively to management information regarding the reasons for contract cancellation, it had failed to take adequate steps to remedy procedural weaknesses in the marketing process.

4.6 The Authority also notes that SLC25.10 places obligations on suppliers to take **all** reasonable steps to establish management arrangements to facilitate its compliance with the licence condition as a whole.

4.7 The Authority considers that, although a considerable amount of management information was available to it, Npower did not use that information effectively in its management processes, which were insufficiently robust. It therefore failed in its management of the administrative system.

4.8 In coming to those conclusions, the Authority decided that there was evidence to indicate that, in some instances, Npower failed to take adequate steps to prevent agents deliberately misleading customers. Furthermore, the Authority considers that Npower failed to take all reasonable steps fully and adequately to interpret the information made available to its management team in respect of cancellations due to misselling, in relation

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to: the levels of success in gaining customers in the PPM market; and numbers of contacts received by energywatch.

4.9 The Authority notes that Npower has subsequently made a number of very significant improvements to their processes including 100% point of sale verification by phone, in line with best practice.

4.10 On the basis of the case put before it, the Authority accepts that there is no evidence to suggest a continuing or future breach of the relevant obligations.

5. The Authority's decision on a financial penalty

5.1. The Authority has considered whether a financial penalty is appropriate in accordance with the requirements of the Acts and with its published penalties statement. In particular, it has had regard to the factors below.

Damage to the interests of consumers or other market participants

5.2. Misselling is a breach of trust and has the potential to create unwillingness by both individuals and the generality of customers to engage in the competitive energy supply market.

5.3. A cost impact upon Npower's competitors would follow insofar as they will have needed to be involved in taking corrective action where a transfer was effected and then cancelled.

Potential incentive for compliance

5.4. The Authority considers that enforcement action is necessary to incentivise compliance and that it is important to send strong messages regarding the consequences of licence breaches and the unacceptable effect of misselling on confidence in the competitive supply market.

Whether the breach was trivial

5.5. The Authority does not consider the breaches to be trivial.

Whether the Authority's objectives or duties preclude the imposition of a penalty

5.6. The Authority does not consider that its objectives or duties preclude the imposition of a penalty. Indeed, it considers its principal objective reinforces the need for a penalty in this case.

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

5.7. Much publicity has been given to energy supply marketing issues within the last 6 – 7 years. In 2001, Npower itself agreed voluntary undertakings to remedy weaknesses in its marketing procedures. Npower will have been aware of the penalty imposed upon London Electricity (now EDF) in 2002.

5.8. The Authority therefore considers that all suppliers should have been on notice of the importance of ensuring compliance in this area.

5.9. The Authority has concluded that in view of the need to take steps to address any loss of customer confidence in the competitive energy supply market, and to provide

appropriate incentives to the other supply licensees, it would be appropriate to impose a financial penalty upon Npower.

6. Criteria for fixing the quantum of a penalty

6.1. Under the Acts, the Authority may impose a financial penalty of up to 10% of the annual turnover of the relevant licence holder. Annual turnover is defined in Regulations issued by the Secretary of State. The Regulations allow the inclusion of all revenue from the activities of the licence holder, whether regulated or not. However, in all the circumstances of this case, including the nature of the contraventions and the scope of the relevant licence condition, the Authority has noted that part of the turnover of the npower companies which concerns the domestic supply market. The combined turnover of the relevant Npower licensees is £5,098m, of which the Authority understands £2,969.6m relates to domestic sales.

6.2. In arriving at the quantum of a penalty in this case, the Authority considered the following factors in accordance with its published penalties statement.

Starting point

6.3. The Authority considered first the following factors in determining the general level of the penalty -

- The seriousness of any contravention or failure – The Authority considers that the principle of misselling is a serious issue which undermines the integrity of the competitive market. It also notes that this is a second breach of the relevant licence condition by a domestic energy supplier.
- The degree of harm or increased cost incurred by consumers or other market participants after taking account of any compensation paid. The breach has had a tangible impact on consumers who in some cases have switched from a less expensive contract. The Authority does not have information on the financial impact on consumers. It notes that information received during the course of the investigation suggests that 6283 customers (1.05% of 597,883 sales) have reported various forms of mis-selling. Financial harm to customers will have been mitigated by compensation payments made pursuant to SLC25.7 and the Energysure scheme – Npower has estimated that 336 such payments were made during the period of the investigation, amounts varying between £25 and £250, and that a further 27 payments were made in respect of erroneous transfers. In addition, competitors will have faced costs in dealing with transfers that were then cancelled. Moreover, the Authority considers that the detrimental effect on confidence in the competitive market might mean that consumers are less inclined to consider switching energy suppliers.
- The duration of the contravention or failure – The precise duration of the contravention is unclear, but the Authority notes that Ofgem’s investigation period covered a six month period from 1 November 2007 to 30 April 2008. Although the information produced by Npower indicates that the licence breach may have been occurring prior to this, the extent to which the contravention was occurring prior to the period 12 months before the issue of an information notice under section 28 of the Electricity Act 1989 and section 31 of the Gas Act 1986 is not relevant to the level of financial penalty that can be imposed.
- The gain (financial or otherwise) made by the licensee – this is difficult to quantify and there is incomplete information on the number of customers affected. However, the Authority considers it likely that Npower will have benefited from increased revenues

