

**WITHOUT PREJUDICE**

**Notice of intention to impose a financial penalty pursuant to section 30A(3) of the Gas Act 1986 and section 27A(3) of the Electricity Act 1989**

**Proposal of the Gas and Electricity Markets Authority to impose a financial penalty, following an investigation into compliance by E.ON Energy Solutions Limited with the requirements of Article 16(1)(a) of the Electricity and Gas (Carbon Emissions Reduction) Order 2008 (as amended in 2009, 2010 and 2011) in relation to the distribution of free compact fluorescent lamps (“energy saving light bulbs”)**

**9 July 2013**

**1 Summary**

- 1.1 The Gas and Electricity Markets Authority (“the Authority”) proposes to impose a financial penalty on E.ON Energy Solutions Limited (“E.ON”) following an investigation by Ofgem into E.ON’s failure to report accurately the number of energy saving light bulbs it distributed pursuant to E.ON’s obligations under the Electricity and Gas (Carbon Emissions Reduction) (“CERT”) Order 2008 (as amended in 2009, 2010 and 2011) (“the CERT Order”). The Authority finds that E.ON breached Article 16(1)(a) CERT Order.
- 1.2 The Authority considers it appropriate to propose a penalty of £500,000 on E.ON for this contravention. In addition, E.ON has agreed to make additional payments amounting to £2,500,000 for the benefit of persons in fuel poverty or in a fuel poverty at risk group, where such customers are eligible to receive Warm Home Discount payments under the “Broader Group” of qualifying recipients. Specifically an additional 18,519 eligible customers will receive a Warm Home Discount “Broader Group” payment of £135, totalling £2,500,000 in value. Whilst the Authority considers a financial penalty to be appropriate for E.ON’s inaccurate reporting, it proposes to impose a reduced penalty of £500,000 to reflect the additional payments to consumers. In addition, E.ON has taken proactive steps to address the inaccurate reporting that was subject to Ofgem’s investigation.
- 1.3 Under the CERT programme, energy suppliers with over 50,000<sup>1</sup> customers were required to deliver carbon emissions reductions in homes in Great Britain. To help achieve this, suppliers were able to distribute energy saving light bulbs.<sup>2</sup>
- 1.4 Distribution of energy saving light bulbs formed part of E.ON’s steps to comply with the overall carbon emissions reduction target. Pursuant to Article 16(1)(a) of the CERT Order, E.ON was required to provide the Authority with information as to whether it had complied with its carbon emissions reduction obligation and its priority group obligation. E.ON gave notice that it had complied with those obligations via a notification to the Authority dated 31 March 2010.
- 1.5 Ofgem’s investigation concerned E.ON’s accuracy in reporting information to Ofgem relating to energy saving light bulbs distributed under CERT Scheme

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<sup>1</sup>This threshold was raised to 250,000 customers as at 31 December 2011 by the Electricity and Gas (Carbon Emissions and Community Energy Saving) (Amendment) Order 2011/3062 Pt 2 art.3(2)

<sup>2</sup>Compact Fluorescent Lamp - It is a type of energy efficient light bulb. CFLs consume less electricity than conventional incandescent light bulbs, hence they reduce overall demand for electricity and the resulting CO<sub>2</sub>.

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EONE08L05<sup>3</sup>; and as to whether it had established systems and procedures sufficient to ensure accurate reporting in relation to CERT obligations.

1.6 The Authority finds that:

(a) Of the total 24,823,202 energy saving light bulbs in Scheme EONE08L05, 3,458,330 energy saving light bulbs were either reported to Ofgem in error as having been distributed, or comprised energy saving light bulbs where it was not possible to confirm that they were distributed in accordance with the requirements of the CERT Order. The energy saving light bulbs in question equate to 493,742tCO<sub>2</sub> reduction<sup>4</sup>, which represents 1.096% of E.ON's total carbon emission reduction obligations under the CERT Order (45,049,932tCO<sub>2</sub>); and

(b) As a result of this inaccuracy, E.ON has failed to comply with Article 16(1)(a) of the CERT Order, containing its obligation:

*to provide information to the Authority relating to –*

- (i) its proposals for complying with any aspect of its carbon emissions reduction obligation, insulation obligation, priority group obligation and super priority group obligation; and*
- (ii) whether it has complied with those obligations.*

Specifically E.ON failed to report accurately as to whether it had complied with its carbon emissions reduction obligation and its priority group obligation and therefore breached Article 16(1)(a)(ii).

