Neutral citation: [2023] UKFTT 947 (GRC)

Case Reference: NV/2023/0010/GGAS

First-tier Tribunal
(General Regulatory Chamber)
Environment

Heard by Written Representations

Heard on 16 October 2023
Decision given on 6 November 2023

Before

TRIBUNAL JUDGE SIMON BIRD KC

Between

SCANIA (GREAT BRITAIN) LIMITED

Appellant

v

ENVIRONMENT AGENCY

Respondent

DECISION

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1. By notice of appeal dated 11 April 2023, the Appellant appeals pursuant to Schedule 5 of the Fluorinated Greenhouse Gases Regulations 2015 (“the Regulations”) against the Respondent’s imposition of a civil penalty of £200,000 by Notice of Civil Penalty dated 15 March 2023. The Notice was issued in respect of the Appellant’s failure to obtain sufficient HFC authorisations before placing HFCs on the market within Great Britain as required by Article 14(1) of EU Regulation 517/2014 (“the EU Regulation”) on fluorinated greenhouse gases.

2. In determining this appeal I have had regard to the appeal bundle of 162 pages which includes the Notice of Appeal and amended grounds of appeal, the Respondent’s Response to the appeal and the Appellant’s reply to that Response.

The Appeal

3. By its notice of appeal, the Appellant argues that the amount of the civil penalty was unreasonable. In support of its appeal it argues in summary that:

    (i) The application of the maximum 2021 cost of a single HFC quota authorisation (HFC QA) of £25.00 to the number of missed HFC QAs did not reflect the actual avoided costs and instead was a theoretical figure which was both too high and disproportionate;

    (ii) In imposing the Civil Penalty of £200,000 the Respondent had failed to follow its own published guidance and, in particular, it failed to have regard to the absence of any actual environmental harm resulting from the breach or properly to take account of the significant mitigation advanced by the Appellant; and

    (iii) The imposition of the maximum available penalty of £200,000 should be reserved for those cases in which there has been higher culpability. The Appellant’s culpability had been characterised by the Appellant as “negligent” and not either “reckless” or “deliberate” and there was significant mitigation. The penalty was therefore disproportionate.

4. In response to the appeal the Respondent argues that the civil penalty of £200,000 was arrived following the steps set out in Section A of Annex 2 to its “Environment Agency enforcement and sanctions policy” (“the ESP”) which was published in 2018 and updated in 2019. The ESP steps are based on those in the Definitive Guide for the Sentencing Council on 1 July 2014.

5. The Respondent argues that applying the ESP’s four steps, the statutory maximum penalty for the breach was £200,000 and this had been set as the

initial penalty amount for breaches of Article 14 of the EU Regulation given the impact that the breaches might have on the integrity of the scheme and the environment. The Respondent considered the Appellant's culpability to be negligent having regard to the guidance in the ESP and it assessed the Appellant's financial gain as £195,900, assuming a maximum HFC QA cost of £25.00. This reflected the known maximum cost of HFC QA in 2021 when the correct quota should have been purchased by the Appellant. The penalty was increased to £200,000 because the Appellant had failed to improve its compliance procedures for imports of pre-charged equipment, following the provision of guidance in January and February 2021.

6. The Respondent maintains that it correctly applied both the requirements of the Regulations and the guidance in the ESP and that the appeal should be dismissed.

7. The parties have agreed that the appeal should be dealt with by way of written representations and, having considered all the submitted documentary evidence, I am satisfied that it is appropriate for the appeal to proceed on this basis.

The Statutory Framework

8. Article 14(1) of the EU Regulation provides:

> "*From 1 January 2017 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 quota system referred to in Chapter IV"*

9. Regulation 31A of the Regulations provides, in so far as is material to this appeal, that:

> *"(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.*
>
> *…......"*

10. Schedule 2 to the Regulations specifies Article 14(1) of the EU Regulation as one of the provisions for which the breach may result in the imposition of a civil penalty.

