

## **Notice of intention to impose a financial penalty pursuant to 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 InterGen with Article 14(1) of the Electricity and Gas (Community Energy Saving Programme) Order 2009**

**28 November 2014**

#### **1 Summary**

1.1 The Gas and Electricity Markets Authority ("the Authority") proposes to impose a financial penalty on Rocksavage Power Company Ltd ("Rocksavage"), Coryton Energy Company Ltd ("Coryton") and Spalding Energy Company Ltd ("Spalding")(collectively known as "InterGen"). This will consist either of:

1.1.1 £11 million split between Rocksavage (£3.65 million), Coryton (£3.7 million), and Spalding (£3.65 million) (the "Penalty Option"); or

1.1.2 a financial penalty of £1 on each of Rocksavage, Coryton and Spalding provided that, in accordance with any final Penalty Notice issued pursuant to section 27A(5) Electricity Act 1989 ("Final Penalty Notice"), Rocksavage, Coryton and Spalding will pay either the balance of £11 million (less the £1 financial penalties) as consumer redress or the balance of £11 million (less the £1 financial penalties) as a combination of redress and penalty. The payment by way of redress is to be made no later than the payment of the financial penalty. The payment by way of consumer redress is to be to a suitable charity or charities of InterGen's choice as approved by the Authority and which pursues any or all of the following objectives<sup>1</sup>:

1.1.2.1 promotion of carbon emissions reduction in domestic homes; and/or

1.1.2.2 promotion of energy efficiency in domestic homes

1.1.2.3 fuel poverty

(the "Penalty in light of Redress Option")

1.2 This follows an investigation by Ofgem into the failure by InterGen to meet obligations under the Electricity and Gas (Carbon Emissions and Community Energy Saving) Order 2009 ("CESP Order").

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<sup>1</sup> the Authority requires that any 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 for Ofgem

- 1.3 The Authority will decide in its Final Penalty Notice as between the two options above.
- 1.4 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.
- 1.5 The investigation arose following the submission of the final CESP report to the Secretary of State on 30 April 2013<sup>2</sup>, which provided details of the obligated parties' ("OP") achievements of the targets and obligations under CESP, which finished on 31 December 2012.<sup>3</sup> The report sets out that InterGen did not comply with the targets set out in its CESP obligation resulting in a shortfall of 489,776 tCO<sub>2</sub> tonnes or 93.6% of its obligation. InterGen accepts that it breached Article 14(1) of the CESP Order.
- 1.6 The Authority notes that although InterGen undertook some mitigation activity by May 2013 to mitigate its carbon saving shortfall, InterGen has not mitigated its shortfall in full. InterGen has 203,276 tCO<sub>2</sub> (38.8% of its obligation) still undelivered. The Authority has had regard to this in setting the level of penalty.
- 1.7 The Authority finds that InterGen breached Article 14(1) of the CESP Order having failed to achieve its carbon emissions reduction obligations by promoting qualifying actions to domestic energy users by 31 December 2012.
- 1.8 The Authority considers it appropriate to propose that a financial penalty should be imposed on InterGen 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 of its proposal to impose a penalty on InterGen. This will consist either of the Penalty Option or the Penalty in light of Redress Option and arises in respect of InterGen's 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, in either of the two Options it has taken into account the following:
  - (a) InterGen's failure to achieve the CESP target was a very serious contravention of a major environmental programme;
  - (b) the extent of the initial shortfall in delivery of carbon reduction measures by InterGen;
  - (c) InterGen has made a significant financial gain from the breach;

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<sup>2</sup> <https://www.ofgem.gov.uk/ofgem-publications/58763/cesp-final-report-2013final-300413.pdf>

<sup>3</sup> Article 8(3) of the CESP Order provided that the obligation period for all generators ended on 31 December 2012.

- (d) InterGen mitigated some consumer harm associated with its breach, albeit to date there is still a shortfall against the original target;
- (e) the level of consumer detriment is high and on-going;
- (f) InterGen has one aggravating factor: (see paragraphs 5.17 – 5.22);
- (g) InterGen has a mitigating factor that applies (see paragraphs 5.37) and several mitigating factors partially apply: (see paragraphs 5.26-31, 5.32-5.33 and 5.39-5.42); and
- (h) InterGen has agreed to settle this investigation.