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from the sales they achieved through mis-selling and there was some cost saving to Npower in respect of the steps necessary to ensure compliance which they had not previously introduced. Offset against this, the Authority is aware that Npower may have already suffered some reputational damage from the Sunday Times reports.

Aggravating factors

6.4. As set out in its penalty statement, having considered these factors, the Authority must then weigh factors tending to increase or decrease the level of any penalty. These factors, with the Authority's assessment of them in the circumstances of this case are set out below.

6.5. Factors tending to increase the level of any penalty are -

- Repeated contravention or failure – There have been no recent contraventions either of this licence condition or by Npower generally. The Authority notes however that in 2001 Npower gave Ofgem voluntary undertakings designed to reduce marketing complaint levels. Npower agreed to provide regular reports on marketing activity, to review progress with Ofgem management on a regular basis, and to introduce new procedures for follow up contact with customers. These undertakings remained in place for one year and were subsequently discharged. These undertakings included the development of new procedures for post sale follow-up contact with customers and the provision of relevant statistics. The Authority also notes that during the period covered by the breach, Npower had the highest number of energywatch contacts about misselling in the industry.
- Continuation of contravention or failure after either becoming aware of the contravention or failure or becoming aware of the start of Ofgem's investigation The Authority notes that Npower took swift and extensive action to improve its processes once it became aware of the concerns raised by the Sunday Times article and Ofgem's investigation, as detailed in Npower's response to the Statement of Case.
- The involvement of senior management in any contravention or failure – The Authority notes that a central part of the breach was the failure of management to take actions to remedy the weaknesses in Npower's marketing activities. However, Npower's policies and training materials made it clear that it took compliance seriously.
- The absence of any evidence of internal mechanisms or procedures intended to prevent contravention or failure. The breach involved the failure of internal mechanisms to remedy the weaknesses in Npower's marketing activities.
- The extent of any attempt to conceal the contravention or failure from Ofgem. There was no attempt to conceal the contraventions from Ofgem.

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Mitigating factors

6.6. Factors tending to decrease the level of penalty are -

- Co-operation with Ofgem's investigation - Npower has co-operated fully with the investigation in responding to the statutory requests for information. However, this has not been beyond the level of co-operation we would expect from any licensee in its position.
- Appropriate action by the licensee to remedy the contravention or failure - Npower took swift and effective action not only to suspend individuals and to retrain staff, but also to introduce new extensive management arrangements designed to prevent a recurrence. The Authority notes that Npower is investing about £4.8m per annum in these arrangements. The Authority also understands that Npower has paid compensation pursuant to the Energysure scheme.
- 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 – the Authority does not consider that this mitigating factor applies in this case as the breach involved the failure of Npower to satisfy its duties under the relevant licence condition.
- Evidence that the contravention or failure was genuinely accidental or inadvertent – the Authority does not consider this to be relevant in the circumstances.
- Reporting the contravention or failure to Ofgem – the Authority does not consider this to be relevant in the circumstances.

6.7. The Authority considers that there were important mitigating factors in this case. It wishes to recognise the swift investment by Npower to address the weakness in its operation of the administrative system and weaknesses in its arrangements for management oversight and review following the investigation, its compensation of customers, and its co-operation during the course of the investigation.

7. The Authority's decision on a financial penalty

7.1. The Authority has imposed a financial penalty of **£1,800,000** which it considers proportionate to the particular circumstances of this case.

7.2. This penalty is split between the relevant licensees in the Npower group in proportion to their turnover in the year ending 31 December 2007³.

7.3. This results in the individual penalties set out below.

Npower Limited ⁴	penalty - £1,063,643
Npower Gas Limited ⁵	penalty - £265,769
Npower Northern Limited ⁶	penalty - £326,226
Npower Yorkshire Limited ⁷	penalty - £144,362.

³ **Source:** company profit and loss statements obtained from Companies House 24.10.08

⁴ turnover for the year ending 31 December 2007- £3,012.9m

⁵ turnover for the year ending 31 December 2007-£752.6m

⁶ turnover for the year ending 31 December 2007-£923.8m

⁷ turnover for the year ending 31 December 2007 -£408.8m

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7.4. The penalties must be paid by 16 March 2009.

A handwritten signature in black ink, appearing to be 'A. M. R.', written over a horizontal line.

On behalf of the
Gas and Electricity Markets Authority

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