

Notice of Decision to impose a financial penalty pursuant to section 30A(5) of the Gas Act 1986 and section 27A(5) of the Electricity Act 1989

Decision of the Gas and Electricity Markets Authority to impose a financial penalty, following an investigation into compliance by ScottishPower with the requirements of Article 14(1) of the Electricity and Gas (Community Energy Savings Programme) Order 2009.

5 March 2015

1. Summary

- 1.1. The Gas and Electricity Markets Authority ("the Authority") has decided to impose a financial penalty of £1 on each of ScottishPower Energy Retail Limited and ScottishPower Generation Limited (together "ScottishPower"). This decision has taken into account that ScottishPower will pay £2.4 million (less the £2 penalty) in consumer redress. The payment of consumer redress is to be made to the ScottishPower Energy People Trust ("SPEPT") and shall be paid at a date to be agreed with the Authority.
- 1.2. The payment of consumer redress is to be made to the Scottish Power Energy People Trust for distribution to organisations which pursue any or all of the following objectives¹ for vulnerable customers;
 - 1.2.1. the promotion of energy efficiency;
 - 1.2.2. the alleviation of fuel poverty;
 - 1.2.3. the reduction of carbon emissions.
- 1.3. This follows an investigation by Ofgem into ScottishPower's failure to meet its obligations under Article 14(1) of the Electricity and Gas (Carbon Emissions and Community Energy Saving) Order 2009 ("CESP Order"), and consideration by the Authority of representations or objections received on its proposed penalty. These representations or objections are discussed in the Annex to this document.
- 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 by the Authority on 30 April 2013², which provided details of the obligated parties' ("OP") achievements of the targets and obligations under CESP which finished on 31 December 2012³.

¹ The Authority required that any consumer redress must not adversely interfere with the delivery of other energy efficiency schemes such as the Energy Companies Obligation (ECO), or create an unreasonable administrative burden for Ofgem.

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

³ Article 10(3) of the CESP Order provided that the obligation period for all suppliers ended on 31 December

The report sets out that ScottishPower did not comply with the targets set out in its CESP obligation resulting in a shortfall of 554,373 tonnes ("tCO₂"), or approximately 30% of its overall obligation which totaled 1,845,515 tCO₂. ScottishPower accepts that it breached Article 14(1) of the CESP Order.

- 1.6. The Authority noted that ScottishPower undertook mitigation action, in excess of the volume of its shortfall associated with not achieving the carbon reduction target, by 30 April 2013 and had regard to this in setting the level of penalty.
- 1.7. The Authority has decided that ScottishPower breached Article 14(1) of the CESP Order, through 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 has decided it is appropriate to impose a financial penalty on ScottishPower for the contravention of Article 14(1) of the CESP Order, which occurred on 31 December 2012.
- 1.9. In the circumstances, the Authority has decided to impose a penalty of £1 on each of ScottishPower Energy Retail Limited and ScottishPower Generation Limited in respect of the failure to comply with Article 14(1) of the CESP Order. This decision has taken into account that ScottishPower will also pay £2.4 million (less the £2 financial penalty) in consumer redress to SPEPT at a date to be agreed with the Authority. In deciding on the level of the penalty, which the Authority considers reasonable in all of the circumstances, it took into account the following:
 - (a) ScottishPower's failure to achieve the CESP target was a serious contravention of a major environmental programme;
 - (b) The extent of the initial shortfall in delivery of carbon reduction measures by ScottishPower was 554,373 tCO₂ or 30.04% of its obligation;
 - (c) ScottishPower is likely to have made a small financial gain through deferred expenditure from the breach;
 - (d) The level of consumer detriment was low;
 - (e) ScottishPower undertook mitigation action exceeding the volume of the shortfall associated with its breach;
 - (f) ScottishPower has one aggravating factor (see paragraphs 5.12-5.20);
 - (g) ScottishPower has several mitigating factors that apply (see paragraphs 5.33-5.34 and 5.37-5.44) and one mitigating factor that partially applies (see paragraphs 5.28-5.32);
 - (h) ScottishPower has agreed to settle this investigation; and
 - (i) ScottishPower has agreed to pay the consumer redress referred to in paragraphs 1.1 and 1.2.

