

Notice of Decision to impose a financial penalty pursuant to 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 GDF SUEZ/IPM 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 on Saltend Cogeneration Company Limited and Deeside Power (UK) Limited following an investigation by Ofgem into the failure to meet obligations under the Electricity and Gas (Carbon Emissions and Community Energy Saving) Order 2009 (“CESP Order”) by Saltend Cogeneration Company Limited, Deeside Power (UK) Limited and Rugeley Power Generation Limited (collectively known as “GDF SUEZ/IPM”¹). This consisted of a financial penalty of £1 on each of Saltend Cogeneration Company Limited and Deeside Power (UK) Limited². This decision has taken into account a payment of £450,000 (less the £2 financial penalty) made by GDF SUEZ/IPM on 12 January 2015, by way of consumer redress.
- 1.2 The payment of consumer redress³ was made to Age UK for programmes which pursue any or all of the following objectives: promotion of carbon emissions reduction in domestic homes; promotion of energy efficiency in domestic homes; and the alleviation of fuel poverty.
- 1.3 This follows an investigation by Ofgem into GDF SUEZ/IPM’s failure to meet its obligations under Article 14(1) of the CESP Order and consideration by the Authority of representations or objections received on its proposed penalty. These representations or objections are considered below (see the Annex to this document). 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.

¹The three licensees in question were the subsidiary companies for International Power and Mitsui via a 75:25 joint venture (“IPM”). Following the completion of the acquisition of International Power by GDF SUEZ in June 2012, International Power was rebranded as GDF SUEZ Energy International.

²Rugeley Power Generation Limited is now a dormant company and consequently no penalty has been imposed upon it.

³ The Authority required that such 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 on Ofgem.

- 1.4 The investigation arose following the submission of the final CESP report to the Secretary of State on 30 April 2013⁴, which provided details of the obligated parties' ("OP") achievements of the targets and obligations under CESP, which finished on 31 December 2012.⁵ The report sets out that GDF SUEZ/IPM did not comply with the targets set out in its CESP obligation. GDF SUEZ/IPM accepts that it breached article 14(1) of the CESP Order.
- 1.5 The Authority noted that GDF SUEZ/IPM initially had an obligation to promote carbon savings equivalent to 852,080 tonnes ("tCO₂"). As was permitted under Article 21 of the CESP Order, in 2010 GDF SUEZ/IPM traded away 562,295tCO₂ of its obligation to third party OPs for them to deliver and was left with a reduced obligation of 289,785tCO₂ for GDF SUEZ/IPM to deliver by 31 December 2012. Therefore, the finding of breach of the CESP Order relates to this reduced obligation of 289,785tCO₂. GDF SUEZ/IPM ultimately delivered 38.6% of its reduced obligation leaving a shortfall of 177,928tCO₂ at 31 December 2012.
- 1.6 The Authority also noted that GDF SUEZ/IPM undertook mitigation action, slightly exceeding the volume of its shortfall associated with not achieving the carbon reduction target, by March 2013 and had regard to this in setting the level of penalty.
- 1.7 The Authority has decided that that GDF SUEZ/IPM 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 appropriate to impose a financial penalty on Saltend Cogeneration Company Limited and Deeside Power (UK) Limited for the contravention of Article 14(1) of the CESP Order, which occurred on 31 December 2012.
- 1.9 In the circumstances, the Authority has decided to impose a penalty of £1 on each of Saltend Cogeneration Company Limited and Deeside Power (UK) Limited in respect of the failure to comply with Article 14(1) of the CESP Order. This has taken into account a payment by GDF SUEZ/IPM of £450,000 (less the £2 financial penalty) in consumer redress to Age UK made on 12 January 2015. In deciding on the level of the penalty, which the Authority considered reasonable in all the circumstances, it took into account the following:
 - (a) GDF SUEZ/IPM's failure to achieve the CESP target was a serious contravention of a domestic energy efficiency programme;

⁴ <https://www.ofgem.gov.uk/ofgem-publications/58763/cesp-final-report-2013final-300413.pdf>

⁵ Article 8(3) of the CESP Order provided that the obligation period for all generators ended on 31 December 2012.