The proposed penalty/total sum to be paid is a lower figure than would have been the case if InterGen had not taken the steps set out in paragraphs (d) and (h) above. The proposed penalty/total sum to be paid is larger than the detriment suffered by consumers and the gain made by InterGen. For settlement, under the Penalty Option, the Authority considers it reasonable to split the proposed penalty equally between Rocksavage, Coryton and Spalding because InterGen's compliance strategy was a Group strategy and the matters described in this Penalty Notice apply to each of Rocksavage, Coryton and Spalding. The split does not reflect the specific performance of each of Rocksavage, Coryton and Spalding.

- 1.10 Any written representations on the proposed penalty must be received by Carol Mounfield at Ofgem ([Carol.Mounfield@ofgem.gov.uk](mailto:Carol.Mounfield@ofgem.gov.uk)) by 5.00pm on **5 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").
- 2.2 CESP was structured to incentivise 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% of all dwellings in a low income area were treated by the same "OP".

- 2.3 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.
- 2.4 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 section 27A Electricity Act 1989.<sup>4</sup>
- 2.5 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 CESP on behalf of the Authority.

#### *InterGen's obligation under CESP*

- 2.6 InterGen had an obligation of 523,770 tCO<sub>2</sub>. Each of the individual licensees, Rocksavage Power Company Ltd, Coryton Energy Company Ltd, and Spalding Energy Company Ltd failed to meet their individual obligations. By 31 December 2012, InterGen as a whole had achieved only 33,994 tCO<sub>2</sub> of its obligation and was left with a shortfall of 489,776 tCO<sub>2</sub>.

#### *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 2012<sup>5</sup>, 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.<sup>6</sup>

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<sup>4</sup> Please see section 41A (7A) (a) Electricity Act 1989 and Article 27 of the CESP Order.

<sup>5</sup> <https://www.ofgem.gov.uk/ofgem-publications/58765/open-letter-cert-cesp-210912.pdf>

<sup>6</sup> 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.

2.8 Following the submission of the final CESP report to the Secretary of State on 30 April 2013 (see paragraph 1.5 above), Ofgem launched an investigation into InterGen. In particular, Ofgem investigated whether InterGen 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 InterGen's compliance with the CESP Order, the Authority is satisfied that InterGen 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 of the Electricity Act 1989 (the Authority's power to impose a financial penalty).<sup>7</sup> Article 14(1) mandated that InterGen licensees achieve their carbon emissions reduction obligations by promoting qualifying actions to domestic energy users in low income areas.

3.3 InterGen failed to meet by 31 December 2012, its carbon emissions reduction obligation mandated under Article 14(1) of the CESP Order. The particular InterGen licensees which failed to meet their obligations were Rocksavage Power Company Ltd, Coryton Energy Company Ltd, and Spalding Energy Company Ltd. InterGen as a whole delivered 6.4% of its obligation and had a shortfall of 489,776 tCO<sub>2</sub>. InterGen's shortfall as a percentage of its obligation (93.6%) was greater than any other OP under CESP.

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. InterGen does not dispute that the breach occurred.

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.

### **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 having

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<sup>7</sup> Please see footnote 3.

regard to its published Statement of Policy with respect to Financial Penalties (October 2003) ("the Policy")<sup>8</sup>.

- 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<sup>9</sup>, 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 were outside the control of InterGen. It has also taken full account of the representations made to it by InterGen.

***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 InterGen'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. InterGen has not fully delivered the outstanding CESP obligation. A significant number of energy consumers have therefore been unable to benefit from CESP energy efficiency measures which they ought to have received. This means that some consumers will have faced higher energy bills than would otherwise be the case.
- 4.5 Whilst InterGen was installing energy efficiency measures as mitigation action from January 2013, it took until May 2013 (by contrast to the 31 December 2012 deadline for substantive compliance) to deliver some of the expected energy efficiency measures, meaning energy savings for some consumers were delayed. Additionally, as at October 2014, InterGen still has 203,276 tCO<sub>2</sub> of its obligation undelivered. A significant number of energy consumers have therefore been unable to benefit from CESP energy efficiency measures which they ought to have received. This means that those consumers will have faced higher energy bills than would otherwise be the case.