In the judgement of the Authority the aggregate of the penalty and the amount of consumer redress is a lower figure than would have been the

case if ScottishPower had not taken the steps as set out in paragraphs (e) and (h) above, and the aggregate of the penalty and the amount of consumer redress is larger than the detriment suffered by consumers and the gain made by ScottishPower.

1.10. The penalty, totaling £2, must be paid by 17 April 2015.

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 certain 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 obligated party (“OP”).
- 2.3. Article 14(1) of the CESP Order required that certain gas and electricity suppliers and certain electricity generators must 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 sections 27A Electricity Act 1989 and/or section 30A Gas Act 1986⁴.
- 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 the CESP, on behalf of the Authority.

⁴ Please see section 41A(7A)(a) Electricity Act 1989, section 33BC(7A)(a) Gas Act 1986 and article 27 of the CESP Order.

ScottishPower's Obligation under CESP

- 2.6. ScottishPower had an obligation of 1,845,515 tCO₂. By 31 December 2012, ScottishPower had achieved only 1,291,142 tCO₂ of its obligation and was left with a shortfall of 554,373 tCO₂.

The 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 2012⁵, 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.⁶
- 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 ScottishPower. In particular, Ofgem investigated whether ScottishPower 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 ScottishPower's compliance with the CESP Order, the Authority is satisfied that ScottishPower 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 and section 30A of the Gas Act 1986 (the Authority's power to impose a financial penalty)⁷. Article 14(1) mandated that ScottishPower achieve its carbon emissions reduction obligations by promoting qualifying actions to domestic energy users in low income areas.
- 3.3. ScottishPower failed to achieve, by 31 December 2012, its carbon emissions reduction obligation mandated under Article 14(1) of the CESP Order. It delivered 69.96% of its obligation and had a shortfall of 554,373 tCO₂.

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

⁶ Ofgem also published three other open letters:

- (i) On **20 December 2012**, setting out the administration arrangement 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.

⁷ See footnote 4.

- 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. ScottishPower 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 and 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 considered whether a financial penalty is appropriate in accordance with the requirements of the Electricity Act 1989 and the Gas Act 1986 and having regard to its published Statement of Policy with respect to Financial Penalties (October 2003) ("the Penalties Policy").⁸
- 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 objective⁹, and having regard to its other duties.
- 4.3. In deciding that it would be appropriate to impose a penalty, the Authority considered and took 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 ScottishPower. It also took full account of the representations made to it by ScottishPower.

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 considered that ScottishPower'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 ScottishPower was installing energy efficiency measures as mitigation action from January 2013, it took until 30 April 2013 (by contrast to the 31 December 2012 deadline for substantive compliance) to deliver all of the expected energy efficiency measures, meaning energy savings for some consumers were delayed.

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

⁹ The Electricity Act 1989 (section 3A) and the Gas Act 1986 (section 4AA) sets 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

- 4.5. This delay 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 2010.¹⁰
- 4.6. During that cold winter, domestic consumers used more gas than during either of the previous two winters.¹¹
- 4.7. Had ScottishPower met its target by 31 December 2012, it is estimated that between 5,500 and 6,000¹² extra households, some of whom had already received CESP measures from ScottishPower, would have benefited from further CESP 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.
- 4.8. Further, the Authority considered whether non-compliance damaged the interests of other market participants who complied with CESP. The Authority considered the evidence to be inconclusive but noted that the case does not turn on this point.
- 4.9. The Authority also considered the extent to which harm caused to consumers will have been offset by the over-delivery of mitigation activities by ScottishPower. We consider this further in paragraphs 5.42-5.44 below.

