SCOTTISHPOWER

Rupert Steele OBE
Director of Regulation

Louise Edwards
OFGEM
9 Millbank
London
SW1P 3GE

19 February 2015

Dear Louise,

**Consultation on REMIT Procedural Guidelines and Penalties Statement**

Thank you for the opportunity to provide views on behalf of ScottishPower on Ofgem's proposals for revisions to its REMIT Procedural Guidelines and REMIT Penalties Statement documents.

We advocate transparent and trusted wholesale energy markets which benefit both customers and investors alike; and we agree that this needs appropriate and effective enforcement which will deter market abuse. This is clearly set out in Article 18 of REMIT which requires penalties that are effective, dissuasive and proportionate. In this context it is desirable for Ofgem to consult on and publish detailed procedural guidelines and penalties statements on the REMIT regulation.

Our responses to the detailed questions in the consultation are set out in Annex 1 (attached) but, within a context of supporting effective and dissuasive penalties, we would also like to highlight the following:

(a) The objectives of the Authority as set out in section 2.2 do not appear to conform with the requirements of REMIT as respects penalties, in particular that they must be proportionate. We suggest that this element is made clear;

(b) Some aspects of the policy in relation to penalties for individuals appear to us to go beyond what is proportionate. This could be contrary to REMIT and, more practically, could affect the ability of the industry to recruit and retain appropriately skilled trading staff at a reasonable cost;

(c) Some aspects of the policy appear to go beyond the corresponding provisions in the financial sector. If this is intended, it is important that Ofgem assures itself that it is proportionate and not likely to have unintended effects.

<u>Impacts on individuals</u>

We agree that it is beneficial for individuals engaged in market abuse to face sanctions where this is appropriate. However, it is important to recognise that the greatest care must be applied (especially in a civil context where the person concerned does not have the benefit of the protections that apply in criminal cases) to ensure that the outcome is just and proportionate. In particular:

ScottishPower London Office, 4th Floor, 1 Tudor Street, London EC4Y 0AH
Telephone +44 (0)141 614 2000, Fax +44 (0)141 614 2001, Direct +44 (0)141 614 2012
rupert.steele@scottishpower.com www.scottishpower.com

(i) We wonder whether there is a need, in cases involving individuals, for the EDP Panel member to be a person with judicial experience. Given that the penalty and restitution regime could in principle involve a person losing their home and their life savings, we think that the process would benefit from an independent view from somebody with experience of assessing appropriate penalties for individuals;

(ii) The guidance implies that Ofgem will normally require an individual to make restitution of any losses suffered by market participants or consumers. This sum could be orders of magnitude greater than any gain made by an individual from misconduct and beyond an individual's means to pay. We think it would be more proportionate in the case of an individual to limit restitution to the individual's gain, and rely on the penalty element to go beyond that;

(iii) The scale of penalties needs to reflect the fact that energy traders are currently paid much less than financial traders. So the sum of £100,000 mentioned for a level 4 or 5 breach may after tax be a month or two's income for a financial trader, but two years' income for an energy trader. We are concerned that this risk could affect the industry's ability to recruit and retain traders without a significant uplift in salaries and insurance costs. This may not be the intended effect.

Elements going beyond the financial services sector

The proposal for restitution goes beyond the corresponding proposal in the financial services sector. In particular, in financial services, restitution is limited to the gain made. We think this is an appropriate principle to apply for energy.

Other issues

We consider that the description of factors indicating recklessness (although similar to the financial services guidance) is not appropriate. Recklessness has been judicially defined over many years and at many levels, and involves a greater wilful disregard of the risks of breach than the words in the guidance suggest. We suggest that either the definition is removed, so falling back on the normal jurisprudence in this area, or that it is conformed much more closely to the accepted meaning of the term.

It is in the interests of market participants including ourselves to have a robust, effective and proportionate enforcement regime for REMIT breaches. However, given the extent of the Upper Tribunal's jurisdiction in these matters, it will be beneficial to ensure that the approach is demonstrably proportionate and procedurally fair. We hope that our comments, which reflect in particular our concerns about the potential impact on individuals, are helpful to you in this context.

Should you wish to discuss any of these points further then please do not hesitate to contact me.

Yours sincerely,

Rupert Steele

**Rupert Steele**
Director of Regulation

**ANNEX ONE**

**Consultation on REMIT Procedural Guidelines and Penalties Statement**

**SCOTTISHPOWER RESPONSE**

**Question 1: Are these the right Vision and Strategic Objectives?**

The key statement of the Vision in terms of creating a culture where individuals and businesses working with wholesale energy products or in wholesale energy markets act in line with their obligations is appropriate. The statement about "putting consumers first" is however not, taken literally, in accordance with how orthodox economics sees a market working. In economic theory, individual market participants follow their own interests (within the regulatory framework) and the operation of competition secures the optimum collective outcome for consumers. We assume that this is what Ofgem means.

