Neutral citation: [2023] UKFTT 1080 (GRC)

Case Reference: NV/2023/0024/GGAS

First-tier Tribunal
(General Regulatory Chamber)
Environment

Heard by: CVP Remote Hearing

Heard on: 8 November 2023

Decision given on: 22 November 2023

Before

TRIBUNAL JUDGE L. ORD

Between

KLIMA-THERM LIMITED

Appellant

and

ENVIRONMENT AGENCY

Respondent

Representation:
For the Appellant: Mr Ian Sinkin KC
For the Respondent: Mr Paul Collins (Senior Lawyer with the Respondent)

Decision: The appeal is allowed in part. The Respondent is ordered to vary the Notice of a Civil Penalty dated 18 May 2023 by reducing the civil penalty to £20,000.

REASONS

The Appeal

1. By notice of appeal dated 14 June 2023, the Appellant appeals pursuant to Schedule 5 against the Respondent's imposition of a civil penalty of £44,725 by Notice of a Civil Penalty ("the Notice") dated 18 May 2023.

2. The Notice was issued in respect of the Appellant's failure to obtain sufficient HFC quota authorisations before placing HFCs on the market within Great Britain (GB) as required by Article 14(1) of EU Regulation 517/2014 on fluorinated greenhouse gases. Article 14(1) requires that refrigeration, air conditioning and heat pump equipment charged with hydrofluorocarbons shall not be placed on the market unless hydrofluorocarbons charged into the equipment are accounted for within the GB quota system.

Evidence

3. In determining this appeal I have had regard to the appeal bundle of 90 pages, the signed statement (with two exhibits) of the Appellant's witness Imelda O'Connor, and Skeleton arguments for both the Appellant and the Respondent, the latter containing a 20 page annex.

4. I have also considered oral evidence under oath given by Imelda O'Conner and oral submissions from Mr Sinkin KC and Mr Collins.

Law and Policy

5. **The Fluorinated Greenhouse Gas Regulations 2015** (F Gas Regulations) implement EU Regulation No 517/2014 on fluorinated greenhouse gases of 16 April 2014. They prescribe offences and lay down rules on penalties applicable to infringements of the EU Regulation, providing enforcement powers to the enforcing authority, which is the Environment Agency (EA). Relevant provisions are as follows:

   Reg. 31A Civil penalties
   (1) A relevant enforcing authority may impose a requirement to pay a civil penalty in accordance with Schedule 4.
   (2) The requirement to pay a civil penalty may be imposed on any person who—
   (a) fails to comply with—
   (i) a provision of the 2014 Regulation specified in Schedule 2;

   Schedule 2 of the 2014 Regulation includes:
   Article 14(1) (pre-charging of equipment with hydrofluorocarbons) which provides:

   "From 1st January 2017, refrigeration, air conditioning and heat pump equipment charged with hydrofluorocarbons shall not be placed on the market
   unless the hydrofluorocarbons charged into the equipment are accounted for within the quota system referred to in Chapter IV".

   Schedule 4 - Civil penalties
   para. 1 - Imposition of a civil penalty
   (1) A relevant enforcing authority may by notice impose on any person, in relation to

a failure to comply with any provision referred to in regulation 31A, a requirement to pay a civil penalty to the relevant enforcing authority of such an amount as the notice may specify or determine, subject to sub-paragraph (4).
(2) The standard of proof to be applied by a relevant enforcing authority imposing a civil penalty under these Regulations is on a balance of probabilities.
(4) The maximum civil penalty is £200,000 ……

Schedule 5 - Appeals
para. 1 - Appeals against notices served by the Environment Agency or the Secretary of State
(1) A person on whom an enforcement notice, a civil penalty notice or an enforcement cost recovery notice is served by the Environment Agency or the Secretary of State may appeal against it to the First-tier Tribunal.
(4) Where an appeal is made under sub-paragraph (1), the notice is suspended until the appeal is withdrawn or determined by the First-tier Tribunal in accordance with sub-paragraph (5).
(5) The First-tier Tribunal may—
(a) affirm the notice;
(b) direct the Environment Agency or Secretary of State to vary or withdraw the notice;
(c) impose such other enforcement notice, civil penalty notice or enforcement cost recovery notice as the First-tier Tribunal thinks fit.

para. 4 - Grounds for appeal

(2) The grounds for an appeal against a civil penalty notice under paragraph 1(1), 2(1), 3(1) or 3(13) of this Schedule are—
(a) that the relevant enforcing authority's decision to serve the civil penalty notice was—
(i) base on an error of fact;
(ii) wrong in law;
(iii) wrong for any other reason;
(iv) unreasonable;

(b) that the amount specified in, or determined by, the notice is unreasonable.