- (b) The extent of the initial shortfall in delivery of carbon reduction measures by GDF SUEZ/IPM was 177,928tCO₂ or 61.4% of its reduced obligation following trades with other OPs;
- (c) GDF SUEZ/IPM has not made any financial gain from the breach;
- (d) GDF SUEZ/IPM undertook mitigation action slightly exceeding the volume of the shortfall associated with its breach;
- (e) The case does not include any aggravating factors;
- (f) The case has several mitigating factors that apply;
 - Action by the licensee to remedy the contravention or failure (see paragraphs 5.28-5.29);
 - Co-operation with Ofgem's investigation (see paragraph 5.32); and
 - Overdelivery of CESP mitigation (see paragraphs 5.38-5.40).

The case also has mitigating factors that partially apply

- Steps taken to secure compliance either specifically or by maintaining an appropriate compliance policy, with suitable management supervision (see paragraphs 5.20-5.27); and
 - Design and administration of CESP scheme and the ability of GDF SUEZ/IPM to deliver it (see paragraphs 5.34-5.37).
- (g) GDF SUEZ/IPM has agreed to settle this investigation;
 - (h) GDF SUEZ/IPM has paid 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 the consumer redress paid is a lower figure than would have been the case if GDF SUEZ/IPM had not taken the steps as set out in paragraphs (d) and (g) above, and the aggregate of the penalty and the amount of consumer redress paid is larger than the detriment suffered by consumers.

1.10 The penalty, totalling £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 the energy companies to install particular measures which had hitherto not been the focus of energy efficiency schemes, and to undertake as much activity as possible in each house treated and in each area targeted, via a number of incentives. These incentives included individual measure uplifts to incentivise particular measures such as Solid Wall Insulation; whole house bonuses

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

- 2.3. 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 sections 27A Electricity Act 1989 and/or section 30A Gas Act 1986.⁶
- 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.

GDF SUEZ/IPM's Obligation under CESP

- 2.6. In 2009, at the start of CESP, GDF SUEZ and IPM were separately obligated. In July 2011, GDF SUEZ acquired International Power plc. After the acquisition, GDF SUEZ/IPM had a combined obligation of 852,080tCO₂. Prior to the acquisition, in 2010 both companies traded a combined total of 562,295tCO₂ to two OPs (equivalent to 66% of the combined obligation).
- 2.7. As to the remaining 289,785tCO₂ to be delivered by 31 December 2012, GDF SUEZ/IPM delivered 38.6% of its obligation. The GDF SUEZ/IPM licence-holding subsidiaries, Saltend Cogeneration Company Limited, Deeside Power Limited and Rugeley Power Generation Limited, failed to meet their individual obligations, which shortfall comprised the remaining 61.4% of the reduced GDF SUEZ/IPM group carbon emissions reduction target.

Investigation

- 2.8. 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

⁶ Please see section 41A(7A)(a) Electricity Act 1989, section 33BC(7A)(a) Gas Act 1986 and Article 27 of the CESP Order.

2012⁷, 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.⁸

- 2.9. Following the submission of the final CESP report to the Secretary of State on 30 April 2013 (see paragraph 1.4 above), Ofgem launched an investigation into GDF SUEZ/IPM. In particular, Ofgem investigated whether GDF SUEZ/IPM had met its carbon emissions reduction target set out under the CESP Order.

3. The Authority's decision on breach

- 3.1. Following an investigation by Ofgem into GDF SUEZ/IPM's compliance with the CESP Order, the Authority is satisfied that GDF SUEZ/IPM breached Article 14(1) of the CESP Order.
- 3.2. Article 14(1) CESP Order is a relevant requirement for the purposes of section 27A Electricity Act 1989 (the Authority's power to impose a financial penalty).⁹ Article 14(1) mandated that GDF SUEZ/IPM licensees achieve their carbon emissions reduction obligations by promoting qualifying actions to domestic energy users in low income areas.
- 3.3. GDF SUEZ/IPM failed to meet by 31 December 2012 its carbon emissions reduction obligation mandated under Article 14(1) of the CESP Order. As a group, it delivered 111,857tCO₂ and had a shortfall of 177,928tCO₂ against its reduced obligation of 289,785tCO₂. The particular GDF SUEZ/IPM licensees which failed to meet their obligations were Rugeley Power Generation Limited, Saltend Cogeneration Company Limited and Deeside Power Limited.
- 3.4. This failure is evidenced by the Authority's report to the Secretary of State in April 2013 in which the Authority set out the levels of carbon emissions reductions achieved by OPs and whether they had met their obligations. GDF SUEZ/IPM does not dispute that the breach occurred.