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<sup>8</sup> <https://www.ofgem.gov.uk/ofgem-publications/74207/utilities-act-statement-policy-respect-financial-penalties.pdf>

<sup>9</sup> The Electricity Act 1989 (section 3A) and/or 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.

- 4.6 For consumers who received measures after the compliance period, this partial mitigation had a material impact on consumers, who experienced a particularly cold winter during the months of January to March 2013, with average temperatures below the long-term average from 1981 to 2010.<sup>10</sup>
- 4.7 During that cold winter, domestic consumers used more gas than during either of the previous two winters<sup>11</sup>.
- 4.8 As InterGen did not fully deliver its obligation, other consumers have not benefitted from the energy savings which these measures would have attracted. This will have had a material impact on those consumers who have not received measures in the 22 months after the compliance period and for whom the impact is therefore ongoing due to InterGen's failure to take any steps to install these measures.
- 4.9 Had InterGen met its obligation by December 2012, more households would have benefited from energy efficiency measures under CESP on time. These households were also 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. The Authority estimates the following numbers of households have suffered detriment:
- a) for schemes where InterGen installed measures by 31 May 2013 by way of mitigation action, the Authority estimates in the order of 2,200 households would have benefitted earlier;
  - b) in respect of the carbon shortfall of 203,276 tCO<sub>2</sub>, Ofgem estimates in the order of 1,550 households would have benefited from insulation and heating measures under CESP had the shortfall been met.
- 4.10 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

- 4.11 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

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<sup>10</sup> <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.

<sup>11</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/266718/et4\\_1.xls](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/266718/et4_1.xls)

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

4.12 The Authority does not consider that InterGen’s failure to meet its CESP obligation is trivial. The Authority notes that InterGen’s shortfall as at 31 December 2012 was 489,776 tCO<sub>2</sub> (93.6% of its obligation) and equivalent to installing energy efficiency measures in around 3,700 households.

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

4.13 The Authority does not consider that its principal objective and duties, as set out in section 3A Electricity Act 1989, preclude the imposition of a financial penalty in this case.

4.14 In reaching this conclusion, the Authority has had regard to, amongst other factors, InterGen’s ability to finance its generation activities referred to in section 3A(2)(b) Electricity Act 1989 and the need to contribute to the achievement of sustainable development development referred to in section 3A(2)(c) Electricity Act 1989.

4.15 In failing to comply with the mandatory targets of the CESP Order, the Authority considers that InterGen 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

4.16 The Authority considers that the breach or possibility of a breach would have been apparent to a diligent licensee. OPs 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

- 4.17 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 270 of the Electricity Act 1989, the Authority may impose a financial penalty of up to 10% of the annual turnover of the relevant license holder. The Authority is satisfied that its proposed penalty falls within the maximum statutory limit.
- 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 InterGen's breach of CESP is very serious. OPs had over three years to comply with the CESP obligation. Four of the ten OPs with obligations under CESP complied. The Authority expects regulated parties to meet mandatory obligations, in full and on time.
- 5.4 InterGen incurred a shortfall of 489,776 tCO<sub>2</sub> (93.6%), the highest percentage shortfall of all the OPs (see paragraph 1.5). 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 be detrimental to the UK's commitment under the Climate Change Act 2008 to reduce carbon emissions by 80% by 2050 compared to 1990 levels.

#### 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 4.10). InterGen has not completed its CESP mitigation activities despite partially mitigating the shortfall by May 2013. There is a remaining shortfall of 203,276 tCO<sub>2</sub> and consumer harm is ongoing.

#### 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. The effects of the breach were partially alleviated when InterGen delivered some additional carbon savings as mitigation action by May 2013. However, the Authority considers that the effects of the breach are continuing as mitigation only covered an equivalent of 61.2% of InterGen’s CESP obligation.

The gain (financial or otherwise) made by the licensee

5.7 The Authority has considered whether or not InterGen may have made a financial gain through not meeting its CESP obligation by the statutory deadline. The Authority has considered this issue in relation to (a) the portion of its original CESP obligation which has not been delivered at all and (b) the portion of its original obligation which was delivered in 2013.

5.8 In relation to (a), the Authority considers that InterGen did make a significant financial gain through avoiding costs. In the period of January 2013 to October 2014, InterGen has avoided costs through non-delivery of its unmitigated shortfall of 203,276tCO<sub>2</sub>. The Authority additionally considers that InterGen would have made a gain, on a time value of money basis by being able to put the non-expenditure to alternative use.