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

- 4.10. The Authority considered that imposing a financial penalty is likely to create an incentive to compliance and deter future breaches;
 - (a) both generally, as the Authority considered 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 Obligation ("ECO").

¹⁰ <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.

¹¹ http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/266718/et4_1.xls

¹² This figure is based on the number of properties treated by ScottishPower after 31 December 2012.

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 did not consider that ScottishPower's failure to meet its CESP obligation was trivial. The Authority noted that ScottishPower's shortfall as at 31 December 2012 was 554,373 tCO₂, which was equivalent to installing energy efficiency measures in between 5,500 and 6,000 homes.

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

- 4.12. 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.

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

- 4.13. The Authority considered 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

- 4.14. Having taken into account the factors set out in the Penalties Policy and the representations made by the company, the Authority decided that the imposition of a penalty was appropriate in this case.

5. Criteria relevant to the level of financial penalty

- 5.1. In accordance with Section 270(1) of the Electricity Act 1989 and Section 300(1) of the Gas Act 1986, the Authority may impose a financial penalty of up to 10% of the annual turnover of the relevant licence holder. The Authority was satisfied that its penalty fell within the maximum statutory limit.
- 5.2. In deciding the appropriate level of financial penalty, the Authority considered all the circumstances of the case, including the amount of consumer redress in the sum of £2.4 million (minus the £2 financial penalty) and following specific matters set out in the Penalties Policy.

Factors which are first considered when determining the general level of penalty

The seriousness of the contravention and failure

- 5.3. The Authority considered that ScottishPower's breach of CESP was 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. ScottishPower incurred a shortfall of 554,373tCO₂ (see paragraph 2.6 above) which was then mitigated by 30th April 2013. 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 noted 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.

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 ScottishPower had completed its CESP mitigation activities in April 2013, the 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 approximately four months after that date until ScottishPower's mitigation activities were completed in April 2013.

The gain (financial or otherwise) made by the licensee

- 5.7. The Authority considered whether or not ScottishPower made a financial gain through not meeting its CESP obligation by the statutory deadline. It considered this by reference to the specific facts surrounding ScottishPower's compliance strategy and costs that ScottishPower might have been expected to incur to achieve compliance.
- 5.8. The Authority noted that ScottishPower's mitigation carbon costs are higher than the average cost per tCO₂ secured in the final year of CESP by all OPs. As a consequence, the Authority does not consider that ScottishPower is likely to have made a gain by delivering at lower cost in mitigation than at the prevailing market rate following the decision to secure schemes which delivered into 2013, discussed at paragraph 5.13.

- 5.9. The Authority did however consider that ScottishPower was likely to have made some gain by delaying a significant proportion of its CESP expenditure into the mitigation period. By not investing in CESP delivery in a manner that would achieve compliance, ScottishPower was able to put the deferred expenditure to alternative use.

Factors tending to increase the level of penalty

Repeated contravention or failure

- 5.10. ScottishPower had not previously failed to meet an energy efficiency obligation. The Authority did 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

- 5.11. The breach of the obligation was "one off" and occurred at 31 December 2012 although the effects of the breach continued for approximately four months. The Authority did not consider that this aggravating factor applies.