11. Schedule 4 to the Regulations sets out the procedural and substantive requirements relating to the service of Civil Penalty Notices. Paragraph 1(2) of Schedule 4 provides that the standard of proof to be applied by a relevant enforcing authority imposing a civil penalty under the Regulations is on the balance of probabilities. Paragraph 1(4) to the Schedule prescribes a maximum penalty of £200,000 (save in respect of a number of specified breaches, none of which is relevant to this appeal).

12. Schedule 5 to the Regulations makes provision for appeals to the First-tier Tribunal. Under paragraph 1(5) to the Schedule, the Tribunal's powers on appeal against the imposition of a Civil Penalty under the Regulations are to:
    (a) affirm the notice;
    (b) direct the Environment Agency 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.

13. The grounds of appeal against a Civil Penalty Notice laid down by the paragraph 4 of Schedule 5 of the Regulations are:

    (a) that the relevant enforcing authority's decision to serve the civil penalty notice was -
        (i) based 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.

14. On an appeal against a penalty notice, the role of the Tribunal is therefore not to place itself in the position of the Respondent and to ask itself what penalty it would have decided to impose, but rather to consider whether the penalty was erroneous either because of a factual or legal error or because it or the penalty imposed was unreasonable. Unreasonable in this context bears its ordinary meaning i.e. one which having regard to the circumstances is unfair, unsound or excessive.

The Facts

15. There is no material dispute of fact in this case. The Appellant accepts that for the 2021 quota year, it failed to obtain sufficient HFC QAs before placing HFCs on the market as required by Article 14(1) of the EU Regulation. It bought 250/tCO_2e HFC QAs in February £10.00, believing that to be sufficient for the year, in May 2022. However, in subsequently reporting to the Respondent, it initially identified a shortfall of 95 HFC QAs which it sought to remedy by purchasing 580t QAs at a cost of £9.50. This was intended to cover both the shortfall for 2021 and the increased projected requirement for 2022. However, as the Respondent has pointed HFC QAs need to be in place during the relevant quota year and cannot be purchased and applied retrospectively to an earlier quota year to make up any quota shortfall.

16. Matters got worse in that, in July 2022, the Appellant identified an additional shortfall of 7.741 HFC QAs for the 2021 quota year. It immediately purchased 7,741 HFC QA to cover the shortfall for 2021 and the further increased projected requirement for 2022. This was at a cost of £7.00 each

17. The Respondent was notified on 15 July 2022 of the increased shortfall and this was confirmed in the form of a revised Annual HFC gas report sent to the Respondent on 22 July 2022. There is no dispute that the Appellant self-reported the breach and had taken steps to remedy it, not appreciating that it was irremediable.

18. Whilst there is no dispute about these facts, the Respondent points out that guidance and advice on the requirements of the Regulations were easily available to the Appellant prior to its importation of any HFCs and yet 34 import referrals were made to the Respondent by HM Customs and Excise during January and February 2021 at a point at which the Appellant had neither the necessary registration or authorisation. The Respondent had provided guidance to the Appellant's agent in January 2021 and subsequently, to assist it with compliance. In particular, the requirement for a declaration of conformity to be made at the time of importation was made clear to the Appellant.

19. A Notice of Intent to Impose a Civil Penalty was served on the Appellant on 13 October 2022 which identified that of the 8086 QAs required for 2021, only 250 QAs were in fact held by the Appellant (as shown on the GB HFC Registry) and indicating the intention to impose a Civil Penalty. The Notice of Intention set out that, using the ESP stepped approach to the identification of the appropriate penalty, the costs that had been avoided in not obtaining the necessary quota were a significant aggravating factor. These costs avoided were calculated in the sum of £195,900. This sum was the product of multiplying the QA shortfall of 7,836 by £25/tCO_2 equivalent which data supplied to the Respondent by

operators in the quota market showed was the maximum cost of quota authorisation in 2021. The price of £25/tCO_2e has been used by the Respondent to calculate the cost avoided for all organisations that breached Article 14(1) in 2021.

20. The market data also showed that the overall mean 2021 QA cost was £7.41/tCO_2. However, the Appellant points out that, as a matter of fact, the cost of the quota it did purchase in February/March 2021 was £10/tCO_2.