1.7 Following our investigation, E.ON agreed with Ofgem that it would not be appropriate to claim carbon savings for the 3,458,330 energy saving light bulbs about which concerns had been identified. Following the breach, but before the end of the CERT programme, E.ON took appropriate remedial actions to make up the 1.096% shortfall in its CERT obligation.

1.8 The Authority considers it appropriate to propose a financial penalty on E.ON for the contravention of Article 16(1)(a) of the CERT Order, which took place on the occasion of E.ON's completion notification made on 31 March 2010.

1.9 In the circumstances, the Authority hereby gives notice under section 30A(3) of the Gas Act 1986 and section 27A(3) of the Electricity Act 1989 of its proposal to impose a penalty of £500,000 on E.ON in respect of its failure to comply with Article 16(1)(a) of the CERT Order relating to the EONE08L05 energy saving light bulbs Scheme which ran from January 2008 until December 2009. In deciding on the level of the penalty, the Authority has taken into account:

- (a) E.ON's willingness to engage and co-operate with Ofgem and, in particular, its work in appointing an independent auditor;
- (b) the remedial action undertaken by E.ON to make up the shortfall in its CERT obligation;
- (c) E.ON's willingness and agreement to settle this investigation with Ofgem; and

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<sup>3</sup> E.ON started the EONE08L05 energy saving light bulbs distribution scheme on 1 January 2008 and distributed energy saving light bulbs under the scheme until 31 December 2009.

<sup>4</sup>tCO<sub>2</sub>= tonnes of carbon dioxide.

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- (d) the agreement by E.ON to make additional payments amounting to £2,500,000 for the benefit of persons in fuel poverty or in a fuel poverty at risk group, where such customers are eligible to receive Warm Home Discount payments under the "Broader Group" of qualifying recipients.

The penalty is a lower figure than would have been the case if E.ON had not taken the above steps.

- 1.10 Any written representations on the proposed penalty must be received by Emily Thoo at Ofgem [emily.thoo@ofgem.gov.uk](mailto:emily.thoo@ofgem.gov.uk) by 5.00pm on **30 July 2013**.
- 1.11 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

### CERT Programme

- 2.1 The CERT programme required energy supply companies which have over 50,000<sup>5</sup> domestic customers to deliver carbon emissions reductions from domestic premises within GB. The obligations upon suppliers in this regard were provided for in the CERT Order. A key objective of CERT was that energy efficiency measures were installed and the carbon savings associated with them were realised. Ofgem administered the CERT Programme on the Government's behalf.
- 2.2 Obligated suppliers were required to meet their obligations by promoting energy efficiency measures to GB households. Ofgem's role was to approve supplier activities at the beginning, and completion notifications of measures installed at the end. Ofgem was also required to report annually to the Secretary of State for Energy and Climate Change in respect of the progress of each supplier in meeting its carbon emissions reduction obligation.
- 2.3 One of the eligible measures, also known as "qualifying actions", as defined in the CERT Order at Articles 2(2) and 10, was the distribution of free energy saving light bulbs. Suppliers were able to distribute energy saving light bulbs for free via giveaways or posting to GB households to meet their targets. The obligated suppliers could distribute free energy saving light bulbs via third parties such as charities, local authorities or social housing providers ("distribution partners"). As a result of the restriction introduced in the amendment of the CERT Order in 2009, from 1 January 2010, only retail energy saving light bulbs counted as qualifying actions. Later in 2010 the CERT Order was amended again with the distribution of all energy saving light bulbs ceasing to be eligible as qualifying actions from 1 April 2011.

### Investigation

- 2.4 On 9 April 2010, it came to Ofgem's attention through a complaint letter from an Irish battery and light bulbs retailer, that E.ON's dual branded light bulbs were on sale at stores in the Republic of Ireland.

