

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 SSE plc and related entities with Article 14 of the Electricity and Gas (Community Energy Saving 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 the following SSE companies (collectively, “SSE”) on the basis that any or all of these companies will pay in aggregate £1.75 million in consumer redress (less the £1 financial penalties):

- (a) SSE Energy Supply Limited;
- (b) Southern Electric Gas Ltd;
- (c) SSEPG (Operations) Ltd;
- (d) Medway Power Ltd;
- (e) Keadby Generation Ltd;
- (f) Greater Gabbard Offshore Windfarm Ltd;
- (g) Uskmouth Power Company Ltd;
- (h) Clyde Wind Farm (Scotland) Ltd; and
- (i) Griffin Wind Farm Ltd.

The payment of consumer redress will consist of: £849,997 to the Foundations Independent Living Trust (FILT); £749,997 to Energy Action Scotland; and £149,997 to the Citizen’s Advice Bureau for use in Wales, with the aim of pursuing any or all of the following objectives¹ for vulnerable consumers: promotion of carbon emissions reduction in domestic homes; promotion of energy efficiency in domestic homes; and fuel poverty. The consumer redress shall be paid at a date to be agreed with the Authority.

1.2 This follows an investigation by Ofgem into SSE’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 Notice. These representations or objections are considered below (see annex).

¹ 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

- 1.3 Under Article 14(1) of the CESP Order, generators and suppliers had to achieve their carbon emissions reduction obligation by promoting qualifying actions to domestic energy users in low income areas.
- 1.4 The investigation arose following the submission of the final CESP report to the Secretary of State on 30 April 2013², which provided details of the obligated parties' ("OP") achievements of the targets and obligations under the CESP programme, whose time for compliance expired on 31 December 2012.³ The report sets out that SSE did not comply with the targets set out in its CESP obligation.
- 1.5 The Authority noted that SSE had an obligation to promote carbon savings equivalent to 2,769,125 tonnes ("tCO₂") . SSE ultimately delivered 90.9% of its obligation leaving a shortfall of 252,168 tonnes tCO₂ or 9.1% of its obligation. SSE accepts that it breached Article 14(1) of the CESP Order.
- 1.6 The Authority also noted that by May 2013, SSE undertook mitigation action equivalent to the volume of its shortfall associated with not achieving the carbon reduction target and has had regard to this in setting the level of penalty.
- 1.7 The Authority has decided that SSE breached Article 14(1) of the CESP Order through having failed to achieve its carbon emissions reduction obligations in 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 SSE 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 £9 collectively on each of SSE in respect of its failure to comply with Article 14(1) of the CESP Order on the basis that SSE will pay £1.75 million (less the £1 financial penalties) in consumer redress at a date to be agreed with the Authority but which shall not in any event be later than 14 days from the date of this Notice. In deciding on the level of penalty, which the Authority considers reasonable in all circumstances, it took into account the following:
- (a) SSE'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 SSE was 252,168 tCO₂ or 9.1% of its obligation;

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 suppliers ended on 31 December 2012.

- (c) SSE has made a financial gain from the breach;
- (d) SSE undertook mitigation action equivalent to the volume of the shortfall associated with its breach;
- (e) the level of consumer detriment is low;
- (f) SSE has one aggravating factor (see paragraphs 5.13-5.20);
- (g) SSE has several mitigating factors that apply or partially apply (see paragraphs 5.25–5.26 and 5.29–5.37); and
- (h) SSE has agreed to settle this investigation;
- (i) SSE has agreed to pay an aggregate of £1.75 million in consumer redress (less the £1 financial penalties) as set out in paragraph 1.1.

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

1.10 The penalty 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 the energy companies to install particular measures which had hitherto not been the focus of energy efficiency schemes, and to undertake as much activity as possible in each house treated and in each area targeted, via a number of incentives. These incentives included individual measure uplifts to incentivise particular measures such as Solid Wall Insulation; whole house bonuses where more than one energy efficiency measure was installed in a property; and area bonuses when at least 25% 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 section 30A Gas Act 1986.⁴

- 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 programme, on behalf of the Authority.

SSE’s Obligation under CESP

- 2.6 SSE had an obligation of 2,769,125 tCO₂. Each of the individual licensees, SSE Energy Supply Limited, Southern Electric Gas Ltd, SSEPG (Operations) Ltd, Medway Power Ltd, Keadby Generation Ltd, Greater Gabbard Offshore Windfarm Ltd, Uskmouth Power Company Ltd, Clyde Wind Farm (Scotland) Ltd and Griffin Wind Farm Ltd failed to meet their individual obligations. By 31 December 2012, SSE as a whole had achieved only 2,516,957 tCO₂ of its obligation and was left with a shortfall of 252,168 tCO₂.