⁷ <https://www.ofgem.gov.uk/ofgem-publications/58765/open-letter-cert-cesp-210912.pdf>

⁸ 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.

⁹ Please see footnote 4.

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

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

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

- 4.1. The Authority considered whether a financial penalty is appropriate in accordance with the requirements of the Electricity Act 1989 and having regard to its published Statement of Policy with respect to Financial Penalties (October 2003) ("the Penalties Policy")¹⁰.
- 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 objective¹¹, 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 GDF SUEZ/IPM. It also took full account of the representations made to it by GDF SUEZ/IPM, including that as to the shortfall in delivery by a key contractor.

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

Whether the contravention or the failure has damaged the interests of consumers or other market participants

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

¹⁰<https://www.ofgem.gov.uk/ofgem-publications/74207/utilities-act-statement-policy-respect-financial-penalties.pdf>

¹¹ The Electricity Act 1989 (section 3A) and the Gas Act 1986 (section 4AA) set out details of the Authority's principal objective as being the protection of the interests of existing and future consumers, wherever appropriate by promoting competition, and including their interests in the reduction of greenhouse gas emissions and the ensuring of the security of energy supply.

- 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 2010.¹²
- 4.6. During that cold winter, domestic consumers used more gas than during either of the previous two winters.¹³
- 4.7. Had GDF SUEZ/IPM met its target by 31 December 2012, it estimated that around 990 households would have benefited from energy efficiency measures under CESP on time. These households were more likely to have been living on a low income than the average household in Great Britain, because CESP was targeted at low income areas.
- 4.8. The Authority also considered the extent to which harm caused to consumers will have been offset by over-delivery of mitigation activities. We consider this further in paragraphs 5.38-5.40 below.
- 4.9. Further, the Authority considered whether non-compliance has 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.

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 Obligations (“ECO”).

¹² <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.

¹³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/266718/et4_1.xls

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 GDF SUEZ/IPM's failure to meet its CESP obligation was trivial. The Authority noted that GDF SUEZ/IPM's shortfall as at 31 December 2012 was 177,928tCO₂, which was equivalent to installing energy efficiency measures in around 990 households.

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

- 4.12. The Authority did not consider that its principal objective and duties as set out in section 3A of the Electricity Act 1989 and section 4AA of the Gas Act 1986 preclude the imposition of a penalty in this case.
- 4.13. In reaching this conclusion, the Authority had regard to, amongst other factors, GDF SUEZ/IPM's ability to finance its generation activities referred to in section 3A(2)(b) Electricity Act 1989 and section 4AA(2)(b) Gas Act 1986 and the need to contribute to the achievement of sustainable development referred to in section 3A(2)(c) Electricity Act 1989 and section 4AA(2)(c) Gas Act 1986.
- 4.14. In failing to comply with the mandatory targets of the CESP Order, the Authority considered that GDF SUEZ/IPM failed to contribute to the achievement of sustainable development in the manner expected, and required, of it.

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

- 4.15. The Authority 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

- 4.16. 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, 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 proposed penalty on Saltend Cogeneration Company Limited and Deeside Power (UK) Limited falls within the maximum statutory limit. Rugeley Power Generation Limited is a dormant company and consequently no penalty had been imposed upon it.
- 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 £450,000 (less the £2 financial penalty) and the 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 GDF SUEZ/IPM'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. GDF SUEZ/IPM incurred a shortfall of 177,928tCO₂ (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.¹⁴

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

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

¹⁴ As is acknowledged by the Authority in paragraphs 5.28-5.29, GDF SUEZ/IPM undertook prompt mitigation slightly exceeding the volume of shortfall associated with not achieving the carbon saving reduction target.