5.9 However, in relation to (b), the Authority does not consider that InterGen avoided costs in respect of the mitigation that it did deliver.

5.10 The Authority considers that InterGen is likely to have made some gain by delaying a proportion of its CESP expenditure into the mitigation period. By not investing in CESP delivery in a manner that would achieve compliance, InterGen would have been able to put the deferred expenditure to alternative use.

5.11 However, the Authority notes that InterGen’s mitigation carbon costs would appear to be higher than the average cost per tCO<sub>2</sub> secured in the final year of CESP by all OPs.

5.12 The Authority has balanced the gain of deferring CESP expenditure until the mitigation period against the high cost that InterGen incurred by delivering its mitigation at above the market rates in 2012. The Authority considers that InterGen has not made a financial gain in respect of this portion of its original CESP obligation.

5.13 InterGen considers that it did not gain on the grounds that the design of the CESP obligation penalised InterGen as an independent generator due to its inability to pass through all of the costs of meeting CESP compared to other OPs. This is notwithstanding that DECC’s Impact Assessment for the CESP programme assumed that generators would be able to pass through costs to customers. In addition, InterGen considers that it was unable to absorb all of the costs of meeting CESP or pass them through to the wider InterGen group. InterGen considers that both of these factors

further inhibited its ability to secure CESP schemes as costs rose during the lifetime of the CESP.

- 5.14 The Authority notes that the obligation to deliver carbon savings was an absolute one and not dependent on whether it was possible to pass costs through. Accordingly, the Authority considers that the financial gain made by InterGen should be taken into account when setting the level of penalty.

### ***Factors tending to increase the level of penalty***

#### Repeated contravention or failure

- 5.15 InterGen 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

- 5.16 The breach of the obligation was "one off" and occurred at 31 December 2012 although the effects are on-going<sup>12</sup>. The Authority does not consider that this aggravating factor applies.

#### Involvement of senior management in any contravention or failure

- 5.17 At the beginning of the CESP compliance period, InterGen made the strategic decision to achieve compliance through contracting a third party to deliver its carbon reduction emissions obligation under CESP. Following commercial tendering in May 2010, InterGen contracted with a third party service provider to deliver its full carbon emissions reduction obligation, equating to up to 523,770 tCO<sub>2</sub>.
- 5.18 From the review of evidence, the Authority considers that InterGen's senior management had early knowledge of InterGen's slow progress in CESP delivery. InterGen had agreed key delivery milestones with its main third party provider; these milestones were not achieved. Reports submitted to InterGen's senior management during the period showed the third party provider demonstrating commitment to pursuing CESP schemes. These reports showed little carbon had been secured under contract. Despite the lack of carbon under contract, management consider it only became apparent in early 2012 that the planned CESP strategy would not deliver the obligation. The Authority considers that as a substantial entity with skills to project manage schemes or the

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<sup>12</sup> The effects of the breach were partially alleviated when InterGen delivered some additional carbon savings as mitigation action in 2013 and before 31 May 2013.

resources to bring in appropriate project management expertise, InterGen should have had the capability to employ alternative strategies sooner when it became clear that delivery was at risk, especially as delivery was only 6.4% of obligation in the compliance period.

- 5.19 The Authority considers that two key factors involving senior management contributed to InterGen's non-achievement of its obligation:
- (a) a failure to respond to market changes in price sooner; and
  - (b) delayed actions to respond to delivery challenges.
- 5.20 InterGen had entered a fixed-price contract with a third party provider to deliver carbon reduction measures to meet its obligation and to provide additional expertise. Evidence shows that senior management were aware of the increasing costs of carbon reduction schemes but did not amend the price strategy until May 2012. In practice, InterGen did not sign contracts with other providers at higher rates until October 2012 and its bids for surplus carbon offered by another OP were below the reserve price.
- 5.21 InterGen provided representations for not increasing the contract price before May 2012 based on: a) contractual obligations and b) the need to take prudent commercial decisions on costs whilst endeavouring to secure compliance. InterGen submits that as with all businesses, its senior management had to act responsibly within a commercial manner and could not simply commit to unlimited funds to ensure compliance with a particular scheme. The Authority agrees that companies should seek to manage their contracts and costs effectively. However, the Authority considers that sufficient priority must be given to complying with legal obligations.
- 5.22 Given the oversight of CESP provided by InterGen's senior management and the matters described above, the Authority considers that InterGen's senior management could and should have taken more action to prevent InterGen's failure to meet its CESP target. In light of the above, the Authority considers that this aggravating factor applies.