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 1.3 above), Ofgem launched an investigation into SSE. In particular, Ofgem investigated whether SSE had met its carbon emissions reduction target set out under the CESP Order.

⁴ Please see section 41A(7A)(a) Electricity Act 1989, section 33BC(7A)(a) Gas Act 1986 and Article 27(1) of the CESP Order.

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 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.

3 The Authority's decision on breach

- 3.1 Following an investigation by Ofgem into SSE's compliance with the CESP Order, the Authority is satisfied that SSE 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 and section 30A Gas Act 1986 (the Authority's power to impose a financial penalty)⁷. Article 14(1) mandated that SSE achieve its carbon emissions reduction obligations by promoting qualifying actions to domestic energy users in low income areas.
- 3.3 SSE failed to achieve, by 31 December 2012, its carbon emissions reduction obligation mandated under Article 14(1) of the CESP Order. It delivered 90.9% of its obligation and had a shortfall of 252,168 tCO₂. SSE's shortfall as a percentage of its obligation (9.1%) was smaller 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. SSE 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/or 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.

⁷ See footnote 4

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

- 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 were outside the control of SSE. It also took full account of the representations made to it by SSE.

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 SSE'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 SSE was installing energy efficiency measures as mitigation action from January 2013, it took until May¹⁰ 2013 (in contrast to the 31 December 2012 deadline for compliance) to deliver all of the expected energy efficiency measures, meaning energy savings for some consumers were delayed.
- 4.5 This delay had a material impact on consumers, who experienced a particularly cold winter during the months of January to March 2013, with average temperatures below the long-term average from 1981 to 2010.¹¹
- 4.6 During that cold winter, domestic consumers used more gas than during either of the previous two winters.¹²
- 4.7 Had SSE met its target by 31 December 2012, it estimated around 2,100¹³ extra households would have benefited from energy efficiency measures under CESP on time. These households were more likely to have been living on a low income than the average household in Great Britain, because CESP was targeted at low income areas.
- 4.8 Further, the Authority considered whether non-compliance damaged the interest of other market participants who complied with CESP. The Authority considered the evidence to be inconclusive but notes that the case does not turn on this point.

appropriate by promoting competition, and including their interests in the reduction of greenhouse gas emissions and the ensuring of the security of energy supply

¹⁰ A small number of works were completed after 30 April before SSE had completed mitigation action equivalent to the volume of the shortfall associated with its breach.

¹¹ <http://www.metoffice.gov.uk/climate/uk/summaries/anomalygraphs>. The Met Office publishes data on 30-year averaging periods, for 1961-1990, 1971-2000 and 1981-2010. Thus, 1981-2010 is the most recent data-set.

¹² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/266718/et4_1.xls

¹³ This figure is based on the number of properties treated by SSE after 31 December 2012.

4.9 The Authority also considered the extent to which harm caused to consumers will have been offset by over-delivery of mitigation activities. We consider this further in paragraphs 5.35 – 5.37 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 was 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 Obligations (“ECO”).

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

If the contravention is trivial in nature

4.11 The Authority did not consider that SSE’s failure to meet its CESP obligation was trivial. The Authority noted that SSE’s shortfall as at 31 December 2012 was 252,168 tCO₂, which was equivalent to installing energy efficiency measures in around 2,100 households. Furthermore, SSE’s shortfall was larger than the entire CESP obligation placed on one of the OP’s.

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

4.12 There is nothing in the Authority’s principal objective and duties as set out in section 3A Electricity Act 1989 and section 4AA Gas Act 1986 that precludes the imposition of a penalty in this case.

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

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 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 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 license 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 £1.75 million (minus the £1 financial penalty to each of the 9 licensees) 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 SSE'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 SSE incurred a shortfall of 252,168 tCO₂ (see paragraph 1.5 above). Unmitigated, that shortfall would have been detrimental to the social policy objectives underlying the CESP obligation, which were to ensure consumers in low income areas in Great Britain benefit from multiple measures to make their homes more energy efficient, reducing their energy bills and increasing thermal comfort. The Authority also 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 SSE had completed its CESP mitigation activities in May 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 occurred at 31 December 2012, although the effects of the breach contravention persisted for approximately five months after that date until SSE’s mitigation activities were complete.