The duration of the contravention or failure

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

The gain (financial or otherwise) made by the licensee

- 5.7. The Authority considered whether or not GDF SUEZ/IPM made a financial gain through not meeting its CESP obligation by the statutory deadline.
- 5.8. The Authority considered that GDF SUEZ/IPM had benefited on a time value of money basis, to a small extent, as a result of the delay to a significant proportion of its CESP expenditure into the mitigation period. By not investing in CESP delivery in a manner that would achieve compliance, GDF SUEZ/IPM would have been able to put the deferred expenditure to alternative use, albeit for a relatively short period given GDF SUEZ/IPM’s prompt action to mitigate the volume of its shortfall associated with non-compliance.
- 5.9. However, the Authority noted that GDF SUEZ/IPM’s mitigation carbon costs were significantly higher than the average cost per tCO₂ secured in the final year of CESP by all OPs.
- 5.10. The Authority balanced the gain of deferring CESP expenditure until the mitigation period against the high cost that GDF SUEZ/IPM incurred in delivering its mitigation in 2013. The Authority considered that overall GDF SUEZ/IPM has not made a financial gain.

Factors tending to increase the level of penalty

Repeated contravention or failure

- 5.11. GDF SUEZ/IPM 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 three months. The Authority did not consider that this aggravating factor applies.

The involvement of senior management in any contravention or failure

- 5.13. GDF SUEZ/IPM provided information to show that throughout the compliance period, there was an internal procedure and mechanisms which were capable of achieving compliance (see paragraph 5.17). This included a reporting structure for GDF SUEZ/IPM's CESP team to escalate CESP issues to Senior Management. After the merger between IPM Group and GDF SUEZ/IPM, i.e., as early as February 2011, this team included one of its UK Business Management Meeting members ("UKBMM") (equivalent to a board member). Review of the evidence shows that the UKBMM member was involved in the delivery of carbon emissions reduction obligations including day-to-day matters.
- 5.14. When CESP compliance became a major concern, GDF SUEZ/IPM's evidence also shows that its CESP team was reporting to the Regional CEO on a regular basis. Excerpts of emails indicate that there was an ongoing commitment by GDF SUEZ/IPM's senior management to secure compliance with CESP by the deadline and a credible plan in place to achieve that.
- 5.15. Specifically, the Authority noted that, when it became apparent to GDF SUEZ/IPM that there was a risk of non-compliance with the CESP obligation, GDF SUEZ/IPM entered into negotiations with third party delivery agents at a carbon price similar to the price GDF SUEZ/IPM paid to undertake mitigation actions, with the aim to deliver its entire outstanding carbon by December 2012. Involvement in these negotiations, which were expected to deliver the remaining carbon tonnage required, mean that GDF SUEZ/IPM did not pursue the option of a carbon auction taking place at the same time (see paragraph 1.14(b) of the Annex addressing representations and objections relating to the possibility of purchase via auction). Although the negotiation fell through, the Authority formed the view that the steps taken by GDF SUEZ/IPM during the compliance period were capable of securing compliance. Additionally the Authority noted that when GDF SUEZ/IPM later did enter into a contract with this particular supplier, in order to deliver its mitigation actions, the cost of such actions exceeded that which would have been payable for equivalent carbon tonnage via auction.
- 5.16. Taking the above into account, the Authority considered that GDF SUEZ/IPM's senior management took appropriate action to avoid or to seek to avoid the contravention. The Authority did not consider that this aggravating factor applies in this case.

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

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

- (a) Organograms of the Senior Management which had oversight of the CESP programme.
- (b) Diagrams showing how information about the companies' progress towards meeting the carbon emissions reduction obligation flowed to management and/or the Board. The existing reporting structure allowed the CESP team to escalate issues surrounding CESP to senior management.
- (c) The use of project management tools maintained by the GDF SUEZ/IPM where it referred to risk registers and risk assessments concerning CESP delivery. The use of project management tools indicated that there was some form of ongoing management maintained by GDF SUEZ/IPM.

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

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

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

5.20. 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.