As far as the strategic objectives are concerned, they do not appear to fully conform with the requirements of Article 18 of REMIT, which requires penalties that are effective, dissuasive and proportionate. While the objectives appear to cover off effective and dissuasive, they do not obviously incorporate the required "proportionate" element.

We share Ofgem's objective of maintaining transparent and trusted wholesale energy markets which benefit both customers and investors alike.

**Question 2: Do you have any comments on the proposed changes to the settlement processes?**

We agree that the proposed changes to the settlement process appear to be in line with the changes made for other investigations.

**Question 3: Do you have any comments on our proposals for oral representations?**

We agree that the proposals for oral representations appear to be appropriate.

**Question 4: Do you have any other comments on the proposed REMIT Procedural Guidelines?**

We have no further comments regarding the proposed REMIT Procedural Guidelines, save that we consider that additional safeguards may be appropriate for individuals. For example, we think it may be appropriate for the EDP Panel member to be a person with judicial experience. Given that the penalty and restitution regime could in principle involve a person losing their home and their life savings, we think that the process would benefit from an independent view from somebody with experience of assessing appropriate punishments for individuals.

**Question 5. Do you agree with the proposed factors that affect the decision to impose a financial penalty and/or make restitution or issue a statement of non-compliance?**

In broad terms we agree with the proposals on this point. We welcome the facility for the Authority to issue a Statement of Non-Compliance as a proportionate alternative to the imposition of a financial penalty and/or restitution order in such circumstances as described in the proposed REMIT penalties statement.

We also consider that the criteria which Ofgem has proposed in relation to any decision to take action against an individual rather than a firm appear sensible.

**Question 6. Is the proposed process for determining the amount of penalties and/or restitution appropriate?**

In the case of firms, we support the principle of removing the detriment suffered by the affected party and/or any gain made by the firm as a result of the breach by means of restitution. As with other enforcement cases, we believe that the use of voluntary restitution in lieu of penalty or part of a penalty may be an appropriate element of a settlement agreement that can benefit consumers as well as being more flexible.

In the case of individuals, any requirement for restitution should be limited to the value of the gain made by the person concerned, because of the risk that it may not be proportionate for an individual to remedy detriments beyond that point. We think that in general the gain should assessed on the basis of the individual concerned and perhaps any close associates. If a breach affected a company-wide bonus scheme, paying a few hundred extra pounds to a few hundred staff, it would be inappropriate to expect a single trader to pay a six-figure sum in restitution if his or her gain was only say £500.

In this context, we note that in the financial sector restitution by individuals is linked to gains. The FCA guidance focuses on financial gain to an individual which is derived from the breach. It does not mention:

- the detriment caused to consumers/other market participants;
- that it will consider whether to impose a financial penalty where no gain has been made or detriment suffered (or is calculable); or
- that it expects an individual proactively to take steps to remedy the consequences of a breach.

In this instance, therefore, Ofgem's proposals are wider than that of the financial services sector and the factors that will be taken into account when an individual is in breach of REMIT as regards remedying the breach are far more onerous than those for a financial trader, even though energy traders are much less generously remunerated than financial traders.

We are supportive of the proposal that the Authority should apply an appropriate penalty in circumstances that merit it. This is in accordance with REMIT.

**Question 7. Do you agree with the proposed approach to assessing the seriousness of a breach and calculating the starting point for a financial penalty?**

We consider that it is particularly important, in comparing Ofgem's proposed regime with that for financial services, that any areas where it is proposed that REMIT enforcement should be more stringent than financial services are carefully assessed for proportionality – especially given relative remuneration levels.

Seriousness of the breach

With regard to assessing the seriousness of the breach, we note that the following diverge from FCA guidance:

- **Impact of the breach** – when considering whether the breach had an adverse impact on the markets the test is whether, in the opinion of Ofgem, confidence in the markets has been affected. This is in contrast to FCA guidance in which the test is objective.

- **Nature of the breach** – The nature of the rules breached and whether or not the individual reasonably believed that their behaviour amounted to a breach are relevant factors for Ofgem but not for the FCA. The Ofgem test of whether the individual took "all reasonable precautions and exercised all due diligence to avoid committing a breach" is higher than the FCA equivalent which considers whether the individual took any steps to comply with the FCA rules and, if so, the adequacy of those steps.

- **Level 4/5 Factors** – The FCA guidance does not include as a factor the fact that "the breach caused a significant loss or risk of loss to individual consumers, investors or other market users."

Calculating the starting point for a financial penalty

We assume that references to an individual's relevant income are intended to be figures after deduction of income tax and other employee PAYE charges, on the grounds that penalties are payable from taxed income. It would be helpful to clarify this.