6. In deciding the question of reasonableness, regard is to be had to the EA's **Enforcement and Sanctions Policy (ESP)** updated 17 March 2022.

   Whilst the policy has been updated since the time of the Notice, there are no changes of relevance to this appeal.

   Annex 2 : Climate change schemes – the Environment Agency's approach to applying civil penalties.

   This applies to the F Gas regime.

   Section A: General Principles

Explains that the EA will apply discretion, using a stepped approach, when deciding whether to impose a civil penalty or to work out the final penalty amount. Within the steps they will assess:

- The nature of the breach
- Culpability
- The size of the organisation
- Financial gain
- Any history of non-compliance
- The attitude of the non-compliant person
- Personal circumstances

The nature of the breach assessment is the seriousness of the breach based on the impact it has on the integrity of the regime and the environmental effect of the breach, where relevant.

Section A: Environment Agency's penalty setting approach for the climate change schemes

Once the EA have determined that a person is liable to a civil penalty…they apply their discretion to decide whether to:

- Waive the civil penalty
- Reduce the civil penalty
- Extend the time for payment

They use a stepped approach to make this decision as follows:

Step 1 – check or determine the statutory maximum penalty for the breach.
Step 2 – decide whether to waive the penalty or set the initial penalty amount by assessing the nature of the breach and other enforcement positions in line with sections B, C, D and E.
Step 3 – if they decide to impose a penalty, work out the penalty point and penalty range based on culpability and size of the organisation.
Step 4 – set the final penalty amount by assessing the aggravating and mitigating factors and adjust the starting point as appropriate.

Culpability in Step 3 is categorized into: deliberate, reckless, negligent, and low or no culpability.

The definitions of the following are relevant in this case:

Negligent: a failure of the organisation as a whole to take reasonable care to put in place and enforce proper systems for avoiding commissions of the offence.

Low or no culpability: an offence committed with little or no fault on the part of the organisation as a whole.

Size of the organisation: small – between £2 million and £10 million annual turnover.

Culpability and size are used to determine a penalty factor (Table 1) which is applied to the statutory maximum to obtain a penalty starting point. An adjustment may then be made within a penalty range (Table 2) to account for the following aggravating and mitigating factors:

- Financial gain
- History of non-compliance
- Attitude of the non-compliant person
- Personal circumstances

Section E covers F Gas penalties and is to be read in conjunction with section A. Paragraph E2 refers to the EA's power to impose civil penalties for breaches of regulation 31A of the F Gas Regulations

E2.1 states:
We will normally impose a civil penalty for all breaches referred to in Regulation 31A of the F Gas Regulations subject to the additional enforcement position in E2.2.

E2.2 states:
We may not impose a civil penalty where:

- ……..
- Punishment or future deterrent is not necessary.

9. On an appeal against a penalty notice, the role of the Tribunal is not to place itself in the position of the Respondent and to ask itself whether it would have decided to impose a penalty and, if so, how much. Rather, it is to consider whether the imposition and/or level of the penalty was erroneous, either because of a factual or legal error or because it was unreasonable. Unreasonable in this context takes the ordinary meaning of being unfair, unsound or excessive, having regard to the circumstances of the case.

Issues

10. Whilst the Appellant indicated in its Skeleton Argument that it was pursuing its appeal on all four grounds of paragraph 4(2)(a)(i-iv) and (b) of Schedule 5 of the F Gas Regulations, at the hearing, Mr Sinkin confirmed that it withdrew ground (ii) "wrong in law".

11. Consequently, the main issues in this case are:

    1) whether the EA's decision to serve a civil penalty notice was:

       based on an error of fact;
       wrong for any other reason than wrong in law;
       unreasonable;

       and if not,

    2) whether the amount specified in the notice is unreasonable.