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

- 5.23 The Authority considers there is evidence that InterGen had some internal mechanisms or procedures in place intended to prevent contravention. Those internal mechanisms or procedures include:
- a) clear management structures in place for the internal management of CESP;

- b) arrangements for frequent and regular monitoring of third party contractor performance;
- c) regular reporting to senior management on the progress of CESP delivery;
- d) use of risk management tools, such as maintenance of risk registers, risk assessments, and regular risk monitoring at senior management level.

5.24 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

5.25 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 licensee had taken steps to secure compliance either specifically or by maintaining an appropriate compliance policy, with suitable management supervision

5.26 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 subjected to appropriate management supervision.

5.27 As outlined in paragraph 5.17, InterGen made the strategic decision to appoint a third party contractor to deliver its carbon reduction emissions obligation. In response to its concerns regarding performance by the third party service provider, InterGen suspended monthly payments to the provider in 2011 and also increased the monitoring frequency of reports in early 2012. InterGen eventually exercised its contractual right to terminate the contract in September 2012.

5.28 Notwithstanding the steps taken and the contingency measures set out in paragraph 5.30 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 InterGen should have acted more quickly to put a "Plan B" in place.

- 5.29 In addition to alleged underperformance by the third party service provider, InterGen attributed part of the reason for its contravention to its lack of experience of implementing this type of obligation. OPs with downstream retail businesses, in contrast to independent generators such as InterGen, 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 database. The Authority considers this lack of previous experience is therefore relevant to InterGen's ability to devise a credible "Plan B" quickly when things started to go wrong.
- 5.30 Furthermore, the Authority has noted that in the light of its growing concerns about the contractor's ability to deliver the required carbon savings, the following contingency measures were devised by InterGen, with the approval and involvement of its management to seek to secure the required alternative carbon savings:
- a) from May 2012, InterGen made contact with other third parties and service providers to secure carbon reduction schemes and other OPs to try to trade carbon. The volume of carbon under discussion through these contacts was over 500,000 tCO<sub>2</sub> but no contracts were secured. In addition, InterGen engaged with DECC and Ofgem over alternative solutions to meeting the obligation; and
  - b) in October 2012, InterGen contracted with three other service providers to deliver the outstanding carbon at prices significantly above its previous contracted price securing over 80% of its carbon shortfall.
- 5.31 Taking all of the above into account, the Authority considers this mitigating factor partially applies.

Appropriate action by the licensee to remedy the contravention or failure

- 5.32 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 OPs 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 parties.
- 5.33 The Authority notes that InterGen undertook some mitigation activity through delivering a further 286,500 tCO<sub>2</sub>. Much of this carbon was delivered by 30 April 2013, albeit some was delivered in May. However 203,276 tCO<sub>2</sub> which equates to 38.8% of InterGen's original obligation has still not been delivered. InterGen looked at continuing mitigation beyond this date; however, it cited regulatory uncertainty over whether Ofgem would continue to take account of such activity as the reason for

not continuing. Ofgem considers its Open Letters were clear, as evidenced by the continuation of other OPs to undertake and conclude mitigating activity. In light of this, the Authority considers that whilst InterGen did undertake some appropriate work, it did not take sufficient action. As a result, this mitigating factor only partially applies.

- 5.34 Some of InterGen's mitigation activity took place in Preston. The Authority is aware that around 60 households where solid wall insulation measures were installed as part of InterGen's mitigation have complained of poor workmanship. Solid wall insulation is expected to have a lifetime of 30 years. If unaddressed, as well as the detrimental impact on consumers, the issue has the potential to reduce the carbon savings associated with InterGen's mitigation. InterGen has undertaken to address and resolve these complaints. The Authority has taken InterGen's commitment into account in setting the level of penalty.