One area where we consider there is a material difference between the energy and financial sectors is in levels of remuneration of traders. Therefore it is neither appropriate nor practical to mirror the financial services sector in setting the starting point for financial penalties to be imposed on individuals in Market Abuse cases. At paragraph 8.9 of the penalties statement it is proposed that the starting point will be the greater of (a) the individual's relevant income (b) a multiple of the profit made or the loss avoided or (c) £100,000 (for level 4 or 5 cases).

While a financial trader might earn £100,000 after tax in a month or two, that sum might represent two years' post tax income for an energy trader. Replicating that figure therefore gives a quite different policy consequence that might not be proportionate. While the ratio in penalty starting points for a financial trader between level 3 and level 4 might be 3:2, that ratio for an energy trader might be 10:1. It is unclear whether this is what Ofgem intend and if so, the basis upon which they think it is proportionate.

We would suggest that a figure of the order of £15,000 might be more appropriate in an energy context given that, in our experience, energy traders cannot achieve a relevant income of anywhere near to £100,000. We are concerned that, if not addressed, this issue

could affect the industry's ability to recruit and retain traders without a significant uplift in salaries and insurance costs. This may not be the intended effect.

**Question 8. Do you agree with our proposed approach in relation to representations that a person believed that the behaviour was not a breach or that a person had taken all reasonable precautions and exercised due diligence to avoid the breach?**

As mentioned above, we note that the corresponding FCA criterion is whether the individual took any steps to comply with the FCA rules and, if so, the adequacy of those steps. Whether Ofgem adopt this criterion, or the much higher hurdle of taking all reasonable precautions and exercising due diligence to avoid a breach, it would be entirely appropriate to allow representations to be made by an individual in such a case. We believe that those representations ought to have a strong influence on the outcome of any decision to impose a penalty and on the resulting penalty.

**Question 9. Do you agree with the factors that may aggravate or mitigate the level of the penal element?**

We generally agree with the factors which Ofgem has proposed to consider for assessing aggravating or mitigating circumstances, recognising that the list may not prove exhaustive in all cases and that some objective flexibility may be required if the particular circumstances merit it. However, we note the contrast with the FCA's guidelines in respect of the financial services sector:

- **Repeated breaches:** In the Ofgem guidance the fact that there are repeated breaches is an aggravating factor. This is not the case for the FCA guidance.

- **Self-reporting:** Ofgem stresses more than the FCA does the importance of immediate and full self-reporting.

**Question 10. Do you agree with the proposed settlement percentage discounts in REMIT cases?**

We note that Ofgem's proposed approach on settlement discounts is similar to its policy on enforcement more generally.

**Question 11. Do you agree with our proposed approach to restitution under REMIT?**

Please see our answer to Question 6 above, which discusses this issue in some detail.

**Question 12. Do you agree with our proposals in respect of serious financial hardship?**

We recognise that the proposals in respect of serious financial hardship are aligned with DEPP6.5D of the FCA Handbook. However, we note that the proposals provide very limited potential relief from serious financial hardship for individuals in such circumstances and could lead to an individual being deprived of his or her home and life savings. This risk may affect the industry's ability to recruit and retain suitably skilled trading staff at a reasonable cost in terms of wages and insurance. It emphasises again the need to ensure that

penalties and restitution, while effective and dissuasive, are also proportionate having regard *inter alia* to the levels of remuneration in this sector.

**Question 13: Do you have any other comments on the proposed REMIT Penalties Statement?**

Regular review

Consideration should be given to the following:

- the first elements of REMIT were only introduced in December 2011;
- ACER's and Ofgem's guidance continue to evolve; and
- market participant registration and trade & trade order reporting obligations are yet to go live.

We believe that, in some respects, the penalty regime is at a more advanced stage of development than the guidance on REMIT itself. Accordingly it will be important to take into account in setting any penalties the relative infancy of REMIT and the possibility of initially more limited knowledge and understanding in the market as to how best to comply with REMIT.

We consider that penalties imposed by Ofgem should be reviewed as the guidance evolves.

Double jeopardy

We request further information as regards the overlap with the jurisdiction of other regulatory authorities in the UK and the relationship between the authorities. We would like to see details published of the procedure for assessing which authority would lead in individual cases, the criteria for deciding between civil and criminal proceedings and the provisions in place for avoiding double jeopardy.

Recklessness

We consider that the description of factors indicating recklessness (although similar to the financial services guidance) is not appropriate. Recklessness has been judicially defined over many years and at many levels, and involves a greater wilful disregard of the risks of breach than the words in the guidance suggest. We suggest that either the definition is removed, so falling back on the normal jurisprudence in this area, or that it is conformed much more closely to the accepted meaning of the term.

ScottishPower
February 2015