21. As required by the Regulations, the Notice of Intent invited the Appellant to make representations to the Appellant on the Respondent's intent to impose a civil penalty and, whilst the Appellant responded, it did so to an incorrect e-mail address. In consequence, the Notice of Civil Penalty with which this appeal is concerned was served on 15 March 2023 without the Respondent having the benefit of the Appellant's representations. The Notice of Civil Penalty imposed a penalty of £200,000 being the product of the claimed £195,900 costs avoided and an uplift of £4,100 because the Respondent considered that:

> "...*the penalty should be increased from the starting point because you failed to improve your compliance procedures, for imports of pre-charged equipment, following provision of guidance in January and February 2021"*

22. The parties only appreciated the fact that the Appellant had sent representations to the Respondent in response to the Notice of Intent but that these had not been received <u>after</u> the Appellant had lodged its appeal to the Tribunal. Very sensibly, the Respondent's Enforcement Panel was asked to consider the Appellant's case again, which it did on 25 May 2023. The Respondent's Panel concluded that the Appellant' advanced mitigation had not been sufficient to change the previous decision to issue the Notice in the terms it was issued. The Respondent supplied its updated Case Summary Record which has been the principal focus of the Appellant's amended Grounds of Appeal.

Submissions on the Civil Penalty

The Appellant

23. The Appellant submits that the Respondent has failed to provide any further statement of reasons as to how it arrived at the civil penalty of £200,000 other than those found in the Notice of Civil Penalty, although the Case Summary Record is assumed to reflect its fuller reasoning. It argues that in the interests of transparency, any relevant factor, aggravating or mitigating should be referred to either within the Notice or the Case Summary Record. Where a

factor is not referred to, it is reasonable to infer that the EA has failed to consider that particular issue.

The use of the figure of £25t/CO_2e for each missed HFC QA

24. The Respondent's reasoning which supports the use of the £25 figure firstly, by reference to the maximum 2021 QA cost; secondly, a claim that its consistent use ensures both that those organisations which did pay that figure in 2021 are not put at a commercial disadvantage; and thirdly, that using anything less than the maximum 2021 HFC QA price might have the effect of undermining the civil penalty, is not consistent with the ESP and fails to reflect the concept of proportionality. The approach is unprincipled and had been adopted as a consequence of the Respondent's lack of empirical data.

25. The Respondent's lack of data is a self-serving argument and cannot justify the blanket adoption of an arbitrary maximum price. Further, reliance on it ignores the fact that the Appellant had provided the actual QA price it paid in 2021 and that the Respondent does possess data on the median and mean price paid in the year by operators. This shows that the figure of £25.00/tCO_2 was a significant outlier when compared to the rest of the data obtained and the provider of the relevant authorisation which had attracted this price, had not provided a median or mean figure to the Respondent.

26. The fact that the Respondent may have applied the £25/tCO_2 figure in its calculation of the avoided costs in all other cases cannot justify the use of the maximum figure in this case, which is disproportionate having regard to the facts. The ESP does not say that the maximum HFC QA cost will be used and any such blanket approach would be unnecessarily rigid and remove any element of discretion. The claim that use of an alternative cost per QA might lead to a competitive advantage being conferred on the Appellant is not made out on the evidence; the fact that one operator may have paid £25/tCO_2 for a single HFC QA during 2021 does not evidence any actual competitive advantage gained by the Appellant. It is an unreasonable claim given the evidence of median and mean figures paid.

27. The ESP states that the Respondent will take financial gain into account under Step 4 of its approach. This states that the penalty may be adjusted from the starting point within the range by assessing the aggravating and mitigation factors including:

> *"financial gain – whether or not a profit has been made or costs avoided <u>as a result of the breach</u>"*

28. The words "*as a result of*" require some form of assessment of the actual costs avoided. To take a theoretical approach based on the maximum potential cost to an organisation is contrary to the wording of the ESP. The Respondent's Case Summary Record sets out the actual price paid by the Appellant in 2021 (£10/tCO_2), the average of the price paid by the Appellant across 2021/22 (£7.13/tCO_2), the market data median for 2021 (£5.75/tCO_2) as well as the maximum of £25/tCO_2. The results of this assessment have been improperly ignored in adopting the £25 figure, as has the wording of the ESP.

