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Making a positive difference for energy consumers

Notice of intention to impose a financial penalty pursuant to section 30A(3) of the Gas Act 1986 and /or 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 GDF SUEZ/IPM with the requirements of Article 14(1) of the Electricity and Gas (Community Energy Savings Programme) Order 2009.

12 December 2014

1. Summary

1.1 The Gas and Electricity Markets Authority ("the Authority") proposes to impose a financial penalty on Saltend Cogeneration Company Limited, and Deeside Power (UK) Limited following an investigation by Ofgem into failure to meet obligations under the Electricity and Gas (Carbon Emissions and Community Energy Saving) Order 2009 ("CESP Order") by Saltend Cogeneration Company Limited, Deeside Power (UK) Limited and Rugeley Power Generation Limited (collectively known as "GDF SUEZ/IPM"[1]). This will consist of a financial penalty of £1 on each of Saltend Cogeneration Company Limited and Deeside Power (UK) Limited. This is provided that as at the date of any Final Penalty Notice issued by the Authority pursuant to section 27A(5) of the Electricity Act 1989 GDF SUEZ/IPM has paid an aggregate total of £450,000 (less £2) by way of consumer redress ("Penalty in light of Redress").

1.2 The payment of consumer redress[2] shall be to Age UK for programmes which pursue any or all of the following objectives: promotion of carbon emissions reduction in domestic homes; promotion of energy efficiency in domestic homes; and fuel poverty.

1.3 Under Article 14(1) of the CESP Order, generators and suppliers had to achieve their carbon emissions reduction obligation by promoting qualifying actions to domestic energy users in low income areas.

1.4 The investigation arose following the submission of the final CESP report to the Secretary of State on 30 April 2013[3], which provided details of the obligated parties' ("OP") achievements of the targets and obligations under the CESP Order, whose time for compliance expired on 31

[1]The three licensees in question were the subsidiary companies for International Power and Mitsui via a 75:25 joint venture ("IPM"). Following the completion of the acquisition of International Power by GDF SUEZ in June 2012, International Power was rebranded as GDF SUEZ Energy International.
[2] The Authority requires that such consumer redress must not interfere with the delivery of other energy efficiency schemes such as the Energy Company Obligation (ECO), or create an unreasonable administrative burden on Ofgem.
[3] https://www.ofgem.gov.uk/ofgem-publications/58763/cesp-final-report-2013final-300413.pdf

December 2012.[4] The report sets out that GDF SUEZ/IPM did not comply with the targets set out in its CESP obligation. GDF SUEZ/IPM accepts that it breached article 14(1) of the CESP Order.

1.5 The Authority notes that GDF SUEZ/IPM initially had an obligation to promote carbon savings equivalent to 852,080 tonnes ("tCO_2"). As was permitted under Article 21 of the CESP Order, in 2010 GDF SUEZ/IPM traded away 562,295tCO_2 of its obligation to third party OPs for them to deliver and was left with a reduced obligation of 289,785tCO_2 for GDF SUEZ/IPM to deliver by 31 December 2012. Therefore, the finding of breach of the CESP Order relates to this reduced obligation of 289,785tCO_2. GDF SUEZ/IPM ultimately delivered 38.6% of its reduced obligation leaving a shortfall of 177,928tCO_2 at 31 December 2012.

1.6 The Authority also notes that GDF SUEZ/IPM undertook mitigation action, slightly exceeding the volume of its shortfall associated with not achieving the carbon reduction target, by March 2013 and has had regard to this in setting the level of penalty.

1.7 The Authority finds that GDF SUEZ/IPM breached Article 14(1) of the CESP Order having failed to achieve its carbon emissions reduction obligation by promoting qualifying actions to domestic energy users by 31 December 2012.

1.8 The Authority considers it appropriate to propose a financial penalty on Saltend Cogeneration Company Limited and Deeside Power (UK) Limited for the contravention of Article 14(1) of the CESP Order, which occurred on 31 December 2012.