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

- (a) In 2010 GDF SUEZ/IPM traded away 562,295tCO₂, which was equivalent to 66% of its total obligation; and
- (b) In March 2010 and May 2011, GDF SUEZ/IPM contracted with two third party service providers to deliver respectively up to

300,000tCO₂ and 70,000tCO₂ of its carbon emissions reduction obligation.

- 5.22. GDF SUEZ/IPM has provided evidence to show that its initial delivery strategy was capable of securing compliance with CESP. However, one of its contractors did not secure sufficient amounts of carbon reduction schemes and fell behind in meeting delivery targets. Ultimately it delivered only 30,481tCO₂ out of a target of up to 300,000tCO₂ for GDF SUEZ/IPM by 31 December 2012. GDF SUEZ/IPM attributed its non-compliance with CESP obligations to alleged under-performance by this contractor.
- 5.23. GDF SUEZ/IPM stated that in response to its concern about the contractor's performance, it sought to reduce its delivery risk by taking the following actions:
- (a) As early as February 2011, as an incentive to better performance, GDF SUEZ/IPM rescheduled the payments to the contractor falling behind in its delivery, so that payments would only be made in respect of invoices based on actual delivery of carbon reduction measures and GDF SUEZ/IPM, in addition, recovered some excess payments the contractor received in 2010; and
 - (b) In February 2012, GDF SUEZ/IPM exercised its contractual right to initiate a review meeting with the contractor where it discussed the contractor's progress, contingency plan and next steps. Under the contract, if GDF SUEZ/IPM reasonably believed that the contractor was unlikely to meet the carbon saving target by 30 June 2012, it had the right to either trade, transfer or contract the outstanding CESP obligation to a third party contractor.
- 5.24. Notwithstanding steps taken and the contingency measures set out in paragraphs 5.15 and 5.26, the Authority was 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 appeared to the Authority that when things started to go wrong with delivery GDF SUEZ/IPM should have acted more quickly to put a "Plan B" in place. GDF SUEZ/IPM has acknowledged that the compliance risk deriving from the CESP obligation remained with it as licensee.
- 5.25. GDF SUEZ/IPM has also attributed part of the reason for its contravention to its lack of experience with this type of obligation. Obligated parties with downstream retail businesses, in contrast to independent generators such as GDF SUEZ/IPM, had previous experience of schemes such as Energy Efficiency Commitment ("EEC") and also had existing access to contacts such as local authorities and housing associations and a domestic retail customer base. The Authority considered this lack of previous experience at the onset of the scheme is relevant to GDF SUEZ/IPM's ability to devise a credible "Plan B" quickly when things started to go wrong.

- 5.26. Further, the Authority noted that in light of its growing concerns about the contractor's ability to deliver the required carbon savings, the following contingency measures were devised by GDF SUEZ/IPM, with the approval and involvement of its management, to seek to secure the required alternative carbon savings:
- (a) GDF SUEZ/IPM explored with other third parties alternative ways to secure compliance. Between 2011 and 2012, GDF SUEZ/IPM continued to negotiate with another OP to increase the volume of traded carbon between the parties (i.e. a further trade after an initial successful trade arrangement). However, ultimately the OP in question declined to increase its trade volume with GDF SUEZ/IPM.
 - (b) In July 2012, GDF SUEZ/IPM increased the delivery obligation placed on another contractor, which ultimately raised the level of delivery of carbon reduction measures by that party from 55,000tCO₂ to 81,000tCO₂.
 - (c) In November 2012, GDF SUEZ/IPM engaged with another third party contractor to deliver the outstanding carbon at a price significantly above the prices it had previously paid. It had in fact sought such an arrangement with this particular contractor earlier in 2012 but the intended target scheme for carbon reduction measures had fallen through.
- 5.27. Taking all of the above into account, the Authority considered that this mitigating factor partially applies.