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<sup>5</sup>This threshold was raised to 250,000 customers as at 31 December 2011 by the Electricity and Gas (Carbon Emissions and Community Energy Saving) (Amendment) Order 2011/3062 Pt 2 art.3(2)

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- 2.5 The complaint letter led to the discovery that a significant number of energy saving light bulbs, claimed as having been distributed through the CERT programme, were on sale in the Republic of Ireland, and energy saving light bulbs which should have been distributed in GB were not distributed at all.
- 2.6 Ofgem opened a formal investigation on 28 March 2011 into the alleged inaccurate reporting, issued an information request to E.ON, and sought further information regarding the alleged inaccurate reporting.
- 2.7 During the investigation, E.ON and Ofgem agreed to appoint an external auditor to audit the distribution of energy saving light bulbs in Scheme EONE08L05.
- 2.8 Following the external audit, E.ON agreed that of the total 24,823,202 energy saving light bulbs in Scheme EONE08L05, they would only claim carbon savings for 21,364,872 energy saving light bulbs. The remaining 3,458,330 energy saving light bulbs were either reported to Ofgem in error as having been distributed, or comprised energy saving light bulbs where it was not possible to confirm that they were distributed in accordance with the requirements of the CERT Order. The energy saving light bulbs not claimed for equate to a saving of 493,742tCO<sub>2</sub>, which represents 1.096% of E.ON's total carbon emission reduction obligations under CERT Order (45,049,932tCO<sub>2</sub>).
- 2.9 The external audit evidenced that E.ON had incorrectly reported to Ofgem, through a completion notification on 31 March 2010, that the energy saving light bulbs in question were distributed to domestic customers in GB and that the distribution should count as an energy efficient measure for the purpose of meeting its CERT obligation. The audit and subsequent correspondence with E.ON revealed errors in the number of energy saving light bulbs purported to have been distributed in accordance with the requirements of the CERT Order. E.ON did not dispute this.
- 2.10 The ability to rely on the accuracy of reported information is fundamental for Ofgem to discharge its duties, both generally and as an administrator of the environmental programme under the CERT Order. The Authority therefore regards any failure to effect accurate reporting as a serious breach.

### **The Contraventions**

2.11 The Authority finds that:

- (a) E.ON inaccurately reported, by way of over-reporting, the distribution of 3,458,330 energy saving light bulbs in Scheme EONE08L05. The energy saving light bulbs in question equate to 493,742tCO<sub>2</sub> reduction, which represents 1.096% of E.ON's total carbon emission reduction obligations under CERT Order (45,049,932tCO<sub>2</sub>); and
- (b) As a result of this inaccuracy, E.ON has failed to comply with Article 16(1)(a) of the CERT Order, containing its obligation:

*to provide information to the Authority relating to -*

- (i) *its proposals for complying with any aspect of its carbon emissions reduction obligation, insulation obligation, priority group obligation and super priority group obligation; and*
- (ii) *whether it has complied with those obligations.*

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Specifically E.ON failed to provide accurate information as to whether it had complied with its carbon emissions reduction obligation and its priority group obligation, and therefore breached Article 16(1)(a)(ii).

- 2.12 E.ON installed other carbon-saving measures to ensure it has met its overall CERT obligation.<sup>6</sup>
- 2.13 The external auditor also identified a number of key weaknesses in E.ON's management systems and procedures that contributed to the error in reporting to Ofgem. The external auditor recommended improvements to prevent the problem recurring on the CERT programme and/or any aspect of any successor environmental programme to CERT.
- 2.14 Ofgem notes that E.ON has provided Ofgem with assurances at Board level that E.ON's management systems and procedures have been improved, in line with audit recommendations, and are now fit for purpose to enable accurate reporting for CERT successor schemes such as ECO. It is for E.ON to ensure it has appropriate management systems in place to meet its obligations at all times and Ofgem does not endorse these either way. Ofgem will take seriously any future instances of inaccurate reporting which come to light on related programmes such as ECO.

### **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 the Gas Act 1986, 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 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,<sup>7</sup> 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 the following specific matters set out in the Policy. These matters are examined in more detail 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

- 3.4 The Authority finds that had the breach not been discovered the interests of consumers would have been damaged as a result of the inaccurate reporting because the carbon and energy efficiency savings associated with the use of

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<sup>6</sup>The Final Report of the Carbon Emissions Reduction Target (CERT) 2008-2012:

[http://www.ofgem.gov.uk/Sustainability/Environment/EnergyEff/Documents1/CERT\\_FinalReport2013\\_300413.pdf](http://www.ofgem.gov.uk/Sustainability/Environment/EnergyEff/Documents1/CERT_FinalReport2013_300413.pdf)

<sup>7</sup>The Electricity Act 1989 (section 3A) and the Gas Act 1986 (section 4AA) set out the Authority's principal objective for energy regulation, thereby defining the purpose of Ofgem's activities as to protect the interests of existing and future consumers, wherever appropriate by promoting competition. The Energy Act 2010 amended the principal objective to clarify that the interests of consumers should be taken as a whole, including their interests in the reduction of greenhouse gas emissions and ensuring security of supply.