12. In determining these issues the Tribunal will have regard to the EA's ESP.

13. For issue 1) particular regard will be had to:

    - The general principles in Annex 2, Section A, namely:
      - The nature of the breach
      - Culpability
      - The size of the organisation
      - Financial gain
      - Any history of non-compliance
      - The attitude of the non-compliant person
      - Personal circumstances

    - The principles in Annex 2, Section E2.1 and E2.2 that civil penalties will normally be imposed for breaches of Regulation 31A, but may not be imposed where:
      - Punishment or future deterrent is not necessary.

14. For issue 2) regard will be had to the stepped approach in Section A (Steps 1 to 4) and particularly culpability in Step 3 and the following aggravating and mitigating factors in Step 4:

    - Financial gain
    - History of non-compliance
    - Attitude of the non-compliant person
    - Personal circumstances

The Facts

15. The Appellant, Klima-Therm Limited (KTL) is a small company. It has a sister company, called Gree UK Limited (GUL), which has just two directors, who are also directors of the Appellant. There is no dispute that GUL is a separate legal entity to the Appellant. In 2016 the Appellant purchased 5,000 EU delegations on behalf of GUL, which went into the GUL account. They were later transferred to GUL's GB account and, as of December 2022, 4,656 tonne of carbon dioxide equivalent (tCO_2e) authorisations remained.

16. The Appellant registered with the GB F-gas Registry and Reporting Service, as confirmed in the EA's email of 12 January 2021. In that email, the EA told the Appellant that the GB F-gas Registry and Reporting Service was not a portal in the same way as the EU system and that the Appellant needed to retain copies of all correspondence from the EA for its records. It sent the Appellant guidance on how equipment importers could obtain quota authorisations.

17. On 3 March 2021 the Appellant received an email from the Respondent's F-gas Support Team setting out the process for exchanging EU HFC quota for GB quota. Tim Mitchell (TM), Sales Director of the Appellant, emailed the Respondent's F-gas Support Team on 29 March to try to transfer the 4,656 tCO_2e from the EU F-gas account to the GB F-gas account.

18. Further email exchanges followed, including a request from TM on 8 May for information on how to buy more quota. The EA replied on 12 May saying the Appellant would need to approach a GB incumbent holder, and attached a list of quota holders and a link to GOV.UK guidance on transferring and authorising F-gas quota to another business.

19. No transfer ever took place from GUL's EU or GB account to the Appellant's GB account.

20. On 3 December the EA emailed Imelda O'Connor (IO'C), the Appellant's Finance Director, reminding her that she needed to ensure she had sufficient GB quota in the GB account by 31 December 2021 to cover the period 1 January 2021 to 31 December 2021. On 6 December, the EA sent her its newsletter explaining its reporting requirements and deadlines (31 March 2022) for submitting an Annual F-gas Report and Verification Report.

21. TM emailed the Respondent on 22 March 2022 stating "We have within our group of companies some quota left from a previous purchase within the EU scheme and transferred to us from there, but we will need more during 2022"

22. On 23 March 2022 IO'C emailed the Respondent about logging onto the transaction system and on 30 March IO'C received confirmation that the Appellant had received 5,000 quota delegations from ACT Energy BV.

23. On 31 March IO'C submitted version 1 of the Appellant's F-gas report, which identified that the Appellant held zero quota for 2021 and was in breach of the Regulations. The Respondent advised the Appellant of the breach on 22 April and subsequently there were further email exchanges about the lateness of the Verification Report.

24. On 19 December 2022 IO'C submitted the Verification Report to the EA, which confirmed that 1,789 quota authorisations were needed for imports of pre-charged equipment in 2021. On 7 February 2023, the Respondent served a Notice of Intent to Impose a Civil Penalty. The Appellant concedes it did not have sufficient quota delegations to cover the 1,789 tCO_2e that it placed on the GB market in 2021, and that it was technically in breach of the Regulations.

The Appellant's case (as set out in its Notice of Appeal, Statement on behalf of the Appellant, Skelton Argument, Imelda O'Connor's Statement with Exhibits, and her oral evidence)

Serving the Notice was based on an error of fact, wrong for any other reason than wrong in law, and/or unreasonable.

25. In essence, the Appellant's case is summarised as follows:

26. The administration changes from the EU to the GB registration scheme and the advice available, was difficult and confusing. Some of the advice referred to by the EA was irrelevant and some of it has since been withdrawn or subsequently updated.