Appropriate action by the licensee to remedy the contravention or failure

- 5.28. As noted in Ofgem's Open Letter of September 2012, mitigation action would not be a substitute for compliance with the carbon emission reduction obligations and obligated parties should not be able to benefit from non-compliance. However in considering mitigation actions, Ofgem said that *"we will give most weight to CERT/CESP measures that are delivered shortly after 31 December 2012"*. Ofgem later stated in its January 2013 Open Letter that 30 April 2013 would be a key date for assessing the mitigation actions taken by the parties.
- 5.29. The Authority noted that GDF SUEZ/IPM undertook mitigation equivalent to the volume of shortfall associated with not achieving the carbon saving reduction target. This mitigation was completed promptly by 31 March 2013, i.e., before the key date of April 2013. The Authority also noted that GDF SUEZ/IPM delivered more than its shortfall as mitigation (see paragraphs 5.38-5.40 below). In light of this, the Authority considered that GDF SUEZ/IPM did take appropriate action to remedy the breach and that this mitigating factor applies to a significant extent in this case.

Evidence that the contravention or failure was genuinely accidental or inadvertent

5.30. GDF SUEZ/IPM has made representations that factors including CESP being an inappropriate obligation imposed on independent generators, its inability to pass through cost of the CESP, its being let down by its contractor and that the CESP did not match assumptions in DECC's impact assessment affected its ability to deliver the obligation by 31 December 2012.¹⁵ These factors are considered in paragraphs 5.22-5.25 and 5.33-5.37. The Authority noted that OPs had over three years to secure compliance with CESP and there is no evidence to suggest that GDF SUEZ/IPM's contravention was genuinely accidental or inadvertent. Accordingly, the Authority did not consider that this mitigating factor applies in this case.

Reporting the contravention or failure to Ofgem

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

Co-operation with Ofgem's investigation

5.32. GDF SUEZ/IPM has responded to Ofgem's Information Requests on time and complied with Ofgem's investigations process. However, the Authority considered that this mitigating factor should only apply where co-operation has gone beyond what would be expected of any licensee facing enforcement action.¹⁶ In this case, GDF SUEZ/IPM has additionally, in response to the Settlement Mandate put forward, accepted its breach and agreed to settle the case at the earliest opportunity. This has achieved a speedier resolution and avoided additional spending of resource by the regulator. Accordingly, the Authority considered that this mitigating factor applies and the Authority imposed a lower penalty that it would otherwise have imposed.

Other factors

5.33. 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.

¹⁵ The Authority considered issues concerning the design and administration of CESP below (please see paragraphs 5.34-5.37).

¹⁶ 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 CESP scheme and the ability of GDF SUEZ/IPM to deliver it

- 5.34. The Authority considered the extent to which the design and administration of CESP may have adversely affected GDF SUEZ/IPM's ability to deliver CESP by 31st December 2012 and the extent to which GDF SUEZ/IPM was disadvantaged compared to suppliers through lack of experience with this type of obligation; for example, a lack of domestic retail customer base. The Authority considered the evidence including a report commissioned by DECC, *Evaluation of the Carbon Emissions Reduction Target and Community Energy Saving Programme*.¹⁷
- 5.35. 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.
- 5.36. The Authority considered that these factors were not insurmountable as several OPs secured compliance. Further, in the case of GDF SUEZ/IPM 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.
- 5.37. The Authority also considered that the lack of previous experience is relevant to GDF SUEZ/IPM's ability to meet its obligation and therefore considered that mitigation applies to an extent. However, the Authority considered that as a large company, GDF SUEZ/IPM was sufficiently well placed to put in place robust contract monitoring arrangements if it decided the use of a contractor was the best way to meet its obligation and to overcome its lack of experience. The Authority considered that this mitigating factor only partially applies.

¹⁷ <https://www.gov.uk/government/publications/evaluation-of-the-carbon-emissions-reduction-target-and-community-energy-saving-programme>