Involvement of senior management in any contravention or failure

- 5.12. The Authority considered that ScottishPower adopted a strategy to secure schemes with delivery into 2013. ScottishPower failed to ensure that delivery of its CESP obligation occurred on time. From consideration of a draft position paper from November 2011, it is apparent that, from the last quarter of 2011, ScottishPower was considering potential consequences of non-compliance and alternatives to delivering its obligation by the statutory deadline.
- 5.13. From February 2012, ScottishPower became aware that it was unlikely to achieve compliance and anticipated a shortfall in delivery of around 30%. In April 2012, a direction was given from senior management to secure schemes with delivery into June 2013. ScottishPower's explanation of the strategy was to deliver as much carbon as possible during 2012 and to ensure that ScottishPower had sufficient schemes to meet the required carbon delivery as early as possible in 2013.
- 5.14. Further, it was apparent to the Authority that ScottishPower's cost policy meant that during most of the obligation window funding limits were in place. In the Authority's view, communications between the delivery team and senior management show that despite having considerable market awareness, ScottishPower bid behind the market rate in its tendering and responded slowly to market price increases. Although in 2012 ScottishPower was funding a higher proportion of scheme costs, it was still operating within a cost and budgetary policy that the Authority considers contributed to its failure to deliver CESP. ScottishPower has explained that it took a prudent approach to funding, and wanted to avoid passing unnecessary cost on to consumers.

- 5.15. ScottishPower has stated that it encountered challenges in delivering its CESP obligation including;
- A third party contractor's alleged failure to deliver in line with its contractual obligations
 - the challenges and uncertainty arising from the Comprehensive Spending Review and its implications on the public sector and private sector contractors (including the insolvency of one of ScottishPower's proposed outsource delivery partners);
 - the complexity of the design of the CESP programme and the administration challenges arising from this (considered further at Paragraphs 5.39-5.41);
 - the unexpected significant increase in the number and size of the schemes required to deliver the CESP programme;
 - the challenges in the market regarding the competition for securing CESP schemes and the continual increase in the costs and funding required to secure CESP schemes
- 5.16. ScottishPower contracted with a third party to increase its ability to deliver CESP schemes. However, the contractor immediately experienced difficulties in securing schemes and delivering carbon due to the increasing disparity between the agreed contractual rate and the market rate for energy efficiency schemes. In mid-2011, ScottishPower took the decision to increase the contractor's target by 17.5% prior to providing an improved funding solution or taking significant action to address underperformance, although this action was undertaken in late 2011.
- 5.17. ScottishPower has stated that the decision to increase its contractor's target was taken principally in order to challenge the contractor to improve its performance. However, the Authority considered that the evidence shows that ScottishPower's reasons for taking this decision were centred on budget, cost and commercial interests. The Authority considered that ScottishPower was not prudent in assessing the likely impact this decision would have on its ability to achieve compliance. Further, it was questionable, in the Authority's view, whether such a step should have been taken by ScottishPower in the circumstances. The Authority was of the view that the strategy adopted with the third party contractor during 2011 was not conducive to achieving compliance.
- 5.18. In late 2012, ScottishPower declined opportunities to purchase surplus CESP carbon from two other OPs. ScottishPower expressed concerns about whether the carbon could be banked and approved by the compliance deadline but ultimately declined stating that although the carbon was of interest, the cost was 'a long way away' from its position. ScottishPower also had existing delivery commitments running into 2013 due to the strategy it adopted from April 2012.
- 5.19. Given the oversight of CESP provided by ScottishPower's senior management (see paragraphs 5.21 to 5.25), the Authority considered that senior management had considerable knowledge of and/or provided input into some of the key decisions which led to ScottishPower's non-

compliance.

- 5.20. In light of the above, the Authority considered there is evidence that this aggravating factor applies.