27. The changing regulatory regime and the numerous convoluted guidance documents, some of which had not been updated since before Brexit, created a lack of

transparency and made compliance with the F-gases Regulations challenging. Finding a knowledgeable auditor was difficult and the Appellant's usual auditors were not aware of the Regulations. There was no help readily available from industry bodies.

28. The Appellant made several attempts to contact the Respondent for assistance during 2021, but no support was available via telephone. Emails sent to the Respondent in 2021 were acknowledged with a reply saying they were in "Incident Mode", which went on for some months, suggesting there were wider issues with the F-gas systems.

29. With respect to the advice "Transfer and authorise F gas quota to another business – GOV.UK", this guidance was originally published on 9 September 2019, before the Brexit changes, and was only updated on 2 August 2022. The update note on 2 August 2022 states "This page has been re-written to provide more accurate information on how to transfer and authorise F-gas quota to another business." This highlights that previous guidance, available at the material time, was not easily available or clear about the necessary process.

30. The current August 2022 guidance states "If you're an F-gas quota holder you can……authorise another company to use some or all of your quota to import or manufacture pre-charged equipment.. " The wording does not set out any formal process for a quota holder to authorize another company to use the available quota. The guidance provides a link to "Manage your fluorinated gas (F-gas) quota", which leads to an online form through which it is said HFC quotas can be transferred, authorised and delegated, but it is unclear now whether this link and form were available at the material time. The Appellant does not recall identifying or having access to this form and did not appreciate that a transfer of quota could be arranged using this online service.

31. At no point was advice given to the Appellant that the quotas transferred into the GUL GB F-gas account would only be available to GUL, and there was lack of clarity around the ability of the quota authorisations to be utilised by the different legal entities in the group. It was always the Appellant's intention that the quota authorisations held by GUL would be utilised within the corporate group and consequently the Appellant believed it had sufficient quota for 2021.

32. This intention was discussed at the quarterly group board meeting on 8 October 2020, the minutes of which record "Discussion on Gree's F-Gas quota. Agree sufficient for 2021 to cover both KT & Gree UK." Also the wording of the 22 March 2022 email that "We have within our group of companies some quota left from a previous purchase…" supports this belief.

33. Under the previous EU scheme GUL could have transferred its quota to KTL by simply writing a letter of authorisation, and it was thought this was also the case under the GB regime, albeit no such letter was written. After receiving the Notice, KTL made numerous attempts to transfer the quota from GUL, and asked the EA to transfer it but the EA refused.

34. The Appellant enquired about buying further quota authorisations, which demonstrates that they were (and remain) a responsible duty holder, keen to comply with their legal obligations.

35. The 4,656 authorisations have not been used and so there have been no savings or competitive advantages, or any increased risk to the environment.

36. The Appellant sought to fully engage with the post Brexit quota regime and did not deliberately fail to follow their regulatory obligations. Whilst the Appellant accepts there was a technical breach, it was unintentional. They did not know they were breaching the Regulations at the time.

37. There has been no impact on the environment or legitimate businesses. The authorisations are still in the account and have not been used to import more HFC pre-charged equipment. The innocent mistake which led to the technical breach does not undermine the integrity of the regime. The Appellant has ensured it fully understands the legal obligations in respect of all companies within the group and has shared this knowledge internally. It has remained engaged and open throughout the process.

38. The respondent has acted disproportionately by issuing a civil penalty when punishing, what was at its core, a lacuna in the Appellant's training.

The amount specified in the Notice

39. The EA chose the most expensive quote, £25/tCO_2e as the base for its calculation. The EA's table demonstrates that far cheaper delegations were available at the relevant time. The penalty should not be calculated by the maximum 2021 price on the market. The penalty imposed amounts to about at third of the appellant's annual profit after tax.

40. The Appellant was offered authorisations in May 2021 for £5.71/tCO_2e. From the Respondent's table of prices, the overall mean price in 2021 was £7.41/tCO_2e and this is more proportionate, resulting in a penalty of £13,256.49, which is within the penalty range.

41. The Appellant paid for all the quota authorisations held by GUL and no costs have been avoided and no unfair advantage gained. It invites the Respondent to deduct the 1,789 quota authorisations from the GUL account.