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inaccurately reported energy saving light bulbs would not have materialised. However the Authority is satisfied E.ON has since taken action to address this concern.

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

3.5 Inaccurate reporting of regulatory information, including information used for the administration of CERT, by any obligated supplier, can lead to the expenditure of considerable resources by Ofgem to identify and resolve. Inaccurate reporting has the potential to cause considerable detriment to other market participants and consumers, should it go undetected for any significant period of time. It is therefore extremely important that obligated suppliers are deterred from inaccurate reporting and incentivised to put appropriate systems, processes and procedures in place to ensure accurate reporting of regulatory information, including information that Ofgem uses for the administration of environmental programmes, such as CERT. The Authority considers that the imposition of a penalty in this case is necessary to have that effect.

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

#### If the contravention is trivial in nature

3.6 The Authority did not consider that E.ON's contraventions of the reporting requirements under CERT were trivial due to:

- (a) the scale of inaccurate reporting, with the number of inaccurately reported energy saving light bulbs having a lifetime carbon savings value in the order of £9m.<sup>8</sup>
- (b) the Authority's reliance on accurate regulatory information, including information used for the administration of CERT, in order to carry out its statutory functions effectively and in a way that maintains public confidence.

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

3.7 There is nothing in the Authority's principal objective and duties that precludes 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

3.8 The Authority considers that a diligent licensee would have put appropriate management systems and procedures in place to avoid such inaccurate reporting.

#### Conclusion

3.9 After consideration of the above factors, the Authority considers that it is appropriate to impose a financial penalty in this case.

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<sup>8</sup>This is based on Article 21 of the CERT Order which used a value of £18.0/tCO<sub>2</sub>. Ofgem are aware that actual costs may have varied. As noted in paragraph 2.12, E.ON installed other carbon-saving measures to make up the shortfall of carbon savings associated with the inaccurately reported energy saving light bulbs.

#### **4. Criteria relevant to the level of financial penalty**

- 4.1 In accordance with section 27A(8) of the Electricity Act 1989 and section 30A(8) of the Gas Act 1986, 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 State.<sup>9</sup> The relevant figure is the turnover shown in published or prepared accounts for the business year preceding the date of this notice. The most recent available set of E.ON's accounts is those prepared for the financial year ending on 31 December 2012 (showing E.ON had a turnover of £7,744 million (to be confirmed)).
- 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 penalty*

##### The seriousness of the contravention and failure

- 4.3 The Authority considers that E.ON's breach of relevant requirements under the CERT Order is a serious one, as Ofgem relies on accurate information being submitted by licence holders to carry out its statutory functions, including administering environmental programmes such as CERT, effectively.
- 4.4 If Ofgem was unable to rely on the accuracy of information submitted by the suppliers, it would need to devote more resources to monitoring work. This would potentially lead to an increased burden on both Ofgem and the suppliers, higher overall costs to consumers of gas and electricity, and an increased likelihood of inaccuracy in regulatory decision-making and administration of environmental programmes such as CERT.

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

- 4.5 The Authority finds that had the breach not been discovered the interests of consumers would have been damaged as a result of the inaccurate reporting because the carbon and energy efficiency savings associated with the inaccurately reported energy saving light bulbs would not have materialised. However the authority is satisfied E.ON has taken action to address this.

##### The duration of the contravention or failure

- 4.6 The breach was a one-off event on 31 March 2010 when E.ON submitted incorrect data to Ofgem. The Authority has taken this into account in assessing the seriousness of the breach.

##### The gain (financial or otherwise) made by the licensee

- 4.7 E.ON avoided the costs associated with having appropriate management systems and processes in place which might have prevented the inaccurate reporting in the first place.

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<sup>9</sup>The Electricity and Gas (Determination of Turnover for Penalties) Order 2002.

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### *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 To date, there has been no other breach of the CERT reporting requirements or of any related environmental programme such as CESP by E.ON. The Authority is satisfied that there has been no continuation of the contravention of the CERT Order after it was identified by Ofgem.

#### The involvement of senior management in any contravention or failure

- 4.9 The Authority does not consider that senior management was involved in any deliberate actions in relation to the contravention. However, the Authority considers that implementing appropriate management systems and procedures was the responsibility of senior management at E.ON. The Authority therefore takes the view that the decisions taken by senior management in this area contributed to E.ON's failure to comply with the reporting requirements under the CERT Order.