1.9 In the circumstances, the Authority hereby gives notice under section 27A(3) of the Electricity Act 1989 and/or section 30A(3) of the Gas Act 1986 of its proposal to impose a Penalty in light of Redress of £1 on each of Saltend Cogeneration Company Limited and Deeside Power (UK) Limited in respect of the failure to comply with Article 14(1) of the CESP Order. In deciding on the level of the penalty, which the Authority considers reasonable in all the circumstances, it has taken into account the following:

(a) GDF SUEZ/IPM's failure to achieve the CESP target was a serious contravention of a domestic energy efficiency programme;
(b) The extent of the initial shortfall in delivery of carbon reduction measures by GDF SUEZ/IPM was 177,928tCO_2 or 61.4% of its reduced obligation following trades with other OPs;
(c) GDF SUEZ/IPM has not made any financial gain from the breach;
(d) GDF SUEZ/IPM undertook mitigation action slightly exceeding the volume of the shortfall associated with its breach;
(e) The case does not include any aggravating factors;
(f) The case has several mitigating factors that apply

[4] Article 8(3) of the CESP Order provided that the obligation period for all generators ended on 31 December 2012.

- Action by the licensee to remedy the contravention or failure (see paragraphs 5.28-5.29)
- Co-operation with Ofgem's investigation (see paragraph 5.32); and
- Overdelivery of CESP mitigation (see paragraphs 5.38-5.40)

The case also has mitigating factors that partially apply

- Steps taken to secure compliance either specifically or by maintaining an appropriate compliance policy, with suitable management supervision (see paragraphs 5.20-5.27); and
- Design and administration of CESP scheme and the ability of GDF SUEZ/IPM to deliver it (see paragraphs 5.34-5.37).

(g) GDF SUEZ/IPM has agreed to settle this investigation

(h) GDF SUEZ/IPM has agreed to pay the consumer redress referred to in paragraphs 1.1 and 1.2.

The aggregate of the proposed penalty and the proposed amount of consumer redress to be paid is a lower figure than would have been the case if GDF SUEZ/IPM had not taken the steps as set out in paragraphs (d) and (g) above. The aggregate of the proposed penalty and the proposed amount of consumer redress to be paid is larger than the detriment suffered by consumers.

1.10 Any written representations on the proposed penalty must be received by Emily Thoo at Ofgem emily.thoo@ofgem.gov.uk or Ofgem, 9 Millbank, London, SW1P 3GE by **5.00pm on 19 January 2015.**

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

The Community Energy Saving Programme

2.1. The Community Energy Saving Programme ("CESP") was a policy, set down in legislation, designed to improve domestic energy efficiency standards in the most deprived geographical areas across Great Britain. The relevant legislation was the Electricity and Gas (Community Energy Saving Programme) Order 2009 ("CESP Order"). CESP was structured to incentivise the energy companies to install particular measures which had hitherto not been the focus of energy efficiency schemes, and to undertake as much activity as possible in each house treated and in each area targeted, via a number of incentives. These incentives included individual measure uplifts to incentivise particular measures such as Solid

Wall Insulation; whole house bonuses where more than one energy efficiency measure was installed in a property; and area bonuses when at least 25% cent of all dwellings in a low income area were treated by the same obligated party (OP).

2.2. Article 14(1) of the CESP Order required that certain gas and electricity suppliers and certain electricity generators had to achieve their carbon emissions reduction obligations by promoting qualifying actions to domestic energy users in areas of low income in Great Britain.

2.3. The CESP obligation ran from 1 October 2009 to 31 December 2012 (referred to here as the 'compliance period'). Obligations under the CESP Order (including Article 14(1) referred to above) are relevant requirements for the purposes of the powers of the Authority to impose a financial penalty for any failure to comply with such, under sections 27A Electricity Act 1989 and/or section 30A Gas Act 1986.[5]

2.4. The Department of Energy and Climate Change ("DECC") was responsible for drafting and implementing the legislation governing the scheme. This included setting the overall CESP target. Ofgem was responsible for administering the CESP, on behalf of the Authority.

GDF SUEZ/IPM's Obligation under CESP

2.5. In 2009, at the start of CESP, GDF SUEZ and IPM were separately obligated. In July 2011, GDF SUEZ acquired International Power plc. After the acquisition, GDF SUEZ/IPM had a combined obligation of 852,080tCO_2. Prior to the acquisition, in 2010 both companies traded a combined total of 562,295tCO_2 to two OPs (equivalent to 66% of the combined obligation).

2.6. As to the remaining 289,785tCO_2 to be delivered by 31 December 2012, GDF SUEZ/IPM delivered 38.6% of its obligation. The GDF SUEZ/IPM licence-holding subsidiaries, Saltend Cogeneration Company Limited, Deeside Power Limited and Rugeley Power Generation Limited, failed to meet their individual obligations, which shortfall comprised the remaining 61.4% of the reduced GDF SUEZ/IPM group carbon emissions reduction target.

