

Graham Knowles  
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31 July 2013

Dear Graham,

**Pricing benchmarks in gas and electricity markets – a call for evidence**

I am responding on behalf of ScottishPower to your call for evidence seeking our views on how we use and contribute to pricing benchmarks in gas and electricity markets and whether we feel current arrangements are fit for purpose or that further action is necessary.

We recognise the important role played by price reporting agencies in the GB gas and electricity markets and the need for confidence in the integrity of benchmarks used to underpin contracts, financial instruments and indices influencing market prices. It is important that market participants, regulators and consumers have confidence in the work of these agencies.

We agree that in the light of concerns raised about price reporting in the GB gas market it is appropriate for Ofgem to consider issues relating to how trading information informs prices, how the process of price assessment is governed and the methodologies by which price assessments are made. Similarly, it is desirable that market participants review and thoroughly check their own activities – as we have done – to ensure that they are not contributing inadvertently to any problems.

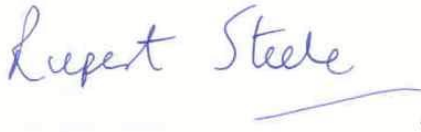
We use benchmark prices provided by price reporting agencies and other price benchmarking services for contract settlement and also for the valuation of forward market positions. Competition between price reporting agencies in the GB gas and electricity markets ensures they have a commercial incentive to deliver products that are robust, impartial and valuable to market participants and we consider them as a sound basis on which to trade against.

In our view, this competitive pressure (combined with the existing self-regulatory regime) should be capable of ensuring that the current arrangements are fit for purpose in the GB gas and electricity markets. In this context, periodic reviews of the arrangements by Ofgem, such as this current process, can be helpful in focussing minds and ensuring that all necessary precautions are being taken.

Our answers to the specific questions set out in your call for evidence are set out in the attached Annex. I hope this provides you with the information you are seeking.

Should you wish to discuss any of these points further then please do not hesitate to contact me or Alex Mackinnon, Market Arrangements Manager with our Energy Management business.

Yours sincerely,

A handwritten signature in blue ink that reads "Rupert Steele". The signature is written in a cursive style and is underlined with a single horizontal stroke.

**Rupert Steele**  
Director of Regulation

**Call for Evidence****Question 1: Do you agree with our review of the issues?**

We agree that in the light of concerns raised about price reporting in the GB gas market it is appropriate for Ofgem to consider issues relating to how trading information informs prices, how the process of price assessment is governed and the methodologies by which price assessments are made.

The review has in our view considered the important issues facing price reporting agencies in the GB gas and electricity markets and has identified how the methodologies and governance procedures in the gas and electricity markets compare to those in the oil and financial markets.

The review has highlighted the benefits of competition in the provision of benchmark services to the GB gas and electricity markets with the three main price reporting agencies competing with each other, with other information services such as Bloomberg, with alternative price indices representative of the over-the-counter market and with alternative prices available through exchanges. Market participants can also use private mark-to-market services in order to benchmark their trading activity. Price reporting agencies thus have a strong commercial incentive to ensure their customers retain confidence in their products.

The review has also recognised the dangers of over-regulation and that while some types of regulation can increase the confidence in the market other types of regulation may introduce risks to the process decreasing confidence in the market and discouraging participation.

The review highlights that while price reporting agencies self regulate they are still subject to regulatory scrutiny and that a recent report by the International Organisation of Securities Commission (IOSCO) on price reporting agencies in the oil market recommended the continuation of a self regulation regime.

**Question 2: What is your company's policy on providing information to price reporters or other price benchmarking services?**

We currently do not provide price information to price reporters or other price benchmarking services. We have provided price information to price reporting agencies and other price benchmarking services in the past and this policy is regularly reviewed. While we understand the benefits to the wider market from participation being as widespread as possible, it is also necessary for us to review our controls and the EU and UK regulation which may bear on the activity.