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

- 4.10 The Authority considers that internal mechanisms or procedures to prevent contravention or failure were inadequate in this case. The external audit of E.ON's EONE05L05 CERT Scheme identified a number of issues with E.ON's management systems and procedures that contributed to the inaccurate reporting to Ofgem.

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

- 4.11 E.ON did not attempt to conceal the contravention or failure from 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 The Authority considers that internal mechanisms or procedures to prevent contravention or failure were inadequate in this case.

#### Appropriate action by the licensee to remedy the contravention or failure

- 4.13 Following the contravention E.ON took the following action:
- (a) It agreed to appoint and fund an independent auditor to determine the extent of inaccurate reporting, and identify issues surrounding management systems;
  - (b) It agreed that it was not appropriate to claim the carbon savings for the energy saving light bulbs in question;
  - (c) It took steps to replace the shortfall of carbon savings associated with the inaccurately reported energy saving light bulbs by installing other carbon-



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saving measures. The extra measures have resulted in E.ON achieving its carbon savings targets under CERT.<sup>10</sup>

### 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, as it was within E.ON's control to allocate appropriate resources to ensure that it had robust management systems and procedures in place to enable compliance with the reporting requirements for CERT.

### Reporting the contravention or failure to Ofgem

4.15 E.ON did not self-report the contravention to Ofgem although it did contact Ofgem pro-actively in relation to it. It was identified by Ofgem through a complaint letter from an Irish battery and light bulb retailer received by Ofgem. The letter stated that E.ON's branded energy saving light bulbs were on sale in the Republic of Ireland.

### Co-operation with Ofgem's investigation

4.16 E.ON has co-operated with Ofgem during the investigation process. E.ON appointed an independent auditor upon Ofgem's request and at E.ON's own cost. As E.ON 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 Enforcement Committee hearing. The Authority has also given weight to E.ON's willingness (and agreement) to settle the investigation.

### Redress payments

4.17 The Authority has also given weight to the fact that E.ON has agreed to pay redress in the sum of £2,500,000 for the purpose of providing additional assistance to E.ON's domestic customers in fuel poverty or in a fuel poverty at risk group. Specifically an additional 18,519 eligible customers in the Warm Home Discount "Broader Group" category will be identified and will receive payments totalling £2,500,000 in value. These payments will be made by 31 October 2013 and E.ON will provide evidence as to that distribution. E.ON has agreed that the £2,500,000 will not be treated as or count towards meeting E.ON's obligations under the Warm Home Discount Scheme. In addition, E.ON has agreed to apply the same processes and procedures as for the WHD "Broader Group" including the same eligibility criteria and verification processes.

## **5. The Authority's decision**

5.1 The Authority hereby proposes to impose a financial penalty on E.ON of £500,000 in respect of the breach it finds has occurred of Article 16(1)(a) of the CERT Order, which it considers to be a reasonable figure in all the circumstances of the case, and which does not exceed 10% of applicable turnover. The penalty is a lower figure than would have been imposed if E.ON:

(a) had not been co-operative and appointed an independent auditor;

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<sup>10</sup>The Final Report of the Carbon Emissions Reduction Target (CERT) 2008-2012: [http://www.ofgem.gov.uk/Sustainability/Environment/EnergyEff/Documents1/CERT\\_FinalReport2013\\_300413.pdf](http://www.ofgem.gov.uk/Sustainability/Environment/EnergyEff/Documents1/CERT_FinalReport2013_300413.pdf)

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- (b) had not taken remedial action to make up the shortfall of carbon savings associated with the inaccurately reported energy saving light bulbs;
- (c) had not been willing to, and agreed to, settle this investigation by Ofgem; and
- (d) had not agreed to make payments of £2,500,000 by way of additional payments to benefit persons in fuel poverty or in a fuel poverty at risk group where such customers are eligible to receive Warm Home Discount payments under the "Broader Group" of qualifying recipients.

- 5.2 Any written representations on the proposed penalty must be received by Emily Thoo at Ofgem ([emily.thoo@ofgem.gov.uk](mailto:emily.thoo@ofgem.gov.uk)) or Ofgem, 9 Millbank, London, SW1P 3GE) by **5pm on 30 July 2013**.
- 5.3 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.

**Gas and Electricity Markets Authority**

**9 July 2013**