The gain (financial or otherwise) made by the licensee

- 5.7 The Authority considered whether or not SSE may have made a financial gain through not meeting its CESP obligation by the statutory deadline. It considered this by reference to the specific facts surrounding SSE’s compliance strategy and costs that SSE might have been expected to incur to achieve compliance.
- 5.8 The Authority noted that SSE’s mitigation carbon costs were lower than the average cost per tCO₂ secured in the final year of CESP by all OPs. As a consequence, the Authority considers that SSE is likely to have made a gain by delivering its CESP obligation during the mitigation period (discussed at paragraphs 5.15 to 5.16 below).
- 5.9 The Authority also considered that SSE gained 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, SSE would have made a gain, on a time value of money basis, by being able to put deferred expenditure to alternative use.
- 5.10 The Authority noted that SSE spent additional money through its over-delivery of CESP measures which is discussed at paragraph 5.35 below.

Factors tending to increase the level of penalty

Repeated contravention or failure

- 5.11 SSE 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

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

Involvement of senior management in any contravention or failure

5.13 From a review of the evidence, it appeared that SSE's senior management became aware of the real risks to compliance during the first quarter of 2011. Further evidence suggested that senior management, rather than positively being involved in the contravention in the sense of having actively determined, instructed or encouraged it, contributed by failing to recommend appropriate steps. An example of this can be highlighted in the board reports produced by SSE in response to Ofgem's first information request.

5.14 Extracts from this report clearly highlighted senior management's failure to recommend an increase in the budget allocation to CESP following a loss of one of SSE's schemes to another OP. Additionally, this failure occurred after the inadequate price of carbon offered for that particular scheme had been brought to senior management's attention.

5.15 Evidence showed that in late 2011, SSE senior management were aware that full delivery and installation of the contracted measures required to meet SSE's obligation would not be complete until June 2013, and failed to take steps to address this.

5.16 SSE submitted its justification of this action as a way of exercising prudent control of costs whilst endeavouring to meet its obligation. The Authority agrees that companies should seek to manage their costs effectively. At the same time, the Authority considered that sufficient priority must be given to complying with legal obligations.

5.17 The evidence showed that SSE later increased its budget gradually in response to the increases in market rates for CESP schemes. However, due to the piecemeal nature of its subsequent budget increases, and a willingness to allow delivery to be delayed into 2013, SSE failed ultimately to ensure that delivery of its CESP obligation occurred on time.

5.18 Towards the end of 2012, SSE declined opportunities to buy CESP carbon from other OPs that had surplus carbon to sell. By this time, SSE had contracted to the full delivery of its obligation and was unwilling to make the additional investment.

5.19 Given the oversight of CESP provided by SSE's senior management (see paragraph 5.21), and given the factors listed above, the Authority

considers that senior management had knowledge of and/or provided input into some of the decisions which led to SSE's non-compliance.

5.20 Accordingly, the Authority considered that this aggravating factor applied.

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

5.21 The Authority considered there was evidence that SSE had some internal mechanisms or procedures in place intended to prevent contravention, including:

- (a) A record of risk registers to monitor risks to compliance. SSE did not produce a full set of risk registers to capture the entire compliance period; however, the process of mitigating such risks was captured through the management of SSE's CESP Plan which was updated throughout the compliance period.
- (b) A CESP Panel set up initially to approve schemes and later a process of monthly reporting to the Management Board on CESP progress.

5.22 Taking the above into account, the Authority did not consider that there was an absence of any evidence of internal mechanisms or procedures intended to prevent contravention or failure.

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

5.23 The investigation found no evidence of any attempt to conceal the contravention from Ofgem. 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

5.24 The Authority considered there is some evidence that SSE 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

- 5.25 As noted in Ofgem's Open Letter of September 2012, mitigation action is not a substitute for compliance with the carbon emission reduction obligations and OP should not be able to benefit from non-compliance.

However in considering mitigation actions, Ofgem said that "*we will give most weight to CERT/CESP measures that are delivered shortly after 31 December 2012*". Ofgem later stated in its January 2013 Open Letter that 30 April 2013 would be a key date for assessing the mitigation actions taken by the parties.

- 5.26 The Authority noted that SSE undertook mitigation action equivalent to the volume of its shortfall associated with not achieving the carbon reduction target. The vast majority of this mitigation was completed by the "key date" of 30 April. The Authority also notes that SSE delivered more than its shortfall as mitigation (see paragraphs 5.35 – 5.37 below). In light of this, the Authority considered that SSE 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

- 5.27 SSE has made representations as to the non-foreseeability of the cost of CESP compliance due to the low estimations set out in DECC's Impact Assessment. The Authority notes that OPs had over three years to secure compliance with the CESP scheme and has seen no evidence to suggest that SSE's 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

- 5.28 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 does not apply.