42. The Appellant has no history of non-compliance and has been open and honest, accepting responsibility for the technical breach and ensuring future breaches will not be committed.

43. The Appellant submits that the EA's calculation was based on an error of fact (namely alleged savings), was unreasonable in its reasoning and was wrong (disproportionate) in its ultimate computation.

The Respondent's Case (as set out in the Notice, the EA's statement, the EA's reply to the Appellant's statement, its skeleton argument and Annex, and the oral submissions of Paul Collins)

44. In essence, the Respondent's case is summarised as follows:

45. Guidance and advice on the F-gases regime was publicly and easily available to the Appellant, clearly explaining that only organisations with sufficient quota could produce or import hydrofluorocarbons (HFCs). The EA also specifically provided the

Appellant with guidance and details of the EA's helpdesk, which was available at all times. Guidance was updated to provide clarity for equipment importers. If the Appellant was unclear on the process, it should have contacted the helpdesk.

46. It is the Appellant's legal responsibility to ensure it has sufficient authorisations in its GB account to cover the quantity of HFCs placed on the GB market. On 31 December 2021, it had no authorisations in its GB account. It is irrelevant that the Appellant paid for authorisations that were in GUL's account as it cannot use GUL's authorisations without GUL delegating them to the Appellant. The Appellant operated within the EU system and should have been aware of the requirements that the legal entity placing goods on the market has to have quota authorisations in place.

47. There is no record of GUL applying to authorise transfer of any of its quota to the Appellant. GUL's authorisations can still be used by GUL for future compliance and therefore the Appellant has avoided costs. The Appellant did not contact the F-gas helpdesk to ask if the quota authorisations held by GUL could be used by the Appellant for 2021 compliance. It is not for the Respondent to pre-empt an attempt to use another legal entity's quota.

48. IO'C email to the Respondent of 23 March 2022 about logging onto the system, was after the deadline for obtaining quota authorisations for 2021. The Respondent has no record of any technical errors that prevented GUL from delegating authorisations to the Appellant or submitting an online request on GOV.UK

49. The Appellant has avoided costs by not complying with the legal requirements and still holds 1,789 quota authorisations that are available for future compliance.

50. In evidence Mr Collins confirmed that, when deciding on a penalty, the EA would have considered whether punishment or future deterrent was necessary, as set out in the ESP Annex 2 E2.2.

The amount specified in the Notice

51. The Respondent made reference to its ESP and how it had been applied proportionately, going through the various steps as summarised in the Notice.

52. It classified the Appellant as a small company with negligent culpability and, on this basis, the penalty starting point is £6,000 and the penalty range is between £2,600 and £24,000.

53. The price of authorisations is market driven and increases towards the end of the year and the compliance deadline. The EA used the maximum price of £25/tCO_2e from a 2021 sample, as anything else might undermine the final civil penalty and give the Appellant an unfair financial advantage over compliant organisations. Consequently, for 1,789 authorizations, the costs avoided amounted to £44,725, and this was the level the penalty was set at.

54. The price in 2022 was not appropriate due to price shifts between years. Although the Appellant bought authorisation in 2022, the F-gasses Regulations require that quota authorisations are in place at the point when the goods are placed on the market in Great Britain.

55. There is no mechanism for deducting the 1,789 authorisations from the GUL account to retrospectively cover the Appellant's 2021 obligations.

Discussion and conclusions

Issue 1: Whether the EA's decision to serve a civil penalty notice was based on an error of fact, wrong for any other reason than wrong in law, or unreasonable, taking account of

- **The nature of the breach**
- **Culpability**
- **The size of the organisation**
- **Financial gain**
- **Any history of non-compliance**
- **The attitude of the non-compliant person**
- **Personal circumstances**

And whether punishment or future deterrent was necessary.

Culpability and Personal circumstances

56. Under the EU scheme, the Appellant was previously able to effect transfers of quota authorisations from its sister company, GUL, by simply writing an authorisation letter. It did not appreciate that the GB regime required something more. It intended to use the GUL quotas, which it had paid for, to cover its 2021 obligations. It did not purposefully breach the Regulations.