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

- 5.21. The Authority considered there is evidence that ScottishPower had some internal mechanisms or procedures in place intended to prevent contravention. Those internal mechanisms or procedures include the following.
- 5.22. ScottishPower provided an organogram of the parent company's senior management with oversight of the CESP, and the dates when individuals had oversight. The reporting lines show that information and decisions on CESP reached the highest levels within ScottishPower and its parent company Iberdrola.
- 5.23. ScottishPower provided a chart showing how information about ScottishPower's progress towards meeting its CESP obligation flowed to management and the Board of the parent company for each of the relevant organisational structures.
- 5.24. Initially, ScottishPower was slow to establish a delegated process to approve schemes and approval was required at Director or CEO level, even when a scheme fell within budget. During 2012, delegated authority for scheme approvals within budget was granted to the CESP delivery manager.
- 5.25. ScottishPower produced extensive documentation provided to senior managers; this includes minutes of meetings between senior management or the Board and Ofgem/DECC and its third party contractor plus various email chains with discussions and attachments, including submission trackers, contractor weekly reports and presentation slides. Risk and action logs were used to monitor risk and progress with achieving compliance. ScottishPower did not produce a full set of risk logs and these were notably absent during the period in 2011 when Iberdrola had oversight of delivery and when approval was required at Director/CEO level to bid for schemes (see paragraph 5.24).
- 5.26. Taking the above into account, the Authority did not consider that there is an absence of any evidence of internal mechanisms or procedures intended to prevent contravention or failure. Therefore the Authority did not consider that this aggravating factor applies.

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

- 5.27. The investigation found no evidence of any attempt to conceal the contravention from Ofgem. Therefore the Authority did 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.

- 5.28. The Authority 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.
- 5.29. At the beginning of the CESP compliance period, ScottishPower made the strategic decision to achieve compliance via a mixed delivery model of outsourced delivery to a contractor(s) and direct delivery/funding.
- 5.30. Initially, ScottishPower agreed to outsource 35% of its obligation to a potential contractor, however this was withdrawn when ScottishPower became aware of serious financial problems at the company, who ultimately went into receivership in September 2010. ScottishPower had to change its delivery strategy and chose to deliver the outstanding share through its direct delivery channel, resulting in a 50/50 split in delivery between ScottishPower and its subsequent third party contractor.
- 5.31. ScottishPower had processes in place to monitor its direct funding activity and the performance of its contractor throughout the duration of the CESP agreement. Scrutiny increased during the final 18 months of the obligation window as the contractor's performance became a key determining factor in ScottishPower's ability to achieve its obligation. The Authority believed that ScottishPower did operate appropriate supervision of its contractor but, as discussed at paragraphs 5.15 to 5.17, failed to take appropriate steps to address under-performance.
- 5.32. The Authority considered there is some evidence that ScottishPower took steps to secure compliance (for example, by increasing its budget for CESP and maintaining suitable management supervision) and that this factor partially applies.

Appropriate action by the licensee to remedy the contravention or failure

- 5.33. 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 parties.
- 5.34. The Authority noted that ScottishPower undertook mitigation action equivalent to the volume of its shortfall associated with not achieving the carbon reduction target. This mitigation was completed by the "key date"

of 30 April 2013. The Authority also noted that ScottishPower delivered more than its shortfall as mitigation (see paragraphs 5.42-5.44 below). In light of this, the Authority considered that ScottishPower did take appropriate action to remedy the breach and that this mitigating factor applies in this case.

Evidence that the contravention or failure was genuinely accidental or inadvertent

- 5.35. ScottishPower made representations that certain factors affected its ability to deliver the obligation by the due date. These factors have been considered in paragraphs 5.15 to 5.17 and 5.39 to 5.41 respectively. The Authority did not see evidence to suggest that the contravention was genuinely accidental or inadvertent. Accordingly, the Authority did not consider that this mitigating factor applies in this case.

Reporting the contravention or failure to Ofgem

- 5.36. 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 considered that this factor did not apply.

Co-operation with Ofgem's investigation

- 5.37. ScottishPower has responded to Ofgem's Information Requests on time and complied with Ofgem's investigations process. However, the Authority considered that this mitigating factor should only apply where co-operation has gone beyond what would be expected of any licensee facing enforcement action.¹³ In this case, ScottishPower 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 considered that this mitigating factor applies and the Authority imposed a lower penalty than it would otherwise have imposed.

Other factors

- 5.38. It was the view of the Authority that the following additional factors tending to reduce the level of any penalty were relevant in this matter.