Investigation

2.7. Ofgem takes compliance with all obligations seriously. When it became clear to Ofgem that there was a risk of non-compliance with CESP by several parties, Ofgem published an open letter dated 21 September

[5] Please see section 41A(7A)(a) Electricity Act 1989, section 33BC(7A)(a) Gas Act 1986 and Article 27 of the CESP Order.

2012[6], setting out its approach to enforcement in relation to CESP. This letter set out the way Ofgem and the Authority would approach actions taken by the OPs under CESP after the scheme's end date of 31 December 2012. The letter stated that Ofgem would take mitigation action into account in its enforcement procedures.[7]

2.8. Following the submission of the final CESP report to the Secretary of State on 30 April 2013 (see paragraph 1.3 above), Ofgem launched an investigation into GDF SUEZ/IPM. In particular, Ofgem investigated whether GDF SUEZ/IPM had met its carbon emissions reduction target set out under the CESP Order.

3. The Authority's decision on breach

3.1. Following an investigation by Ofgem into GDF SUEZ/IPM's compliance with the CESP Order, the Authority is satisfied that GDF SUEZ/IPM breached Article 14(1) of the CESP Order.

3.2. Article 14(1) CESP Order is a relevant requirement for the purposes of section 27A Electricity Act 1989 (the Authority's power to impose a financial penalty).[8] Article 14(1) mandated that GDF SUEZ/IPM licensees achieve their carbon emissions reduction obligations by promoting qualifying actions to domestic energy users in low income areas.

3.3. GDF SUEZ/IPM failed to meet by 31 December 2012 its carbon emissions reduction obligation mandated under Article 14(1) of the CESP Order. As a group, it delivered 111,857tCO_2 and had a shortfall of 177,928tCO_2 against its reduced obligation of 289,785tCO_2. The particular GDF SUEZ/IPM licensees which failed to meet their obligations were Rugeley Power Generation Limited, Saltend Cogeneration Company Limited and Deeside Power Limited.

3.4. This failure is evidenced by the Authority's report to the Secretary of State in April 2013 in which the Authority set out the levels of carbon emissions reductions achieved by OPs and whether they had met their obligations. GDF SUEZ/IPM does not dispute that the breach occurred.

[6] https://www.ofgem.gov.uk/ofgem-publications/58765/open-letter-cert-cesp-210912.pdf
[7] Ofgem also published three other open letters:
(i) on **20 December 2012**, setting out the administrative arrangements that Ofgem would use to process the mitigation actions delivered by OPs under CESP;
(ii) on **31 January 2013**, setting out the way the Authority and Ofgem would approach the assessment and timing of mitigation actions taken by OPs under CESP; and
(iii) on **29 May 2013**, setting out the administrative arrangements that Ofgem would use to process the mitigation actions delivered beyond 30 April 2013.
[8] Please see footnote 4.

3.5. In light of the finding of breach, the Authority considered whether to impose a financial penalty, under section 27A of the Electricity Act 1989 and/or section 30A of the Gas Act 1986.

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

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

4.1. The Authority has considered whether a financial penalty is appropriate in accordance with the requirements of the Electricity Act 1989 and/or the Gas Act 1986 and having regard to its published Statement of Policy with respect to Financial Penalties (October 2003) ("the Policy")[9].

4.2. The Authority is required to take a decision on penalty in the manner which it considers is best calculated to further its principal objective[10], and having regard to its other duties.

4.3. In deciding whether it would be appropriate to impose a penalty, the Authority has considered and taken into full account the particular facts and circumstances of the contravention under consideration, including the extent to which the circumstances from which the contravention or failure arose may have been outside the control of GDF SUEZ/IPM. It has also taken full account of the representations made to it by GDF SUEZ/IPM, including the shortfall in delivery by a key contractor.

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

4.4. The Authority considers that GDF SUEZ/IPM's breach of Article 14(1) of the CESP Order damaged the interests of consumers in that energy efficiency measures were not installed in people's homes by the end of the CESP compliance period. Whilst GDF SUEZ/IPM was installing energy efficiency measures as mitigation action from January 2013, it took until 31 March 2013 (as opposed to 31 December 2012) to deliver all of the expected energy efficiency measures, meaning energy savings for some consumers were delayed.