Proportionality

29. When the actual costs paid by the Appellant in both 2021 and 2022 are taken into account, the imposition of the maximum price paid in 2021 was entirely disproportionate. Use of the average price paid by the Appellant per event (£8.83t/CO_2) or per HFC QA (£7.13t/CO_2) or the highest price paid by it (£10.00t/CO_2), would have been more proportionate. Proportionality would also have required the approximately £117,500 spent by the Appellant in attempted remedial action to be taken into account.

30. Alternatively, the Respondent should have taken the average cost per HFC QA across 2021 and considered whether this would have been a proportionate approach. There is no discussion of proportionality in the context of any of the scenarios within the Respondent's stated reasoning and the word "proportionate "does not feature in it. Instead, the Respondent appears to have been one of applying an "agreed methodology" as stated in the Case Summary Record which has resulted in the imposition of a civil penalty at a level double the highest alternative. There also appears to have been a 30% uplift in penalty which is nowhere referred to in the ESP and no analysis is set out as to why such an uplift was appropriate in this case.

The ESP

31. The Respondent failed to follow the ESP in setting the penalty. There is no evidence of any environmental harm in this case and no apparent assessment of such harm (Step 1). Further, the Respondent wrongly took the claimed financial advantage into account in working out the penalty starting point and penalty range (Step 3) when it fell to be taken into account at Step 4.

32. At Step 4, the Respondent failed to have regard to the available mitigation in this case. The Appellant had sought to correct the position in 2022 by purchasing HFC QAs in addition to those required for 2022. No offence would have been committed had it been possible to purchase HFC QA retrospectively for a given quota year. Nowhere in its reasoning for the penalty imposed does

the Respondent refer to the Appellant's exemplary character nor that it has never committed this or a similar breach in the past. Nor is there a reference to its cooperation, self-reporting or acceptance of responsibility. Instead, the Case Summary Record records that the costs avoided are treated as a significant aggravating factor, despite the fact that the penalty had already been adjusted based on the Respondent's flawed calculation of financial gain.

33. The Appellant's wrongdoing was the result of not having a clear understanding of the requirements of the Regulations, as is shown by the fact that it thought it could retrospectively remedy the breach by purchasing additional quota in 2022. Had it appreciated the requirements of the Regulations at the relevant time it would undoubtedly have purchased the full amount of HFC QAs required at the appropriate time. The Appellant has taken steps to ensure that the mistake cannot happen again.

34. The Respondent's uplift in the penalty to reflect its claim that the Appellant failed to implement procedures in a reasonable timeframe as an aggravating factor was unreasonable. The breach was the product of a lack of understanding of the legal requirements reflected in the negligent culpability and did not reflect a poor attitude which might aggravate the offence under Step 4 of the ESP.

The Imposition of the Maximum Penalty

35. As a matter of principle the maximum penalty should be reserved for those cases of the utmost gravity; which exemplify the most serious level of conduct for that offence. In this case the culpability has been assessed as negligent and not reckless or deliberate, steps were taken to remedy the breach, the Appellant has self-reported and fully cooperated with the Respondent and full responsibility for the breach. These factors all militate against the imposition of the maximum possible penalty.

The Respondent's Submissions

36. The ESP sets out the Respondent's enforcement and sanctions policy. It explains that it will act proportionately and take account of and balance a number of factors in deciding on the relevant penalty. Section A of Annex 2 to the ESP explains the steps which are applied in deciding whether to impose a civil penalty and, if so, to work out the final penalty amount in relation to climate change schemes including that relating to F-gases. The steps are based on the Definitive Guide for the Sentencing of Environmental Offences published by the Sentencing Council on 1 July 2014.

37. Within the steps the Respondent assesses:

- 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

38. Section E of Annex 2 to the ESP explains how the Respondent will initially assess each F-gases Regulations breach and the normal "nature of breach" assessment and other enforcement positions specific to breaches of the Regulations. The nature of the breach assessment is the seriousness of the breach based on the impact it has on the integrity of the regime. This means the trust in, transparency, reliability and effectiveness of the regime. It may include the length of time a person had been required to comply with the law. Maintaining the integrity of the regime is vital to reduce the UK's contribution to climate change. The "nature of the breach" assessment" and the enforcement positions resulting from it, seek to ensure that the Respondent's penalty approaches are proportionate to the nature of the breaches that have occurred.