**Question 3: In what way do you use benchmark prices provided by price reporting agencies or other price benchmarking services?**

We use data from price reporters and other benchmarking services for calculation of indices, against which some of our contracts are settled, and also for the valuation of forward positions we have taken or are considering taking in the market.

**Question 4: Do you use a single price provider only, or a combination or variety of prices?**

A combination and variety of sources are used, depending upon the contractual pricing details and whether the calculation is for settlement or for market valuation (mark-to-market) purposes.

**Question 5: What are your views on the terms of the Independent Price Reporting Organisation's (IPRO) code of conduct and the various published methodologies of the price reporting services with particular reference to gas and electricity markets?**

The current IPRO code applies to activities, policies and structures associated with the publication of price assessments by price reporting agencies and does not govern the specific design or substance of the methodologies used by the agencies to produce these assessments. This may be an area where the code needs to be expanded.

In relation to the current main constituent parts of the code:

**Governance**

Transparent robust governance arrangements are essential with clearly defined reporting lines and consistent allocation of authority and responsibility.

**Managing and mitigating conflicts of interest**

While seeking to avoid conflicts of interest agencies should set out their policies to manage any such conflicts that arise.

**The integrity and transparency of the price reporting process**

Publication of the methodologies used to produce the price assessments is essential.

**Non-discriminatory participation and data collection processes**

Agencies must have clear policies and processes for collecting, evaluating and utilising data.

**Timely publication of assessments, corrections and modifications**

Agencies should publish in a timely, consistent and transparent manner their price assessments, any material corrections to those assessments and any material changes to any of their price assessment methodologies.

**Monitoring and detecting non-representative data**

Agencies should have robust monitoring processes in place to detect non-representative data and take appropriate action.

**Responding to complaints**

Agencies should have a written complaints handling policy.

**Confidential information and record-keeping**

Agencies should have control systems and procedures to protect the confidential nature of information provided by market participants.

The IPRO code of conduct is being redrafted and we would anticipate the new draft incorporating more of the IOSCO principles. We will be able to comment on the new draft of the IPRO code of conduct when it is published.

In relation to the various published methodologies of the price reporting agencies with particular reference to gas and electricity markets, we view the methodologies as broadly similar and accept that some editorial judgement will be a necessary factor whenever price assessments

involve gathering market data through telephone, e-mail and instant messenger. The value of these price assessments, and the indices and other end products derived from them, are judged on an ongoing basis by customers and potential customers for use in calculating settlement values and mark-to-market values of positions. An agency which produces figures that are judged to be unreliable or potentially influenced by manipulation would be very likely to lose its client base.

**Question 6: In the context of GB gas and electricity markets, do you consider the current arrangements whereby price reporting agencies operate under a self-regulatory regime are fit for purpose?**

Yes. In our view the competitive pressure (combined with the existing self-regulatory regime) should be capable of ensuring that the current arrangements are fit for purpose in the GB gas and electricity markets. In this context, periodic reviews of the arrangements by Ofgem, such as this current process, can be helpful in focussing minds and ensuring that all necessary precautions are being taken. Paragraph 2.19 of the consultation document recognises the risk that some types of regulation may deter market participants from providing information to price reporting agencies in order to mitigate risk to a company and individuals. Such an outcome may have an adverse impact on market transparency.

**Question 7: Are there any other issues that you wish to raise in the context of this call for evidence?**

The competition between price reporting agencies in the GB gas and electricity markets ensures they have a commercial incentive to deliver products that are robust, impartial and valuable to market participants. The fact that many companies are willing to transact commercial contracts which use price reporting agencies' data to calculate settlement values demonstrates that they regard price reporting agencies' data as robust enough to trade against. Furthermore, given the large number of alternative sources available, including WebICE settlement data, Thomson Reuters, Bloomberg and OTC brokers, anomalous reporting is likely to stand out.

We would also raise the point that in markets with weaker liquidity, price reporting agencies provide a much needed service that encourages transparency and participation in the markets.

ScottishPower  
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