4.5. This delay had a material impact on consumers, who experienced a particularly cold winter during the months of January to March 2013,

[9] https://www.ofgem.gov.uk/ofgem-publications/74207/utilities-act-statement-policy-respect-financial-penalties.pdf
[10] The Electricity Act 1989 (section 3A) and the Gas Act 1986 (section 4AA) set out details of the Authority's principal objective as being the protection of the interests of existing and future consumers, wherever appropriate by promoting competition, and including their interests in the reduction of greenhouse gas emissions and the ensuring of the security of energy supply.

with average temperatures below the long-term average from 1981 to 2010.[11]

4.6. During that cold winter, domestic consumers used more gas than during either of the previous two winters.[12]

4.7. Had GDF SUEZ/IPM met its target by 31 December 2012, it estimated that around 990 households would have benefited from energy efficiency measures under CESP on time. These households were more likely to have been living on a low income than the average household in Great Britain, because CESP was targeted at low income areas.

4.8. The Authority has also considered the extent to which harm caused to consumers will have been offset by over-delivery of mitigation activities. We consider this further in paragraphs 5.38-5.40 below.

4.9. Further, the Authority has considered whether non-compliance has damaged the interests of other market participants who complied with CESP. The Authority considers the evidence to be inconclusive but notes that the case does not turn on this point.

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

4.10. The Authority considers that imposing a financial penalty is likely to create an incentive to compliance and deter future breaches:

(a) both generally, as the Authority considers compliance with mandatory deadlines to be very important and not imposing a penalty in this case would not create the right incentives around the need for regulated parties to comply with deadlines; and

(b) specifically, in relation to environmental programmes, to incentivise companies to comply in full and on time with future mandatory energy efficiency obligations such as the Energy Companies Obligations ("ECO").

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

If the contravention is trivial in nature

4.11. The Authority does not consider that GDF SUEZ/IPM's failure to meet its CESP obligation is trivial. The Authority notes that GDF SUEZ/IPM's

[11] http://www.metoffice.gov.uk/climate/uk/summaries/anomalygraphs. The Met Office publishes data on 30-year averaging periods, for 1961-1990, 1971-2000 and 1981-2010. Thus, 1981-2010 is the most recent data-set.
[12] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/266718/et4_1.xls

shortfall as at 31 December 2012 was 177,928tCO_2, which was equivalent to installing energy efficiency measures in around 990 households.

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

4.12. The Authority does not consider that its principal objective and duties as set out in section 3A of the Electricity Act 1989 and section 4AA of the Gas Act 1986 preclude the imposition of a penalty in this case.

4.13. In reaching this conclusion, the Authority has had regard to, amongst other factors, GDF SUEZ/IPM's ability to finance its generation activities referred to in section 3A(2)(b) Electricity Act 1989 and section 4AA(2)(b) Gas Act 1986 and the need to contribute to the achievement of sustainable development referred to in section 3A(2)(c) Electricity Act 1989 and section 4AA(2)(c) Gas Act 1986.

4.14. In failing to comply with the mandatory targets of the CESP Order, the Authority considers that GDF SUEZ/IPM failed to contribute to the achievement of sustainable development in the manner expected, and required, of it.

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

4.15. The Authority considers that the breach or possibility of a breach would have been apparent to a diligent licensee. Companies were given over three years to deliver their full obligation and were aware that a breach of this obligation would occur if they did not meet their full obligation by 31 December 2012.

Conclusion

4.16. Having taken into account the factors set out in the Policy and the representations made by the company, the Authority considers that the imposition of a penalty is appropriate in this case.

5. Criteria relevant to the level of financial penalty

5.1. In accordance with Section 27O(1) of the Electricity Act 1989 and/or Section 30O(1) of the Gas Act 1986, the Authority may impose a financial penalty of up to 10% of the annual turnover of the relevant regulated person. The Authority is satisfied that its proposed penalty on Saltend Cogeneration Company Limited and Deeside Power (UK) Limited falls within the maximum statutory limit. Rugeley Power Generation

Limited is dormant and no penalty has been imposed on Rugeley Power Generation Limited.

5.2. 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 general level of penalty

The seriousness of the contravention and failure

5.3. The Authority considers that GDF SUEZ/IPM's breach of CESP is serious. Companies had over three years to comply with the CESP obligation. Four of the ten parties with obligations under CESP complied. The Authority expects regulated parties to meet mandatory obligations, in full and on time.