39. The Respondent normally imposes a civil penalty for all breaches referred to in Regulation 31A of the F-gases regulations as set out in the ESP. The steps taken by the Respondent in deciding upon the civil penalty in this case are fully set out in the Case Summary Record, the Notice of Intent and the Civil Penalty Notice.

40. At Step 1 the Regulations set a maximum penalty of £200,000. At Step 2 the initial penalty amount is set at the statutory maximum because of the impact of any breach on the integrity of the breach and the potential environmental effect of the breach. At Step 3 the penalty starting point is worked out based on culpability and the size of the organisation. The Appellant is a large organisation and its culpability was "negligent". This led to a penalty starting point of £60,000 and a penalty range of £28,000 to £150,000. However, the starting point was revised to take account of the financial gain assessed at £195,900. At Step 4, which includes an assessment of financial gain as an aggravating factor, the final penalty amount was set at £200,000 because the Respondent considered that the penalty should be increased from the starting point because the Appellant had failed to improve its compliance procedures following the provision of guidance in January and February 2021.

The use of £25/tCO_2e

41. The Respondent had contacted all Bulk Incumbent Organisations and Authorisations Managers and requested data on the minimum, maximum, mean and median price charged by their organisation for a tonne of carbon dioxide equivalent for relevant transactions during the 2021 calendar year. There were 21 Respondents. The data was provided voluntarily and the Respondent is limited to data which has been provided in determining the 2021 authorisation price. The price of QAs is market driven with varying costs throughout the year; prices increase towards the end of the year and the compliance deadline.

42. The Respondent concluded that it should use the maximum cost of an HFC QA in 2021 when determining the costs avoided, to ensure that the Appellant did not benefit financially from the breach. Using anything less than the maximum price paid to calculate financial gain might have the effect of undermining the final civil penalty. For example, if the overall mean price of £7.41/tCO_2 was used the costs avoided would have been assessed at £58,064.76. Taking the prices paid by the Appellant of £8.83, £7.13 and £10, the costs avoided would have been assessed at £69,191.88, £55, 870.68 and £78,360.00 respectively. All are substantially lower than the costs avoided using the maximum market data information. Applying less than the maximum authorisation price when calculating the costs avoided, would give the Appellant an unfair financial advantage over compliant organisations that bought their authorisations in 2021.

43. The price paid by the Appellant in 2022 for HFC QAs is not relevant as the Appellant should have purchased the authorisations in 2021. There will have been a shift in price from when it should have complied.

44. Although the Appellant bought authorisations in June 2022, the Regulations require the that the HFC QAs are in place at the point when the goods are placed on the market in Great Britain. The authorisations that were bought by the Appellant in March 2022 can only be used for compliance from 2022.

45. The Appellant failed to comply with the requirements of the Regulations, the Respondent acted correctly in accordance with both the Regulations and the ESP in setting the level of the civil penalty imposed and the appeal should be dismissed.

Findings

46. The Appellant's appeal is founded on the ground of appeal contained in paragraph (4)(b) of Schedule 5 to the Regulations i.e. that the amount specified in the Respondent's notice is unreasonable. As I have said above, "*unreasonable*" in this context bears its ordinary meaning i.e. a penalty which having regard to the circumstances is unfair, unsound or excessive.

47. The Respondent has adopted a policy in relation to applying civil penalties which sets out a stepped approach to the decision on the civil penalty to be applied in any given case. The four steps are based on the Definitive Guideline for the Sentencing of Environmental Offences, but adjusted so that they are appropriate for the climate change civil penalties, including those under Regulations.

48. I am satisfied that this stepped approach, provided that it is correctly followed, provides a sound and therefore reasonable basis for determining the appropriate civil penalty in a given case. I do not understand the Appellant to contend otherwise. Its concern is that the Respondent has departed from and/or misapplied its policy and, in doing so, departed from the principle of proportionality.