¹³ 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>

Design and administration of the CESP scheme and the ability ScottishPower to deliver it

- 5.39. The Authority considered the extent to which the design and administration of CESP may have adversely affected ScottishPower's ability to deliver CESP by 31st December 2012. The Authority considered the evidence including a report commissioned by the Department of Energy & Climate Change, Evaluation of the Carbon Emissions Reduction Target and Community Energy Saving Programme".¹⁴
- 5.40. The Authority considered 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 noted there were a number of issues which impacted upon scheme approval times. These included: 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.
- 5.41. The Authority considered that these factors were not insurmountable as several OPs secured compliance. Further, in the case of ScottishPower the Authority did not consider that these factors prevented the company from complying with its obligations. Nonetheless, the Authority considered it reasonable in all of the circumstances that a small mitigating factor should be applied to reflect these challenges.

Over-delivery of CESP mitigation measures

- 5.42. ScottishPower delivered mitigation actions in excess of the level required to address the harm associated with its breach. The Authority recognised that this additional delivery by ScottishPower provided enduring benefits for those consumers who had received those measures.
- 5.43. At the same time, the Authority was aware that in relation to CERT and CESP, compliant suppliers were able to carry forward part of any over-delivery of compliance actions into the ECO scheme, albeit not necessarily on a pound for pound basis.¹⁵
- 5.44. The Authority balanced both of these points and considered a mitigating factor should apply.

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

¹⁵ ScottishPower has indicated that it elected to keep these measures as additional CESP mitigation, instead of using these measures under ECO where they were potentially claimable qualifying actions.

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

- 6.1. Taking all of the above into account, which includes the representations or objections submitted in response to its proposed penalty the Authority has decided to impose a penalty of £1 on each of ScottishPower Energy Retail Limited and ScottishPower Generation Limited. This decision has taken into account that ScottishPower will also pay £2.4 million (less the £2 financial penalty) in consumer redress to SPEPT at a date to be agreed with the Authority.
- 6.2. The Authority considered this penalty to be reasonable in all the circumstances of the case. In reaching this decision the Authority took into account the following:
- (a) ScottishPower's failure to achieve the CESP target was a serious contravention of a major environmental programme;
 - (b) The extent of the initial shortfall in delivery of carbon reduction measures by ScottishPower which was 554,373 tCO₂ or approximately 30% of its obligation;
 - (c) ScottishPower is likely to have made a small financial gain through deferred expenditure from the breach;
 - (d) The level of consumer detriment was low;
 - (e) ScottishPower undertook mitigation action exceeding the volume of its shortfall;
 - (f) ScottishPower has one aggravating factor (see paragraphs 5.12-5.20);
 - (g) ScottishPower has several mitigating factors (see paragraphs 5.33-5.34 and 5.37-5.44) and one mitigating factor that partially applies (see paragraphs 5.28-5.32);
 - (h) ScottishPower has agreed to settle this investigation; and
 - (i) ScottishPower has agreed to pay the consumer redress referred to in paragraphs 1.1 and 1.2.

In the judgement of the Authority, the aggregate of the penalty and the amount of consumer redress is a lower figure than would have been the case if ScottishPower had not taken the steps as set out in paragraphs (e) and (h) above, and the aggregate of the penalty and the amount of consumer redress is larger than the detriment suffered by customers and the gain made by ScottishPower.

- 6.3 The penalty must be paid by 17 April 2015.

Gas and Electricity Markets Authority

5 March 2015

Annex:

Representations or Objections on the Proposed Penalty

Introduction

1.1 The Authority received four representations or objections in response to its proposed penalty. The points made by the respondents can be grouped into four areas:

- The level of proposed penalty was too low (see paragraphs 1.3 to 1.6)
- The proposed Penalty Notice lacked transparency (see paragraphs 1.7 to 1.9)
- Points in relation to consumer redress (see paragraphs 1.10 to 1.15)
- Other matters (see paragraphs 1.15 to 1.17)

1.2 The Authority has considered carefully all of the representations or objections, and its responses in respect of these four areas are set out below.