#### Evidence that the contravention or failure was genuinely accidental or inadvertent

- 5.35 InterGen has made representations that certain factors affected its ability to deliver the CESP obligation by 31 December 2012. These include CESP being an inappropriate obligation to be imposed on independent generators; InterGen's inability to pass through the cost of CESP; InterGen being let down by its contractor; and CESP not matching assumptions in DECC's impact assessment. These factors have been considered in paragraphs 5.13-5.14, 5.29, and 5.40-5.42. The Authority notes that OPs had over three years to secure compliance with the CESP scheme and there is no evidence to suggest that InterGen's contravention was genuinely accidental or inadvertent. Accordingly, the Authority does not consider that this mitigating factor applies.

#### Reporting the contravention or failure to Ofgem

- 5.36 InterGen contacted Ofgem in both May and September 2012 to express reservations around delivery of the CESP obligation, noting it was unlikely to deliver its obligation in full by 31 December 2012. However, as Ofgem were aware of the potential for non-compliance based on progress against the obligation, the Authority does not consider self-reporting the likelihood of a breach of an absolute obligation in advance as sufficient to warrant a decrease in the level of any penalty. 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

5.37 InterGen 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 to such co-operation where that co-operation has gone beyond what would be expected of any licensee facing enforcement action<sup>13</sup>. In this case, InterGen 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 than it would otherwise have imposed.

#### Other factors

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

#### Design and administration of the CESP scheme and the ability of InterGen to deliver it

5.39 The Authority has considered the extent to which the design and administration of CESP may have adversely affected InterGen's ability to deliver CESP by 31<sup>st</sup> December 2012 and the extent to which InterGen 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 a report commissioned by the DECC, "Evaluation of the Carbon Emissions Reduction Target and Community Energy Saving Programme"<sup>14</sup>.

5.40 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 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.

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<sup>13</sup> 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>

<sup>14</sup> <https://www.gov.uk/government/publications/evaluation-of-the-carbon-emissions-reduction-target-and-community-energy-saving-programme>



- 5.41 The Authority considers that these factors were not insurmountable as several OPs secured compliance. Further, in the case of InterGen 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 this is a mitigating factor in this case.
- 5.42 The Authority considers that the lack of previous experience is relevant to InterGen's ability to meet its obligation and therefore considers that a mitigating factor applies to an extent. However, the Authority also considers that as a large company, InterGen 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.

## **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 on InterGen. This will consist either of the Penalty Option or the Penalty in light of Redress Option. The Authority will decide in its Final Penalty Notice as between these two options.
- 6.2 The Authority considers the proposed penalties in either of the two options to be reasonable in all the circumstances of the case. In reaching this decision the Authority has taken into account the following:
- (a) InterGen's failure to achieve the CESP target was a very serious contravention of a major environmental programme;
  - (b) the extent of the initial shortfall in delivery of carbon reduction measures by InterGen;
  - (c) InterGen has made a significant financial gain from the breach;
  - (d) InterGen mitigated some consumer harm associated with its breach, albeit to date there is still a shortfall against the original target;
  - (e) the level of consumer detriment is high and on-going;
  - (f) InterGen has one aggravating factor: (see paragraphs 5.17 – 5.22);
  - (g) InterGen has a mitigating factor that applies (see paragraphs 5.37) and several mitigating factors partially apply: (see paragraphs 5.26-31, 5.32-5.33 and 5.39-5.42); and
  - (h) InterGen has agreed to settle this investigation.

6.3 The proposed penalty in the Penalty Option or the total sum by way of penalty and consumer redress in the Penalty in light of Redress Option is lower than would have been the case if InterGen had not taken the steps as set out in paragraphs (d) and (h) above. This sum is larger than the detriment suffered by consumers and the gain made by InterGen. Under the Penalty Option, the Authority could have split the proposed penalty in a number of ways but has proposed to split it equally between Rocksavage, Coryton and Spalding. This is because InterGen's compliance strategy was a Group strategy and the matters described in this Penalty Notice apply to each of Rocksavage, Coryton and Spalding. The split does not reflect the specific performance of each of Rocksavage, Coryton and Spalding.

- 6.4 Any written representations on the proposed penalty must be received by Carol Mounfield at Ofgem [Carol.Mounfield@ofgem.gov.uk](mailto:Carol.Mounfield@ofgem.gov.uk) by 5pm on **5 January 2015**.
- 6.5 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**

**27 November 2014**