49. In my view, it is important that the four steps of contained in Section A of Annex 2 to the ESP are kept discrete and applied having regard to their individual underlying purpose within the penalty setting decision. Applied in this way, the approach of the ESP avoids double counting.

50. Step 1 is uncontentious in this appeal. The statutory maximum penalty is £200,000.

51. Step 2 is contentious in part, because the Appellant contends that the absence of any actual environmental harm should have been taken into account in setting the level of the civil penalty. Step 2 invites a decision on whether to waive the penalty or to set an initial penalty amount by reference to the nature of the breach and the other enforcement positions in line with, in this case, section E of the guidance. Section E2.1 of the ESP states that the Respondent will normally impose a civil penalty for all breaches of the Regulations referred to in regulation 31A (save where advice or guidance would be sufficient to rectify the breach of punishment of future deterrent is not necessary). I see nothing unreasonable in the respondent's decision to impose a civil penalty in this case. Advice and guidance provided to the Appellant in January and February 2021 had failed to secure compliance with the Regulations and this was not an inadvertent breach not meriting sanction.

52. I also see nothing unreasonable in the use of the statutory maximum as the initial penalty amount. Whilst this is a case in which there is no evidence of any actual environmental harm having occurred (which is one example of a circumstance in which the ESP states that the Respondent might decide as a matter of discretion to use a lower initial penalty amount than the statutory maximum), the impact of any breach on the integrity of schemes such as that put in place under the Regulations, is a very important consideration.

53. Whilst there is nothing to indicate that the Respondent actually considered whether this might be a case in which a lower initial penalty amount might have been used, I see nothing unreasonable in the Respondent use of the statutory maximum given the need to protect the integrity of the scheme. That said, the fact that the need to protect the integrity of the scheme in this way has already been taken into account at Step 2, must be borne in mind when considering Steps 3 and 4.

54. In relation to Step 3, there is no dispute that the Appellant is a large organisation and that, having regard to the descriptors within the ESP, its breach is reasonably described as a negligent one i.e. the failure by the organisation as a whole to take reasonable care to put in place and enforce proper systems for avoiding commission of the breach. Applying the ESP's appropriate penalty factors the penalty starting point was assessed as £60,000 and the penalty range between £28,000 and £150,000. The ESP advises that in Step 4:

> "...we will normally adjust the penalty starting point within the penalty range"

55. That is both logical and reasonable. The aggravating and mitigating factors to be taken into account at Step 4 should be used to inform where, normally within the Step 3 range, the civil penalty will fall.

56. However, I agree with the Appellant that the Respondent took a false step in this case at Step 3. The Case Summary Record records under Step 3:

> "Revised penalty starting point, taking into account financial gain £195,000".

57. Applying the stepped approach correctly, this is an adjustment which should have been made at Step 4 and not Step 3. That of itself does not render the civil penalty of £200,000 an unreasonable one, but what is clear in this case is that the assessed calculated financial gain effectively short circuited the proper application of the four stage stepped approach set out in the ESP. Because the penalty starting point was adjusted at Step 3, very little consideration was given at Step 4, to the mitigation which the Appellant advanced. That approach

was erroneous although, as I have said, it does not necessarily mean that the civil penalty applied was an unreasonable one.

58. This is because, as the ESP makes clear, the penalty starting point will *normally* be adjusted at Step 4 *within the identified penalty range*. That indicates that exceptionally the imposed penalty might lie outside the range once the Step 4 factors are taken into consideration. The ESP states in terms that:

> "*We will normally adjust a penalty within the range but, in some circumstances, we may move outside the range, including waiving the penalty*"

59. Important within the Step 4 factors is financial gain i.e. whether or not a profit has been made or costs have been avoided as a result of the breach. I see nothing in principle unreasonable in the starting point for a civil penalty being adjusted at Step 4 to a sum outside the Step 3 penalty range in order to reflect the costs which an operator has avoided as a result of the breach. That would be entirely consistent with the Sentencing Council's Environmental Offences Definitive Guidelines on which the ESP has been based. These state under the heading "*General principles to follow in setting a fine*":

> "*The level of fine should reflect the extent to which the offender fell below the required standard. The fine should meet, in a fair and proportionate wat, the objectives of punishment, deterrence and the removal of gain through the commission of the offence; it should not be cheaper to offend than to take the appropriate precautions". Reflecting this guidance, Step 5 of the Sentencing Council Guidelines is to "Ensure that the combination of financial orders (compensation, confiscation if appropriate, and fine) removes any economic benefit derived from offending*".