Co-operation with Ofgem's investigation

- 5.29 SSE has responded to Ofgem's Information Requests on time and complied with Ofgem's investigation process. However, the Authority

considered 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.¹⁴

5.30 In this case, SSE 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

5.31 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.

Design and administration of the CESP scheme

5.32 The Authority considered the extent to which the design and administration of CESP may have adversely affected SSE's ability to deliver CESP by 31 December 2012. The Authority considered the evidence including a report commissioned by DECC, Evaluation of the Carbon Emissions Reduction Target and Community Energy Saving Programme¹⁵.

5.33 The Authority considered that CESP was a complex programme. The complexity stemmed from the design of the 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 noted there were a number of issues which impacted on 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.

¹⁴ 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>

¹⁵ <https://www.gov.uk/government/publications/evaluation-of-the-carbon-emissions-reduction-target-and-community-energy-saving-programme>

5.34 The Authority considered that these factors were not insurmountable as other OPs secured compliance. Further, in the case of SSE 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

5.35 SSE 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 SSE provides enduring benefits for those consumers who had received these measures.

5.36 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.

5.37 The Authority balanced both of these points and considered that a mitigating factor should apply.

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 on SSE £1 Penalties on the basis that SSE will also pay £1.75 million (less the £1 financial penalties) in consumer redress to the FILT, Energy Action Scotland and Citizens Advice Bureau at a date to be agreed with the Authority but which shall not in any event be later than [14 days] from the date of this Notice . The Authority considered this penalty to be reasonable in all the circumstances of the case. In reaching this decision the Authority taken into account the following:

- (a) SSE'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 SSE;
- (c) SSE has made a financial gain from the breach;
- (d) SSE undertook mitigation action equivalent to the volume of the shortfall associated with its breach;
- (e) the level of consumer detriment was low;
- (f) SSE has one aggravating factor (see paragraphs 5.13-5.20);
- (g) SSE has several mitigating factors that apply or partially apply (see paragraphs 5.25–5.26 and 5.29–5.37); and
- (h) SSE has agreed to settle this investigation;

- (i) SSE has agreed to pay an aggregate of £1.75 million in consumer redress (less the £1 financial penalties) as set out in paragraph 1.1.

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

6.2 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

Introductions

- 1.1 The Authority received eight representations or objections in response to its proposed penalty. The points made by the respondents can be grouped into four areas:
- The level of the 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 1.14)
 - Other matters (see paragraphs 1.15 to 1.16)
- 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 Five respondents submitted that the level of proposed penalty was too low. They contended that, in assessing the extent to which SSE may have made a financial gain, the Authority should have compared SSE'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 the 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 penalties and consumer redress is larger than the detriment suffered by consumers and the gain made by SSE."*
- 1.4 The Authority's judgement is that statement is correct and that the level of penalty for SSE is reasonable in all of the circumstances. In assessing any financial gain made by SSE, the Authority has considered the particular facts and circumstances of SSE's compliance strategy.
- 1.5 Ultimately, the assessment of financial gain is by necessity a judgement taking into account a number of factors. In coming to its view that SSE made a financial gain (see paragraphs 6.7-6.8) the Authority considered the suitability of a range of possible compliance scenarios SSE could have

¹⁶ See footnote 15 (paragraph 5.32)

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 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 SSE made a 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 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 SSE 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 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:
- (i) that it proposes to impose/has imposed a penalty and the amount;
 - (ii) the relevant condition breached;
 - (iii) the acts or omissions which in the Authority's opinion constitute the contravention of failure and the other facts which justify the imposition of a penalty and the amount proposed for such penalty; and
 - (iv) 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 several points in relation to the consumer redress SSE is proposing. These points are considered below.

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

- 1.11 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.
- 1.12 Several respondents submitted representations requesting that they should receive redress monies. The Authority considered that it was for SSE to choose its redress recipients subject to the funding meeting the objectives referred to in paragraph 1.1.
- 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 1.1 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 SSE's proposal is within the scope of this mandate. The Authority notes that the FILT, Energy Action Scotland and Citizens Advice Bureau will be able to fund suitable projects. Further, the Authority notes that SSE 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 .

Other matters

- 1.15 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 believed 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.

1.16 Each of these points are 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 SSE 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 paragraph 5.18)
- (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

5 March 2015