5.4. GDF SUEZ/IPM incurred a shortfall of 177,928tCO_2 (see paragraph 1.4 above). Unmitigated, that shortfall would have been detrimental to the social policy objectives underlying the CESP obligation, which were to ensure consumers in low income areas in Great Britain benefit from multiple measures to make their homes more energy efficient, reducing their energy bills and increasing thermal comfort. The Authority also notes that unmitigated shortfalls would have been detrimental to the UK's commitment under the Climate Change Act 2008 to reduce carbon emissions by 80% by 2050 compared to 1990 levels.[13]

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

5.5. The degree of consumer harm has been set out above (see paragraphs 4.4 to 4.9). Once GDF SUEZ/IPM had completed its CESP mitigation activities in March 2013, the short period of consumer harm ceased.

The duration of the contravention or failure

5.6. The breach of the obligation was "one off" and the contravention occurred at the deadline on 31 December 2012, although the effects of the contravention persisted for three months afterwards albeit on a declining basis, i.e., until GDF SUEZ/IPM's mitigation activities were complete.

[13] As is acknowledged by the Authority in paragraphs 5.28-5.29, GDF SUEZ/IPM undertook prompt mitigation slightly exceeding the volume of shortfall associated with not achieving the carbon saving reduction target.

The gain (financial or otherwise) made by the licensee

5.7. The Authority has considered whether or not GDF SUEZ/IPM made a financial gain through not meeting its CESP obligation by the statutory deadline.

5.8. The Authority considers that GDF SUEZ/IPM has benefited on a time value of money basis, to a small extent, as a result of the delay to a significant proportion of its CESP expenditure into the mitigation period. By not investing in CESP delivery in a manner that would achieve compliance, GDF SUEZ/IPM would have been able to put the deferred expenditure to alternative use, albeit for a relatively short period given GDF SUEZ/IPM's prompt action to mitigate the volume of its shortfall associated with non-compliance.

5.9. However, the Authority notes that GDF SUEZ/IPM's mitigation carbon costs were significantly higher than the average cost per tCO_2 secured in the final year of CESP by all OPs.

5.10. The Authority has balanced the gain of deferring CESP expenditure until the mitigation period against the high cost that GDF SUEZ/IPM incurred by delivering its mitigation in 2012. The Authority considers that overall GDF SUEZ/IPM has not made a financial gain.

Factors tending to increase the level of penalty

Repeated contravention or failure

5.11. GDF SUEZ/IPM has not previously failed to meet an energy efficiency obligation. The Authority does not consider that this aggravating factor applies.

Continuation of contravention or failure after either becoming aware of the contravention or failure or becoming aware of the start of Ofgem's investigation

5.12. The breach of the obligation was "one off" and occurred at 31 December 2012 although the effects of the breach continued for three months. The Authority does not consider that this aggravating factor applies.

The involvement of senior management in any contravention or failure

5.13. GDF SUEZ/IPM provided information to show that throughout the compliance period, there was an internal procedure and mechanisms which were capable of achieving compliance (see paragraph 5.17). This included a reporting structure for GDF SUEZ/IPM's CESP team to escalate CESP issues to Senior Management. After the merger between IPM Group and GDF SUEZ/IPM, i.e., as early as February 2011, this team included one of its UK Business Management Meeting members ("UKBMM") (equivalent to a board member). Review of the evidence shows that the UKBMM member was involved in the delivery of carbon emissions reduction obligations including day-to-day matters.

5.14. When CESP compliance became a major concern, GDF SUEZ/IPM's evidence also shows that its CESP team was reporting to the Regional CEO on a regular basis. Excerpts of emails indicate that there was an ongoing commitment by GDF SUEZ/IPM's senior management to secure compliance with CESP by the deadline and a credible plan in place to achieve that.

5.15. Specifically, the Authority notes that, when it became apparent to GDF SUEZ/IPM that there was a risk of non-compliance with the CESP obligation, GDF SUEZ/IPM entered into negotiations with third party delivery agents at a carbon price similar to the price GDF SUEZ/IPM paid to undertake mitigation actions, with the aim to deliver its entire outstanding carbon by December 2012. Although the negotiation fell through, the Authority forms the view that the steps taken by GDF SUEZ/IPM during the compliance period were capable of securing compliance.

5.16. Taking the above into account, the Authority considers that GDF SUEZ/IPM's senior management took appropriate action to avoid or to seek to avoid the contravention. The Authority does not consider that this aggravating factor applies in this case.