The Guidelines further advise that:

> "*The court should remove any economic benefit the offender has derived through the commission of the offence including:*
>
> - *avoided costs*
> - *operating savings*
> - *any gain made as a direct result of the offence*"

60. The Respondent's ESP is not so specific as to how any financial gain obtained by an operator should bear on the level of civil penalty, but as applied by the Respondent in this case, to remove any economic benefit enjoyed by the Appellant as a result of the avoided costs, involves no unreasonableness in principle. Seeking to deprive an operator of the gains which have been obtained as a result of the relevant breach is a reasonable and principled

approach. The extent of the benefit wrongly obtained and ensuring that those in breach do not benefit from their wrongdoing, is clearly an important factor in assessing the overall reasonableness of a civil sanction.

61. However, Step 4 of the ESP also requires consideration of a range of mitigating factors which, where relevant, need to be taken into account in assessing the overall reasonableness of a civil penalty. Economic gain should not be the sole determinant of the appropriate sanction, where there are clearly mitigating circumstances.

62. Further, as the ESP makes clear, the financial gain which is relevant is that which has been obtained by an operator *as a result of the breach.* This requires a calculation or estimate of the *actual* financial gain which has been obtained. This may not always be capable of calculation or assessment as the Sentencing Council's Guidelines recognise:

> "*Where it is not possible to calculate or estimate the economic benefit, the court may wish to draw on information from the enforcing authorities about the general costs of operating within the law*".

63. That brings me to the Respondent's use of the £25/tCO_2e as the cost avoided for each HFC QA which the Appellant failed to have purchased in 2021.

64. I do not find persuasive the Respondent's arguments that the use of the maximum figure paid for QA in 2021 was reasonable on the facts of this case. That sum was an outlier and exceeded the next closest maximum (£19.00/tCO_2) by a considerable margin. As the responses received from the Bulk Incumbent Organisations and Authorisation Managers show, there was a wide range of maximum cost in 2021 (£5/tCO_2 to £25/tCO_2) with the median cost being £5.75. As the Respondent points out, the cost of each QA varies throughout the year, increasing as the end of the compliance period draws nearer. However, even allowing for that, it is inherently improbable that, had the Appellant complied with its obligations in 2021 as required, it would have been necessary for it to have purchased *all* of the QA at the maximum price charged in that year from single provider. In my view, that is an unreasonable and speculative assumption which is not justified by the evidence.

65. This is a case in which the precise calculation of the economic benefit gained by the Appellant cannot be calculated or estimated with precision because it cannot be known with certainty when, but for the breach, the Appellant would have purchased QA and from who. However, what the evidence shows is that it is highly unlikely and certainly <u>not</u> more likely than not to have been from the provider charging £25/tCO_2e.

66. The wide range of minimum and maximum costs charged by providers in 2021, coupled with the evidence from the Respondent as to the varying cost throughout the year, also lead me to conclude that the use of a mean 2021 cost is not sound in this case. I also agree with the Respondent that seeking to average costs paid by the Appellant for QA in both 2021 and 2022 is not appropriate as the 2022 costs are not relevant to the 2021 authorisation year.

67. Where, as is the case in this appeal, there is evidence of the price actually paid by the Appellant for its QA in 2021, in the absence of any better evidence, that price should be used in calculating the costs avoided. In a case in which there the breach is a negligent one, that is both logical and reasonable. But for its failure to take proper steps to acquaint itself with the requirements of the Regulations, it is more likely than not that the Appellant would have purchased all of the requisite quota at the same time as it purchased its initial 250 QA in February/March 2021. It made a bulk purchase in 2022 and there is nothing before me to suggest that, had it properly appreciated its obligations in 2021, it would have acted differently then.

68. In these circumstances, in my view, the use of the £25/tCO_2e figure by the Respondent in the assessment of costs avoided in this case was unreasonable and the figure which it should have used was £10 /tCO_2e. In consequence, the costs avoided by the Appellant amounted to £78,360.