57. The GB regime, which came into force in 2021, imposed new requirements representing a significant change for businesses importing F-gases. The EA wrote to Appellant on several occasions in 2021, reminding it of its obligations and sending it information. Transfers of quota authorisations required a specific form to be completed and submitted online, and the form was embedded in guidance. The Appellant found the Government and EA guidance to be complicated and confusing and the assistance available from the EA was limited. There was little help available from other organisations at the time. The guidance has since been updated and is now clearer.

58. Having considered all the evidence, it seems to me that, at the time, the mechanism for transfer was not immediately apparent without some research, and there was an initial period when Government and EA guidance was less than clear. Whilst it is understandable why the Appellant thought it could transfer by letter, had it persevered in studying the guidance, it would have discovered the necessary form. It was negligent in not doing so.

Attitude and history of non-compliance

59. There is no history of non-compliance and the Appellant has engaged with the EA in tyring to understand and comply with the regime. It sought advice and guidance at various times throughout 2021 and thereafter, and it has taken its obligations seriously.

Size and financial gain

60. The Appellant is a small company.

61. It says that there was no financial gain because it bought the authorisations that are in the GUL account. However, those authorisations have not been utilized and cannot retrospectively cover the 2021 obligations. They are still available to the Appellant for future compliance, should it chose to transfer them. The fact the Appellant was the entity that bought them is irrelevant.

62. The Appellant was offered authorisations in May 2021 for £5.71/tCO_2e. At that price, the financial gain for 1,789 authorisations would be £10,215.19. Alternatively, taking the mean 2021 price from the EA's table of £7.41/tCO_2e, the gain would be £13,256.49. If the highest 2021 price of £25.00/tCO_2e were used, the gain would be £44,725.00.

63. It is unlikely that the Appellant would have bought at £25.00/tCO_2e and therefore, the gain is more proportionately assessed as between £10,215.19 and £13,256.49.

Nature of the breach

64. The nature of the breach assessment reflects the seriousness of the breach based on the impact it had on the integrity of the regime. It may include the length of time a person had been required to comply with the law.

65. Most breaches will have some effect on the regime, which aims to limit HCF use to reduce the UK's impact on climate change. In this case, the breach has resulted in additional quota authorisations of 1,789 tCO_2e becoming available, which translates into an ability to import and place more pre-charged HCF equipment on the GB market. This could potentially have some small incremental impact on climate change, and would give the Appellant a commercial advantage over competitors who complied with the regime

66. However, it was a one off breach within the first year of compliance.

Whether punishment or future deterrent was necessary

67. Whilst the breach was unintentional, the Appellant could have done more to research the requirements of the regime. If a penalty were not imposed, the Appellant would benefit from a significant financial advantage and commercial advantage over those who had complied. This would undermine the regime. Consequently, a penalty is necessary.

Conclusion on Issue 1

68. The tribunal concludes that the decision to serve a civil penalty notice was not based on an error of fact, was not wrong for any reason, and was reasonable.

Issue 2: whether the amount specified in the notice is unreasonable, having particular regard to culpability and the following aggravating and mitigating factors:

- **Financial gain**
- **History of non-compliance**
- **Attitude of the non-compliant person**
- **Personal circumstances**

69. There has been a significant financial gain to the Appellant in that the 1,789 quota authorisations are still available to use for future compliance, thereby making a considerable saving. Whilst the Appellant has offered to relinquish them, there is no mechanism for doing this.

70. There is no history of non-compliance.

71. The Appellant did not intend to breach the regulations and its failure was based on a misunderstanding. It has engaged with the process and with the EA, and wishes to meet its obligations.

72. The Tribunal finds that culpability is at the level of negligent. It agrees with the Respondent that for a small company with negligent culpability, the penalty starting point is £6,000 and the penalty range is between £2,600 and £24,000.

73. The financial advantage to the Appellant is between £10,215.19 and £13,256.49. There needs to be some deterrent to prevent breaches of the regime, and to achieve this the penalty must be greater than the financial gain. Nonetheless, the particular circumstances of the breach must be taken into account, including the misunderstanding over the inability to transfer quota from GUL by letter, and the quality of advice and assistance available in the first year of the regime. On this basis, the additional amount, over and above the financial gain, should be modest, albeit towards the top end of the penalty range.

Conclusion on Issue 2

74. In the Tribunal's judgment, the amount specified in the Notice is unreasonable and consequently, the Respondent is directed to reduce the penalty to £20,000.

Signed: Judge Liz Ord

Date: 21 November 2023