The level of proposed penalty was too low

1.3 Four respondents submitted that the level of proposed penalty was or might be too low. It was contended that, in assessing the extent to which ScottishPower may have made a financial gain, the Authority should have compared ScottishPower's expenditure on CESP with the market rates for CESP measures prevailing in the second half of 2012. A number of respondents noted the particularly high market rates (when compared over the whole of CESP) at the end of 2012 referring the Authority to DECC's evaluation report.¹⁶ One respondent questioned whether the level of penalty sent a clear enough signal to all parties about the importance of complying on time and in full for future obligations. Some respondents questioned the statement in the proposed penalty notice that, *"the aggregate of the proposed penalty and the proposed amount of consumer redress is larger than the detriment suffered by consumers and the gain made by ScottishPower."*

1.4 The Authority's judgement is that this statement is correct and that the level of penalty for ScottishPower is reasonable in all of the circumstances. In assessing any financial gain made by ScottishPower, the Authority has considered the particular facts and circumstances of ScottishPower's compliance strategy.

1.5 Ultimately, the assessment of financial gain is by necessity a judgment taking into account a number of factors. In coming to its view that ScottishPower made a financial gain (see paragraphs 5.7-5.9) the Authority considered the suitability of a range of possible compliance scenarios ScottishPower could have adopted in order to have met its target on time, some with higher costs as has been suggested by some of the respondents, as well as some with significantly lower costs (as would

¹⁶ See footnote 17 (paragraph 6.35).

have been the case, for example, by spreading delivery costs more evenly over the whole CESP period, or utilising different approaches to compliance). In reaching its decision that ScottishPower is likely to have made some financial gain, the Authority was sensitive to the potential risk of incentivising inefficient compliance strategies, which may not be in the best interests of consumers.

- 1.6 In relation to the point about sending a clear signal about the importance of compliance, the Authority is satisfied that the level of penalty is reasonable in all the circumstances of the case and addresses the seriousness of the contravention.

The proposed penalty notice lacked transparency

- 1.7 A number of respondents submitted that the proposed penalty notice needed a greater level of detail in order to enable respondents to comment meaningfully on the level of penalty and/or consider whether ScottishPower gained an unfair advantage from not complying.
- 1.8 The decision on financial penalty (and the prior proposed decision on financial penalty) has been taken by the Authority having regard to its Penalties Policy. This includes that the assessment of the appropriate level of penalty should be taken having regard to a number of factors (rather than as an arithmetical calculation). The Authority is satisfied that the level of detail in this Penalty Notice (and that previously in the proposed Penalty Notice) is fair, consistent with the Penalties Policy and follows the statutory requirements¹⁷, namely that the Authority states in its Notice:
- (a) that it proposes to impose/has imposed a penalty and the amount;
 - (b) the relevant condition breached;
 - (c) the acts or omissions which in the Authority's opinion constitute the contravention or failure and the other facts which justify the imposition of a penalty and the amount proposed for such penalty; and
 - (d) the time period within which representations or objections may be made with respect to the proposed penalty/the penalty is required to be paid.
- 1.9 Further, the Authority believes that the level of detail in the proposed penalty notice was sufficient for external stakeholders to comment meaningfully.

Points in relation to consumer redress

- 1.10 A number of respondents made a number of points in relation to the consumer redress ScottishPower is proposing. These points are considered below.

¹⁷ In section 30A Gas Act 1986 and section 27A Electricity Act 1989.