69. The Respondent argues that the use of anything less than the maximum 2021 cost of QA might have the effect of undermining the civil penalty and would not give the Appellant an unfair advantage over compliant organisations that bought their authorisations in 2021. However neither is a good argument. Firstly, the fact that a higher financial penalty is likely to have a stronger deterrent effect than a lesser one, could be used to justify any unreasonable civil penalty. It cannot justify the disproportionate. Secondly, the evidence before the Tribunal does not support the claim that using the cost of quota actually paid by the Appellant in 2021 would have any adverse consequences for fair competition.

70. In my view, the overwhelming likelihood on the evidence before me is that the use of £25/tCO_2 would unfairly prejudice the Appellant by not only removing the financial benefit it in fact gained from its breach, but also adding a penalty for anti-competitive behaviour which would not be reasonable. On the evidence, it is far more likely than not that many of the Appellant's competitors would have obtained their QA at a cost well under £25/tCO_2. A balance needs to be struck between ensuring, to the extent possible, that operators do not benefit from their breaches and avoiding seeking a threshold of such certainty that the effect of the penalty is a disproportionate one having regard to the objectives of the

sanctions regime. I do not find that the Respondent's balance was a reasonable one in this respect.

71. Applying the ESP Stepped process correctly, the Respondent should have concluded as the first step of Step 4 that the sum of £78,360 should be added to the penalty starting point of £60,000 giving a penalty starting point of £138,360. As the Respondent reasonably concluded, the Appellant was very slow to appreciate what the Regulations required of it despite the assistance it received from the Respondent. It was not until well into 2022, that it has established the full extent of its breaches in 2021. That is an aggravating factor which points to a penalty at the upper end of the range.

72. However, there is also considerable mitigation in this case. The Appellant is of good character and self-reported the breaches and has fully cooperated with the Respondent. It attempted to take steps to remedy its breaches although there is no provision for obtaining HFC QAs after the end of the calendar year in which they should have been held by the operator. The Appellant spent £55,089.50 in May and July 2022 on the purchase of 7,836 HFC QAs relating to 2021.

73. Whilst the ineffective purchase of quota in 2022 relating to the 2021 calendar year clearly reduces the economic benefit which the ultimately Appellant derived from its breach, it would wrong in my view to give the Appellant the full benefit of this sum by deducting it all from the civil penalty. To do so might be seen as sanctioning retrospective compliance which is not provided for by the Regulations and might undermine the integrity of the scheme. However, where, as here, there was no deliberate attempt to secure a financial advantage, some reduction in the penalty is appropriate. Reducing the penalty by 50% of the £55098 i.e. £27,549 would be the reasonable reduction, striking a balance between the need to protect the integrity of the statutory regime and properly reflecting the mitigation attempted by the Appellant.

74. Credit must also be given for the other mitigation in this case which is powerful and, properly reflecting this mitigation, in my view, the penalty starting point of £60,000 should have been reduced by a third to reflect the level of negligence but also the mitigation. To this adjusted starting penalty of £40,000 should be added the costs avoided which I have concluded were £78,360 less £27,549.25 to reflect the ineffective attempt to remedy the breach. This leads to a penalty of £90,511. That is a penalty which reasonably and proportionately reflects the nature of the breach, the Appellant's culpability and the mitigation whilst also respecting the need to protect the integrity of the regime.

75. I therefore allow the appeal and direct the Respondent to vary the Notice of Civil Penalty as follows. In Table 1 Step 3, the words "Revised penalty starting

point taking into account financial gain £195,900" to be omitted. In Table 1 Step 4 replace the figure of £200,000 with £90,511. Remove references to the figure of £25t/CO_2e and in Table 2 replace the calculation of the costs avoided with "7,836 X £10.00 calculated maximum cost of 2021 quota authorisation = £195,900". Replace all references to the final penalty amount of "£200,000" and replace it with "£90,511" and replace the payment due date with "20 December 2023".

JUDGE SIMON BIRD KC
4 November 2023
Corrected pursuant to Rule 40 7 November 2023