<u>The absence of any evidence of internal mechanisms or procedures intended to prevent contravention or failure</u>

5.17. GDF SUEZ/IPM has provided evidence to show that it had internal procedures/mechanisms in place to prevent contravention of CESP, including:

(a) Organograms of the Senior Management which had oversight of the CESP programme.

(b) Diagrams showing how information about the companies' progress towards meeting the carbon emissions reduction obligation flowed to management and/or the Board. The existing reporting structure allowed the CESP team to escalate issues surrounding CESP to senior management.

(c) The use of project management tools maintained by the GDF SUEZ/IPM where it referred to risk registers and risk assessments concerning CESP delivery. The use of project management tools indicated that there was some form of ongoing management maintained by GDF SUEZ/IPM.

5.18. Taking the above into account, the Authority does not consider that there is an absence of any evidence of internal mechanisms or procedures intended to prevent contravention or failure. The Authority does not consider that this aggravating factor applies.

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

5.19. The investigation found no evidence of any attempt to conceal the contravention from Ofgem. The Authority does not consider that this aggravating factor applies.

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

5.20. The Authority would have expected a licensee seeking to meet its CESP obligation to devise a plan capable of achieving delivery within the compliance period – i.e. before 31 December 2012. This delivery process should have been subject to appropriate management supervision.

5.21. At the beginning of CESP compliance period, GDF SUEZ/IPM made the strategic decision to achieve compliance via a combination of trades and contracting third parties to deliver its carbon emissions reduction obligation under CESP. This approach included the following actions:

(a) In 2010 GDF SUEZ/IPM traded away 562,295tCO_2, which was equivalent to 66% of its total obligation; and

(b) In March 2010 and May 2011, GDF SUEZ/IPM contracted with two third party service providers to deliver respectively up to 300,000tCO_2 and 70,000tCO_2 of its carbon emissions reduction obligation.

5.22. GDF SUEZ/IPM has provided evidence to show that its initial delivery strategy was capable of securing compliance with CESP. However, one of its contractors did not secure sufficient amounts of carbon reduction schemes and fell behind in meeting delivery targets. Ultimately it delivered only 30,481tCO_2 out of a target of up to 300,000tCO_2 for GDF SUEZ/IPM by 31 December 2012. GDF SUEZ/IPM attributed its non-compliance with CESP obligations to alleged under-performance by this contractor.

5.23. GDF SUEZ/IPM stated that in response to its concern about the contractor's performance, it sought to reduce its delivery risk by taking the following actions:

(a) As early as February 2011, as an incentive to better performance, GDF SUEZ/IPM rescheduled the payments to the contractor falling behind in its delivery, so that payments would only be made in respect of invoices based on actual delivery of carbon reduction measures and GDF SUEZ/IPM, in addition, recovered some excess payments the contractor received in 2010; and

(b) In February 2012, GDF SUEZ/IPM exercised its contractual right to initiate a review meeting with the contractor where it discussed the contractor's progress, contingency plan and next steps. Under the contract, if GDF SUEZ/IPM reasonably believed that the contractor was unlikely to meet the carbon saving target by 30 June 2012, it had the right to either trade, transfer or contract the outstanding CESP obligation to a third party contractor.

5.24. Notwithstanding steps taken and the contingency measures set out in paragraphs 5.15 and 5.26, the Authority is of the view that the risk of non-delivery by the contractor would have been reduced with a more proactive approach to project management and supervision. Further, it appears to the Authority that when things started to go wrong with delivery GDF SUEZ/IPM should have acted more quickly to put a "Plan B" in place. GDF SUEZ/IPM has acknowledged that the compliance risk deriving from the CESP obligation remained with it as licensee.

5.25. GDF SUEZ/IPM has also attributed part of the reason for its contravention to its lack of experience with this type of obligation. Obligated parties with downstream retail businesses, in contrast to independent generators such as GDF SUEZ/IPM, had previous experience of schemes such as Energy Efficiency Commitment ("EEC") and also had existing access to contacts such as local authorities and housing associations and a domestic retail customer base. The Authority considers this lack of previous experience at the onset of the scheme is relevant to GDF SUEZ/IPM's ability to devise a credible "Plan B" quickly when things started to go wrong.

5.26. Further, the Authority has noted that in light of its growing concerns about the contractor's ability to deliver the required carbon savings, the following contingency measures were devised by GDF SUEZ/IPM, with the approval and involvement of its management, to seek to secure the required alternative carbon savings:

(a) GDF SUEZ/IPM explored with other third parties alternative ways to secure compliance. Between 2011 and 2012, GDF SUEZ/IPM continued to negotiate with another OP to increase the volume of traded carbon between the parties (i.e. a further trade after an initial successful trade arrangement). However, ultimately the OP in question declined to increase its trade volume with GDF SUEZ/IPM.