- 1.11 Several respondents submitted representations requesting that they should receive redress monies. The Authority considered that it was for ScottishPower to choose its redress recipients subject to the funding meeting the objectives referred to in paragraph 1.2 of the main body of this Notice.
- 1.12 As a preliminary matter, the Authority's role is to consider whether the penalty is reasonable in all the circumstances, which includes taking into account any consumer redress paid or to be paid. In this case, the Authority is satisfied that the aggregate of the penalty and consumer redress is reasonable.
- 1.13 One respondent said that redress should be "hard" energy efficiency measures (that is, solid wall insulation and other energy efficiency measures as opposed to more general advice and support). Wherever possible the Authority will wish to see consumer redress aligned to the original harm. Accordingly, the Authority has required that any consumer redress pursue the objectives referred to in paragraph 1.2 of this Penalty Notice. This is consistent with the policy objectives of CESP. At the same time, the Authority requires that any consumer redress must not adversely interfere with the delivery of other energy efficiency schemes such as the Energy Companies Obligation (ECO), or create an unreasonable administrative burden for Ofgem.
- 1.14 The Authority is satisfied that ScottishPower's proposal is within the scope of this mandate. The Authority notes that the SPEPT will be able to fund suitable projects involving "hard" energy efficiency measures. Further, the Authority notes that ScottishPower undertook mitigation action in excess of the volume of the shortfall associated with its breach meaning that the original CESP objectives have been met and additional "hard measures" have been installed in any event.
- 1.15 A number of respondents considered it inappropriate for ScottishPower to make consumer redress through the SPEPT. However, the Authority notes that ScottishPower has given a senior Board-level assurance that the redress payment will not displace existing charitable funding, and that the SPEPT will be open to suitable applications from organisations matching at least one of the objectives set out in paragraph 1.2 above. Further, the Authority would be concerned if ScottishPower sought to derive any inappropriate publicity benefits from the payment to the SPEPT. The Authority notes from due diligence conducted by Ofgem that the SPEPT has a satisfactory track record and that other safeguards will be put in place to protect consumers' interests as part of the redress package.

Other matters

1.16 One respondent raised the following additional points:

- (a) It objected to the Authority's conclusion that a mitigating factor should apply for the design and administration of CESP. It noted that the design of the scheme was equally complex for all OPs, and that costs were incurred by the compliant OPs because of this. The respondent considered the inclusion of this mitigating factor was "unduly lenient" towards the non-compliant OPs, and asked what effect this factor had on the final penalty levels;
- (b) It commented that with regard to the failure of non-compliant OPs to purchase excess carbon in auctions at the end of the CESP compliance period, the extent to which this was factored into the penalty amounts of those OPs was unclear;
- (c) It raised concerns that a non-compliant supplier should not be able to receive any credit for CESP mitigation which had also been claimed by the supplier under the ECO; and
- (d) It stated that any redress proposals should not distort the ECO and/or Green Deal in such a way that would cause detriment to the compliant CERT and CESP OPs.

1.17 Each of these points is taken in turn below:

- (a) Regarding the mitigating factor concerning the design and administration of CESP; the Authority considered this to be appropriate because whilst it noted that all of the compliant OPs were able to overcome these challenges, the fact still remained that CESP was a complex scheme. This was well documented by DECC's evaluation report, and also supported by evidence gathered during the investigation process. Therefore, the particular challenges that were posed by the design and administration of the CESP were relevant facts for the purposes of determining the level of penalty. However, the Authority wishes to clarify that this was a small mitigating factor in its determination of the level of penalty and further, in the Authority's judgement the overall level of financial penalty is such that it would have been better for ScottishPower for it to have met its obligations on time.
- (b) Regarding the auctions of surplus carbon, this factor was one amongst a number of factors which led to the Authority's decision in each case on whether the aggravating factor relating to the involvement of senior management applied or not (see paragraphs 5.12 to 5.20).
- (c) Regarding the possibility of a non-compliant supplier submitting the same activity as both substantive ECO compliance and CESP mitigation, Ofgem has been unable to identify any duplicate measures based on its records.

- (d) Regarding redress activities causing possible impacts on the ECO and Green Deal programmes, the Authority considers that the proposed redress activities are not on a scale that would cause any significant distortions to these markets.

Gas and Electricity Markets Authority

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