Over-delivery of CESP mitigation measures

- 5.38. GDF SUEZ/IPM delivered mitigation actions in excess of the level required to address the harm associated with its breach, albeit not to a significant extent. The Authority recognises that this additional delivery by GDF SUEZ/IPM provided enduring benefits for those consumers who had received those measures.
- 5.39. 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.
- 5.40. 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 a penalty of a £1 on each of Saltend Cogeneration Company Limited and Deeside Power (UK) Limited in respect of the failure to comply with Article 14(1) of the CESP Order. This decision has taken into account a payment of £450,000 (less the £2 financial penalty) by GDF Suez/IPM by way of consumer redress to Age UK made on 12 January 2015. The Authority considered this penalty to be reasonable in all the circumstances of the case. In reaching this decision the Authority considered in particular the following:
- (a) GDF SUEZ/IPM's failure to achieve the CESP target was a serious contravention of a domestic energy efficiency programme;
 - (b) The extent of the initial shortfall in delivery of carbon reduction measures by GDF SUEZ/IPM which was 177,928tCO₂ or 61.4% of its reduced obligation following trades with other OPs;
 - (c) GDF SUEZ/IPM has not made any financial gain from the breach;
 - (d) GDF SUEZ/IPM undertook mitigation action equivalent to the volume of its shortfall;
 - (e) The case does not include any aggravating factors;
 - (f) The case has several mitigating factors that apply
 - Action by the licensee to remedy the contravention or failure (see paragraphs 5.28-5.29);
 - Co-operation with Ofgem's investigation (see paragraph 5.32); and
 - Overdelivery of CESP mitigation (see paragraphs 5.38-5.40).

The case also has mitigating factors that partially apply

- Steps taken to secure compliance either specifically or by maintaining an appropriate compliance policy, with suitable management supervision (see paragraphs 5.20-5.27); and
 - Design and administration of CESP scheme and the ability of GDF SUEZ/IPM to deliver it (see paragraphs 5.34-5.37).
- (g) GDF SUEZ/IPM has agreed to settle this investigation.
- (h) GDF SUEZ/IPM has paid 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 paid is a lower figure than would have been the case if GDF SUEZ/IPM had not taken the steps as set out in paragraphs (d) and (g) above and the aggregate of the penalty and the amount of consumer redress paid is larger than the detriment suffered by consumers.

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

Introduction

- 1.1. The Authority received four representations in response to its Notice to impose a financial penalty dated 12 December 2014 (the “proposed Penalty Notice”). 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 1.5)
 - The proposed Penalty Notice lacked transparency (see paragraphs 1.6-1.8)
 - Points in relation to consumer redress (see paragraphs 1.9 to 1.12)
 - Other matters (see paragraphs 1.13 to 1.14)
- 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. Three respondents submitted that the level of proposed penalty was too low. They contended that, in assessing the extent to which GDF SUEZ/IPM may have made a financial gain, the Authority should have compared GDF SUEZ/IPM’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.¹⁸ 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.
- 1.4. Ultimately, the assessment of financial gain is by necessity a judgment taking into account a number of factors which were considered by the Authority in coming to its view that GDF SUEZ/IPM did not make any financial gain (see paragraphs 5.7- 5.10, and paragraph 5.15 (as well as paragraph 1.14(b) of this Annex) in the context of costs incurred as an alternative to buying carbon at auction. Furthermore, as noted in paragraph 5.26(c), GDF Suez/IPM in fact contracted for delivery of mitigation measures into 2013 at market rates prevailing in the second half of 2012.

¹⁸ <https://www.ofgem.gov.uk/ofgem-publications/58763/cesp-final-report-2013final-300413.pdf>.

- 1.5. 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

- 1.6. 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 GDF SUEZ/IPM gained an unfair advantage from not complying.
- 1.7. The decision on the 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 requirements¹⁹, 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 or 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.
- 1.8. 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

- 1.9. A number of respondents made a number of points in relation to the consumer redress GDF SUEZ/IPM is proposing. These points are considered below.
- 1.10. Several respondents submitted representations requesting that they should receive redress monies. The Authority considered that it was for GDF Suez/IPM to choose its redress recipients subject to the funding meeting the objectives referred to in paragraph 1.2.

¹⁹ In section 27A Electricity Act 1989.

- 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. 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 Company Obligation (ECO) or create an unreasonable administrative burden for Ofgem.
- 1.13. The Authority is satisfied that GDF SUEZ/IPM's proposal is within the scope of this mandate. Further, the Authority notes that GDF SUEZ/IPM 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 miscellaneous matters

- 1.14. One respondent raised the following 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; and
 - (c) 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.
- 1.15. 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 GDF SUEZ/IPM 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 as to the non-application of the possible aggravating factor relating to the involvement of senior management (see paragraphs 5.13-5.16).
- (c) 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