(b) In July 2012, GDF SUEZ/IPM increased the delivery obligation placed on another contractor, which ultimately raised the level of delivery of carbon reduction measures by that party from 55,000tCO_2 to 81,000tCO_2.

(c) In November 2012, GDF SUEZ/IPM engaged with another third party contractor to deliver the outstanding carbon at a price significantly above the prices it had previously paid. It had in fact sought such an arrangement with this particular contractor earlier in 2012 but the intended target scheme for carbon reduction measures had fallen through.

5.27. Taking all of the above into account, the Authority considers this mitigating factor partially applies.

<u>Appropriate action by the licensee to remedy the contravention or failure</u>

5.28. As noted in Ofgem's Open Letter of September 2012, mitigation action would not be a substitute for compliance with the carbon emission reduction obligations and obligated parties should not be able to benefit from non-compliance. However in considering mitigation actions, Ofgem said that *"we will give most weight to CERT/CESP measures that are delivered shortly after 31 December 2012".* Ofgem later stated in its January 2013 Open Letter that 30 April 2013 would be a key date for assessing the mitigation actions taken by the parties.

5.29. The Authority notes that GDF SUEZ/IPM undertook mitigation equivalent to the volume of shortfall associated with not achieving the carbon saving reduction target. This mitigation was completed promptly by 31 March 2013, i.e., before the key date of April 2013. The Authority also notes that GDF SUEZ/IPM delivered more than its shortfall as mitigation (see paragraphs 5.38-5.40 below). In light of this, the Authority considers that GDF SUEZ/IPM did take appropriate action to remedy the breach and that this mitigating factor applies to a significant extent in this case.

<u>Evidence that the contravention or failure was genuinely accidental or inadvertent</u>

5.30. GDF SUEZ/IPM has made representations that factors including CESP being an inappropriate obligation imposed on independent generators, its inability to pass through cost of the CESP, its being let down by its contractor and that the CESP did not match assumptions in DECC's impact assessment affected its ability to deliver the obligation by 31 December 2012.[14] These factors are considered in paragraphs 5.23-5.25 and 5.33-5.37. The Authority notes that OPs had over three years to

[14] The Authority considers issues concerning the design and administration of CESP below (please see paragraphs 5.34-5.37).

secure compliance with CESP and there is no evidence to suggest that GDF SUEZ/IPM's contravention was genuinely accidental or inadvertent. Accordingly, the Authority does not consider that this mitigating factor applies in this case.

Reporting the contravention or failure to Ofgem

5.31. The arrangements under the CESP Order were that the Authority was required to report in April 2013, to the Secretary of State for Energy and Climate Change, its determination as to whether OPs had achieved their carbon emissions reduction targets. This report was duly presented and the OPs were notified of its conclusions. The Authority therefore considers that this factor does not apply.

Co-operation with Ofgem's investigation

5.32. GDF SUEZ/IPM has responded to Ofgem's Information Requests on time and complied with Ofgem's investigations process. However, the Authority considers that this mitigating factor should only apply where co-operation has gone beyond what would be expected of any licensee facing enforcement action.[15] In this case, GDF SUEZ/IPM has additionally, in response to the Settlement Mandate put forward, accepted its breach and agreed to settle the case at the earliest opportunity. This has achieved a speedier resolution and avoided additional spending of resource by the regulator. Accordingly, the Authority considers that this mitigating factor applies and the Authority has imposed a lower penalty that it would otherwise have imposed.

Other factors

5.33. It is the view of the Authority that the following additional factors tending to reduce the level of any penalty are relevant in this matter.

Design and administration of CESP scheme and the ability of GDF SUEZ/IPM to deliver it

5.34. The Authority has considered the extent to which the design and administration of CESP may have adversely affected GDF SUEZ/IPM's ability to deliver CESP by 31st December 2012 and the extent to which GDF SUEZ/IPM was disadvantaged compared to suppliers through lack of experience with this type of obligation; for example, a lack of domestic retail customer base. The Authority has considered the evidence including

[15] See the Notice of decision to impose a financial penalty upon SSE for non-compliance with its obligations under conditions 23 and 25 of the Standard Conditions of the Electricity and Gas Supply Licences - https://www.ofgem.gov.uk/sites/default/files/sse-penalty-notice.pdf

a report commissioned by DECC, *Evaluation of the Carbon Emissions Reduction Target and Community Energy Saving Programme*.[16]

5.35. The Authority considers that CESP was a complex programme. The complexity stemmed from the design of CESP which promoted new approaches and innovation. These factors led to technical and management challenges for all OPs, and for Ofgem, in administering the CESP. Further, the Authority notes there were a number of issues which impacted upon scheme approval times. These include: the scheme's promotion of new approaches and innovation leading to many technical issues which had to be resolved during the scheme, the complexity of the programme and legislative requirements, initial predictions (which determined resourcing) regarding scheme numbers proving inaccurate, and a slow start to CESP by OPs resulting in back-loading of activity later into the programme.

5.36. The Authority considers that these factors were not insurmountable as several OPs secured compliance. Further, in the case of GDF SUEZ/IPM the Authority does not consider that these factors prevented the company from complying with its obligations. Nonetheless, the Authority considers it reasonable in all of the circumstances that a mitigating factor should be applied to reflect these challenges.

5.37. The Authority also considers that the lack of previous experience is relevant to GDF SUEZ/IPM' ability to meet its obligation and therefore considers that mitigation applies to an extent. However, the Authority considers that as a large company, GDF SUEZ/IPM was sufficiently well placed to put in place robust contract monitoring arrangements if it decided the use of a contractor was the best way to meet its obligation and to overcome its lack of experience. The Authority considers this mitigating factor only partially applies.

Over-delivery of CESP mitigation measures

5.38. GDF SUEZ/IPM delivered mitigation actions in excess of the level required to address the harm associated with its breach, albeit not to a significant extent. The Authority recognises that this additional delivery by GDF SUEZ/IPM provides enduring benefits for those consumers who have received those measures.

5.39. At the same time the Authority is aware that in relation to CERT and CESP, compliant suppliers were able to carry forward part of any over-delivery of

[16] https://www.gov.uk/government/publications/evaluation-of-the-carbon-emissions-reduction-target-and-community-energy-saving-programme

compliance actions into the ECO scheme albeit not necessarily on a pound for pound basis.

5.40. The Authority has balanced both of these points and considers that a mitigating factor should apply.

6. The Authority's proposed decision as to the level of penalty

6.1. Taking all of the above into account, the Authority proposes to impose a financial Penalty in light of Redress of £1 on each of Saltend Cogeneration Company Limited and Deeside Power (UK) Limited. The Authority considers this penalty to be reasonable in all the circumstances of the case. In reaching this decision the Authority has considered in particular the following:

(a) GDF SUEZ/IPM's failure to achieve the CESP target was a serious contravention of a domestic energy efficiency programme;
(b) The extent of the initial shortfall in delivery of carbon reduction measures by GDF SUEZ/IPM which was 177,928tCO_2 or 61.4% of its reduced obligation following trades with other OPs;
(c) GDF SUEZ/IPM has not made any financial gain from the breach;
(d) GDF SUEZ/IPM undertook mitigation action equivalent to the volume of its shortfall;
(e) The case does not include any aggravating factors;
(f) The case has several mitigating factors that apply
- Action by the licensee to remedy the contravention or failure (see paragraphs 5.28-5.29)
- Co-operation with Ofgem's investigation (see paragraph 5.32); and
- Overdelivery of CESP mitigation (see paragraphs 5.38-5.40)

The case also has mitigating factors that partially apply
- Steps taken to secure compliance either specifically or by maintaining an appropriate compliance policy, with suitable management supervision (see paragraphs 5.20-5.27); and
- Design and administration of CESP scheme and the ability of GDF SUEZ/IPM to deliver it (see paragraphs 5.34-5.37).

(g) GDF SUEZ/IPM has agreed to settle this investigation;
(h) GDF SUEZ/IPM has agreed to pay the consumer redress referred to in paragraphs 1.1 and 1.2.

The aggregate of the proposed penalty and the proposed amount of consumer redress to be paid is a lower figure than would have been the case if GDF SUEZ/IPM had not taken the steps as set out in paragraphs (d) and (g) above.

6.2. Any written representations on this Penalty Notice must be received by Emily Thoo, emily.thoo@ofgem.gov.uk or Ofgem, 9 Millbank, London, SW1P 3GE by **5pm on 19 January 2015**.

6.3. 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

12 December 2014